TaxFlash

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Implementing rules of Income Tax under the HPP Law

On 20 December 2022, the Government issued Regulation No.GR-55[1] to implement the Income Tax Law (ITL) amendments introduced under the Harmonisation of Tax Regulations (*Harmonisasi Peraturan Perpajakan/HPP*) Law[2].

GR-55 revokes several Government Regulations[3] (GR) and consolidates the contents into this GR. Other implementing regulations (i.e. other than GRs) remain valid to the extent that they do not contradict GR-55.

Under the HPP Law all implementing rules are now initially mandated to a GR. Under the previous ITL, many of the implementing rules were instead initially mandated by Minister of Finance (MoF) Regulation (*Peraturan Menteri Keuangan/PMK*).

It seems therefore that GR-55 will consolidate the features of these PMKs into this GR to accommodate this new hierarchical mandate. This is as well as streamlining the existing rules that were governed under existing GRs, PMKs and the ITL.

GR-55 covers the following broad topics:
a) territorial taxation for foreigners;
b) non-taxable objects;
c) deductible expenses;
d) depreciation and amortisation;
e) benefits-in-kind;
f) anti-tax-avoidance measures, and

[1] Government Regulation No.55 Year 2022 (GR-55) dated and effective from 20 December 2022
[2] Law No.7 Year 2021 dated and effective from 29 October 2021
[3] - Government Regulation No.18 Year 2009 on Aid or donation categorised as alms (*zakat*) or mandatory religious donation, which is excluded from Income Tax object;
- Article 2A of Government Regulation No.94 Year 2010 on Calculation of taxable incomes and settlement of Income Tax in current year as lastly amended by Government Regulation No.9 Year 2021 on Taxation treatment to support Ease of Doing Business;
- Government Regulation No.23 Year 2018 on Income Tax on operating income received or acquired by taxpayers having certain gross turnover;
- Article 10 of Government Regulation No.29 Year 2020 on Income Tax facilities in the context of handling of COVID-19;
- Government Regulation No.30 Year 2020 on Decrease in Income Tax rate for resident corporate taxpayers in the form of publicly listed limited liability company.

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g) international tax agreements.

In this TaxFlash, we highlight only the areas of GR-55 which provides changes of substance which are for topics d) to g). Topics a) to c) are largely unaffected by GR-55.

Depreciation and amortisation

The HPP Law stipulates that, if a permanent building or other intangible asset has a useful life of more than 20 years, then the depreciation or amortisation can be carried out using:
a) the straight-line method over a 20-year period; or
b) the actual useful life based on the taxpayer's bookkeeping.

GR-55 further stipulates that these new rules apply for permanent buildings or intangible assets that are:
a) owned and used prior to Fiscal Year (FY) 2022; and
b) are depreciated/amortised according to a useful life of 20 years.

In this case the taxpayer may choose to depreciate/amortise according to the actual useful life based on the taxpayer's bookkeeping. This is by submitting a notification to the Director General of Taxes (DGT) by the end of FY 2022 (i.e. as a single year "incentive"). We do not expect this to be of interest to most taxpayers.

In addition, the MoF will separately stipulate the depreciation rules for repairs of tangible assets which have a useful life of more than one year. This is an area of greater interest, and we will comment further once the MoF Regulation issues.

Benefits-in-kind

The HPP Law changed the rules on the treatment of benefits (*kenikmatan*) and in-kind (*natura*) remuneration, collectively referred to as Benefits-in-Kinds (BIKs). Under this change, BIKs are now taxable to the employee (with some exceptions) and the cost is deductible to the employer (providing of course that the cost relates to obtaining, collecting, and maintaining income).

GR-55 defines "in-kind" as compensation in goods other than money. A "benefit" is defined as compensation in the form of the right to use a facility or a service which is provided by either the employer or a third-party where the asset is rented or paid for by the employer.

The BIK categories excluded from taxable income are as follows:
a) food and beverages provided for all employees;
b) BIKs in certain areas;
c) BIKs necessary to carry out the employees' work activities;
d) BIKs sourced or financed from the regional/state revenue budget; or
e) BIKs of certain types and/or thresholds.

The scope of BIKs under point a) and b) above has been regulated under PMK-167[4]. GR-55 has now added food or beverage ingredients available to all employees with certain thresholds under point a).

The scope of point c) was taken from the elucidation of the previous ITL. GR-55 now adds BIKs received in the context of handling endemics, pandemics, and national disasters to the scope of point c).

