HHP Law Firm - Recent Updates Affecting the Wealth Management Industry – Indonesia

With a sizeable number of wealth management firms operating in the country, Indonesia is a key market that boasts more than just a reputation as a famous vacation destination. Aiming to assist those firms which operate in the world's largest island nation, Ria Muhariastuti shares her insights into the industry updates and key considerations those with a presence in the nation need to be aware of.

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INCOME TAX ON DIVIDENDS

On 17 February 2021, the Minister of Finance issued regulation No. 18/PMK.03/2021 as the implementing rules of Law No. 11/2020 (known as the Omnibus Law). This regulation deals with the taxation of dividends and certain types of offshore income.

Onshore dividends

A dividend paid by an Indonesian company that is received by:

- an individual resident taxpayer, or
- a corporate tax resident,

is exempt from income tax provided the dividend is distributed based on a general shareholders' meeting or as an interim dividend in accordance with Indonesian law. In addition, for an individual resident taxpayer to obtain the exemption, the dividend must be invested in Indonesia for at least three years after the fiscal year in which the dividend is received.

Dividends received by an individual resident taxpayer that do not fulfill these requirements are subject to income tax.

Offshore dividends and other offshore income

- Offshore dividends

  - Dividends from a listed offshore company (i.e., an offshore company whose shares are listed on a stock exchange) are similarly exempt from tax, provided that they are invested in certain eligible investments in Indonesia for at least three years after the fiscal year in which the dividend is received. Dividends that are not so invested are subject to income tax.
  - The same exemption applies to dividends from an unlisted offshore company. However, the dividend amount that should be invested in Indonesia must be at least 30% of the after-tax profit of the offshore company. The dividend should be invested before the Indonesian tax authority issues a tax assessment letter with respect to the dividend under Indonesia's controlled foreign company (CFC) rules.

    If the dividend that is invested is less than 30% of the after-tax profit, the dividend that is invested is exempt from income tax. However, the short-fall will be treated as ordinary taxable income.

- Offshore income of a permanent establishment

  - To qualify for tax exemption, at least 30% of the after-tax profit from an offshore permanent establishment must be invested in eligible investments in Indonesia for at least three years after the fiscal year in which the after-tax profit is received.
  - If the invested amount is less than 30% of the after-tax profit, the after-tax profit that is actually invested is exempt from income tax and the short-fall will be treated as ordinary taxable income.

- Offshore income of an active business (not from a permanent establishment or subsidiary)

  - To qualify for tax exemption, the offshore income must be invested in eligible investments in Indonesia for a period of at least three years after the fiscal year in which the income is received. The offshore income must be generated from an active business outside Indonesia and must not be generated from an offshore company owned by the taxpayer.
  - If the investment amount is less than the offshore income received from the active business outside Indonesia, the investment income is exempt from income tax and the short-fall will be taxed as ordinary income.

The calculation of the after tax-profit mentioned above will be calculated in proportion to the percentage of shares owned by the recipient taxpayer.

The foreign tax paid on the offshore dividend income or offshore income that is not subject to tax in Indonesia cannot be credited or treated as a cost, and the taxpayer cannot ask for a refund of any Indonesian tax due.

The reinvestment of offshore dividend income and other offshore income as described above must be in eligible investments. These include the following:

a. Republic of Indonesia securities and Republic of Indonesia Sharia securities;

b. bonds or State Owned Enterprises' sukuk, the trade of which is supervised by the Financial Services Authority;

c. bonds or financing institutions' sukuk owned by the Government, the trade of which is supervised by the Financial Services Authority;

d. financial investments in designated banks, including Sharia banks;

e. bonds or private companies' sukuk, the trade of which is supervised by the Financial Services Authority;

f. infrastructure investment through cooperation between the Government and business entities;

g. real sector investment based on priorities determined by the Government;

h. equity participation in newly established companies and domiciled in Indonesia (i.e., as a shareholder of the newly established companies in Indonesia);

i. equity participation in companies that have been established and domiciled in Indonesia (i.e., as a shareholder of the established companies in Indonesia);

j. cooperation with the sovereign wealth fund;

k. usage to support other business activities in the form of lending for micro and small businesses within the territory of the Unitary State of the Republic of Indonesia in accordance with the provisions of the law in the field of micro small and medium enterprises; and/or

l. other forms of investment that are legal in accordance with the provisions of the law.

