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■ Tax cut for all starting in 2009

A tax cut will be available for all taxpayers starting in 2009 following the approval of the proposed income tax bill by the special committee of Parliament early this month.

■ Further clarification on tax-neutral mergers

The procedures for obtaining tax-neutral merger approval are clarified by the DGT.

Tax cut for all starting in 2009

After more than two years, Parliament's Special Committee on income tax finally completed the discussion on the proposed income tax bill early last month. The next step is to bring the approved bill to the plenary session, which may take place in this month, to pass it into law. Hence, starting on 1 Jan 2009 a new set of income tax laws will be effective.

What follows is a summary of the main changes set forth in the press release of the director general of tax (DGT) issued on 21 July 2008.

- **Reduction of corporate income tax rate.** A flat rate of 28% will apply starting in 2009 and will be further reduced to 25% in 2010. Public companies, subject to a minimum listing of 40% and other conditions, may have a tax cut of 5% from the top rate. This will give them an effective tax rate of 23% in 2009 and 20% in 2010.

Small enterprises, i.e. corporate taxpayers with turnover up to Rp4.8 billion, may have a tax discount at 50% of the normal rate.

- **Reduction of individual income tax rate.** The top rate will be reduced from 35% to 30% starting in 2009 and will be applicable for taxable income above Rp500 million. The non-taxable threshold (PTKP) will be increased to Rp15.84 million.
- **Intercompany dividends.** Dividends received by a PT company from another PT company will be exempt from income tax, subject only to a minimum share ownership of the dividend recipient in the company paying dividends of 25%. Hence, the "active business" requirement is omitted.
- **Dividends received by individual residents.** Final income tax at the maximum rate of 10% will apply to dividends received by individual taxpayers from PT companies.
- **Education and R&D organizations.** Income surplus received by such organizations, subject to reinvestment in education or R&D, will be declared non-assessable.
- **Investment fund.** Investment fund companies will no longer enjoy any privileges given that bond interest income received by them is assessable in their hands.
- **Tax withholding.** Individual taxpayers who do not have a Tax Identification Number (NPWP) will be subject to higher income tax withholding than the normal rate: 20% higher for Art. 21 income tax and 100% higher for 22 and 23 income tax.
- **Article 22 income tax on high luxury goods.** Purchases of high luxury goods will be subject to Art. 22 income tax. These may include luxury condominiums, apartments, and private airplanes.
- **Exit tax.** A tax exemption will apply to individuals (including their family members but excluding children above 21 years old) who have an NPWP starting in 2009 and continuing through 2010. Those who do not have an NPWP will continue to pay exit tax during 2009-2010. A complete elimination will apply starting in 2011.
- **Deduction contributions.** Certain contributions will be treated as deductible expenses, e.g. contributions for scholarships, national disasters, social infrastructure, R&D, and educational facilities.

The income tax law amendment is part of the tax reform package consisting of proposed bills on tax administration, income tax, and VAT. The tax administration law was completed last year and is effective starting this year.

The discussion on the proposed VAT bill is scheduled to start in mid August or early September. Among others the bill proposed the following changes:

- **Zero-rating VAT on the export of intangible goods and services.** The export concept should apply not only to tangible goods but also to intangible goods and services. If it is approved, the rule will only relieve non-residents from Indonesian VAT on services and intangible goods provided by Indonesian entities.
- **Input VAT incurred in the pre-production stage of a business.** Such input VAT will continue to be claimable as a tax credit and VAT refunds may be applied for during the pre-production stage. However, if the company concerned fails to reach the production stage, it should repay the refund obtained and pay an interest penalty at 2% per month starting from the refund date.
- **VAT in a business merger.** Transfers of goods in a business merger would be regarded as a non-taxable event.
- **VAT in a finance leasing transaction.** It is proposed that the goods in question would be deemed to be transferred directly from the supplier to the lessee. Under current legislation, the goods are understood to pass through the lessor before they reach the lessee.

People are hoping the discussion will be completed this year so that the full package of tax reform will be effective starting next year.

Further clarification regarding tax-neutral mergers

The DGT issued PER 28/PI/2008 on 19 June 2008 to clarify the procedures for obtaining tax-neutral merger approval. This serves as an implementing regulation of Reg. 43/PMK.03/2008 issued in March 2008 (TaxFlash No. 3/2008). An interested party, i.e. the surviving company in a merger, should file a complete application with the DGT no later than six months after the effective merger date. The DGT will then respond to the application within a maximum of one month from the filing date. If no response is issued by the DGT within a month, the application is considered approved.

Before filing the application, an applicant should make sure that it has settled all outstanding tax liabilities and that the merger plan satisfies a business purpose test. The other conditions it should observe include:

- **Determination of the surviving company.** When two or more companies merge, the surviving company should be the one without or with the least outstanding commercial and fiscal losses.
- **Business purpose test.** The merger should aim at creating business synergy and a more solid capital structure, not for the purpose of tax evasion.
- **Merging companies' business status.** The business activities of the companies which transfer assets should continue up to the effective merger date and subsequently be carried out by the surviving company for at least five years.
- **Prohibition from transferring qualifying assets.** The surviving company should retain the assets received from the merging companies for at least two years following the effective merger date. Transfers of such assets before two years are prohibited except for reasons of efficiency.

Any breach of the above conditions may result in the DGT cancelling the tax-neutral merger approval.

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