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Taxation of Foreigners in Indonesia

by
Robert N. Hornick*

During the past fifteen years the volume of investment and trade between Indonesia and the industrialized world has grown dramatically and with it has developed an interest in Indonesia's system of taxation, particularly as it affects foreign persons doing business in or with Indonesia.

The purpose of this Article is to describe how Indonesian taxes, normally applicable to Indonesian persons, are assessed on foreign persons doing business in or related to Indonesia, and to discuss certain special rules applicable in determining the amount of tax payable by such foreign persons. In this connection, Indonesia's tax treaties with Belgium, Canada, France, Germany, Japan, the Netherlands, and the United Kingdom will also be examined, although recent treaties with the Philippines and Thailand are not discussed.

The following Indonesian taxes, which are the most important for foreigners, are treated in this Article: (i) the Company Tax Act of 1925, pursuant to which company tax (at a maximum rate of 45%) is imposed on the taxable profit of corporations, partnerships, and other entities, (ii) the Personal Income Tax Act of 1944, pursuant to which an income tax (at a maximum rate of 50%) is imposed on the taxable income of individuals, (iii) the Interest, Dividend and Royalty Tax Act, pursuant to which withholding tax (at a maximum rate of 20%) is imposed on interest, dividend, and royalty payments, (iv) the Sales Tax Act of 1951 pursuant to which sales taxes (at rates ranging from 1% to 20%) are imposed on the importation and/or sale of specified goods and services, and (v) the Stamp Duty Act of 1921, pursuant to which stamp duties (at fixed or ad valorem rates) are payable in connection with specified documents and transactions. Amendments and regulations through December 31, 1982 are covered.¹

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1. A list of English language materials on Indonesian tax law through 1972 can be found in R. HORNICK, *ENGLISH LANGUAGE WRITINGS ON INDONESIAN LAW* 8-9, 24 (1973). See also J. BALL, *BIBLIOGRAPHY OF MATERIAL ON INDONESIAN LAW IN THE ENGLISH LANGUAGE* (3rd ed. 1981). The following English language materials have been published since 1972: Booth, *Ipeda—Indonesia's Land Tax*, 10 *BULL. INDON. ECON. STUDIES* 55 (1974); Brasier, *An Investor's Guide to Indonesian Corporate Income Tax—II*, *E. ASIAN EXEC. REP.* (June 1981); Bus. Int'l Corp., *Indone-*

I
COMPANY TAX (PAJAK PERSEROAN)

Indonesia taxes the worldwide profit of corporations, partnerships and other entities organized under Indonesian law or otherwise resident in Indonesia. In addition it taxes the Indonesian source profit of foreign corporations, partnerships, and other foreign entities not resident in Indonesia to the extent such profit is derived from the activities of permanent establishments in Indonesia, immovable property situated there, or certain loans secured by an hypothecation over such property.²

The rate of company tax is graduated and ranges from 20% to 45%. The profit levels to which the rates apply are determined from time to time by the Minister of Finance.³ Currently the levels vary depending

sia, in 2 INVESTING, LICENSING AND TRADING CONDITIONS ABROAD (1976); S. CNOSSEN, THE INDONESIAN SALES TAX (1973); CNOSSEN, *Sales Taxation in Indonesia*, 28 BULL. INT'L FISCAL DOC. 15 (1974); Diamond W., *Indonesia*, in 1 FOREIGN TAX AND TRADE BRIEFS (MB) Far East 65 (1975); Granucci & Bambang Notodisurjo, *Indonesia: Taxation of Foreign Companies with Representative Offices in Indonesia*, 73 TAX MGMT. INT'L J. (BNA), at 3 (June 1973); INDONESIA, DEP'T OF FINANCE, *INDONESIAN TAX GUIDE FOR FOREIGNERS* (1975); INDONESIA, DIRECTORATE GENERAL TAXATION, *AGREEMENT BETWEEN THE REPUBLIC OF INDONESIA AND THE KINGDOM OF BELGIUM, THE REPUBLIC OF INDONESIA AND THE GOVERNMENT OF THE UNITED KINGDOM OF GREAT BRITAIN AND NORTHERN IRELAND* (1976); INDONESIA, *CORPORATE TAX ORDINANCE 1925* (1973); INDONESIA, *INCOME TAX ORDINANCE 1944* (1973); INDONESIA, *SALES TAX ACT OF 1951* (1973); INDONESIA, *TAX LAW ON INTEREST DIVIDEND AND ROYALTY 1970* (1973); INDONESIA, 1973 *GUIDE FOR EMPLOYERS/ENTREPRENEURS FOR INCOME TAX DEDUCTIONS ON SALARIES, WAGES, HONORARIUM AND THE LIKE* (1973); INDONESIA, 1974 *GUIDE FOR EMPLOYERS/ENTREPRENEURS FOR INCOME TAX DEDUCTIONS ON SALARIES, WAGES, HONORARIUM AND THE LIKE* (1974); Jones, *Taxation of the Petroleum Industry in Indonesia: Issues and Objectives*, 13 LAW & POL'Y INT'L BUS. 1047 (1981); Manning, *New Investment Tax Incentives*, E. ASIAN EXEC. REP. 14 (May 1981); Mochtar, Karuwin & Komar, *Indonesia: Report on Agreements on Avoidance of Double Taxation and Prevention of a Fiscal Evasion Entered into by the Republic of Indonesia*, 81 TAX MGMT. INT'L J. (BNA), at 33 (Sept. 1981); Mochtar, Karuwin & Komar, *Indonesia: Special Tax Regime for Foreign Companies Engaged in Geothermal Development in Indonesia*, 82 TAX MGMT. INT'L J. (BNA), at 31 (July 1982); Nadaisan, *Some Aspects of Corporate and Taxation Laws Affecting Foreign Investment in Indonesia*, 2 MALAYAN L.J. 54 (1978); Peacock & Shaw, *Fiscal Measures to Create Employment: The Indonesian Case*, 27 BULL. INT'L FISCAL DOC. 443 (1973); PRICE WATERHOUSE, *DOING BUSINESS IN INDONESIA* (1981); P.T. SGV-UTOMO, *DOING BUSINESS IN INDONESIA* (1974); Soemitro, *Issues Pertaining to the Taxation of Foreign Investors in Indonesia*, in PAJAK DAN PEMBANGUNAN 25 (R. Soemitro ed. 1974); Soemitro, *Issues Pertaining to the Taxation of Foreign Investment in Indonesia*, 15 MALAYA L. REV. 145 (1973); R. SOEMITRO, *SURVEY OF INDONESIAN ECONOMIC LAW: TAXATION* (1973); Soemitro, *Taxation and its Function as to Create a Favorable Climate for Private Capital Investments*, in PAJAK DAN PEMBANGUNAN 43 (R. Soemitro, ed. 1974); Sukarya, *Indonesia*, 63a CAHIERS DE DROIT FISCAL INT'L 333 (1978); Sutanto, *Negotiation of Selected Provisions of Bilateral Tax Treaties*, 15 MALAYA L. REV. 159 (1973). Finally, the Commercial Advisory Foundation in Indonesia (C.A.F.I.) publishes translations of some Indonesian tax regulations in the English language edition of its daily newspaper bulletin WARTA C.A.F.I.. Citations in this Article to WARTA C.A.F.I. are to the Indonesian language edition, but in most cases the citation also corresponds to the English edition.

