Consulting Group

Edition 12, 2018

TAXGuide

Enrich your Knowledge

EditorialNotes

Assalamualaikum Wr. Wb. May peace and prosperity befall upon all of us. All praise and thanks be to the One Almighty God for the publication of MUC Tax Guide to the readers.

As always, MUC Tax Guide is present carrying several interesting taxation and business issues. The main topic we bring about this time is about the evaluation and direction of tax reform in Indonesia from the side of supervision.

For that purpose, we present Vice Chairman of Taxation Oversight Committee Prof. Dr. Gunadi, M.Sc as the most competent person to explain the issues. Other thing we highlight is the urgency of institutional tax reform in Indonesia, which is ideally not only a mere name-changing but also focusing on the strenghtening of the tax authority's power and resources.

We also talk about the side effect of tax incentive policy amidst the tight competition of Countries in the world competing for capital.

Last, related to investment, we cover BKPM Regulation Number 13 Year 2017 that gives space to Foreign Capital Investment (PMA) for not executing divestment obligation under specific conditions.

To know further about these issues, please read this latest edition of Tax Guide. We hope that what we serve can be an enlightment for us all, and is useful for the readers.

We are open to any input, suggestion and critics from you, to be used as evaluation in enhancing the quality of Tax Guide onwards. Happy reading, Wassalamualaikum, Wr. WB.

Jakarta, February 2018.

Sugianto

MUC Consulting Group

Editorial Address

MUC Building 4th floor
Jl. TB Simatupang 15, Tanjung Barat
Jakarta (12530)
Phone: +6221 788 37111
Fax: +6221 788 37 666
Email: publishing@mucglobal.com

EXCLUSIVE INTERVIEW

Prof. Dr. Gunadi, M.Sc., Ak

Mutual Trust and Data Integration as the Main Investment of Tax Reform

In the state context, the role of Tax Authority is as important as that of Taxpayer in funding national development through tax. An effective and efficient service supported with close supervision become the key activity to ensure that the relation between both sides is equivalent and harmonious.

Therefore, the tax Ombudsman role becomes so vital to make sure a tax system management that is transparent and fair. In Indonesia, this function is run by Supervisory Committee of Taxation pursuant to the Law mandate of Tax General Provisions and Procedure.

To find out how the Supervisory Committee works in guiding tax reform over the last decade, Tax Guide had a chance to discuss directly with the **Vice Chairman of Supervisory Committee Prof. Dr. Gunadi, M.Sc., Ak.** The dialogue script is as follows:

What is the role of Supervisory Committee in tax reform process so far?

Supervisory Committee was formed under Article 36C of KUP. The duty is to help Minister of Finance (MoF) in monitoring tax institutions or agencies consisting of Directorate General of Taxes (DGT) and Director General of Customs and Excise (DGCE). This controlling is conducted to the task implementation of these institutions performing Taxation Laws, (which are) Tax Law and Customs and Excise Law. That's the beginning. But, then starting from last year's MoF Regulation, the Supervisory Committee's responsibilities are broadened to cover the supervision on policy. Therefore, commencing last year, the supervision is not only over the tax administration but also the tax policy.

Basically, this Supervisory Committee is treated similar to some kind of tax Ombudsman. So, we should convey Taxpayers' aspiration. Then, (we) communicate it with tax institutions (regarding) how the formulation of the policy and the implementation of the laws would be. Thus, their rights are protected.

How does the Supervisory Committee absorb the public aspiration?

We do what we call as public communication in which every year there are four times of public communication. Through this public communication, we'd like to know the people's aspiration regarding the implementation of tax system. It is like Focus Group Discussion (FGD). So, people share their complaints, and then we bring the complaints to the stakeholders, which are DGT and DGCE Regional Office in case of local scope. It is to be confirmed, whether the issue is true. If so, we then ask for the solution so that there are legal certainty and justice for them (Taxpayer).

What are the recommendations of the Supervisory Committee in national scope, both those already and not yet implemented by the Tax Authority?

There are several recommendations. For those recommendations, we generally conduct a study, we investigate them, collect facts, then we submit the recommendations to the Minister of Finance. We have submitted many recommendations. Some have been done, some have not.

First, it relates to efficiency. This was during the former Minister of Finance Chatib Basri's era. We conveyed recommendation on Value-Added Tax (VAT) upon Crude Palm Oil (CPO). At that time, CPO was considered as strategic *goods to guarantee the availability of cooking oil. That is why the VAT was exempted for consumers. Meanwhile, the entrepreneurs were still subject to VAT and it might not be credited.*

However, at that moment there were complicated issues in which upon the new Decree of Supreme Court, when the palm oil plantation was integrated with the CPO plant, it (VAT) could be credited. We gave conditions that we should see what kind of element or substance. When the element or the substance could not be credited, in whatever form, it could not be credited as well. Previously, there was actually MoF Regulation Number 21/PMK.011/2014 that allowed it. In the past, Mr. Chatib Basri asked a dissenting opinion from the Supervisory Committee to strengthen the policy. We explained it to him that this MoF Regulation contradicted the Laws since it returned the unnecessary taxes. It might give loss to the State if it was credited. And, it had been run.

But then, there was legal review to the Supreme Court on Goverment Regulation Number 31 Year 2007. The Supreme Court affirmed that it (the VAT exemption) conflicted with the higher regulation. The impact spread to agricultural products, which in fact were subject to tax so it could be credited again.

Regarding the recommendations that have not been performed, for instance, how to make a tax audit become more efficient. We try to attain an audit that is not causing any problems. It is because appeal and objection processes are time-consuming and costly. It also keeps people so busy with tax matters. We recommend that the selection of the audit should be truly based on data. (We) should have valid and concrete data that the incomes are not reported. So, if there is no data, do not complicate it. The audit are generally supposed to relate with transfer pricing. For that, an Advance Pricing Agreement (APA) is conducted. In APA, it has been discussed from the beginning, how much the profit is. So, entrepreneurs should not be complicated or bothered by the tax matters. Let them make their businesses successful.

