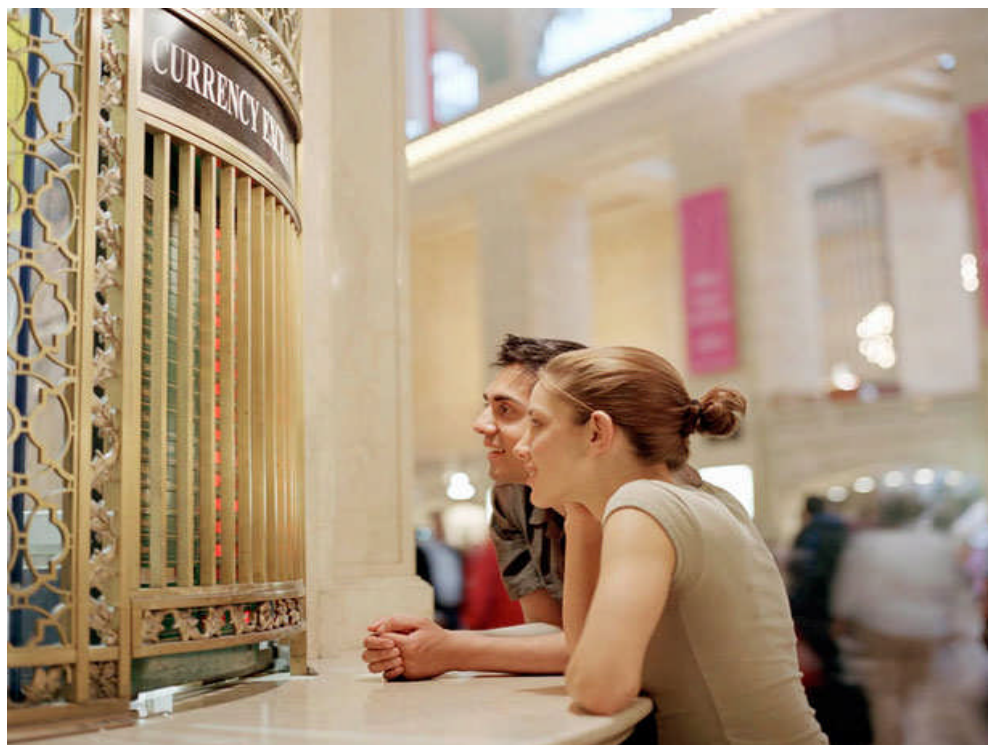




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VAT on Banking Services – How far does it go?

Article 4A of the New Value Added Tax (VAT) Law No.42/2009 (“Law No.42/2009”) mandated certain services as not subject to VAT and among them are financial services. Under Law No. 42/2009 and its Elucidation, the definition of financial services is quite detailed but it does not cover the whole range of banking services. There are several banking services which had been left in uncertainty with regard to the VAT treatment.

In response to queries from the banking sector, the Director General of Tax (DGT) issued Circular Letter No.SE-121/PJ/2010 dated 29 November 2010. In the Circular, the DGT concludes that non VAT-able financial services performed by general banks have the following main characteristics:

- a. the financial service is a financing, which obtains income in the form of interest, or
- b. if it is not a financing, the financial service should be directly rendered to the bank’s customers.

The Circular and its attachments provide a detailed list of the VAT-able and the non VAT-able financial services. The services are listed down below and compared with banking services according to the Banking Law No.7/1992 as amended by Banking Law No.10/1998.

Banking Law No.10/1998		Circular Letter No.SE-121/PJ/2010			
Banking activities (Article 6)		Non VAT-able banking activities (Paragraph 4)		VAT-able banking activities (Paragraph 5)	
a	collect funds from public in the form of deposits, comprising demand deposits, time deposits, certificate of deposits, savings and/or other equivalent forms of deposits	a	collect funds from public in the form of deposits, comprising demand deposits, time deposits, certificate of deposits, savings and/or other equivalent forms of deposits		
b	provide credits	b	provide credits		
c	issuing notes	f	issuing notes		
d	buy, sell and guarantee on own risk or for and as instructed by customers: 1) bill of exchange, including bank's acceptance which maturity are not longer than common practice in the trade papers referred to; 2) promissory notes and other commercial papers, the maturity of which are not more than the common practice in the trade papers referred to; 3) treasury bills and government guarantees; 4) certificate of Bank of Indonesia (<i>SBI</i>); 5) bonds; 6) commercial papers with maturity within a year; 7) other security instruments with maturity within a year	g	guarantee on own risk: 1) bill of exchange, including bank's acceptance which maturity are not longer than common practice in the trade papers referred to; 2) promissory notes and other commercial papers, the maturity of which are not more than the common practice in the trade papers referred to; 3) treasury bills and government guarantees; 4) certificate of Bank of Indonesia (<i>SBI</i>); 5) bonds; 6) commercial papers with maturity within a year; 7) other security instruments with maturity within a year	f	buy, sell and guarantee for and as instructed by customers: 1) bill of exchange, including bank's acceptance which maturity are not longer than common practice in the trade papers referred to; 2) promissory notes and other commercial papers, the maturity of which are not more than the common practice in the trade papers referred to; 3) treasury bills and government guarantees; 4) certificate of Bank of Indonesia (<i>SBI</i>); 5) bonds; 6) commercial papers with maturity within a year; 7) other security instruments with maturity within a year
e	fund transfer either on own behalf or for the interest of non-customers			a	fund transfer for the interest of non-customers
f	placing funds in, borrowing funds from, or lending funds to other banks, whether by letter, telecommunications device, or by sight draft, cheque, or other means	c	placing funds in, borrowing funds from, or lending funds to other banks, whether by letter, telecommunications device, or by sight draft, cheque, or other means		
g	receive payment of claim for securities and perform calculation with or among third parties			c	receive payment of claim for securities and perform calculation with or among third parties
h	providing a place to store valuable goods and securities			d	providing a place to store valuable goods and securities

