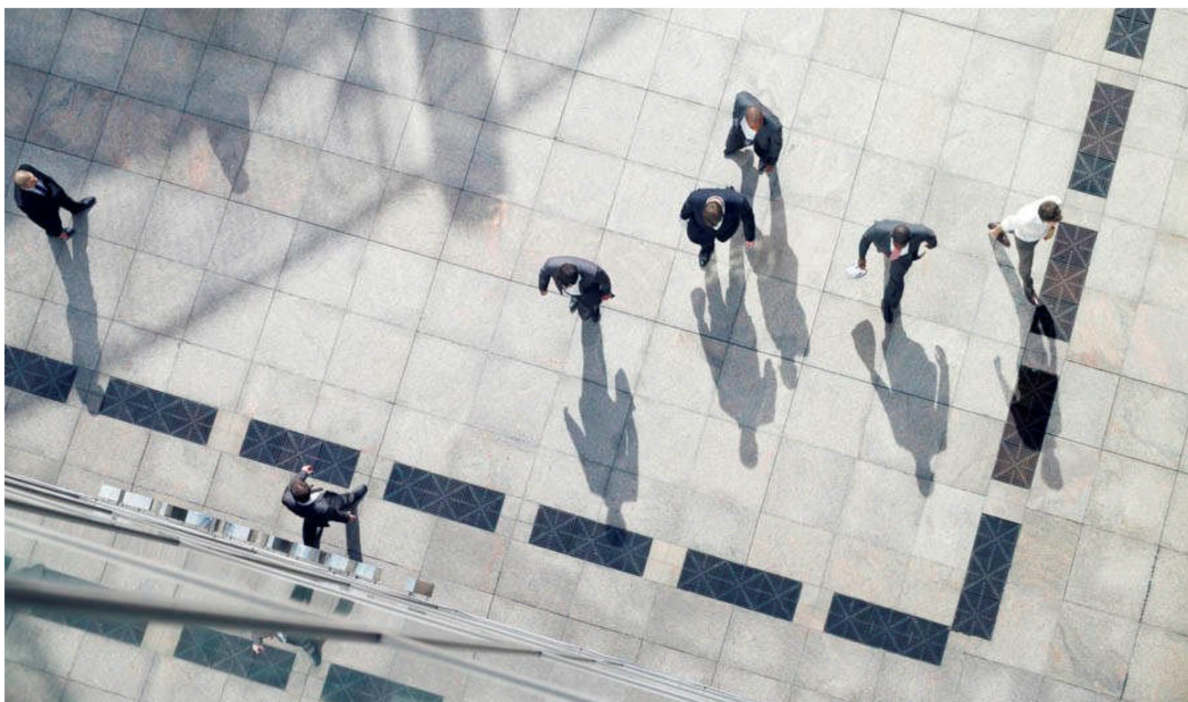
TaxFlash



Implementing rules for the Debt to Equity Ratio

As most readers would be aware, Indonesia has set in place a single Debt to Equity Ratio (DER) of 4:1 for tax purposes. This means that the amount of debt allowable in order to obtain full deductibility of the associated financing costs is limited to four times the equity amount (with an exemption for certain taxpayers). This policy was set out in Minister of Finance Regulation No.169/PMK.010/2015 (PMK-169).

On 28 November 2017, the Director General of Tax issued Regulation No.PER-25/PJ/2017 (PER-25) which provides certain detail in relation to the implementation of PMK-169.

Key points from PER-25 are set out below.

Exclusion of certain debt

PMK-169 already excludes from the DER calculation debt used to generate non-taxable income or income subject to final tax. PER-25 now also excludes debt for which the existence cannot be formally verified. This appears to be targeting debt which cannot be substantiated through ordinary commercial arrangements and so with some question over its legitimacy.

Non-deductible financing costs

Deemed Dividends

PMK-169 already stipulates that deductibility of financing costs derived from related party lending is still subject to the arm's length principle (i.e. as well as satisfaction of the DER).

PER-25 further stipulates that financing costs will be deemed to be a dividend if the taxpayer fails to satisfy the arm's length principle. Remittance of the relevant tax (presumably as withholding tax) will be due upon actual payment or the due date of payment.