What is the Supervisory Committee's recommendation related to the revision of Taxation Laws package?

Particularly for KUP Laws, we advise that the self-assesment principles should be maintained. These self-assessment principles should give trust to the people. So put the trust first on anything received, it should be the positive thinking principle. Except, if they are proven wrong, they should be audited. But, the first thing is trust, mutual trust. Through the mutual trust, the audit should be transparent. So that the tax underpayment stipulation does not bind. Since the power is on the people, they should be the one that is right. So when the Tax Office issues the Tax Underpayment Assessment Notice, it should be only as correction. If this correction is approved by the corrected party, they shall pay. However, if they disagree, (or) they object, this correction will be disputed. So, if there is none (correction), it does not bind. Thus, do not trouble the entrepreneurs too much. If possible, the KUP should be business-pro, be fair, and attempt to obtain more income with less effort. Do not fuss over it since the Tax Office has very limited staff, thus, don't be too aggresive. They may be aggressive when there is proof. If there is no proof, just don't.

In terms of institutional reform, from the Supervisory Committee's view, what does the Tax Authority really need?

Actually, the self-assessment demands a close supervision. What happens in practice now is that the supervision is considerably low. Why it is so, because the organization has not yet been strong, it is still weak. It is considered weak, because the IT-based has yet to work. First, the data should be valid. Second, it should also be comprehensive. Third, the system should be integrated. It is in fact still fragmented. The system integration is required because in the future everything will be processed IT-based. The more the Taxpayers are, the more complicated it will be if using the manual system. The audit may be conducted automatically, not manually.

For example, the VAT system in which the key is tax invoice. There is VAT-In on the buyer's side and VAT-Out on the seller's. So if there is no tax paid by the seller, it may not be credited. If the match is available, the refund should be automatic, no need to be audited or such. The same goes to Income Tax. In Income Tax, there are expenses that become withholding objects. Like wage and salary expenses, the match is Income Tax Article (ITA) 21. When there is ITA 21 paid, it is deductible.

What is an ideal institutional structure of our tax authority? Is it in the form of semi-autonomous entity separated from Ministry of Finance or still in the current form?

Those are two models that are similarly productive. The autonomous tax authorities in Asia are, for example, Singapore, Malaysia, the Philippines. Yet, in Thailand and Vietnam, their Directorate General of Taxes is not separated from Ministry of Finance, but they are still productive. It is just a matter of the man behind, depending on the individual.

So far, what is the Supervisory Committee's view on the performance and coordination of Tax Authority, in this case, DGT and DGCE?

DGT and DGCE are both the part of Ministry of Finance. Why may not both of them be united? As an illustration, all export-imports are conducted through DGCE. Why does not DGT use the number (data) of DGCE related to transfer pricing? In fact, DGCE should also understand about it. Especially since the profiling, as well as the company audited are the same. If possible, both DGCE and DGT are one unit, even share the same opinion. So, it is like whether it is possible to be simplified, for instance, if the import and export become single submission. So that anything reported by DGCE is also useful for DGT. So (until now), it has not been integrated. It is just a matter of data exchange because they still have their own interests.

The same applies in internal DGT, the national conceptual thinking has not existed yet. It is because each Tax Office still competes to gain income. It is supposed to be national pattern, not individual or local pattern.

Concerning monitoring issue, has currently the authority of the Supervisory Committee been quite effective to guide the tax reform?

Previously in 2007 tax reform draft, the first idea was to form an independent Supervisory Commission of Taxation, because DGT wanted to be an entity. However, the political situation has not allowed it. Since DGT was not an entity, the Supervisory Commission of Taxation changed to Supervisory Committee of Taxation. Until now, we have not seen a strong DGT as in the era of Mr. Marie Muhammad and Mr. Darmin Nasution. So, if DGT wants to be an independent institution, it takes a strong man to exist.

Speaking of the broadening role of Supervisory Committee that also includes policy controlling, what does the Supervisory Committee think about the current tax policies? Especially for Tax Amnesty?

The Tax Amnesty is needed for a change in tax system. Both are changes in behaviour and in administration that are fundamental. The amnesty means erasing the Taxpayers' sins in the past with intention to start a good thing. In fact, the point of starting a good thing has not yet begun, for example, by disciplining the data. Do not handle the big things first, but start trying to manage the Taxpayers' data based on its validity. The thing is, there has not been a pioneer to the integration of data to date. So, the pattern and the way are just the same as the past amnesties.

The current data is kept. Why it is supposed to be kept, instead of disseminating it to each Taxpayer. It is expected that for the improvement in the future, there should be concrete data. We hope that with the new system, the tax system can adapt like bank. In banks, even those in the suburbs, all accounts are detectable. The tax information system should be like that, which is real time.

Does it mean similar to banking information network or financial data integration?

It's only the model that is similar to bank account. Let's see Bank Republik Indonesia (BRI), which is a State-Owned Enterprise, (the information network) can reach suburban areas. It's impossible if DGT as a part of the state government could not be like that. (They) should give a try, it doesn't have to be in a big scale firstly, start it from VAT-Registered Person. The number of VAT-Registered Persons are approximately 650,000. And, those having role in 93% of revenue are only the 17% or around 105,000 taxpayers. Start it by accessing the data of these 105,000 taxpayers first. It should be acknowledged, where the purchase is from, to which party the sale is made. It will be automatically discovered about those making sales to VAT-Registered Person as well as the revenue of all entrepreneurs in Indonesia. No need to perform any audits.

Have these ideas been forwarded to the government? What is the response?

We have brought these ideas, however it is not a simple thing. It is easier to create policy, one day is possible. What to make sure is which models we should use. There are various models, for example by simply following Australia's model, any model is good. It has fixed and good software. We do not need to formulate our own design. It is similar to the current banking that becomes global network that all bankings should match. It is like ticket system that is also global network. Even the company level can make it happen, thus the Tax Office should be able to do so.

