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TaxFlash

In This Issue

Bad Debt Write-off – Good News!

As outlined in our Tax Flash No. 07/09, The Ministry of Finance issued Regulation No. 105/PMK.03/2009 in June 2009 which provides the criteria which must be satisfied before a bad-debt write-off can be claimed. The criteria are as follows:

- The debtor has recognized the amount of uncollectible receivables as income in the relevant year;
- The taxpayer must submit a list of uncollectible account receivables to the Directorate General of Taxation (DGT); and
- A legal case to enforce collection has been brought to a District Court or government agency that handles state receivables; or there is written agreement on cancellation of receivables/debt release and discharge between the concerned creditor and debtor; or it has been publicised in a general or a special publication; or the debtor has otherwise acknowledged that his/her debts have been cancelled.

The first requirement would cause the most difficulties for creditors in claiming their bad debts. At a practical level, it is almost impossible to force the debtor to acknowledge the bad-debt relief in its income tax return.

Finally, the Ministry of Finance (MoF) responded to the above issue by releasing Regulation No. 57/PMK.03/2010 dated 9 March 2010 (with a retroactive effective date of 1 January 2009). Under this new MoF Regulation, the first requirement above is revoked and replaced by a requirement that the written-off bad debts should be expensed in the creditor's commercial income statement.

Tax Treaty between Indonesia and Hong Kong – What's in it for us?

On 23 March 2010 Indonesia signed an agreement with Hong Kong for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income ("the tax treaty"). The tax treaty will come into force after the completion of ratification procedures on both sides. The earliest possible dates are 1 January 2011 for Indonesia and 1 April 2011 for Hong Kong.

We discuss below the key features of the tax treaty and share our observations on the tax planning opportunities arising from it.

Key Features

a. The treaty follows the United Nations Model in general, but using the latest OECD standard on Exchange of Information, whereby the scope of information exchange is restricted to "taxes covered" by the tax treaty and the information exchanged shall not be disclosed to the oversight body of the relevant tax authorities or to any third jurisdiction for any purpose.

b. Under the tax treaty, a **service Permanent Establishment** (PE) is defined to include the provision of services by an enterprise if the services continue (for the same or a connected project) for a period or periods aggregating more than **183 days** within any 12-month period.

c. In the absence of a tax treaty, Hong Kong residents receiving income (dividends, interest, royalties, service fees) from Indonesia not attributable to a PE here are subject to a 20% withholding tax. Under the treaty the rate will be reduced to **10% for dividends**, but if the recipient is a company holding at least 25% of the share capital of the paying company, the withholding tax rate will be **further reduced to 5%.** The withholding taxes for **royalties** and **interest** will be capped at **5% and 10%** respectively. Fees from services will be exempt from Indonesian tax if in performing the services no PE is created in Indonesia.

d. In Indonesia, branch profits are subject to the ordinary corporate tax rate and the after-tax profits are further subject to a withholding tax ('branch profit tax " /BPT) at 20% regardless of whether the profits are remitted to the head office in the home country. In the absence of a treaty , profits of a Hong Kong company doing business through a branch in Indonesia will be double taxed if the profits derived by the branch are not regarded as offshore for Hong Kong profits tax purposes. Such double taxation is avoided by means of a **tax credit** under the treaty. In addition, the **BPT** is capped at **5%** on the after-tax amount (except for the Production Sharing Contracts/PSC and Contract of Work /CoW companies in Indonesia).

e. Capital gains derived from alienation of shares in a company that does not derive 50% or more of its asset value directly or indirectly from immovable property owned by the company and located in the other country, regardless of the percentage of shareholding and holding period, are exempt from tax. On the other hand, capital gains derived from transfer/sale of shares in a property holding company may be taxed under the treaty, except in the case that the transfer is made in the framework of a reorganization ; or the immovable property held is used to carry on its business (such as a mine or a hotel).

f. The treaty has a provision allowing the contracting parties to apply their domestic laws and anti tax avoidance measures. A "beneficial owner requirement" clause in respect of the withholding tax rates on passive income is also included in the treaty.