2. Company Tax Act, art. 1(1).

3. *Id.* art. 10.

on whether the company is privately or publicly held, whether (in the case of private companies) its financial statements are audited or unaudited, and (in the case of public companies) what percentage of shares are publicly held.⁴ The 45% rate begins for unaudited private companies at approximately \$50,000 of taxable profit and for audited private companies at approximately \$350,000 of taxable profit. For publicly held companies 51% or more of whose shares are publicly traded, the 45% rate begins at approximately \$1,100,000 of taxable profit.

Indonesian Residence. Company tax is imposed on the worldwide profit (i.e. non Indonesian as well as Indonesian source profit) of a foreign entity only where such entity is "resident" in Indonesia. The Company Tax Act does not define residence, but provides merely that it should be based on the factual circumstances of each case.⁵ There are no published revenue rulings or cases directly on point. Commentators generally state that residence for company tax purposes should not be determined by the nationality of the enterprise (its place of incorporation or organization) but rather by the place of effective management—where top management is located, and to a lesser extent where financial books are kept and annual shareholders' meetings held.⁶ In theory, therefore, an Indonesian company can have a foreign residence and a foreign company can have an Indonesian residence.

In practice, however, nationality is the key criterion. We do not know of any company organized under Indonesian law which has been deemed to have foreign residence for Indonesian company tax purposes, even where management is directed from abroad. For example, Indonesian subsidiaries of foreign companies are regularly treated as having Indonesian residence, even though top management may be situated outside Indonesia and key decisions made abroad. Similarly, while a foreign company having a place of effective management in Indonesia may in theory be deemed to have Indonesian residence, we do not know of any to which Indonesian residence has in fact been attributed, although there are some such foreign companies doing business in Indonesia.

4. Min. Finance Decree No. 110/KMK.04/1979 dated Mar. 27, 1979, 27 WARTA C.A.F.I. 80 (1979).

5. Company Tax Act, art. 1(2).

6. See, e.g., R. SOEMITRO, HUKUM PAJAK INTERNASIONAL INDONESIA 59 (1977) [hereinafter cited as SOEMITRO, HPII (1977)]; R. SOEMITRO, PENUNTUN PERSEROAN TERBATAS DENGAN UNDANG-UNDANG PAJAK PERSEROAN 113 (5th ed. 1976) [hereinafter cited as SOEMITRO, PAJAK PERSEROAN].

Permanent Establishment. Company tax is imposed on the profits a non-resident foreign company derives from the activities of a "permanent establishment" in Indonesia.⁷ The term "permanent establishment" is not defined in the Company Tax Act. A revenue ruling, issued in 1949 and never explicitly repealed, states that the United States-Netherlands Tax Treaty should be used as a guideline for determining what is a permanent establishment.⁸ The 1948 version of the treaty⁹ defines permanent establishment to mean "a branch office, factory or other fixed place of business" but expressly excludes a fixed place of business used "exclusively" for the purchase of goods or merchandise or a subsidiary corporation.

The treaty does not address whether the mere presence of a representative or employee in the territory, or the performance of services in the territory by an employee for a period of time, constitutes a permanent establishment. However, an agent in the territory is said to be a permanent establishment only if he has, and "habitually" exercises, a general authority to negotiate and conclude contracts on behalf of the foreign enterprise or if he maintains a stock of merchandise from which he "regularly" fills orders "on behalf of such enterprise." A "bona fide" commission agent, broker or custodian who acts on behalf of the foreign enterprise "in the ordinary course of business" is said not to be a permanent establishment.

In our view a sales representative of a foreign company who establishes a representative office and regularly engages in sales promotion, advertising, and information gathering does not constitute a permanent establishment in Indonesia, provided that he does not habitually negotiate and sign contracts on behalf of the foreign company or otherwise regularly engage in activities outside the scope of his representative's license. Furthermore, the mere presence of a foreign company's employee in Indonesia or the occasional performance of services there by an employee (e.g. commissioning of equipment, after sales service, consulting, construction services) should not of itself constitute a permanent establishment. The adjective "permanent" clearly requires something more than infrequent activities. Precisely when activities achieve a frequency sufficient to constitute a permanent establishment may be debated but, in our view, the requisite frequency certainly does not exist when services are performed in Indonesia for less than 183 days during any twelve month period.

7. Company Tax Act, art. 1(1) (iii).

8. 1949 T.L.N. 15829. See *Pengertian Pendirian Tetap menurut versi Indonesia, 1976-1977* KUMPULAN BINA PAJAK KOMPAS 133 (Dec. 3, 1976).

9. Treaty on Double Taxation of Income, Apr. 29, 1948, United States-Netherlands, 62 Stat. 1757, T.I.A.S. No. 1855.

Some tax commentators and tax inspectors have, however, taken a more aggressive position where there is no tax treaty provision defining what duration of activity constitutes a permanent establishment. For example, the Tax Inspectorate for Foreign Bodies and Aliens, a division of the Directorate General for Taxation, Ministry of Finance, maintains that:

[T]he Directorate General for Taxation in Indonesia not only respects the understandings and principles as set out in the OECD draft convention, but also takes into account the understandings and principles presented in several United Nations reports concerning 'Tax Treaties between Developed and Developing Countries.' Thus, at this stage it can be said that the Directorate General for Taxation adheres to the understanding that: the presence of an employee of a foreign enterprise in Indonesia or of its representative in Indonesia who carries on activities (in Indonesia) for the benefit of the foreign enterprise is sufficient evidence of the existence of a permanent establishment in Indonesia of that enterprise.¹⁰

Although these statements do not specify how long an employee must be present and performing services in Indonesia to constitute a permanent establishment, the reference to United Nations tax treaty reports may suggest a shorter period than 183 days. One former tax official has even argued that "one day" is sufficient.¹¹ Although the "one day rule" has not been applied literally, its articulation is indicative of the aggressive trend in Indonesian tax collection.

It should also be noted that some foreign companies with representative offices in Indonesia are paying company tax pursuant to a 1971 decree of the Director General of Taxes¹² which requires such companies to make estimated monthly tax payments for eventual crediting against company tax liability. It is not clear why the Director General assumes that such companies owe company tax. If the assumption is that such companies have a permanent establishment in Indonesia merely because they maintain a representative office, then the assessment would seem to be unlawful in view of the foregoing discussion. Perhaps it is assumed that such companies are liable for company tax not simply because they have a representative office but because their representatives are thought regularly to engage in commercial activities, such as negotiating and signing contracts, outside the scope of their representative licenses. That this may be the assumption

10. *INDONESIAN TAX GUIDE FOR FOREIGNERS*, *supra* note 1, at 28.

11. Usman, 1973-1974-1975 KUMPULAN KARANGAN PAJAK SINAR HARAPAN 46 (Mar. 26 1973); 1976-1977 KUMPULAN BINA PAJAK KOMPAS 133, 135 (Dec. 3, 1976).