Regarding Automatic Exchange of Information (AEoI), how the Supervisory Committee view this?

This data is like the blood vessel of tax. It is also the key of self-assessment. Because in all aspects, the initiative of each tax activity is on Taxpayer. The Tax Authority is only responsible to check whether what is reported has been accurate in accordance with the real situation. How to check it is not like how paranormals do it, but like regular people that the supporting data should be at hand. In the Netherlands, for instance, there is no tax withholding on saving interest in bank. Yet, at the end of the year, the bank reports it to the Tax Office.

Do the data integration, information openness, and institutional reform may close any tax avoidance loopholes?

Whether Taxpayers are compliant or non-compliant is not because all the humans are like angles, it is not. It is more because of the system that is created in many ways (and) put people with no option, except to comply. What makes it so is the tax administration. So, the data and the tax system should be strengthened to secure the revenue, and it should attach to payment system. The payment system in this context is through the withholding, the collection. If requested to remit tax by their own initiative, it's impossible.

So, it should start, if related to sales-purchase transaction, the Tax Office should not retreat. It is a condition that should not happen. If the sales transaction between VAT-Registered Person and consumers does not use buyer data, it is not a big deal. But, if the transaction between entrepreneurs, the data is a must. The VAT-Registered Person is doing business because of profit motive, while the buyers are only regular citizen.

Regarding the global trend in which many countries decrease their tax rates, should Indonesia follow?

Yes, (Indonesia) should follow. If not, the tax competitiveness will be low. Indonesia is the country that is attractive for product marketing. Thus, in the future, people will do export to Indonesia but the profit will be shifted or make Base Erosion of Profit Sharing (BEPS) to the country with low tax rate.

Is the tax rate reduction will be followed by the increasing of Taxpayer's compliance?

The compliance is actually the opposite of the rate. If the rate is lower, the level of compliance will increase. The higher the compliance is. It is because the economic value of tax compliance is so big. Thus, (the tax rate reduction) also gives rise to the increase of compliance.

How is the tax challenge in 2018?

In 2018, the economic growth is forecast to increase to 5.4%. It is also expected that the more tax potentials may be realized. Now the problem is what kind of tax instruments (should be used) to realize it. Nowadays, the approach of State Budget and Expenditure to the economic sectors or posts is considered booming. Again, the tax system should adhere to those sectors, so the possibility of the tax ratio will stick to each sector.

Thailand for example with the VAT rate of 7%, its tax ratio is 5.6% towards Gross Domestic Product (GDP). Indonesia with the VAT rate of 10%, the tax ratio is only 3.9%. Why Thailand has higher tax ratio, because its tax base is larger than ours. The sectors that are easily taxed like finance, insurance, and capital market are subject to taxes. The stock exchange is subject to tax, it is called special business tax with the rate of 3%, which is lower than general rate of 7%.

Tax Institutional Re
Should Not Be A Me

In the Draft Law of Taxation General Provisions and Procedures (KUP), the Government added a clause on establishment of special institution or body as a prospective substitute of Directorate General of Taxes (DGT) and probably Directorate General of Customs and Excise (DGCE) as well. This has been a long discourse that comes and goes along with the spirit of tax reform that has been on and off in Indonesia.

Discourse on the tax authority reinforcement is not a new talk in the context of global world. The awareness of the increasing importance of tax as the source of development funding demands an efficient and competitive authority performance. This phenomenon stimulates many countries in the world in giving autonomy and function flexibility to the tax authority over the last decades.

In practice, the form and the power of tax authority in every country vary. There is hardly, in any country, a tax authority that is having a full autonomy. Some tax authorities are in the form of semi-autonomous institutions and some are in directorate level under Ministry of Finance.

Singapore tax authority, for instance, Inland Revenue Authority of Singapore (IRAS), is a semi-autonomous tax institution that is not under the Ministry of Finance. Instead, it is closely supervised under a kind of Supervisory Board, in which the Minister of Finance acts as the leader. IRAS as the country representation has the authority to conduct tax agreement negotiation, draft the taxation laws, and give suggestion related to property appraisal to the Government.

However, there are also tax authorities in directorate level or under a ministry having authority almost equal to or even wider than that of the semi-autonomous tax authority in other countries. For example, in Thailand, the directorate of tax revenue has a considerably broad authority if compared to that of the semi-autonomous tax institution of Japan.

Meanwhile, in Indonesia, the tax administrative system is managed by multiple directorates under the Ministry of Finance, namely DGT and DGCE. With very limited authority, tax authorities are unable to design their own organization quickly due to the bureaucracy process. The lack of flexibility makes it difficult for DGT and DGCE to make changes in and development of the tax administrative system, as well as internal improvement in order to be balance with the dynamic and rapid business development in practice. This authority limitation, to some according to several parties, is considered as an obstacle of tax reform in Indonesia.

Country | Authority	Authority Delegated to Revenue Body								
	Make Tax Rulings	Remit Interest or Penalties	Design Own Internal Structure	Allocate Budget	Set Staff Levels/ Staff Mix	Influence Staff Recruitment	Hire and Dismiss Staff	Negotiate Staff Pay Levels	Determining service standard
Australia	√	√	√	√	√	√	√	√	√
Brunei	√	√							
Kamboja	√	√							
Hongkong	√	√	√	√					
Indonesia	√	√							
Japan	√	√	√	√					
Korea	√	√	√	√	√				
Laos	√	√	√	√					
Malaysia	√	√	√	√	√	√	√	√	√
Papua	√	√	√	√	√	√	√	√	√
Philippines	√	√	√	√	√	√			
Singapore	√	√	√	√	√	√	√	√	√
Thailand	√	√	√	√	√	√			

(Sumber: OECD, diolah)

form

ere Name-Changing

Sectoral Ego

The plan of tax institutional transformation actually has been a discourse in Indonesia since 2007. However, instead of focusing on the tax reform, conflicts of interest as well as sectoral ego are in the spotlight. It is proven by the fact that up to six top DGT leaders and five Director Generals of Customs and Excise successions, the plan is never realized.

