HSC

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IMPLEMENTING REGULATION ON INCOME TAX

Government Regulation No. 55/2022 ("GR-55") regarding Adjustment of Regulations in the Field of Income Tax was issued on 20 December 2022. This regulation addresses the following topics:

- Non-taxable income
- Deductible expenses
- Depreciation and amortization
- Benefits in-kind
- Tax avoidance prevention
- International agreements in the field of tax
- Income tax on businesses with certain gross turnover
- Reduced tax rate for public companies

In this News Alert we highlight only the significant clarifications to the Income Tax Law, Law No. 7/1983 as last amended by Law No. 7/2021 on Harmonization of Tax Regulations ("HPP Law"). In particular, we focus on those provisions relating to taxation of benefits in-kind and anti-avoidance measures. (See our April 2021 and October 2021 News Alerts for details on the HPP Law and earlier regulations.)

Benefits in-kind

Benefits in-kind ("BIK") were treated as non-taxable income to the employee and non-deductible for the employer before FY 2022. From FY 2022, BIK are treated as taxable income for the employee and a deductible expense for the employer in its corporate income tax calculation. The employer is required to withhold Art. 21 employee income tax.

For a company whose FY 2022 starts before 1 January 2022, the tax treatment for BIK comes into effect on 1 January 2022:

When BIK Were Provided	For the Employer	For the Employee
Before 1 January 2022	Non-deductible expense	Non-taxable income
Beginning 1 January 2022	Deductible expense	Taxable income

For a company whose FY 2022 starts on 1 January 2022 or after, the tax treatment for BIK comes into effect at the start of FY 2022. For example, a company whose FY 2022 begins 1 April 2022 would treat BIK as follows:

When BIK Were Provided	For the Employer	For the Employee
Before 1 April 2022	Non-deductible expense	Non-taxable income
Beginning 1 April 2022	Deductible expense	Taxable income

The income tax withholding requirement for the employer is as follows:

- The obligation to withhold Art. 21 income tax applies to income received or earned from 1 January 2023.
- For BIK received by an employee from 1 January 2022 up to 31 December 2022 or the beginning of FY 2022 up to 31 December 2022, for which Art. 21 income tax has not been withheld by the employer or by the provider of the BIK, the income tax must be calculated, paid, and reported by the employee in his annual individual income tax return for 2022.

BIK that are exempt from income tax

The following BIK are not subject to income tax:

- Food, beverages, and their ingredients given to all employees. This will be further regulated in a Minister of Finance ("MoF") regulation.
- BIK provided for employees and their families in certain areas, including housing, health services, education, and transportation. The location is one which lacks infrastructure and must receive approval from the Director General of Tax ("DGT"). The procedure for granting the exemption will be further regulated in a MoF regulation.
- BIK which are required for work in relation to employee safety, security, or health, as required by the appropriate ministry. These include, for example, uniforms, safety equipment, and items for handling pandemics.
- BIK sourced from the state, regional or village budget.
- BIK of certain types or with restrictions, taking into consideration the type or value of the BIK and criteria of the recipient. This will be further regulated in a MoF regulation.

Based on a recent DGT press release, the MoF regulation is being drafted and the types of BIK that could be exempt from income tax include gifts (with certain limits), equipment needed for work (such as laptops and mobile phones), vehicle facilities received by employees other than in a management position, and health service facilities.

Valuation of BIK for income tax purposes

GR-55 differentiates between two types of employee benefits. The distinction is relevant when determining the value of the BIK provided. The definition and valuation methods are:

- Goods given other than in money (*natura*): This is compensation provided in-kind rather than money in connection with work or services performed. This type of BIK is uncommon; an example would be if a company were to give a car to an employee, which would then belong to the individual. The value is based on the market value of the goods provided.
- Facilities or services (*kenikmatan*): This is compensation in the form a right to use a facility or service sourced from a company asset of the employer or a third-party asset which is rented or financed by the employer. This is the more common type of BIK, such as providing an employee with the use of a car, housing, medical benefits, or school fees.

  The value is to be based on the actual cost or the cost that should have been incurred by the employer to provide the facility or service. A potential issue is how to determine the basis of WHT Art. 21 for assets (e.g., car, housing) that are owned by the employer, e.g. acquisition cost, depreciation cost.

The procedure for evaluating and calculating a reimbursement or compensation in the form of a BIK will be regulated in a future MoF regulation.

Prevention of Tax Evasion

A number of anti-avoidance measures are described in GR-55. These provide further clarification of Article 18 of the Income Tax Law, as amended by the HPP Law, as well as offering additional ways the MoF can prevent tax avoidance. Preventing tax avoidance practices can be done by:

a) Determining when a dividend is acquired by a domestic taxpayer of a controlled foreign corporation ("CFC") and the basis for its calculation (CFC rules). The timing of the determination depends on whether the overseas company is required to file an annual tax return or not. Further details are to be provided in a future MoF regulation. Currently, the CFC rule is regulated by MoF Regulation No. 93/PMK.03/2019.

b) Redetermining the amount of income and deduction by applying the principles of fairness and common business practice using an appropriate transfer pricing method. The methods which can be used are:

   - Price comparison method (comparable uncontrolled price method)
   - Resale price method
   - Cost-plus method
   - Other methods, such as:
     - ✓ Profit split method
     - ✓ Transactional net margin method
     - ✓ Comparable uncontrolled transaction method
     - ✓ Valuation of tangible assets or intangible assets methods
     - ✓ Business valuation methods

   The difference between the value of a transaction affected by a special relationship and an arm's-length price represents distribution of profits to an affiliate entity that is treated as a dividend that is subject to income tax (secondary adjustment). Further provisions on the application of the fair and common business practice principles will be in a future MoF regulation.

c) Determining the actual purchaser of shares or assets of a company bought through a special purpose company if impropriety in price fixing is found. The special purpose company is one which has no business substance and was set up by a domestic taxpayer for the purpose of buying the shares or assets of another domestic taxpayer.

d) Determining the party conducting the sale or transfer of shares of an intermediary company established or domiciled in a country that provides tax protection (tax haven country). If there is a special relationship with an entity domiciled in or having a permanent establishment in Indonesia, the transaction can be treated as a sale or transfer of shares of an Indonesian entity or permanent establishment. As such, income from the sale or transfer will be subject to withholding tax.

e) Redetermining the amount of income earned by a domestic individual taxpayer from an employer who transfers all or part of the individual's income into a cost or expense paid to an overseas company with which it has a special relationship. This will be further regulated by the MoF.

f) Redetermining the tax which should be paid where a taxpayer:

   - Reports profits which are too low in comparison to comparable companies, or
   - Reports unreasonable losses.

   This applies for a taxpayer that has been in commercial operation for five years and has reported fiscal losses for three consecutive years.

   The MoF is to provide further details on the comparison of the financial performance for calculating the tax payable.

g) Determining the limit on the amount of borrowing costs (interest) that can be charged for tax calculation purposes. This can be done by the MoF using various methods, including determining an appropriate:

   - Debt-to-equity ratio (currently no more than 4:1, except for certain industries)
   - Percentage of borrowing cost compared to EBITDA

   Further details are to be provided in a future MoF regulation.

h) Redetermining the amount of tax that should be paid by treating a payment by a domestic taxpayer to a foreign taxpayer as not deductible where this arises from a hybrid instrument and the tax treatment is different in the foreign taxpayer's jurisdiction. The payment will not be deductible in Indonesia if the payment is:

   - Not treated as taxable income in the foreign taxpayer's jurisdiction (i.e., deductible for the payer and non-taxable to the recipient); or
   - Charged as a deduction in the foreign taxpayer's jurisdiction, resulting in a double deduction.

   This will be further regulated by the MoF.

Note that points (a)–(f) above can only be used for parties which have a special relationship, whereas points (g) and (h) apply to all.

Depreciation and Amortization

Permanent buildings and intangible assets owned and used before FY 2022, and which have a useful life of more than 20 years can be depreciated/amortized using either:

a) The straight-line method over 20 years; or

b) In accordance with the actual useful life based on the taxpayer's bookkeeping, for which a notification must be submitted to the DGT by the end of FY 2022.

Further guidance on a number of issues is to be provided in a future MoF regulation, including the depreciation/amortization calculation, repair cost for tangible assets with a useful life of more than one year, and the notification procedure for assets with a useful life of more than 20 years.

International Agreements

The Government of Indonesia can enter bilateral or multilateral treaties or agreements in the field of taxation. These can be in the form of:

1) Double taxation avoidance agreements (tax treaties)
2) Multilateral conventions to implement tax treaties to prevent tax base erosion and profit shifting ("BEPS")
3) Exchange of Information agreements for tax purposes
4) Conventions on mutual administrative assistance in the field of taxation
5) Bilateral or multilateral competent authority agreements
6) Agreements to address the tax challenges resulting from the digitalization of the economy or other BEPS action

Point 6 above allows Indonesia to enter agreements to apply the action commonly known as the OECD's Two-Pillar Solution as follows:

- *Pillar One – Reallocation of profit*

  To overcome challenges from digitalization of the economy, multinational companies that meet certain criteria set out in a treaty or agreement are deemed to meet subjective and objective tax obligations so that they are subject to tax in Indonesia.

- *Pillar Two – Minimum global tax*

  To address the challenges of BEPS, a multinational corporate group covered by a treaty or agreement may be subject to global minimum tax in Indonesia based on such treaty or agreement.

Details on how these will be implemented will be provided in a future MoF regulation.

Other

GR-55 revokes the following regulations.

- GR No. 18/2009 on aid or donations including alms (*zakat*) or mandatory religious donations, which are exempt from income tax
- Article 2A of GR No. 94/2010 on the calculation and payment of income tax in the current year as last amended by GR No. 9/2021 on tax treatment to support the ease of doing business
- GR No. 23/2018 on income tax on the operating income of taxpayers with certain gross turnover
- Article 10 of GR No. 29/2020 on income tax facilities in the context of handling COVID-19
- GR No. 30/2020 on the reduced income tax rate for resident corporate taxpayers in the form of a publicly listed company

All implementing regulations of the Income Tax Law which do not conflict with GR-55 remain in effect.

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