12. Dir. Gen. Taxes Decree No. D.15.4/4/II/D/4-13/71 dated July 7, 1971 re tarip perusahaan perdagangan asing yang berusaha melalui perwakilan di Indonesia; R. SOEMITRO, *IV PERUNDANG-UNDANGAN PAJAK INDONESIA* 406 (1972).

is evidenced by the fact that some foreign companies reportedly have obtained exemptions by proving that their representative offices merely promote sales and provide information but do not themselves engage in commercial transactions.¹³

Foreign shipping companies and air carriers that lift passengers and cargo from Indonesia are generally presumed to have permanent establishments in Indonesia in the person of their shipping agents or sales representatives because such agents or representatives have, and exercise, a general authority to sell passage on the relevant vessel or aircraft.¹⁴

In each of Indonesia's double taxation treaties, the term "permanent establishment" is defined to mean a fixed place of business in which the business of the enterprise is conducted in whole or in part.¹⁵ This would include any branch, office, other place of management, factory, workshop, farm or plantation, mine, oil-well, quarry or other place of extraction of natural resources. A building site or assembly project which exists for more than three months (in the case of the Dutch treaty) or for more than six months (in the case of the Belgian, Canadian, French, German, Japanese, and U.K. treaties) would also be included. An enterprise is deemed to have a permanent establishment in Indonesia under all of the double taxation treaties (except the German treaty) if it furnishes services, including consultancy services, in Indonesia through an employee or other person (other than an independent agent) for a period exceeding 183 days in any twelve-month period. Under the Japanese treaty the twelve month period must be a taxable year. In the Dutch treaty, the relevant duration is 91 rather than 183 days in certain cases involving prospecting operations for mineral resources. The German treaty is silent on the issue.

Under the treaties the term "permanent establishment" does not include the use of facilities solely for any one of the following purposes: storage or display of goods or merchandise belonging to the foreign enterprise; maintenance of a stock of goods or merchandise for storage, display or processing by another enterprise; purchasing goods or merchandise; or advertising, collecting or supplying information, or conducting scientific research or similar activities which have a preparatory or auxiliary character for the foreign enterprise.

None of the treaties deem a foreign enterprise to have a permanent establishment merely because it carries on a business in Indonesia

13. Granucci & Bambang Notodisurjo, *Indonesia: Taxation of Foreign Companies with Representative Offices in Indonesia*, 73 TAX MGMT. INT'L J. (BNA) at 3 (June 1973).

14. 1978 KUMPULAN PAJAK SINAR HARAPAN 149 (Oct. 26, 1978).

15. Belgian Treaty, art. 5; Canadian Treaty, art. 5; Dutch Treaty, art. 5; French Treaty art. 5; German Treaty, art. 4; Japanese Treaty, art. 5; U.K. Treaty, art. 5.

through brokers or other agents of independent status, if such persons are acting in the ordinary course of their business. The Canadian treaty further provides that a foreign enterprise will not be deemed to have a permanent establishment merely because it maintains in Indonesia a stock of goods with an agent of independent status from which deliveries are made by that agent. However, the treaties provide that when the activities of such an agent are devoted wholly or almost wholly to the business of the foreign enterprise, the agent will not be considered an agent of independent status. In the case of the French treaty, the agent will be considered an agent of independent status unless it is proved that transactions between the agent and the foreign enterprise are not made at arm's length conditions. The fact that a foreign company controls a company which is resident in Indonesia or which carries on business in Indonesia does not of itself make the latter company a permanent establishment of the foreign company.

Six treaties¹⁶ provide that a foreign enterprise's profits from the operation of ships or aircraft in international traffic shall be exempt from Indonesian tax provided the enterprise meets a foreign residency requirement. The U.K., French, and Canadian treaties require the enterprise to be a resident of the foreign country, while the German and Belgian treaties require a foreign place of effective management. The Japanese treaty requires the enterprise to be "of" Japan. However, in the case of the Belgian treaty the exemption applies with respect to shipping profits only if the ships are operated in regular lines. In the case of the Japanese, Canadian, French, and German treaties the exemption applies only if the foreign enterprise carries on the shipping business on its own account and responsibility. In the U.K. treaty, the exemption applies only if the ships are registered in the United Kingdom or are operated under the Indonesia-Europe Freight Conference arrangements. The Dutch treaty has no special provisions for ships or aircraft.

Immovable Property. Income earned by a foreign company from the leasing or other use of immovable property situated in Indonesia is subject to company tax.¹⁷ Although the term "immovable property" is not defined in the Company Tax Act, it is generally assumed that the definition of immovable property set forth in the Civil Code is applicable. The Civil Code defines "immovable property" to mean primarily land, vegetation, buildings, and fixtures.¹⁸ Ships and aircraft are not

16. Belgian Treaty, art. 8; Canadian Treaty, art. 8; French Treaty, art. 8; German Treaty, art. 7; Japanese Treaty, art. 8; U.K. Treaty, art. 9.

17. Company Tax Act, art. 1(1)(iii).

18. Civil Code, arts. 506-507.

immovable property for tax purposes.

Each of Indonesia's double taxation treaties¹⁹ incorporates the principle that income derived from immovable property may be taxed in the state in which such property is situated. The treaties provide that the term "immovable property" shall have the meaning assigned to it under the laws of the state in which such property is situated, but in any case shall include property accessory to immovable property, livestock and equipment used in agriculture and forestry, rights to which the provisions of general law respecting landed property apply, usufruct of immovable property and rights to variable or fixed payments as consideration for the working of, or the right to work, mineral deposits, sources, and other natural resources. In addition, the Dutch treaty alone defines "immovable property" to include debt claims of every kind (excluding bonds) secured by a hypothec. In all of the treaties, ships and aircraft are expressly excluded.

Secured Loans. Income earned by a foreign company from any loan or other form of debt claim "arising outside the business" is subject to company tax if such loan or claim is secured by a hypothec on immovable property situated in Indonesia.²⁰ Some tax commentators and tax officials have stated that under this rule income from *any* loan or debt claim so secured is subject to company tax.²¹ This interpretation is clearly too broad because the Company Tax Act states that only loans or other debt claims "arising outside the business" are covered. The meaning of "debt claim arising outside the business" is unclear, and the phrase is not defined in the Company Tax Act. In our view, it means loans or other extensions of credit made by persons not in the business of giving credit. Thus, foreign banks and financial institutions, which are in the business of extending credit should not be subject to company tax under this rule.

This provision has not been enforced in practice—perhaps for the reason that the government realizes greater revenue from its withholding tax on gross payments of interest than it would realize from net tax on profit earned from a loan if the Company Tax Act were applied. In 1980 the Director General of Taxes issued a circular letter formalizing the practice of non-enforcement by declaring that, notwithstanding the provisions of the Act, company tax will not be assessed on a foreign lender's interest income where such income has been subject to interest

19. Belgian Treaty, art. 6; Canadian Treaty, art. 6; Dutch Treaty, art. 6; French Treaty, art. 6; German Treaty, art. 5; Japanese Treaty, art. 6; U.K. Treaty, art. 7.