A serious discussion upon this matter was actually held in the mid 2014 and was a part of the last 100-day presidency program of the 6th President of the Republic of Indonesia, Susilo Bambang Yudhoyono (SBY). As a result, three options of tax structural reform turned up.

First, establishing a new institution named State Revenue Agency (Badan Penerimaan Negara/BPN) under the coordination of Minister of Finance. Second, BPN as a new institution is separated from Ministry of Finance and is responsible directly to the President as the head of the state. Third, by simply giving flexibility to DGT to conduct staff recruitment and determine remuneration system so that they can collect taxes easier.

Then, question arises: what kind of institutional transformation is suitable to improve Indonesian taxation system? Is it by establishing special institution separated from Ministry of Finance structure or simply by giving a wider authority to DGT and DGCE?

Institutional reform of United States (US) tax authority, Internal Service Revenue (IRS), can at least be a lesson. Now, IRS is a semi-autonomous institution with several authorities strenghtening it. However, prior to this status, IRS had gone through various stages of institutional transformation.

IRS prototype, which is the position of Commisioner of Internal Revenue, has been confirmed since 1862 in Abraham Lincoln's presidency, which later on changed into a new institution named the Bureau of Internal Revenue. In 1953, the US reorganized the Bureau of Internal Revenue to become IRS as we know today. In other words, it took 91 years or nearly a century to find a suitable tax authority format for US.

Proportional Authority

Based on the research of Arthur Mann (2004), the establishment of Semi-Autonomous Revenue Authorities (SARA) cannot guarantee the success of a country in enhancing its revenue, reducing corruption practice and tax avoidance, and improving taxation service. The examples are the implementation of SARA in Ecuador, Guatemala, Peru, and Tanzania that is limited to provision of platform or base to create efficient taxation administration without guaranteeing success. The point is that the establishment of semi-autonomous institution or SARA is not necessarily the panacea that will quickly heal the tax problems. In other words, the real problem is not the institutional status or form, yet the range of the tax authority's power.

According to Organization for Economic Cooperation and Development (OECD), there are nine authorities ideally owned by a tax authority: (1) authority to make regulations; (2) authority to impose sanction or penalty; (3) authority to design its own internal organizational structure; (4) authority to arrange and allocate budget; (5) authority to arrange level and composition of staff; (6) authority to recruit staff; (7) authority to appoint or dismiss staff; (8) authority to determine staff' salary; and (9) authority to determine performance standard.

The more complete the tax authority's power is, hopefully the better taxation system of a country will be. However, it is only a few taxation institution having complete authorities.

A lot of considerations can be references in deciding the type of power a tax authority shall have. One of them is the consideration of needs and capacity of resources. Each country has different characters in terms of human resources, information technology, as well as number of taxpayers and width of area.

In other words, the authority has to be proportional to the needs and resources available. An authority that is too big will only create a super power institution that is hard to control. Meanwhile, if the authority given is limited, the performance of the tax authority will not be optimal.

Bigger autonomy and authority will enable a tax authority to break any boundaries restraining them this whole time from creating a more effective and efficient organization management. It is also important that transparency and accountability have to be maintained.

In many cases, including in Indonesia, the Minister of Finance has a significant role in controlling and performing direct supervision to the tax authority. Nonetheless, ideally, according to OECD, strategic authority and direct supervision by Minister of Finance shall be limited to appointment of board of directors and drafting of taxation policy.

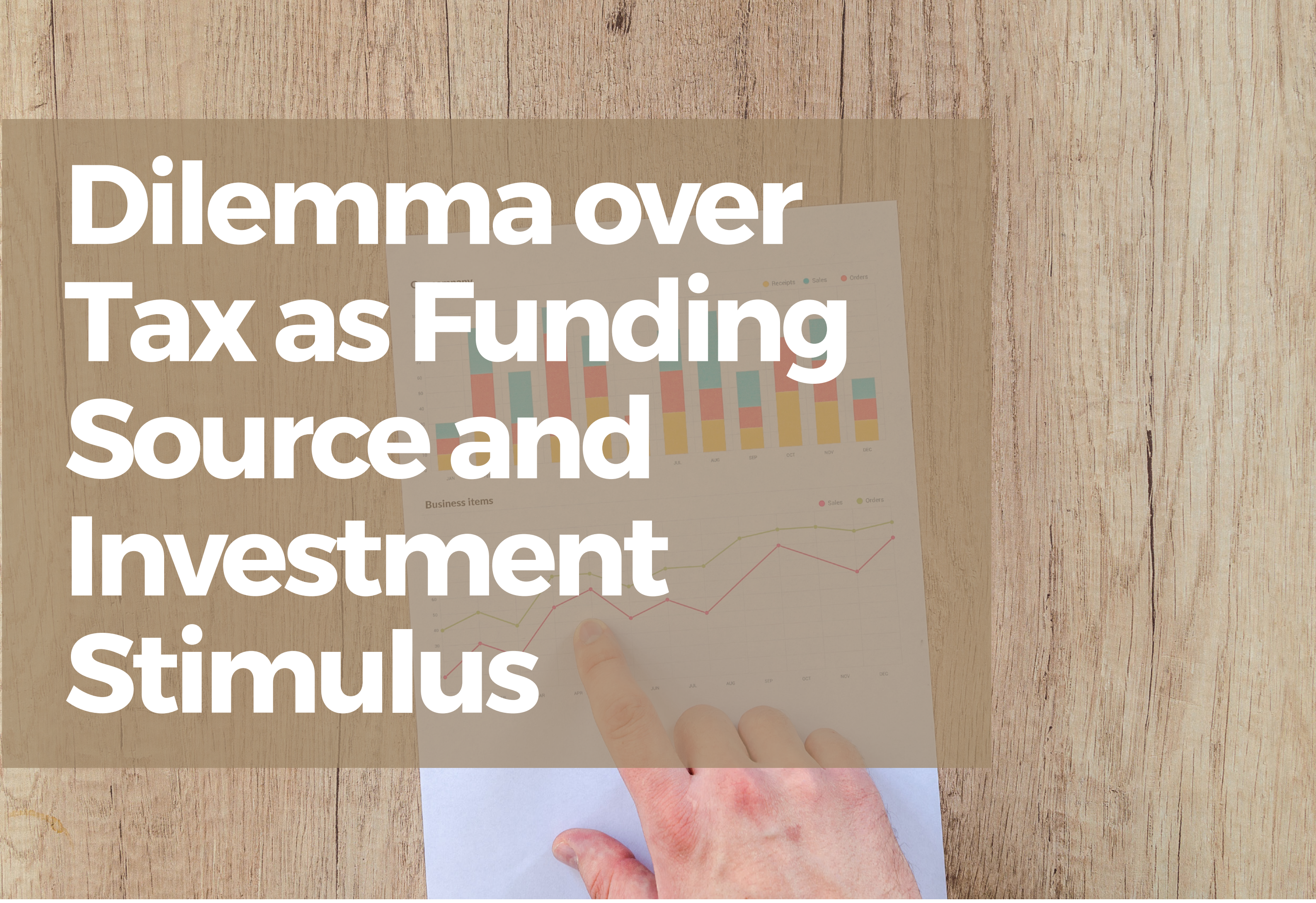
Indonesia can learn from supervision performed towards Singapore tax authority, IRAS, by some kind of supervision committee. The committee cooperates with external auditor in reviewing IRAS' financial statements. The supervisory committee also has the authority to approve policies on remuneration and appointment, promotion and main remuneration of the senior executives in IRAS.