Capitalised financing costs

PMK-169 already stipulates that the following financing costs are not deductible:

a. financing costs to the extend of being connected to debt which exceeds the DER threshold;
b. related party financing costs to the extend of any failure to meet the arm's length principle;
c. financing costs of debt used to generate non-taxable income; and
d. financing costs of debt used to generate income subject to final tax.

PER-25 now clarifies that these provisions apply even where the taxpayer capitalises the financing costs as part of an asset acquisition (i.e. meaning that the relevant depreciation cannot be deducted).

Reporting requirement

PER-25 provides the following standard forms necessary to report DER compliance:

a. an overall DER calculation; and
b. a summary of "offshore" loans

Both forms must be attached to the relevant taxpayer's annual Corporate Income Tax Return (CITR) with the CITR treated as incomplete if the taxpayer fails to do so. Further, and specifically for offshore loans, failure to submit the report will result in the automatic non-deductibility of the relevant financing costs.

Both reports are mandatory starting in the 2017 tax year (i.e. for CITRs to be filed by April 2018).

There is however no guidance on taxpayers excluded from DER such as those included in infrastructure projects.

Your PwC Indonesia contacts:

Abdullah Azis
abdullah.azis@id.pwc.com

Adi Poernomo
adi.poernomo@id.pwc.com

Adi Pratikto
adi.pratikto@id.pwc.com

Alexander Lukito
alexander.lukito@id.pwc.com

Ali Widodo
ali.widodo@id.pwc.com

Andrias Hendrik
andrias.hendrik@id.pwc.com

Anton Manik
anton.a.manik@id.pwc.com

Antonius Sanyojaya
antonius.sanyojaya@id.pwc.com

Ay Tjhing Phan
ay.tjhing.phan@id.pwc.com

Brian Arnold
brian.arnold@id.pwc.com

Dany Karim
dany.karim@id.pwc.com

Deny Unardi
deny.unardi@id.pwc.com

Engeline Siagian
engeline.siagian@id.pwc.com

Enna Budiman
enna.budiman@id.pwc.com

Gadis Nurhidayah
gadis.nurhidayah@id.pwc.com

Gerardus Mahendra
gerardus.mahendra@id.pwc.com

Hanna Nggelan
hanna.nggelan@id.pwc.com

Hasan Chandra
hasan.chandra@id.pwc.com

Hendra Lie
hendra.lie@id.pwc.com

Hisni Jesica
hisni.jesica@id.pwc.com

Hyang Augustiana
hyang.augustiana@id.pwc.com

Laksmi Djuwita
laksmi.djuwita@id.pwc.com

Lukman Budiman
lukman.budiman@id.pwc.com

Mardianto
mardianto.mardianto@id.pwc.com

Margie Margaret
margie.margaret@id.pwc.com

Mohamad Hendriana
mohamad.hendriana@id.pwc.com

Otto Sumaryoto
otto.sumaryoto@id.pwc.com

Parluhutan Simbolon
parluhutan.simbolon@id.pwc.com

Peter Hohtoulas
peter.hohtoulas@id.pwc.com

Raemon Utama
raemon.utama@id.pwc.com

Runi Tusita
runi.tusita@id.pwc.com

Ryosuke R Seto
ryosuke.r.seto@id.pwc.com

Ryuji Sugawara
ryuji.sugawara@id.pwc.com

Soeryo Adjie
soeryo.adjie@id.pwc.com

Sujadi Lee
sujadi.lee@id.pwc.com

Sutrisno Ali
sutrisno.ali@id.pwc.com

Suyanti Halim
suyanti.halim@id.pwc.com

Tim Watson
tim.robert.watson@id.pwc.com

Tjen She Siung
tjen.she.siung@id.pwc.com

Turino Suyatman
turino.suyatman@id.pwc.com

Yessy Anggraini
yessy.anggraini@id.pwc.com

Yuliana Kurniadjaja
yuliana.kurniadjaja@id.pwc.com

Yunita Wahadaniah
yunita.wahadaniah@id.pwc.com

www.pwc.com/id

PwC Indonesia

@PwC_Indonesia

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