PricewaterhouseCoopers firms observations

The conclusion of the tax treaty between Indonesia and Hong Kong will foster economic and trade links between the two parties. Especially because the treaty offers a number of favourable benefits that are not or rarely available under the other treaties of Indonesia, for example it is the only treaty that offers a 5% withholding tax rate on

dividends for non-portfolio investments and the 5% withholding tax rate on branch profits is also the lowest offered by Indonesia (only two other treaties with Indonesia, i.e. Taiwan and United Arab Emirates, provide the same cap rate).

The maximum 5% withholding tax rate on royalties provided under the treaty is currently only offered to Qatar and United Arab Emirates.

In addition, the treaty also provides protection on capital gains derived from subsequent disposal of the investments in Indonesia, although with some conditions (refer to Feature – e above). The provision would provide Hong Kong tax residents satisfying the conditions, a protection from the 5% Indonesian withholding tax imposed on sale value of non-listed Indonesian company shares. In comparison, the Indonesia – Singapore Tax Treaty does not provide this exemption.

Foreign companies currently investing in Indonesia should review their existing holding structure to explore if they can take advantage of the benefits under the Indonesia – Hong Kong Tax Treaty taking into considerations the anti-abuse provisions in the treaty and the relatively tough Indonesian rules in claiming the treaty benefits.

VAT Claims for Entrepreneurs Providing VATable and Non-VATable Goods and/or Services.

Recently released Minister of Finance Regulation No. 78/PMK.03/2010 dated 5 April 2010 provides detailed guidance in calculating Input VAT claims for entrepreneurs delivering both VATable and Non-VATable goods and/or services, in the case the Input VAT can not be clearly identified as relating to the production or delivery of VATable goods and/or services.

In principle, input VAT claims should be calculated proportionally to the sales of the VATable goods and/or services. This principle remains the same in the new regulation, but the calculation formula has changed.

The old regulation distinguished the Input VAT claims into those related to the acquisition of capital goods and non-capital goods. For the capital goods, the Input VAT claimed proportionally to the sales of VATable goods and/or services had to be spread over the useful life of the goods. For the purpose of this calculation, the capital goods were divided into two groups, buildings and non-buildings, with the useful life of 10 years and 5 years respectively.

In the new regulation, there is no more distinction between capital and non-capital goods for the Input VAT claims, but the distinction is between goods and/or services with a useful life of more than 1 year and up to 1 year. The Input VAT claimed proportionally to the sales of VATable goods and/or services then must be spread over the useful life of the purchased goods and/or services. For the purpose of this calculation, goods and/or services with a useful life of more than 1 year, are classified into either land and building or other goods and services, with the useful life of 10 years and 4 years respectively.

If previously Input VAT claims have been made without using the above formula, a recalculation has to be made and the resulting difference must be reported in the VAT Return at the latest three months after the end of the relevant book year.

Can we use our "old" printed VAT Invoices?

You may still have a stack of printed Standard VAT Invoices, and are wondering whether you can still use them or your customers may have asked you to replace them because since the enforcement of the Amended VAT Law on 1 April 2010, VAT invoices are no longer classified into Standard and Simple, and therefore the requirement to print the word "Standard" on our VAT invoices is no longer applicable.

Article 13 paragraph (5) of the Amended VAT Law regulates the information that must be available in VAT invoices, which is more or less the same as the information required by the previous regulation. The implementing regulation regarding VAT

invoices, MoF Regulation No.38/PMK.04/, further states that the format and size of VAT invoices can be made according to *PKP* (Tax Entrepreneurs) needs.

Considering the above rules, any additional information on VAT invoices would not make them invalid, and hence the old printed Standard VAT Invoices Form can still be used. This is confirmed by a circular letter issued by the Directorate General of Taxes (SE-56/PJ/2010) dated 27 April 2010.

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