[4] MoF Regulation No.PMK-167/PMK.03/2018 dated and effective from 19 December 2018

The determination of taxable value for in-kind remuneration is based on market value. The taxable value for benefits is the actual cost incurred (or what should have been incurred) by the employer.

The following matters will be separately regulated by the MoF:
a) BIKs in certain areas;
b) BIKs of certain types and/or thresholds, as well as food/beverage ingredients available to all employees with certain thresholds;
c) the determination of taxable value for BIKs.

The determination of BIKs under point b) above is quite important and the PMK should provide guidance on the type or value of the BIK in question and the relevant criteria.

Transitional provisions related to BIKs are as follows:
a) that the rules for employers (presumably around deductibility) apply from:
   i. 1 January 2022 for taxpayers whose FY 2022 started prior to 1 January 2022; or
   ii. the start of the Fiscal Year for taxpayers whose FY 2022 started from 1 January 2022 and onwards;
b) that the withholding tax obligations for employers do not however start until 1 January 2023;
c) with b) in mind, that the Income Tax due on BIKs received from 1 January 2022 until 31 December 2022 (or from FY 2022 for taxpayers whose FY 2022 starts after 1 January 2022) must be calculated, paid, and reported by employees in their 2022 Annual Income Tax Return (where the tax has not been withheld by the employer).

Anti-tax-avoidance measures

This section implements Article 18 of the ITL and represents a significant development with regard to Indonesia's now evolving anti-avoidance framework.

Interestingly, the policies introduced in this GR are based on the elucidation of the article rather than the body of the article itself. This is despite Article 32C of the ITL only providing mandates to implement paragraphs (1) to (4) of Article 18.

The elucidation to Article 18 of the ITL states that the government is authorised to prevent tax avoidance by taxpayers who seek to reduce, avoid, or defer the payment of tax that is otherwise due and where this is in contrary to the purpose and objectives of the tax laws and regulations. GR-55 outlines the measures that can be taken by the government to combat this.

On top of the measures stipulated under Article 18 (1) to (3d), GR-55 provide the MoF the authority to carry out the following:

a. Recalculation of tax due based on financial performance comparison

This applies to related party transactions and allows for the recalculation of tax to what "should" be due based on a comparison of the taxpayer's financial performance against comparable companies. This can be applied to taxpayers that are:
   i. reporting profits that are "too low" when compared to the financial performance of taxpayers in a similar business; or
   ii. reporting "unreasonable" losses where the taxpayer has been in commercial operation for more than five years and has reported tax-losses for any three consecutive years.

b. Recalculation of tax due by denying deductibility of amounts relating to hybrid entities or instruments

This applies to all situations (i.e. irrespective of whether between related parties). This intervention targets the deductibility of payments made by a resident taxpayer to a foreign taxpayer where "different" tax treatment arises from the use of a hybrid entity or instrument in the country of domicile of the foreign taxpayer. The payment by the resident taxpayer can be treated as not deductible if:

a) the amount is not treated as taxable income in the country of the foreign taxpayer (i.e. deduction − non-inclusion); or
b) the amount is also deductible in the country of the foreign taxpayer (i.e. a double deduction), and

this results in that income becoming not-taxed or low-taxed either in Indonesia or in the country of domicile of the foreign taxpayer.

c. Redetermination of tax due based on "substance-over-form" principle

This intervention also applies to all situations and provides that, in the case of "tax avoidance" that cannot be prevented using any other measure, the DGT can redetermine the tax that should be due based on a "substance-over-form" approach.

This approach must consider:

i. the limits of any authority and implementation procedures (noting this terminology is not clear);
ii. whether the taxpayer's activities generally fall within the scope of "tax avoidance";
iii. the formal and material testing stages of the transaction (noting this terminology is not clear);
iv. any quality control mechanism (noting this terminology is not clear); and/or
v. the protection of the taxpayer's rights.

These measures must also be carried out with "good governance" and with the taxpayer retaining general dispute resolution rights.

Further details on the above will be set out in PMKs. Taxpayers will no doubt be interested on the technical and practical limits of these developments.

Separately, GR-55 now provides for an "Advance Pricing Agreement" to be concluded on a multilateral basis, on top of the existing unilateral and bilateral arrangements.

International tax agreements

As has always been the case, the government has the authority to enter into bilateral or multilateral international tax agreements with other countries or jurisdictions.