Thus, what is debated now should be more about the distribution of proportional power to tax authority without ignoring the importance of supervision. It is no more about the position of an institution, whether autonomous or still under Ministry of Finance. If it is always only about "separation from bed and board" and name changing, Indonesia is not getting anywhere. Don't let the long discourse and discussion be pointless just because we are trapped in the politics of identity. *What's in a name?*

*Short version of this article has been published in **CNBC Indonesia,** February 28, 2018

Reference:

- Arthur J Mann, Are Semi-Autonomous Revenue Authorities The Answer To Tax Administration Problems in Developing Countries? A Practical Guide, Georgia State University, 2004.
- OECD, Tax Administration 2017, Comparative Information on OECD and Other Advanced and Emerging Economies, OECD Publishing, Paris, 2017.
- Republik Indonesia, Rancangan Undang-Undang Ketentuan Umum dan Tata Cara Perpajakan, 2017.



Dilemma over Tax as Funding Source and Investment Stimulus

Recently, President of Republic of Indonesia Joko Widodo was disappointed with the performance of Indonesia's investment. Even though the gross fixed capital formation grew by 13% in 2017, surpassing the target of investment growth of 11% and the previous year's realization of 12.4%, this accomplishment could not satisfy him. It is because the performance of Indonesia's investment was considerably much lower than that of peer countries in Asia, among others, India's investment that increases by 30%, the Philippines' by 38%, and even Malaysia's by 51%. Complicated licensing and regulation overlapping were considered by Jokowi still becoming obstacles to set up investment in Indonesia.

Shortly afterwards, Minister of Finance Sri Mulyani Indrawati questioned the effectiveness of the implementation of tax allowance and tax holiday policies. Instead of attracting new investment, in reality, the level of participation is low, even during 2017, there was no new investor utilizing it.

The legal base of the tax facility provision by government is stipulated in Article 31A of Law Number 36 Year 2008 on Income Tax, which was elaborated through the implementing rules in the form of Government Regulation Number 9 Year 2016 on the Amendment to Government Regulation Number 18 Year 2015 on Income Tax Facility for Capital Investment in Specific Business Fields and or in Specific Regions.

Tax allowance is an incentive of tax relief technically stated in MoF Regulation Number 89/PMK.010/2015 on the Procedures of Provision of Income Tax Facility for Capital Investment in Specific Business Fields and/or in Specific Regions as well as Transfer of Asset and Sanction for Resident Corporate Taxpayer Given the Income Tax Facility.

The tax relief offered includes; (1) net income deduction of 30% from total capital investment for 6 (six) years or 5% per annum; (2) accelerated depreciation upon tangible and intangible assets; (3) Income Tax imposition on dividend paid to Non-resident Taxpayer other than Permanent Establishment (PE) in Indonesia of 10% or lower rate based on the prevailing Double Tax Avoidance Agreement; (4) loss compensation that is more than 5 (five) years but no more than 10 (ten) years.

However, not all entrepreneurs can obtain the tax allowance facility. The facility provision is limited only to the investment with specific criteria in 145 business segments that are the focus of national industrial development. Meanwhile, the requirements of tax allowance recipient candidate are having: high investment value, high level of workforce absorption, as well as local content level of more than 20%.

In terms of tax holiday, it is regulated further in MoF Regulation Number 103/PMK.010/2016 on the Amendment to MoF Regulation Number 159/PMK.010/2015 on the Provision of Corporate Income Tax Deduction Facility. In the policy, the government is given the discretion to provide Income Tax deduction facility of 10% at minimum to 100% at maximum for new investment in specific business fields and for certain periods. The MoF Regulation affirms that the tax holiday facility may be granted for the period of 5 (five) to 15 (fifteen) years and can be extended to 20 years for the project deemed strategic for Indonesia's economy or to 25 years at maximum particularly in Special Economic Zone (SEZ).

The criteria and requirements that shall be met by the investor candidates for obtaining tax holiday are stricter than those for tax allowance. First, only investor candidates having status as new

Taxpayers and are the pioneer industry subjects in 9 (nine) priority business sectors may apply for tax holiday. They shall also have investment plan amounting to IDR1 trillion at minimum and fulfill Debt to Equity Ratio (DER) provision of 4:1. In addition, the investor candidates shall have legal entity status (ratification since/after 15 August 2011) and make statement of fund allocation in Indonesian banking of 10% at minimum from the investment plan.

