Tax
Indonesia

29 Sept 2009

No. 09/09

TaxFlash

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  The parliament passed the proposed VAT law amendment into law in mid September. The concept of export is expanded to include services. Business mergers between taxable companies are treated as non-taxable events. There are also some other changes.

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  More information about transfer pricing must be disclosed in the 2009 corporate income tax return. This is another step following the transfer pricing documentation requirement released in 2007. Further implementing regulations are required. However, the latest development represents the ITO's adoption of the transfer pricing methodologies recommended by the OECD.

What has changed in the 2009 VAT law?

The parliament finally passed the long-awaited proposed VAT law amendment into law on 16 September. The event signified the completion of the parliament's lengthy discussion on the tax law amendment package initiated in 2005. Besides the VAT law amendment, the package also covered amendments to income tax and tax administration laws which were approved by the parliament earlier.

The new VAT law will constitute the third amendment to the 1983 VAT law and will come into force on 1 April 2010. Two other previous amendments took place in 1994 and 2000. What follows is a summary of the main changes covered in the new VAT law.

- Export of taxable intangible goods (TIG) and taxable services (TS). VAT on exports of TIG and TS is zero rated. Exports of TIG are defined as "activities of utilizing TIG from the Customs Area outside the Customs Area". Reference is made to the definition of royalty provided in the income tax law for the meaning of TIG. Exports of TS are vaguely defined as "activities of delivering taxable services to outside the Customs Area". The definition includes toll manufacturing services ('maklon') rendered to foreign principals. Further elaboration regarding the scope of activities and the types of services eligible for the tax treatment will be provided by a minister of finance (MoF) regulation.

- Transfers of taxable goods in shariah-based financing. The new law confirms that transfers of taxable goods in the context of shariah-based financing are deemed to take place from the supplier directly to the party in need of the taxable goods ('buyer') bypassing the financing company. This implies that a tax invoice should be issued by the supplier to the buyer without regard to the financing company.

- Business merger. Transfers of taxable goods between taxable companies in a merger are treated as non-taxable events. The rule also applies to such other business restructuring as consolidation, expansion, business split and acquisition. It is uncertain whether the rule will still prevail in a merger between non-taxable companies.

- **Non-taxable goods and services.** Mining and drilling products extracted directly from their sources remain as non-taxable goods. These include coal before being processed into briquettes. Financial services are also specified as non-taxable service. These include traditional banking services (fund raising and placement), underwriting, and financing services including shariah-based financing (leasing with option, factoring, credit card, and consumer financing).

- **Tax refunds.** By default, tax refunds can only be applied for at book year end. Overpaid tax for a particular month must be carried forward to the following month. Unless it is fully absorbed by the output tax of the following month(s), the overpaid tax must be accumulated up to book year end. By then, companies can apply for a tax refund. Otherwise, they have to carry forward the overpaid tax to the following year. However, certain designated companies bearing a low tax risk profile are granted the privilege of obtaining tax refunds earlier (referred to as pre-audit refunds). These include exporters (of taxable goods or taxable services), suppliers of taxable goods or taxable services to tax collectors, and companies engaged in deliveries of taxable goods with a facility of non-tax collection. The director general of tax (DGT) may conduct an audit after granting an earlier tax refund. Any excessive refunds will be subject to an interest penalty of 2% per month. As a comparison, under the 2000 VAT law, the penalty is 100% of any excessive refunds.

- **Cancellation of service provision.** The new law explicitly acknowledges possible cancellation of service provision and the need for a corresponding adjustment of the relevant VAT which has been accounted for by the service provider and the service recipient. This is an analogy of a sale return. The procedure for the VAT reduction is yet to be elaborated by an MoF regulation.

- **VAT during the pre-production stage.** During the preproduction stage, taxable companies may apply for VAT refunds on a monthly basis for the input tax in respect of capital goods. However, if they fail to reach the production stage within three years from the date they have credited input tax, they must repay the refunds. Input tax for non-capital expenditures (CAPEX) cannot be claimed as a tax credit. It is unclear whether the amounts spent by a project owner in EPC and turn-key contracts constitute CAPEX or non-CAPEX. The procedures for determining the production stage and the refund repayment are yet to be elaborated by an MoF regulation.