In light of the developments on international collaboration to end tax avoidance in the form of Base Erosion and Profit Shifting (BEPS), GR-55 updates the type of international tax agreements to which Indonesia can be bound:

a) Double Taxation Avoidance Agreements (i.e. Tax Treaties);
b) Multilateral Conventions to implement Tax Treaties related measures to prevent BEPS;
c) Exchange of Information agreements for tax purposes;
d) Bilateral or Multilateral Competent Authority Agreements; and
e) Agreements to address the tax challenges arising from the digitalisation of the economy and/or other BEPS actions. − *new*

As of 16 December 2022, 138 members of the OECD/G20 Inclusive Framework on BEPS joined the Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy, including Indonesia. Provisions on the implementation of this Two-Pillar Solution are still in process at the global level. This will be determined through multilateral international tax agreements and where necessary by way of correlative changes to domestic law.

GR-55 acknowledges that a new concept of allocating taxing rights has been designed based on a new business model without the need for a physical presence which gives broader taxing rights to the source country. In addition, other solutions are also designed to end profit shifting to no-tax or low-taxed countries/jurisdictions and to ensure Multinational Enterprises (MNEs) pay a global minimum tax as agreed in the agreement. GR-55 serves as a legal basis to incorporate components of each Pillar as follows:

a) Pillar One:

   MNEs that satisfy certain criteria determined in an international tax agreement (such as consolidated turnover and profit level) are considered to fulfil the subjective and objective tax obligations and therefore, subject to tax in Indonesia.

b) Pillar Two:

   The group of MNEs that falls within the scope of the international tax agreement will be subject to a global minimum tax collected in Indonesia based on the said agreement.

Detailed implementation on the Two-Pillar Solution in Indonesia will be regulated further in MoF Regulations.

Your PwC Indonesia Contacts:

Abdullah Azis
abdullah.azis@pwc.com

Adi Poernomo
adi.poernomo@pwc.com

Adi Pratikto
adi.pratikto@pwc.com

Adrian Hanif
adrian.hanif@pwc.com

Alexander Lukito
alexander.lukito@pwc.com

Ali Widodo
ali.widodo@pwc.com

Andrias Hendrik
andrias.hendrik@pwc.com

Anton Manik
anton.a.manik@pwc.com

Antonius Sanyojaya
antonius.sanyojaya@pwc.com

Avinash Rao
a.rao@pwc.com

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

Brian Arnold
brian.arnold@pwc.com

Dexter Pagayonan
dexter.pagayonan@pwc.com

Enna Budiman
enna.budiman@pwc.com

Esa Perdana
esa.perdana@pwc.com

Gadis Nurhidayah
gadis.nurhidayah@pwc.com

Gerardus Mahendra
gerardus.mahendra@pwc.com

Hasan Chandra
hasan.chandra@pwc.com

Hendra Lie
hendra.lie@pwc.com

Hisni Jesica
hisni.jesica@pwc.com

Hyang Augustiana
hyang.augustiana@pwc.com

Kianwei Chong
kianwei.chong@pwc.com

Lukman Budiman
lukman.budiman@pwc.com

Made Natawidnyana
made.natawidnyana@pwc.com

Mardianto
mardianto.mardianto@pwc.com

Margie Margaret
margie.margaret@pwc.com

Marlina Kamal
marlina.kamal@pwc.com

Nicholas Sugito
nicholas.sugito@pwc.com

Nikolas Handradjid
nikolas.handradjid@pwc.com

Oki Octabiyanto
oki.octabiyanto@pwc.com

Omar Abdulkadir
omar.abdulkadir@pwc.com

Otto Sumaryoto
otto.sumaryoto@pwc.com

Peter Hohtoulas
peter.hohtoulas@pwc.com

Raemon Utama
raemon.utama@pwc.com

Runi Tusita
runi.tusita@pwc.com

Ryuji Sugawara
ryuji.sugawara@pwc.com

Soeryo Adjie
soeryo.adjie-c@pwc.com

Sujadi Lee
sujadi.lee@pwc.com

Sukma Alam
sukma.alam-c@pwc.com

Surendro Supriyadi
surendro.supriyadi-c@pwc.com

Susetiyo Putranto
susetiyo.putranto@pwc.com

Sutrisno Ali
sutrisno.ali-c@pwc.com

Suyanti Halim
suyanti.halim@pwc.com

Tim Watson
tim.robert.watson@pwc.com

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

Turino Suyatman
turino.suyatman@pwc.com

William Christopher
william.christopher@pwc.com

Yessy Anggraini
yessy.anggraini@pwc.com

Yuliana Kurniadjaja
yuliana.kurniadjaja@pwc.com

Yunita Wahadaniah
yunita.wahadaniah@pwc.com

www.pwc.com/id

PwC Indonesia

@PwC_Indonesia

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