20. Company Tax Act, art. 1(1)(iii). Although an Indonesian vessel can be hypothecated, a vessel is movable rather than immovable property and therefore interest earned on loans secured by an Indonesian ship mortgage is not subject to this provision.

21. B. USMAN & R. SUBROTO, PAJAK-PAJAK INDONESIA 79 (2d ed. 1980).

withholding tax.²² The circular apparently assumes that company tax would otherwise be chargeable on income derived from any foreign loan secured by an Indonesian hypothec, not just loans arising outside the business, and so leaves open the possibility that the revenue authorities may try to assess company tax on such secured foreign lenders whose interest income is for any reason not charged withholding tax.

All of the tax treaties limit the maximum tax that may be charged by Indonesia on payments of interest (see Section IIIA, *infra*), but otherwise are silent on the secured loan issue, except that the Dutch treaty expressly provides that income derived from debt claims of every kind (other than bonds) secured by an Indonesian hypothec is subject to Indonesian company tax.²³

Deemed Profit. Given the difficulty of verifying accurately the Indonesian portion of the worldwide income of foreign companies that do business in several countries, the Company Tax Act empowers the Minister of Finance to fix company tax for most foreign companies based on a percentage of gross turnover.²⁴ Their deemed Indonesian profit is equal to a specified percentage of gross income, and company tax is assessed based on such deemed profit. Sometimes a deemed profit is established for all foreign companies in a particular industry, sometimes for particular companies working on particular projects.

The Company Tax Act contains special provisions respecting the taxation of non-resident foreign insurance companies.²⁵ Based on these special provisions, life insurance companies are deemed to earn a taxable profit attributable to Indonesia equal to 5% of gross premiums and capital received from insured persons resident or domiciled in Indonesia. Non-life insurance companies are deemed to earn a taxable profit attributable to Indonesia equal to 10% of gross premiums and capital received with respect to risks located in Indonesia. Alternatively, any foreign insurance company may elect to calculate its Indonesian profit by multiplying its worldwide profit times a fraction the numerator of which is the amount of gross premiums and capital received with respect to insured persons and risks in Indonesia, and the denominator of which is the amount of gross premiums and capital received worldwide.

22. Dir. Gen. Taxes Circular No. SE-32/PJ.22/1980 dated Aug. 28, 1980, 28 WARTA C.A.F.I. 249 (Oct. 24, 1980). For a succinct discussion of this circular, and the general background respecting the taxation of secured loans, see Komar, *Indonesian Corporate Tax Obligations of Foreign Banks Clarified*, 80 TAX MGMT. INT'L J. (BNA) at 38 (Dec. 1980).

23. Dutch Treaty, art. 6(2).

24. Company Tax Act, arts. 6, 4(7); *Laba Berdasarkan Persentase*, 1980 KUMPULAN PAJAK SINAR HARAPAN 128-131 (Sept. 4, 1980).

25. Company Tax Act, art. 6.

Foreign shipping companies that take on cargo or passengers in Indonesia are subject to company tax on their taxable profit attributable to such operation. The Minister of Finance and his subordinates have issued special regulations for determining such tax.²⁶ The general rule is that taxable profit equals 5% of gross freight earned during the taxable year from cargo lifted in Indonesia. In practice, the tax is collected through estimated tax payments that are made at the time of each shipment by the foreign shipping company's shipping agent in Indonesia. The rate of estimated tax is 2% of gross freight charges for the cargo being lifted. Presumed freight charges are established from time to time by the Tax Inspectorate for Foreign Bodies and Aliens, and these, rather than the actual freight charges, are used for calculating the estimated tax. Presumed freight charges have been established for logs, sawn timber, shrimp, cement, fertilizer, and crude oil which vary depending on the port of destination. For example, the presumed freight for cement being transported from Indonesia to Asian ports is currently \$17 per ton.

Foreign drilling companies that operate in Indonesia usually do so through branch offices in Indonesia and are subject to Indonesian company tax on their taxable profit attributable to Indonesia. In recent years such tax has been assessed based on an industry-wide deemed profit that is renegotiated from time to time by the Ministry of Finance and the International Association of Drilling Companies.²⁷ The deemed profit is a fixed percentage of all gross payments made to the foreign drilling company for services performed in Indonesia, except payments for incidental reimburseables not "normally" part of the day rate and payments for mobilization and demobilization expenses. For the period March 31, 1981 to March 31, 1982 the applicable percentage

26. Minister of Finance Decree No. Kep-579/MK/II/9/1972 dated Sept. 7, 1972 re perhitungan dan penetapan besarnya laba kena pajak perusahaan² pelayaran dan penerbangan yang berkedudukan di luar negeri, R. SOEMITRO, V PERUNDANG-UNDANGAN PAJAK INDONESIA 212 (1973); Dir. Gen. Taxes Decree No. D.15.4/II/9-28/1974 dated Mar. 8, 1974 re pelimpahan sebagian wewenang Dir. Gen. Pajak, Berita Pajak, PAJAK PERSEROAN 225 (1976); Chief Inspector for Foreign Bodies and Aliens Decree No. SK.018.WPJ.10/KI.11/81 dated Mar. 23, 1981, 29 WARTA C.A.F.I. 90 (Apr. 16, 1981); Dir. Gen. Taxes Decree No. D.15.4.1-0.192-1-71/MPS.MPO dated Feb. 8, 1971 re penentuan tarif MPS dan masa pajak perusahaan² pelayaran luar negeri, R. SOEMITRO, *supra* note 12, at 400; Dir. Gen. Taxes Decree No. D. 15.4-II-0222-10-1972/MPS-MPO dated Oct. 20, 1972 re perubahan besarnya tarif MPS/pajak perseroan bagi perusahaan pelayaran luar negeri, R. SOEMITRO, V PERUNDANG-UNDANGAN PAJAK INDONESIA 394 (1973); Dir. Gen. Taxes Instruction No. SE-08/P.J.222/1979 dated Apr. 11, 1979, 27 WARTA C.A.F.I. 100 (Apr. 30, 1979); Dir. Gen. Taxes Letter No. S-149/PJ.22/1981 dated Jan. 28, 1981 re MPS dan PPs tanker asing, 29 WARTA C.A.F.I. 45 (Feb. 23, 1981).

27. Min. Finance Decree No. 128/KMK.01/1981 dated Mar. 14, 1981 re perhitungan dan penetapan besarnya laba kena pajak dari perusahaan pengeboran minyak bumi, 29 WARTA C.A.F.I. 99 (Apr. 28, 1981); Dir. Gen. Taxes Circular No. SE 10/PJ.2/1981 dated Mar. 28, 1981 re pemungutan pajak² perusahaan² pengeboran minyak bumi, 29 WARTA C.A.F.I. 99 (Apr. 28, 1981).

was 14%. For the period March 31, 1982 to March 31, 1983 it was 15% and for the period March 31, 1983 to March 31, 1984 it is 16%. The tax is paid monthly at the rate of 45% of the deemed profit for the month.²⁸ The foreign drilling company, in lieu of filing annual accounts, is obligated to cause the oil company for whom it works and from whom payments are received to send a letter to the tax authorities confirming the amount paid to the drilling company during the tax year for drilling services.