The 9 (nine) priority business fields being the targets of tax holiday comprise: base metal industry, oil refinery industry, industry of organic basic chemical from oil and gas, machinery industry, telecommunication equipment industry, agricultural product manufacturing industry, maritime industry, manufacturing industry in SEZ, and economic infrastructural project other than Public Private Partnership (PPP).

Evaluation

However, the tax space reserved by the government every year for tax allowance and tax holiday seems unnecessary, if not wanting to be called pointless. It is because the entrepreneur's response to this tax facility is quite low, let alone to use it.

Say, this question is brought up to an entrepreneur, why not interested in using the tax holiday or the tax allowance? The answer is relatively the same over years. Again, the main problem causing the investors unwilling to take the government's offer is the difficult and complicated procedures for obtaining the facility. Majority of entrepreneurs claim that the business criteria and requirements to obtain the tax allowance—not to mention the tax holiday—are too hard to meet.

Furthermore, there is not something new demanded by downstream industry. In other words, the tax facility offered by the government does not match business world's expectation. In fact, many a time what is promised contradicts the reality. Sectoral ego is still visible resulting in conflict of policy among institutions. This fact always raises a question, is the government really serious about giving the tax incentive?

If we ask further, what are the most crucial factors for entrepreneurs? The answer will be closely related to issues about the sophisticated bureaucracy, infrastructure limitation, energy supply guarantee, and legal certainty. It is because, for them, all these issues are the causal factors behind the high cost of economy or business in Indonesia.

The government is actually not unaware that the prescription offered to investor to solve the problem of high economic cost is inaccurate. The Minister of Finance of Republic of Indonesia Sri Mulyani Indrawati assumes that the unpopularity of tax allowance and tax holiday may be because the incentive needed by the investors are not those two. For that reason, the tax incentive policy shall be evaluated and reviewed. The evaluation is not only about the amount of incentive, but also the administrative requirements and procedures along with its impact on the country's revenue and economy.

Global Tax Competition

Mitsuhiro Furusawa, Deputy Managing Director of International Monetary Fund (IMF), during his visit to Jakarta in the mid 2017 reminded the Indonesian Government to anticipate the excess of too many tax incentive offers. Trade liberalization indicated by integration of economy and cross-border investment is considered giving rise to undesirable side effects.

Not only aggresive tax planning acts by multinational and regional companies, another impact that shall be taken into account is aggressive competition among countries over investment through the provision of various incentives and tax exemptions.

Regarding these issues, Organisation for Economic Co-operation and Development (OECD) within the last several years has routinely conducted review to measure the negative effect of harmful tax competition from each decision of investment in financial sector and its consequences to tax. In conclusion, the tax practices considered harmful (harmful tax practices) are the result of harmful preferential tax regime and tax haven.

There are four tax policies in Indonesia becoming OECD's review material, i.e. tax incentive for public company, tax allowance, tax holiday, and SEZ. The good news is that those four policies are not included in the list of harmful tax practices.

Even though not included in the scope of harmful tax practices, the 'sale' of tax incentive rendered by Indonesian Government may be regarded by other countries as an unfair policy to fight over the capital. It is worried that those policies will be responded by other countries by cutting tax rate so that it may give rise to tax war.

Lately, there is an upward global trend, in which many countries compete to cut their tax rate into the lowest level (race to the bottom), like what the United States has applied. It is a picture of tax base annihilation as a result of the massive profit shifting practices to tax haven countries.

The issue of Base Erosion and Profit Shifting (BEPS) then appears as a threat for tax authorities around the world, including Indonesia. Despite the fact that G20 countries and OECD agree to fight BEPS, among others by averting the tax rate war, willingly or not, each country shall go with the flow of competition if they do not want to suffer loss. Nowadays, Indonesia faces the dilemma to determine the most realistic tax policy option.

If it is about collecting capital, is tax the only reason for investor to make investment? If investment competitiveness is the reason, is the low interest in the 'sale' of tax allowance and tax holiday not enough to be a lesson learnt? Similarly, if the purpose is to avoid the Taxpayer performing profit shifting, how much tax rate should be pressed to prevent that action? If all of these things are accomodated through tax, in the end the country is unconsciously directed to remove the tax.

If it remains implemented, the consequence is that fiscal balance is getting bad because it is dominated by debt. This phenomenon has emerged within the last few years, in which tax revenue target was not attained and, on the contrary, the number of debt withdrew is getting bigger.

In regard to some fundamental problems that are always complained by Taxpayers especially entrepreneurs: the complicated bureaucracy; infrastructure limitation; energy supply guarantee; and legal certainty, the main disease has been diagnosed, that the medicine formulated shall be based on needs. If the tax revenue is sacrificed again, it is concerned that the country will run out of resources to make budget as economic stimulus.

*Short version of this article has been published in **Kompas.com**, March 6, 2018

References:

- Galih Gumelar, *"Tax Holiday dan Tax Allowance Tak Laku, Sri Mulyani Evaluasi," CNN Indonesia*, 9 January 2018, https://www.cnnindonesia.com/ekonomi/20180109090959-532-267571/tax-holiday-dan-tax-allowance-tak-laku-sri-mulyani-evaluasi.
- Silvia Zucchini, *"The International Tax Dimension of Economic Growth in Asia",* 12 July 2017, http://www.imf.org/en/News/Articles/2017/07/11/sp071217-international-tax-dimension-of-economic-growth-in-asia.
- OECD, *Harmful Tax Practices-2017 Progress Report on Preferential Regimes,* (Paris: OECD Publishing, 2017).
- Dessy S Saputri, *"Jokowi: Peningkatan Investasi Indonesia Kalah di ASEAN",* Republika, 23 January 2018, http://www.republika.co.id/berita/ekonomi/korporasi/18/01/23/p2zxrr382-jokowi-peningkatan-investasi-indonesia-kalah-di-asean.

