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NEWS ALERT

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- The Omnibus Law: Law No. 11/2020

Key Takeaways

The Omnibus Law makes changes to the Income Tax Law, VAT Law, and the KUP Law including:

- Exempting tax on dividends which are invested in Indonesia
- Easing the crediting of input VAT
- Changing administrative sanction penalties

The tax portion of the Omnibus Law provides some relief to taxpayers. Companies may want to consider restructuring their business and investment strategy to take advantage of the investment exemption from income tax on dividends.

However, the tax benefits come at a cost insofar as Indonesia's economy has taken a serious hit from the Covid-19 pandemic. Taxpayers need to prepare for greater scrutiny during audits and ensure their supporting documentation is in order and sufficiently robust.

The effective date of the Omnibus Law is 2 November 2020. However, there is no transitional provision provided. This might create difficulties or confusion for the implementation in practice.

The Omnibus Law – Tax Cluster

In an effort to create more job opportunities and improve Indonesia's investment climate, the Law on Job Creation ("Omnibus Law"), Law No. 11/2020, was signed on 2 November 2020. The Omnibus Law covers a variety of diverse, but related, sectors including labor, infrastructure, environment, investment, and tax. This newsletter discusses three of the tax laws addressed – Income Tax, VAT, and General Tax Provisions and Procedures ("KUP").

A number of implementing regulations (in the form of Government Regulations and Minister of Finance ("MoF") Regulations) are expected to be issued within the next few months which will provide further guidance on procedures and other criteria addressed in the Omnibus Law.

Below we highlight the major changes to the tax laws and discuss the potential impact to taxpayers.

Potential Impact

After the 1998 financial crisis, the DPR set a state budget deficit ceiling of 3%. Due to the Covid-19 pandemic, the ceiling has been relaxed until 2023. The budget deficit target for 2020 was initially set at 1.76% of GDP. However, because the Indonesian economy will be in recovery mode post-pandemic, this target was modified to 5.07% in April and again to 6.34% in June. The budget deficit in excess of 3% has been used to finance the social safety net and various economic stimulus programs to combat the pandemic.

The tax section of the Omnibus Law combined with the negative economic impact of the pandemic render the situation a double-edged sword. While the tax provisions offer some relief and legal certainty to taxpayers, the practical consequences could be problematic. Indonesia's tax regime is based on a self-assessment system. Under such a system, it is generally anticipated that when tax relief is offered, such as lower tax rates, there will be greater compliance by taxpayers, as required, thereby increasing tax revenue to the government – a win-win situation. However, the combined effect of the Omnibus Law and the pandemic will very likely be a decrease in tax revenue.

In order for a low tax regime to be successful, high compliance by taxpayers and broadening the taxpayer base is needed. To promote high compliance (based on self-assessment), broad based tax audits could be conducted. In Indonesia, the economic downturn caused by the pandemic, combined with tax incentives during the pandemic and the other relief in the Omnibus Law, will lead the tax office to conduct broader tax audits and review taxpayers' positions with greater scrutiny. Taxpayers will have a greater burden to ensure that their supporting documentation is readily available, comprehensive, and robust in order to defend their position. This makes it important that the government improve the quality of its human resources which will enhance the certainty of law and improve the tax audit process to ensure the tax laws are properly enforced and fair, and ensure the courts are impartial and treat taxpayers fairly.

Changes to Income Tax Law

Tax subjects

There is no change to the criteria for an individual (Indonesian or foreign citizen) to be treated as a resident tax subject.

The following criteria define an individual as a non-resident tax subject:

- An individual who does not reside in Indonesia
- Foreign citizens who are in Indonesia for not more than 183 days in a 12-month period
- Indonesian citizens who are outside Indonesia for more than 183 days in a 12-month period *and meet the following criteria:*
  - A place to live
  - Main center of activity
  - A place where normal activities are conducted
  - Tax subject status
  - Other requirements stipulated by the MoF

The change regarding Indonesian citizens is beneficial for migrant workers as they won't be taxed on their non-Indonesia sourced income. It also protects high-net worth Indonesians who are able to reside overseas, and therefore outside the reach of Indonesian tax, as they may now be able to shelter their income.

Territorial income concept

There is a change to the worldwide income concept which has applied until now. Under the Omnibus Law, foreign citizens who are resident taxpayers are subject to tax only on income sourced from Indonesia (this includes income received from employment or activities in Indonesia which is paid outside Indonesia) *provided*:

- They have certain skills; and
- This only applies for the first four years after becoming a resident tax subject.

Note, however, this is not applicable if a tax treaty is utilized.