Many other foreign contractors, such as foreign construction companies, are subject to Indonesian company tax on their taxable profit attributable to Indonesia because they operate through a branch in Indonesia, or because they maintain a construction site in Indonesia or furnish other services in Indonesia for a substantial period of time. Often where large projects are involved the Minister of Finance establishes special rules for determining the company tax of the foreign contractor and subcontractors, based on deemed rather than actual profit. The deemed profit is usually a specified percentage of the contract price. For example, in the case of the Asahan project in North Sumatra, the deemed profit was 3% of the contract price.²⁹

Oil Companies. Foreign oil companies explore and develop oil and gas resources in Indonesia pursuant to production sharing contracts with the Indonesian national oil company, Pertamina. These contracts, whose terms and conditions must be approved by the government, originally included tax provisions that differed markedly from the statutory rules. However, as a result of U.S. Internal Revenue Service rulings in 1976 and 1978, which had the effect of denying foreign oil companies tax credits for Indonesian company taxes, the method of taxing oil income under production sharing contracts has been revised to resemble more closely the method for taxing the income of non-oil companies. Still, there are many special rules applicable to foreign oil companies, including rules as to what costs are deductible for purposes of calculating taxable income and what costs must be amortized.³⁰

28. *E.g.*, for the period Mar. 31, 1981 to Mar. 31, 1982, $45\% \times 14\% = 6.3\%$ of the deemed monthly profit.

29. Min. Finance Decree No. 13/KMK/04/1979 dated Jan. 15, 1979 re penghitungan dan penetapan besarnya laba kena pajak bagi perusahaan² kontraktor nasional dan asing dari usahanya dalam rangka pembangunan proyek Asahan, 27 WARTA C.A.F.I. 75 (Mar. 30, 1979); Dir. Gen. Taxes Circular No. SE-13/PJ.221/1982 dated Apr. 13, 1982, 30 WARTA C.A.F.I. 124 (May 31, 1982).

30. For a discussion of the taxation of oil companies, see Jones, *Taxation of the Petroleum Industry in Indonesia: Issues and Objectives*, 13 LAW POL'Y INT'L BUS. 1047 (1981).

Mining Companies: Many foreign mining companies operate in Indonesia under so-called contracts of work with the government of Indonesia. These contracts often include special tax provisions that supersede the statutory rules, including special provisions as to the scope of tax, the method of calculation and the applicable rates. Since 1967 several "generations" of contracts have evolved, with each succeeding generation containing terms and conditions, including tax provisions, more favorable to the government.³¹

Exemptions from Company Tax. There are two classes of exemptions from Indonesian company tax. First, foreign contractors who provide goods and services in Indonesia for a governmental project are exempt from company tax on their earnings if the project is financed either by official aid or by export credits.³² A project is governmental for purposes of the exemption whether it is owned by the government directly, or indirectly through a state enterprise such as the national oil company. Moreover, the exemption applies to governmental projects which are only partly financed by export credits and partly by commercial credits, as long as the financing is primarily export credit. For example, the exemption would apply to a project financed 85% by export credits and 15% by commercial credits, without regard to whether the payments to the contractor are derived from the export credit portion or commercial credit portion of the financing. However, a 2% tax is payable by the contractor on gross rupiah payments which it receives if the source of payment is the state budget. The 2% tax, payable at the time of receipt, technically constitutes a prepayment of estimated company taxes, but in practice is treated as a final assessment.

Second, Indonesian corporations established by foreign investors under Indonesia's Foreign Investment Law may be eligible for exemption from company tax for up to six years, and thereafter for reduced rates of company tax for up to ten more years.³³ Companies that operate in fields designated by the government as priority sectors are eligi-

31. For a comparison of typical tax provisions in the first three generations of hard minerals contracts, see M. KUSUMAATMADJA, *SURVEY OF INDONESIAN ECONOMIC LAW—MINING LAW* 68-118 (1974).

32. Min. Finance Decree No. B-329/MK/II/4/1972 dated Apr. 12, 1972; Min. Finance Decree No. S-331/MK/1977 dated June 9, 1977, 25 *WARTA C.A.F.I.* 156 (July 6, 1977); Min. Finance Decree No. S-270/MK.04/1978 dated Apr. 20, 1978, 26 *WARTA C.A.F.I.* 116 (May 19, 1978); Min. Finance Decree No. S-333/MK.04/1979 dated Apr. 28, 1979, 27 *WARTA C.A.F.I.* 137 (June 13, 1979); Min. Finance Decree No. S-769/MK.04/1979 dated Sept. 18, 1979, 27 *WARTA C.A.F.I.* 290 (Dec. 15, 1979); Min. Finance Decree No. S-448/MK.04/1981 dated Apr. 14, 1981, 29 *WARTA C.A.F.I.* 141 (June 17, 1981). See also Dir. Gen. Taxes Letter No. S-335/PJ.22/1979 dated Mar. 7, 1979.

33. Foreign Investment Law, arts. 15-17; Gov't. Regulation No. 2 dated Feb. 7, 1981 re pemberian tambahan kelonggaran perpajakan dalam rangka penanaman modal asing, 29 *WARTA C.A.F.I.* 43 (Feb. 20, 1981).

ble for a basic two year holiday. An additional year of holiday may be granted for each of the following: (i) the project earns or saves \$750,000 foreign exchange per year during each of its first three years of operations, (ii) the project is located outside of Java, (iii) the investment exceeds fifteen million dollars or is otherwise deemed "high risk," and (iv) the government assigns the project a high priority rating. Also, foreign investment companies that employ large numbers of Indonesian laborers, generate large export earnings, or are located in wilderness areas can be eligible for reduced rates of tax during some or all of the ten year period following expiration of the company tax holding.

Estimated Taxes. Most persons liable for company tax are required to prepay monthly estimated tax, based on a specified percentage of gross monthly receipts. Special prepayment regulations have been established for certain foreign taxpayers. For example, foreign construction companies are required to pay an estimated tax equal to 3.6% of gross receipts. The estimated tax is withheld by the Indonesian payor and remitted directly to the government, and is intended as a prepayment not only of estimated company tax, but also of estimated dividend withholding tax.³⁴

II

PERSONAL INCOME TAX (PAJAK PENDAPATAN)

Individuals, irrespective of nationality, who are residents of Indonesia are subject to income tax on their net worldwide personal income.³⁵ Individuals who are not residents of Indonesia are subject to tax on income from their carrying on a trade or business in Indonesia, from their immovable property situated in Indonesia, from loans they make that are secured by a hypothec on immovable property in Indonesia, and from their employment in Indonesia, whatever the duration.³⁶ In practice, however, foreign employees of companies that do not have permanent establishments in Indonesia are exempt from tax even on their Indonesian source income from such employment provided that they are in Indonesia for no more than 183 days during any twelve month period.