Banking Law No.10/1998		Circular Letter No.SE-121/PJ/2010			
Banking activities (Article 6)		Non VAT-able banking activities (Paragraph 4)		VAT-able banking activities (Paragraph 5)	
i	conducting deposit activities for the interest of other parties under certain contracts			e	conducting deposit activities for the interest of other parties under certain contracts
j	fund placement from a customer to another customer in the form of securities not listed in the stock exchange			b	fund placement from a customer to another customer in the form of securities not listed in the stock exchange
k	conducting activities in factoring, credit cards, and trustee services	d	conducting activities in factoring and credit cards	e	conducting activities in trustee services
l	providing financing and/or conducting other activities based on Syariah Principles, in accordance with the regulations stipulated by Bank Indonesia	e	providing financing and/or conducting other activities based on Syariah Principles, in accordance with the regulations stipulated by Bank Indonesia		
m	perform other activities commonly done by the bank as long as they do not contradict the Banking Law and prevailing regulations	h	perform other activities commonly done by the bank as long as they do not contradict the Banking Law and prevailing regulations	g	perform other activities commonly done by the bank as long as they do not contradict the Banking Law and prevailing regulations

The attachments to the Circular also provide examples of banking products/services for each group listed above.

Other than the above list, foreclosed assets which are then sold by the bank are also subject to 10%VAT. The technical regulatory basis of this treatment is not mentioned in the Circular.

Although this Circular is quite comprehensive, it still leaves some issues to be clarified, amongst others:

- As banking products are continuously developing, how would banking practitioners assess the VAT implications of new products not included in the Circular?
- One of the main characteristics of non VAT-able financial service is the service is directly rendered to customers; however, we noted that in the examples mentioned in the Circular that certain banking income e.g., from transactions of bank drafts, traveler's checks, telex, and swift, are subject to VAT. Is it true then that those services are not directly rendered to customers?
- In practice, it will be challenging to identify services rendered to customers and to non-customers. Clearer definitions of "customers" and "non-customers" in day-to-day banking operation are needed.
- The Circular was issued to confirm the implementation of the Law No. 42/2009, specifically on financial services issues. Since the Law No. 42/2009 has been effective since 1 April 2010, does it mean that banks delivering services subject to VAT according to the above Circular will be imposed administrative penalties for not issuing VAT invoices (2% of Tax Imposition Base) and for late issue of VAT invoices (2% per month) starting from 1April 2010 ? What is the impact to the customers for late VAT invoice issued more than three months since the related service delivery, would the VAT be creditable?

VAT treatment of Financial Lease and Sale and Leaseback

As defined in Law No. 42/2009, leasing with option right (financial lease) is classified as a non VAT-able service, whereas leasing without option right (operating lease) is subject to 10% VAT. The DGT recently released a guideline on VAT treatment of the above leasing activities in the form of Circular Letter No. SE-129/PJ/2010 ("SE-129") dated and effective as of 29 November 2010.

In 1994, the Indonesian Tax Office already issued a comprehensive guideline on VAT and Income Tax treatments of leasing transactions i.e., SE-10/PJ.42/1994 ("SE-10"). However, this Circular was revoked by SE-129, which is not as comprehensive as SE-10 and only addresses the VAT treatment.

The most significant change brought by SE-129 is the confirmation that sale and leaseback of capital goods in financial lease scheme is not subject to VAT.

It is now confirmed that in the financial lease of capital goods, the lessor is not required to register for VAT purposes (to be a PKP/VAT-able Entrepreneur) considering the following reasons:

- a. the taxable (capital) goods are from supplier and considered directly delivered by supplier to lessee;
- b. lessor is only rendering a financing service which is not subject to VAT; and
- c. the delivery of taxable goods from lessee to lessor in substance are for collateral purposes.

Consequently, the lessor is not required to issue VAT invoice for financial lease. Previously, the party who delivers/sells the goods has to fill out the buyer's identity in the VAT invoice with the identity of the lessor q.q.(*qualitate qua*) the lessee. Now, the VAT invoice is directly issued to the lessee and the lessor's identity does not need to be mentioned again.

The new Circular does not clearly address VAT impact for early termination of a financial lease.

Confirmation on the VAT Cancellation Notes

The DGT has recently released Circular Letter No. SE-131/PJ/2010, which is a confirmation of the treatment on the VAT Notes for Returned Goods and Cancellation of Services. This Circular is an implementing regulation of the MoF Regulation No. 65/PMK.03/2010.

The DGT confirmed that the VAT cancellation note cannot be used as a base for deduction to the seller's Output VAT if the VAT invoice previously issued on the delivery of relevant goods/service did not mention the buyer's identity. Thus, to fulfill the validity criteria, the buyer's identity is necessary to be put in the VAT invoice as the requirement of VAT deduction if any return of goods or cancellation of services occurs.

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