Investments must be made no later than:

- the end of the third month, for individual taxpayers,
- the end of the fourth month, for corporate taxpayers, after the end of the fiscal year in which the dividends or offshore income are received or earned.

Investments must be held for three fiscal years after the fiscal year of the receipt of offshore dividends or other offshore income. Investments cannot be transferred, except into other eligible investments.

Taxpayers whose dividends or offshore income are exempted from tax must submit investment realization reports electronically through certain channels specified by the Directorate General of Taxes. Taxpayers must submit their reports no later than the end of the third month (for individual taxpayers) or the end of the fourth month (for corporate taxpayers), each year until the third year after the fiscal year in which the dividends or offshore income are received or earned.

WITHHOLDING TAX ON INTEREST ON BONDS

Under the Income Tax Law, a payment to a non-resident taxpayer is subject to 20% withholding tax (subject to tax treaty application). Law No. 11/2020 (known as the Omnibus Law) stipulates that the withholding tax rate on interest may be reduced.

Under Government Regulation No. 9/2021, interest on bonds paid to a non-resident taxpayer is now subject to 10% withholding tax (or the applicable tax treaty rate if lower). This withholding tax rate applies to all types of income that are considered as bond interest including capital gains (i.e., premiums and discounts) that are received upon disposal of the bond. The 10% withholding tax rate applies from 2 August 2021.

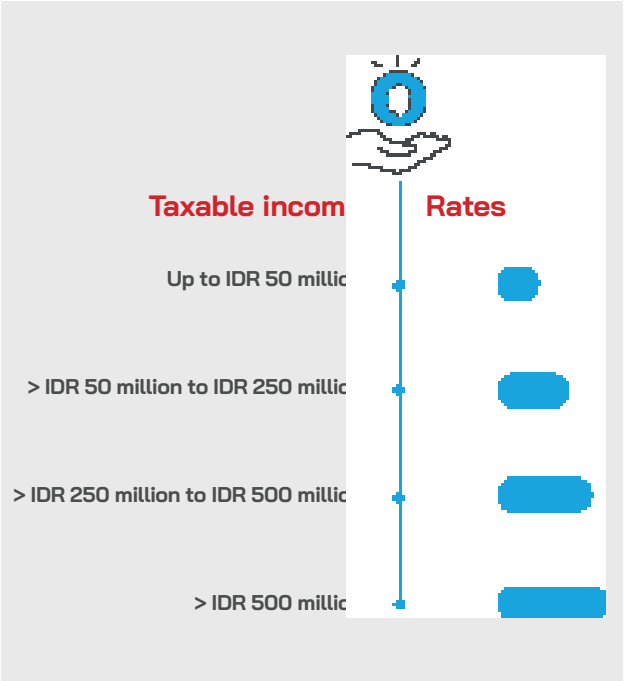
MLI FOR 21 TAX TREATIES

On 18 February 2021, the Directorate General of Tax issued 21 circular letters to stipulate that the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (MLI) has come into force and implemented key changes to the relevant tax treaty articles. The circulars and the MLI provisions came into effect on 1 January 2021 for tax withheld at source and on 1 January 2022 for other taxes.

POTENTIAL DEVELOPMENTS

Increased income tax rates for individual resident taxpayers

The Government is considering increasing the income tax rates for individual taxpayers receiving income of IDR 5 billion and above. Currently, the income tax rates for individual resident taxpayers are as follows:



The increase will be stipulated in a draft tax law included in the 2021 Priority National Legislation programme.

Second tax amnesty program

Due to the success of the tax amnesty program in 2016 and 2017, the Government is considering introducing another tax amnesty. The discussion of the second tax amnesty is still at the preliminary stages. ■

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