Exemption from income tax on dividends

There are significant changes to the treatment of dividends which are briefly summarized in the table below:

Description	Old Law	Omnibus Law
Indonesia-sourced dividends received by a resident taxpayer	a) Corporate shareholder with ≥ 25% ownership: exempt b) Corporate shareholder with ≤ 25% ownership: normal rate c) Individual shareholder: 10% final	a) Corporate shareholder: exempt b) Individual shareholder: – If dividends are invested in Indonesia for a certain period of time: exempt – If dividends are not invested: 10% final
Foreign-sourced dividends received by a resident taxpayer (corporate or individual shareholder) *and* Profit after tax of a permanent establishment outside Indonesia	Subject to tax at normal rate	a) If the invested dividend or profit of a PE is at least 30% of the profit after tax and this is invested in Indonesia for a certain period of time: exempt b) If the invested dividend or profit of a PE in Indonesia is less than 30% of the profit after tax: – The amount invested: exempt – The difference between the portion invested and 30% of the profit after tax: subject to income tax – The remaining profit after tax (after deducting points 1 and 2): exempt

This change on taxation of dividends is expected to increase both domestic and foreign investment. Given the changes, companies might consider how to utilize this relief and restructure their business in Indonesia.

WHT rate on interest

The withholding tax rate on interest paid to non-resident taxpayers (including premiums, discounts, and returns in connection with guarantees of debt repayment) can be reduced from 20% by a Government Regulation.

Changes to VAT Law

Changes to VAT object

The following are no longer subject to VAT:

- Delivery of taxable goods by consignment
- Transfer of taxable goods for the purpose of capital injection, provided both parties are VATable entrepreneurs ("PKP")

Under the old law coal was not subject to VAT. Now, coal is subject to VAT. The change to coal now being subject to VAT could benefit coal producers by reducing their production costs as input VAT can be passed on to the energy producers/buyers. If buyers cannot pass on the increased cost, their profit could be eroded by the amount of the VAT. As a result, this could have an impact on the cash flow of coal buyers, such as PLN.

Loosening for claiming input VAT

The rules have been relaxed concerning input VAT which can be credited. The main changes are discussed below.

Previously, a PKP not yet in production could only claim input VAT on the purchase of capital goods. Under the Omnibus Law, a PKP who has made no delivery or export of VATable goods or services can credit input VAT related to that company's activities. If within three years (longer for certain sectors) there has been no delivery of taxable goods/services:

- Input VAT which has been credited but not refunded or offset against output VAT cannot be credited any longer, and the credit should be cancelled.
- Input VAT which has already been refunded or offset against output VAT must be repaid.

Other changes are summarized in the following table:

Description	Old Law	Omnibus Law
Input VAT obtained before company obtained a VAT ID (PKP)	Cannot be credited	Can be credited at 80% of output VAT
Input VAT which was not reported in the VAT return but is found during a tax audit	Cannot be credited	Can be credited
Input VAT charged from a tax assessment letter	Cannot be credited	The principal amount can be credited provided the assessment has been paid and no legal dispute is pursued
Time limit for crediting input VAT	No later than 3 months after the end of the tax period and not charged as an expense and not yet audited	No later than 3 months after the VAT invoice was created provided it has not been charged as an expense or capitalized

Administrative requirements for VAT invoice

The Omnibus Law relaxes the information to be included in a VAT invoice (*faktur pajak*) for an individual buyer as follows:

- Name, address, and NPWP (tax ID number) or NIK (an individual's identity number) or passport number
- Name and address for buyers who are foreign tax subjects or not subject to tax

A VAT invoice from a retailer to an end consumer does not need to include:

- Buyer's identity
- Seller's name and signature

The information required on a VAT invoice reduces the administrative burden on taxpayers.

Changes to KUP Law

The most significant changes in the KUP Law relate to administrative sanctions and penalties. The rate for penalties imposed on taxpayers will be the benchmark rate as determined by the MoF plus a spread, capped at 24 months. The previous interest rate of 2%/month given to taxpayers who have overpaid tax is now the benchmark interest rate, with no spread, capped at 24 months. Below is a summary of the changes.

Interest compensation to taxpayers

Description	Interest
Interest compensation on late payment of a refund for tax overpayment Interest compensation for DGT's failure to issue a decision on a refund of overpaid tax Interest compensation if an objection, appeal or judicial review is fully or partially granted, which results in a tax overpayment	Benchmark interest rate* / 12, capped at 24 months

**The amount of the monthly interest rate will be provided by the MoF.*

Interest compensation is now given up to the amount of the overpayment *agreed at the tax audit* closing conference on a tax return overpayment. This is a significant change as taxpayers could previously claim interest on an overpayment which resulted from the *payment of a tax underpayment assessment letter* which was cancelled by an objection, tax court or Supreme Court decision. This could be unfair to taxpayers as the penalty amount paid based on an assessment letter generally tends to be significantly higher than the interest compensation that can be claimed at the end of a dispute process.

