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Revocation of final income tax on the initial margin of exchange-traded derivatives

On 6 June 2011, the Government of Indonesia issued Government Regulation (GR) No.31/2011 (GR-31) to revoke GR No.17/2009 (GR-17) which had imposed 2.5% Article 4(2) Final Income Tax on the initial margin of exchange-traded derivatives. The revocation was made in order to carry out the Supreme Court Decision on a judicial challenge towards GR-17.

The revocation of GR-17 through this judicial challenge is the first known case that has resulted in a complete reversal of a GR. This case shows that the public can file a judicial challenge against a particular regulation if it is perceived that the regulation is not in accordance with the relevant law.

Based on media coverage during and after the process, the judicial challenge was made on the following grounds:

a) the final income tax regulated by GR-17 was in conflict with Articles 4(1) and 4(2)(c) of Income Tax Law No.36/2008 (Law-36);
b) the final income tax rate of 2.5% is high compared to the 0.1% final income tax rate imposed on shares traded on the Indonesian Stock Exchange, and therefore would be detrimental to the development of derivatives trading; and
c) GR-17 was issued on 9 February 2009 but applied retroactively from 1 January 2009, which created difficulties in collecting the tax due.

If the last point was one of the bases of the Supreme Court Decision, the Director General of Taxes may need to be careful in future to align the effective date and the issuance date of tax regulations and not to issue retroactive regulations.

With regard to the tax already collected while GR-17 was in effect, GR-31 stipulates that the collected tax will be refunded to taxpayers based on the prevailing tax refund regulation.

Implementation of withholding tax mechanism on bonds

Two years after the effective date of GR No.16/2009 (GR-16), the Minister of Finance (MoF) published Regulation No.85/PMK.03/2011 (PMK-85), dated 23 May 2011, which came into effect on that date. PMK-85 revoked the regulation previously in force, i.e. MoF Decision No.121/KMK.03/2002.

PMK-85 is applicable for bonds (including government bonds) issued in Indonesia with maturity periods longer than twelve months. PMK-85 provides more detailed implementation of the withholding tax (WHT) mechanism for bond transactions, including WHT rates, deadlines, details pertaining to the tax withholder and the mechanism to be used, and more detail guidelines. There are no conceptual changes.

Key changes

1. The First In First Out (FIFO) method – now mandatory

In the previous regulation, the FIFO method was required to be used when determining the acquisition cost and date of a bond sale transaction only for script-less bonds where the acquisition date could not be determined. Now the FIFO method must be used for all transactions.

As this MoF regulation was not published immediately on the date of issue, it could be problematic for sellers who use a method other than FIFO during the period after the issuance of this MoF regulation up until this regulation becomes publicly available.

2. Netting off losses is now prohibited

When calculating the final income tax due, netting off of interest income against a loss incurred in a sale transaction (i.e. the selling price being lower than the acquisition price) is now prohibited.

Remaining issues – Withholding tax slip collection for determining the acquisition cost and date

As was also required in the old regulation, sellers must inform the tax withholder of the acquisition cost of the bonds and the actual date of acquisition by providing the final WHT slip from the previous bond purchase. The addition made in PMK-85 is that any tax underpayment resulting from the unavailability of the WHT slips will be subject to interest penalty.

Although this is a general sanction applicable for any tax underpayment, it puts more burden on the tax withholder to collect the WHT slips.

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