The personal income tax is graduated and rates range from 10% to 50%. The income levels to which the various rates apply are fixed from time to time by the Minister of Finance. Under current regulations, the

34. Min. Finance Decree No. KEP 1/PJ/5/1982 dated Jan. 20, 1982, 30 WARTA C.A.F.I. 71 (Mar. 26, 1982).

35. Personal Income Tax Act, art. 1(1).

36. *Id.* art. 2.

50% rate is reached at approximately US \$19,000 of net income.³⁷

Indonesian Residence. The Personal Income Tax Act does not define Indonesian residence but, like the Company Tax Act, provides merely that residence should be determined based on the factual circumstances of each case.³⁸ The key criterion is not nationality but length of stay in Indonesia, although in practice a different test of residence is applied to foreigners than to Indonesian nationals. Commentators generally state that being present in Indonesia continuously for more than twelve months constitutes residence for tax purposes; and that an individual, once resident in Indonesia, remains an Indonesian resident despite foreign travel unless he stays abroad for more than twelve months, in which event he becomes a non-resident as from the date of his departure from Indonesia.³⁹ The Director General of Taxes has adopted the twelve month test of residency, although a foreigner who possesses a temporary resident's visa valid for at least one year may be deemed an Indonesian resident, irrespective of the actual length of his stay.⁴⁰ Also, such foreigner is deemed a non-resident from the date his temporary resident's visa is cancelled if he leaves Indonesia; the fact that he returns to Indonesia on a business trip within twelve months of his departure will not reactivate his residence.

Employment Income. In principle both resident and non-resident foreigners are subject to Indonesian personal income tax on wages, pensions, and other remuneration and benefits derived from an employment in Indonesia (including Indonesia's territorial waters), whatever the duration of employment and irrespective of whether the employer is an Indonesian or foreign person.⁴¹ However, in practice an individual who is employed in Indonesia by a foreign employer for no more than 183 days during any twelve month period is exempt from personal income tax, provided that such employee does not possess a temporary residence visa that is valid for at least twelve months, if his

37. *Id.* art. 8; Appendix to Min. Finance Decree No. 559/KMK.04/1979 dated Dec. 26, 1979 re penetapan penuntun bagi para majikan untuk pemotongan pajak pendapatan, 28 WARTA C.A.F.I. 19 (Jan. 23, 1980); Dir. Gen. Taxes Circular No. SE-25/PJ.62/1980 dated Dec. 30, 1980 re batas pendapatan bebas pajak dan tarip pajak pendapatan tahun 1981, 29 WARTA C.A.F.I. 17 (Jan. 21, 1981).

38. Personal Income Tax Act, art. 1(2).

39. R. SOEMITRO, DASAR² HUKUM PAJAK DAN PAJAK PENDAPATAN 48-49 (7th ed. 1965); R. SOEMITRO, HUKUM PAJAK INTERNASIONAL INDONESIA PERKEMBANGAN DAN PENGARUHNYA 58-59 (1977); B. USMAN & K. SUBROTO, *supra* note 21, at 32-33. See also Simbolon, *Domisili (Pengertiannya dalam B.W. dan Hukum Pajak)*, 442 MINGGUAN BERITA PAJAK 13-16 (July 26, 1976).

40. Dir. Gen. Taxes Circular No. SE-19/PJ.23/1982 dated June 22, 1982 re pelaksanaan penganan PPD dan kewajiban SPT atas pegawai/karyawan asing (expatriate) yang bekerja di Indonesia, 30 WARTA C.A.F.I. 173 (July 30, 1982).

41. Personal Income Tax Act, arts. 1 and 2(e).

employer is non-resident and his remuneration is not borne by the employer's permanent establishment.⁴²

Employers are required to make monthly tax withholdings from wages paid to foreign employees, using rates of withholding that are fixed from time to time by the tax authorities.⁴³ The amount of withholding is in fact frequently negotiated with the tax authorities ahead of time by the employer, based on a deemed package of remuneration which may be lower than actual wages and benefits. For example, foreign employees of foreign drilling companies are deemed to earn monthly wages as negotiated by the International Association of Drilling Companies. The deemed wage varies according to the type of job.⁴⁴

Until 1980 the aggregate amount withheld and remitted to the government by the employer was treated as final payment of personal income taxes due, and the foreign employee was not required to file a separate annual return. However, beginning with the tax year 1980, foreign employees have been required to file an annual return. The amount withheld by the employer is now treated merely as a provisional assessment, with final assessment based on the annual return in which actual wages and benefits must be reported. The foreign employee is required to report all wages and benefits, wherever received, attributable to employment in Indonesia, but is not required to report income received outside Indonesia that is not attributable to Indonesian employment.⁴⁵ To facilitate enforcement, guidelines have been established for tax inspectors respecting the standard wages of typical categories of foreign employees.⁴⁶

Non-Employment Income. Theoretically, any foreigner who resides in Indonesia, whether or not he derives income from employment

42. See Dir. Gen. Tax Circular No. D.15.4/VI/B/1-48/75 dated Nov. 4, 1975; Simbolon, *supra* note 39, at 15-16 (July 26, 1976).

43. Min. Finance Decree No. 559/KMK.04/1979 dated Dec. 26, 1979 re penetapan penuntun bagi para majikan untuk pemotongan pajak pendapatan, 28 WARTA C.A.F.I. 19 (Jan. 23, 1980); Dir. Gen. Tax Circular No. SE-25/PJ.62/1980 dated Dec. 30, 1980; Min. Finance Decree No. 123/KMK.04/1982 dated Feb. 27, 1982, 30 WARTA C.A.F.I. 128 (June 4, 1982).

44. Dir. Gen. Taxes Circular No. SE-10/PJ.2/1981 dated Mar. 28, 1981, 29 WARTA C.A.F.I. 99 (Apr. 28, 1981).

45. Min. Finance Decree No. 559/KMK.04/1979, *supra* note 43, at appendix, para. 15(2)(c); Dir. Gen. Tax Circular No. SE-36/PJ.23/1979 dated Sept. 5, 1980 re penyampaian surat pemberitahuan pajak pendapatan kepada buruh/karyawan asing yang bekerja di Indonesia, 28 WARTA C.A.F.I. 250 (Oct. 25, 1980). See also, Komar, *Tax Return Requirements for Foreign Workers in Indonesia*, 81 TAX MGMT. INT'L J. (BNA) at 44 (1981); *SPT-Pajak Karyawan Asing*, 1981 BINA PAJAK KOMPAS 30 (Mar. 6, 1981); *SPT Karyawan Asing (II Habis)*, 1981 BINA PAJAK KOMPAS 33 (Mar. 31, 1981).