Divestment Is Only An Option, Foreign Investors Are Not Required to Issue Their Shares to Domestic

Indonesian Government loosens the divestment obligation for Foreign Investment (PMA) companies. Effective from this year, PMA companies—both those whose share is a joint venture with domestic investors and those controlling 100% shares—are allowed not to divest its shares if the shareholders are unwilling to perform share issuance.

The flexibility of the divestment obligation is expressed in Indonesia Investment Coordinating Board (BKPM) Regulation Number 13 Year 2017 on Guidelines and Procedures for Investment Licensing and Facility promulgated on 11 December 2017.

Article 16 paragraph (1) of BKPM Regulation Number 13 Year 2017 affirms that:

> *"[As for] PMA companies assigned with divestment obligations on shares of the company in its approval letter and/or Business License prior to the enactment of this BKPM Regulation, the obligations remain binding and shall be executed in accordance with the stipulated period."*

Meanwhile, in Article 16 paragraph (6), it is stated that:

> *"The divestment obligation as referred to in paragraph (1) is allowed not to be executed if in the General Meeting of Shareholders documents:*
>
> *a. for a joint venture company, the Indonesian party declares that (they) do not want/demand any share ownership in accordance with the divestment provisions contained in the approval letter and/or Business License; or*
>
> *b. for a PMA company whose shares are 100% foreign-owned, the shareholders declare that (they) have no commitment/agreement with any Indonesian party to sell the shares."*
>
> Thus, PMA companies unable to undertake divestment shall expressly state in General Meeting of Shareholders or Circular Resolution that the company will not issue any of its shares to domestic party. However, if in the future there are Indonesian parties demanding divestment, the responsibility is on the shareholders.

OSS Permission

Based on the agreement of shareholders not to carry out divestment obligation, PMA companies shall propose Investment Registration request with the type of alteration (change) registration to the authority in charge to cancel the divestment obligation. The authorities include One-stop Service Center (OSS) at BKPM, OSS of Free Trade Zones and Free Ports (KPBPB), or OSS of Special Economic Zone (SEZ).

The BPKM regulation starts to take effect for OSS of BKPM on 2 January 2018. As for the Department of Capital Investment & OSS of Province and Regency/City, OSS of KPBPB, OSS of SEZ, it is no later than 2 July 2018.

By the issuance of BKPM Regulation Number 13 Year 2017, five related regulations are revoked and declared no longer applicable. The five revoked regulations include:

- Head of BKPM Regulation Number 18 Year 2015 on Amendment to Head of BKPM Regulation Number 8 Year 2015 on the Procedures for the Application of Income Tax Facility for Investment Purposes in Specific Business Areas and/or Specific Regions;
- Head of BKPM Regulation Number 19 Year 2015 on Amendment to Head of BKPM Regulation Number 13 Year 2015 on Guidelines and Procedures for Granting Tax Reduction Incentive of Corporate Income/Tax Holiday;
- Head of BKPM Regulation Number 8 Year 2016 on Second Amendment to Head of BKPM Regulation Number 14 Year 2015 on Guidelines and Procedures for Capital Investment Principal License;
- Head of BKPM Regulation Number 15 Year 2015 on Guidelines and Procedures for Licensing and Non-Licensing of Capital Investment; and
- Head of BKPM Regulation Number 16 Year 2015 on Guidelines and Procedures for Capital Investment Facility Services.

For foreign investors, this policy is a good news to run a business in an open business sector in Indonesia. With the possibility of not doing divestment, it will be easier for PMA to renew their business license without searching for local partner.

Negative Investment List

In the previous regulation (Head of BKPM Regulation Number 14 Year 2015), the divestment obligation was binding and mandatory for PMA companies although investors might propose deadline extension request to OSS. The minimum nominal value of shareholdings in order to fulfill the divestment obligation is of IDR10,000,000 for each Indonesian individual and corporate shareholder.

With the issuance of BKPM Regulation Number 13 Year 2017, share divestment becomes an option that can be done or not by PMA based on agreement of shareholders. Nevertheless, the policy excludes PMA in specific business sectors as specifically stipulated in related regulations and provisions.

In order to enhance business competitiveness as well as to ensure the protection of Micro, Small, and Medium Enterprise (MSME) and strategic business sectors, the Government stipulates Negative Investment List (DNI). Previously, DNI was regulated under Presidential Regulation (Perpres) Number 44 Year 2016 on List of Business Fields Closed to and Business Fields Open with Conditions to Investment, as the revision of Perpres Number 39 Year 2014.

In the policy, the Government excludes 35 business sectors previously listed in DNI, such as toll road concession, cold storage, and several tourism and creative economic sectors such as bar, cafe, sport center, to recording studio. In addition, foreign ownership of pharmaceutical raw materials and health support services such as laboratorium clinic and medical check up are no longer limited.

Therefore, there are only 20 closed or forbidden business sectors for capital investment (see table).

The rest, as much as 97 business sectors are reserved for MSME and cooperatives as well as 48 business sectors specified for partnership. Some business sectors reserved for MSME and cooperatives include: agriculture, public works such as construction and construction consultation services, and several sectors in Tourism and Creative Economy such as tourism travel agent, homestay, art studios, tour guides, to internet cafes.

Meanwhile, as much as 16 business sectors are open for investment under specific condition, i.e. agricultural sector, forestry sector, marine affairs and fisheries sector, energy and mineral resources sector, industrial sector, defense and security sector, public works sector, trade sector, tourism and creative economy sector, transportation sector, communication and informatics sector, financial sector, banking sector, manpower sector, education sector, and health sector.

For mineral and coal mining business sector, the investment regulation is stipulated specifically in Law Number 4 Year 2009 on Mineral and Coal Mining, with implementing rules in Government Regulation (PP) Number 1 Year 2017 on Operational Activity of Mineral and Coal Mining.