- **VAT reporting centralization.** By default, VAT must be settled and reported in each business location. It follows that a company with many business locations must decentralize VAT reporting and settlement to each of those business locations. However, under the new VAT law a taxable company may choose to centralize their VAT reporting and settlement in a single business location merely by submitting a written notification to the DGT. Under the 2000 VAT law, specific DGT approval is required for the same purpose. Nevertheless, despite the default rule, companies registered with certain tax service offices (KPP), e.g., LTO and PMA tax service offices, have been required by the DGT to centralize their VAT reporting for several years already.

- **The time to issue tax invoices.** In principle, a tax invoice must be issued at the same time as the incurrence of the underlying taxable event (delivery of taxable goods or taxable services). However, if a payment takes place before the underlying taxable event, a tax invoice must be issued at the payment date. Where a work of a project is delivered in stages and paid on a term basis, a tax invoice must be issued upon the receipt of each term payment. Alternatively, a combined tax invoice can be issued for one-month deliveries of taxable goods or services to same buyers or customers at the end of the relevant month. An MoF regulation will be issued to govern situations for which determining the time to issue a tax invoice is difficult.

- **Tax payments and reporting.** The tax return for a particular month must be filed by the end of the following month with the relevant underpaid tax having been settled beforehand.

- Deliveries of originally not-for-sale assets. A taxable company which delivers originally not-for-sale assets constituting taxable goods is required to impose VAT thereon. However, VAT is not due if the assets are non-business assets or in the form of sedans or station wagons.

- Several responsibility. The new VAT law resumes the several responsibility provision which had been removed from the tax administration law (KUP). The provision states that buyers of taxable goods or recipients of taxable services are severally responsible for the payment of tax if they cannot demonstrate any evidence that they have paid the tax.

- Luxury sales tax (LST). In addition to VAT, import of luxurious goods or deliveries of such goods by the manufacturer to any other parties are subject to LST at 10% to 200%. The top rate has been increased from 75% as per the current law. The types of goods categorized as luxurious gods and the corresponding LST rates are yet to be elaborated by an MoF regulation.

The implementing regulations are awaited.

More to be disclosed about transfer pricing

The Indonesian Tax Office (ITO) has introduced a new disclosure form for corporate taxpayers, effective for financial years ending on or after 31 December 2009, which requires taxpayers to make detailed disclosures relating to transactions with related parties and the type of documentation held to support the arm's length nature of these transactions. The new disclosure form (Special Attachment 3-A) significantly expands the existing disclosures, which were limited to simple disclosures about a taxpayer's related-party transactions. Specifically, the new disclosures include:

- Business details of the related parties that the taxpayer transacted with;
- Details of the nature and value of the taxpayer's related-party transactions;
- Details of the pricing methodologies applied to set/review the price of the taxpayer's related-party transactions, and the rationale for the selection of these methodologies;
- Disclosures regarding what transfer pricing documentation the taxpayer has prepared to demonstrate that its related-party transactions adhere to the arm's length principle (documentation relating to business profile, functions and ownership structure; types of transactions and any similar transactions with independent parties; analysis of OECD comparability factors; and the application of the most appropriate transfer pricing method).

While the ITO is yet to release detailed guidance relating to the content of transfer pricing documentation, the new disclosure requirements in the corporate income tax return are in line with the analysis that would be performed under an approach consistent with the OECD's "Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations".

This latest development in transfer pricing compliance reinforces the ITO's continued focus in this area - after introducing mandatory documentation rules in December 2007, formally adopting the OECD pricing methods as acceptable methods to accept or review transfer prices in the Indonesian taxation law and transfer pricing issues becoming a focus area in tax audits.

Taxpayers need to commence planning and preparing early if they want to make positive responses to the disclosures regarding transfer pricing, as a considerable amount of time and effort may be required to prepare

documentation which satisfies the OECD standard and allows the taxpayer to respond positively to the disclosures. For the majority of taxpayers, the filing deadline for the first income tax return containing the new disclosure requirements will be 31 March 2010.

Our experience to date indicates that the ITO is moving towards a systematic targeting of taxpayers for transfer pricing focused audits - and not responding positively on the new disclosure form will likely increase a taxpayers risk of audit. Preparation of documentation in line with the OECD Guidelines, that supports the arm's length nature of a taxpayer's transfer prices has proven to be an effective mechanism by which to manage and mitigate the risk of transfer pricing audits or assessments. We recommend that all taxpayers that need to complete this form review their transfer pricing documentation position and consider what additional documentation may be required as soon as possible.

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