A tax collection letter/STP can be issued to recover any interest payment that should not have been given in the first place.

Sanctions and penalties

Description	Penalty
Interest penalty from installment or postponement of tax payment and additional tax underpayment between the extension and the normal annual tax return Interest penalty on the late payment of assessment letters, objection decision, etc.	Benchmark interest rate* / 12, capped at 24 months
Interest penalty due on issuance of a tax collection letter ("STP") for unpaid or underpaid income tax Interest penalty on late tax payment after due date of periodic or annual return Interest penalty due to amendment of a periodic or annual tax return which results in a larger tax underpayment	Benchmark interest rate* + 5% / 12, capped at 24 months

Description	Penalty
Interest penalty on disclosure of incorrect tax return after audit, but before tax assessment issued	Benchmark interest rate* + 10% / 12, capped at 24 months (previously 50% of underpaid tax)
Interest penalty on unpaid or underpaid tax, based on audit Interest penalty on underpaid tax if NPWP issued or confirmed as a PKP *ex officio* Interest penalty on underpaid tax of a PKP who was given a refund or credited input VAT on goods or services but, after 3 years, no taxable goods or services were delivered or exported (failed to produce) *(new)*	Benchmark interest rate* + 15 / 12, capped at 24 months
Penalty on disclosure of wrongdoing (i.e. failure to submit or submission of incorrect tax return) after audit on preliminary evidence started, before investigation process is submitted to public prosecutor	100% of tax underpayment (previously 150%)
Penalty for a PKP who fails to issue a VAT invoice, late issuance of a VAT invoice, or improper VAT invoice	1% of VAT base (previously 2%)
Sanction for termination of investigation of criminal offense after taxpayer pays tax owed	3x amount of underpaid tax (previously 4x)

**The amount of the monthly interest rate will be provided by the MoF.*

Penalties not addressed above remain the same as in the old law.

With the above changes, taxpayers may not be able to estimate in advance the potential risk of the interest penalty as a result of a tax audit, because the interest rate fluctuates.

Other changes

Other changes to the KUP Law include:

- The Director General of Tax can allow a taxpayer to pay in installments or postpone payment for an indeterminate period (previously limited to 12 months).
- In the event of double application of sanctions based on an audit of VAT and sales tax on luxury goods, only the sanction with the highest amount is applied.
- A tax collection letter/STP is to be issued within five years after tax becomes payable or at the end of the relevant tax period and interest is for a maximum of 24 months. The five year period does not apply to the following cases:
  - A tax underpayment assessment letter/SKPKB, additional tax underpayment assessment letter/SKPKBT, correction decree, objection decision, appeal decision, and judicial review decision, which has not been paid by the deadline
  - An STP for collection of the 50% sanction to be made within five years from the objection decision, if no appeal is filed
  - An STP for collection of the 100% sanction is to be made within five years from the appeal decision
- If, as a result of negligence, a taxpayer does not submit a tax return or submits an incorrect return which results in a loss to the State, a penalty of 1-2 times the underpaid tax applies, or the taxpayer can be imprisoned for 3-12 months. The provision does not differentiate between a first-time offender and others. Previously, a first-time offender was not considered as a criminal offense, but only paid a 200% penalty of the underpaid taxes.

Effective date

The effective date of the Omnibus Law is 2 November 2020. However, there is no transitional provision as is normally included when a law is changed to provide a bridge to facilitate implementation. Having no transitional period could create difficulties or confusion as the rights and obligations of taxpayers have been changed in the middle of the fiscal year or period. The transitional provisions may be regulated in a Government Regulation, although would be an unusual approach. It remains to be seen how the tax provisions under the Omnibus Law will be implemented in practice.

It is possible that challenges to the Omnibus Law could be brought to the Constitutional Court for judicial review. Therefore, we have to see the Court's decision and whether this will have any impact on the tax provisions.

New implementing regulations for this law are to be issued within three months.

Earlier changes to the tax rate

As a result of the Covid-19 pandemic, in March the government issued Government Regulation in Lieu of Law No. 1, later becoming Law No. 2/2020, which incorporated several changes proposed in the 2019 draft omnibus tax law. This included lowering the corporate income tax rate to:

- 22% for tax years 2020-21
- 20% from tax year 2022

For listed companies with at least 40% of their shares listed on the Indonesia stock exchange, the rates were reduced by an additional 3% (19% in 2020-21; 17% from 2022).

(See our News Alert No. 3/2020 for details.)

Other

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