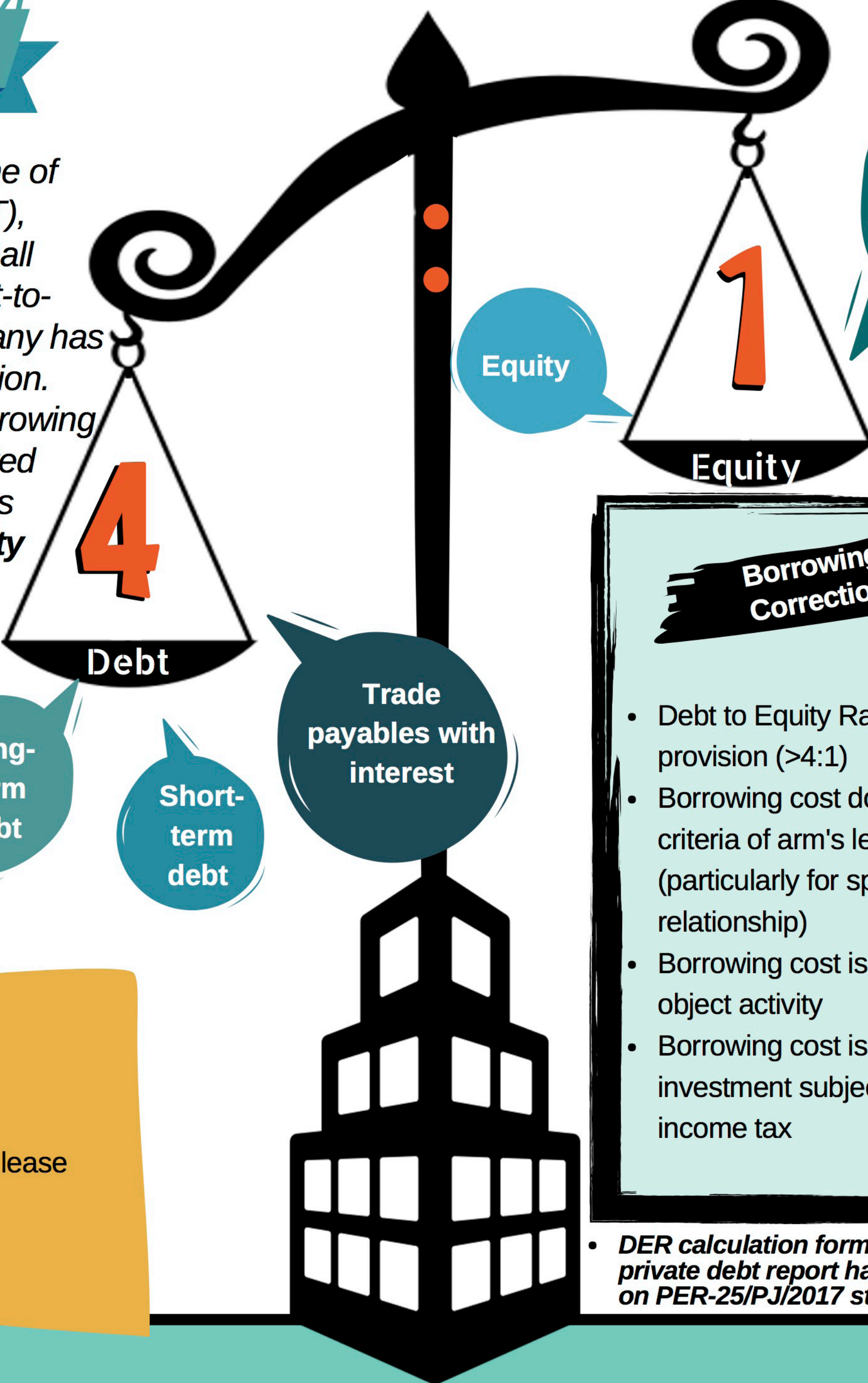
Negative Investment List (DNI)	
Cultivation of marijuana;	Malt beverage industry;
Catching of specific fish species;	Conduct and operation of terminals for land transport passenger;
Utilization/collection of living coral and dead coral from nature;	Conduct and operation of weigh stations;
Lifting of valuable cargo from shipwrecks;	Telecommunication or Vessel Traffic Information System (VTIS);
Chlor Alkali making industry under Mercury process;	Provision of Air Navigation Services;
Industry of specific pesticide active substances;	Conduct of Vehicle Type Test;
Industrial chemical industry and Ozone Depleting Substances (BPO);	Management and conduct of radio frequency spectrum and satellite orbit monitoring stations;
Industry of chemicals for chemical weapons;	Government’s museum;
Alcoholic hard liquor industry;	Historical and archaeological artifacts;
Alcoholic beverage industry: wine;	Gambling/casinos

MUC
TAX RESEARCH INSTITUTE

BORROWING COST DEDUCTING GROSS INCOME

DEBT to EQUITY RATIO

*Approaching the deadline of Annual Tax Return (SPT), Corporate Taxpayers shall ensure whether the debt-to-equity ratio of the company has complied with the provision. This is related to the borrowing cost that can be calculated as the deduction of gross income or **Debt to Equity Ratio (DER)** is at maximum **four times the total equity**.*



Borrowing Cost Correction Risk

- Debt to Equity Ratio exceeds the provision (>4:1)
- Borrowing cost doesn't meet criteria of arm's length principle (particularly for special relationship)
- Borrowing cost is used for non tax object activity
- Borrowing cost is used for investment subjected to final income tax

- ***DER calculation format and foreign private debt report have to be made based on PER-25/PJ/2017 standard format***

BORROWING COST

- Interest
- Discount & premium
- Ancillary costs
- Finance charges of finance lease
- Loan guarantee fees
- Exchange difference

EXCEPTION FOR SPECIFIC BUSINESSES & CONDITIONS

Banks | Financial Institutions | Mining | Insurance | Infrastructure | Final Income Tax Targets

(Source: Minister of Finance Regulation No. 169/PMK.03/2015 & DGT Regulation No. PER-25/PJ/2017)