46. Dir. Gen. Taxes Circular No. SE-11/PJ.23/1981 dated Mar. 31, 1981 re pedoman standar gaji-upah karyawan asing tahun² 1981 dan 1982, 29 WARTA C.A.F.I. 107 (May 7, 1981).

in Indonesia, is subject to Indonesian personal income tax on his worldwide non-employment income.⁴⁷ But until 1980, foreigners who were resident in Indonesia by reason of their employment there but who were not permanent residents were taxed only on their income from such employment, and not on their other worldwide income. Beginning with the 1980 tax year, resident foreign employees have also been required to pay personal income tax on that portion of their non-Indonesian source income which is remitted to Indonesia. In practice, however, non-Indonesian source worldwide income of such persons remains exempt.⁴⁸

A non-resident foreigner, regardless of whether he derives income from employment in Indonesia, is subject to Indonesian personal income tax on income derived from an independent trade or business which he conducts in Indonesia, or from immovable property situated in Indonesia which he owns or from any loan which he makes that is secured by a hypothec on Indonesian immovable property.⁴⁹ However, with respect to income derived by a non-resident foreigner from the conduct of a trade or business in Indonesia, the practice is basically the same as for non-resident foreign employees of foreign employers: if the foreigner is present in Indonesia for no more than 183 days during any twelve month period, no tax is payable and no return need be filed as long as the individual does not possess a temporary residence visa valid for at least twelve months and the income is not borne by a permanent establishment in Indonesia.

Exempt Individuals. Non-resident foreign employees of non-resident employers, independent professionals, and non-resident entrepreneurs are all exempt in practice from tax on their Indonesian source income if they work in Indonesia not more than 183 days and their remuneration is not borne by a permanent establishment in Indonesia. Foreign diplomatic and consular personnel are exempt from personal income tax in Indonesia if they conduct no other business there and their sending country extends reciprocal treatment to Indonesian diplomatic and consular personnel. Military personnel and civilian employees of foreign armed services and representatives of international organizations specified from time to time by the Minister of Finance (e.g. UNDP, WHO, IMF) are also exempt.⁵⁰

47. Personal Income Tax Act, art. 1(1).

48. Dir. Direct Taxes Letter No. S-232/PJ.23/1981 dated Feb. 17, 1981 re penegasan atas pengisian SPT Ppd oleh buruh/karyawan asing yang bekerja di Indonesia, 29 WARTA C.A.F.I. 69 (Mar. 23, 1981); Dir. Direct Taxes Letter No. 5-240/PJ.23/1981 dated Feb. 18, 1981 re petunjuk² untuk pengisian SPT asing 1981, 29 WARTA C.A.F.I. 69 (Mar. 23, 1981).

49. Personal Income Tax Act, art. 2.

50. *Id.* art. 9.

Tax Treaties. Under each of Indonesia's tax treaties, an individual can be a resident for tax purposes of only one of the two countries party to such treaty. Residence is first determined with reference to the laws of each party to the treaty. Where an individual is a resident of both, then under the Japanese treaty, the competent authorities of the respective countries must determine residence by mutual agreement, while under the other treaties, the individual is deemed to be a resident only of the country in which he has a permanent home. If he has a permanent home in both countries, then he is deemed a resident only of the country in which his personal and economic interests are greater. If the individual's center of vital interests cannot be determined, then he is deemed to be a resident of the country in which he has an habitual abode. If the individual has an habitual abode in both countries, or in neither, all of the treaties except for the Canadian and Japanese provide that competent authorities of the respective countries must determine residence by mutual agreement. Under the Canadian treaty, an additional test is prescribed before the matter is referred to competent authority: an individual will be deemed to be a resident of the country of which he is a national.⁵¹

Under all of the treaties a foreign resident of Indonesia may be taxed by Indonesia on his worldwide income, and a non-resident may be taxed in Indonesia in respect of remuneration derived from employment in Indonesia. However, the non-resident is not subject to Indonesian tax on such remuneration if he is present in Indonesia for not more than 183 days during any twelve month period (calendar year in the case of the German and Japanese treaties), his remuneration is paid by an employer whose residence is outside Indonesia, and his remuneration is not borne by a permanent establishment or fixed base which the employer has in Indonesia.⁵² A non-resident may not be taxed by Indonesia in respect of any employment exercised aboard a ship or aircraft in international traffic under the Belgian and Dutch treaties. The other treaties provide that remuneration paid to a non-resident in respect of employment exercised aboard a ship or aircraft operated by an Indonesian enterprise (under the Canadian, French, and Japanese treaties), by an enterprise effectively managed in Indonesia (the German treaty), or by an Indonesian resident (the U.K. treaty) may be taxed by Indonesia.⁵³

51. Belgian Treaty, art. 4; Canadian Treaty, art. 4; Dutch Treaty, art. 4; French Treaty, art. 4; German Treaty, art. 3; Japanese Treaty, art. 4; U.K. Treaty, art. 4.

52. Belgian Treaty, art. 15; Canadian Treaty, art. 15; Dutch Treaty, art. 15; French Treaty, art. 15; German Treaty, art. 14; Japanese Treaty, art. 15; U.K. Treaty, art. 16.

53. *Id.*

Personal income earned by any non-resident independent professional may be taxed by Indonesia only if such person has a fixed base regularly available to him in Indonesia for the pursuit of his profession, and then only to the extent that the income is attributable to such fixed base. Income derived by public entertainers and athletes from activities in Indonesia may be taxed by Indonesia regardless of the duration of such activity. Income derived by a teacher from teaching in Indonesia may not be taxed so long as such teacher teaches in Indonesia for a period not exceeding two years, provided, in the case of the German treaty, that the remuneration is derived by the teacher from outside Indonesia, and provided, in the case of the U.K. treaty, that the remuneration is subject to tax in the U.K. Under the Japanese treaty, one is presumed to have a fixed base in Indonesia if one performs activities there for more than 183 days in any calendar year. Under the Canadian, French, and Japanese treaties, income derived in Indonesia under governmental cultural exchange programs or visits substantially supported by public funds is exempt from Indonesian tax.⁵⁴

III

INTEREST, DIVIDEND, AND ROYALTY TAX (PAJAK ATAS BUNGA, DIVIDEN, DAN ROYALTY)

Indonesia imposes withholding taxes on gross payments of interest, dividends, and royalties. The normal rate of withholding is 10% on interest and 20% on dividends and royalties. In the absence of any tax treaty provision to the contrary, "dividends" and "royalties" are broadly interpreted to include numerous payments not ordinarily thought of as dividends and royalties, including branch office profit remitted to a head office abroad and fees for consulting services furnished abroad. Indeed, some commentators state that virtually any payment abroad which includes a profit component for the payee is subject to tax.

A. Interest Tax

Indonesia imposes an interest withholding tax on "earnings," particularly interest, derived by foreign (and domestic) creditors from "cash loans" to certain categories of debtors in Indonesia.⁵⁵ The tax is

54. Belgian Treaty, arts. 14, 17, and 20; Canadian Treaty, arts. 14, 17; Dutch Treaty, arts. 14, 17, and 20; French Treaty, arts. 14, 17, and 21; German Treaty, arts. 13, 16, and 19; Japanese Treaty, arts. 14, 17, and 20; U.K. Treaty, arts. 15, 18, and 21. The Canadian Treaty contains no special provision respecting teachers.

55. Interest, Dividend and Royalty Tax Act, art. 1a.

withheld at the time of payment of the interest.⁵⁶ The debtor-payor is liable for the tax, even though it is charged against and withheld from the payment of interest, and failure to pay the tax results in an overdue tax liability for the debtor, not the creditor.⁵⁷ Recently the tax authorities have taken the position that Indonesian branches of certain foreign banks can be held responsible to the government for non-payment of interest withholding tax by customers of the foreign bank.⁵⁸ The credit agreement may require the debtor to gross up the interest payment so that the net amount received by the creditor equals what it would have received if there had not been any withholding.⁵⁹

Rate of tax. The statutory rate of withholding is 20%.⁶⁰ However, the rate has been reduced by administrative decree to 10% for all "foreign credits" (*kredit luar negeri*) regardless of the duration of the credit (short-term or long-term) or the nature of the creditor (bank, financial institution, or other).⁶¹ The relevant decree does not define the term "foreign credit." However, the term has been defined by the Minister of Finance in another context to mean any borrowing, including a domestic borrowing, which gives rise, or may give rise to an obligation to make payments abroad in foreign or domestic currency.⁶² It seems that any loan by a foreign bank, whether booked in an offshore or onshore branch, is a foreign credit irrespective of its currency, and therefore interest paid in connection with such loan is eligible for the lower withholding rate.

The maximum rate of withholding tax on interest permitted under the tax treaties is 20% in the case of the Dutch Treaty, 15% in the case of the Belgian, Canadian, French, and U.K. Treaties and 10% in the case of the German and Japanese Treaties.⁶³ However, the Belgian, Dutch, French, and U.K. Treaties provide for a maximum rate of only

56. *Id.* arts. 5(2) and 6; Dir. Gen. Taxes Circular No. SE-17/PJ.222/1980 dated Apr. 14, 1980 re penegasan mengenai saat terhutang PBDR, 28 WARTA C.A.F.I. 111 (May 12, 1980).

57. *Id.* arts. 10, 24.

58. Dir. Gen. Taxes Letter No. S-443/PJ.22/1982 dated Apr. 5, 1982.

59. Interest, Dividend and Royalty Tax Act, Art. 5(4).

60. *Id.* art. 5(1).

61. Min. Finance Decree No. Kep.502/MK/11/7/1973 dated July 3, 1973 re pemberian fasilitas perpajakan untuk bunga kredit luar negeri, 21 WARTA C.A.F.I. 157 (July 9, 1973); Dir. Gen. Taxes Circular No. D.15.4/D.2/1-35/1973 dated July 26, 1973 re pelaksanaan S.K. 502/1973; BAPENEK, PAJAK ATAS BUNGA, DIVIDEN DAN ROYALTY-1981 50 (1981); Dir. Gen. Taxes Letter No. D.15.4/II/D2/1-15/75 dated May 14, 1975 re PBDR atas bunga kredit luar negeri, 23 WARTA C.A.F.I. 139 (July 17, 1975); Usman, *Kredit Luar Negeri, 1973-1974-1975 KUMPULAN KARANGAN PAJAK SINAR HARAPAN* 167 (July 17, 1975).

62. Min. Finance Decree No. 261/MK/IV/5/73 dated May 3, 1973, 21 WARTA C.A.F.I. 117 (May 22, 1973).

63. Belgian Treaty, art. 11; Canadian Treaty, art. 11; Dutch Treaty, art. 10; French Treaty, art. 11; German Treaty, art. 10; Japanese Treaty, art. 11; U.K. Treaty, art. 12.

10% where the creditor is a bank or financial institution (or other enterprise in the case of the Dutch, French, and U.K. Treaties) and the debtor is a bank or financial institution or an enterprise engaged in agriculture, plantations, forestry, fishery, mining, manufacturing, transportation, non-luxury housing, tourism, or infra-structure (or other fields of production in the case of the Dutch Treaty). The German and U.K. Treaties exempt interest paid on government-to-government credits from any interest withholding tax. The Japanese treaty exempts from interest withholding tax interest paid by an Indonesian borrower to a Japanese government owned financial institution or to a private entity resident in Japan if the underlying debt has been guaranteed by a Japanese government owned financial institution. Both the Canadian and French treaties also exempt interest paid to the Canadian and French governments, respectively, a statutory body or political subdivision thereof (as well as the Export Development Corporation in the case of the Canadian treaty), and to an enterprise of each of the foreign countries on loans or credits granted with the participation of a financing public institution and with the consent of the Indonesian government in connection with the sale of any industrial or scientific equipment or with the installation, supply or survey of industrial or scientific premises or public works. Finally, in the case of the German treaty, interest paid by an Indonesian borrower to the Deutsche Bank and the Kreditanstalt für Wiederaufbau is exempt from Indonesian withholding tax.

Subject Debtors. The interest withholding tax is payable only on interest payments for cash loans to the following categories of debtors: (i) entities domiciled and doing business in Indonesia, (ii) individuals residing and doing business in Indonesia, (iii) permanent establishments doing business in Indonesia, or (iv) the central government or a provincial government. Thus interest on mere personal loans or loans to charitable foundations would not be subject to tax because the borrower, even if domiciled or resident in Indonesia, is not "doing business" there.⁶⁴

What Constitutes a Cash Loan. The interest withholding tax is payable only on interest payments by specified categories of debtors, and then only if such interest is paid in connection with "cash loans" (*pinjaman uang*). The Interest, Dividend and Royalty Tax Act does not define "cash loan," but use of the relatively narrow term "cash loan" as

64. Interest, Dividend and Royalty Tax Act, art. 1a. See also Usman, *Pajak Atas Bunga*, 1973-1974-1975 KUMPULAN KARANGAN PAJAK SINAR HARAPAN 155, (June 5, 1975); B. USMAN & K. SUBROTO, *supra* note 21, at 110-111.

opposed to the broader term "loan" (*pinjaman*) or "credit" (*kredit*) suggests that only cash borrowings involving actual cash receipts by the debtor were intended. Nevertheless commentators are generally of the view that the term "cash loan" should be broadly interpreted to mean credit in the widest sense, including supplier credits and even in-kind borrowings.⁶⁵ In practice, although the tax authorities have not yet interpreted the term to cover credit in-kind, they have sometimes given it a broad meaning that includes deferred payment supplier credits and the discounting of commercial paper. Certainly the typical commercial bank loan or purchase of interest bearing promissory notes constitutes a cash loan within the meaning of the Act.

What Constitutes Interest. The Act imposes withholding tax on "earnings" (*hasil*) in any form which is derived from loans to specified categories of borrowers. While interest is the most obvious type of earning covered, it is clear that other interest-like payments in connection with loans are also subject to interest withholding tax; loan syndication fees and other loan-related fees are prime examples. An interesting question is whether such fees are eligible for the reduced 10% rate of withholding that clearly applies to "interest." Whereas the 20% withholding tax is imposed on all "earnings" in whatever form derived from loans, the 10% concessionary rate is available only with respect to "interest on foreign credits." Recently the tax authorities have taken the position with respect to some borrowings that loan syndication fees are not "interest" within the meaning of the concessionary rate decree and are therefore subject to withholding at the higher 20% rate. This position is unwarranted. The focus of the concessionary rate decree was clearly on "foreign credit," and the reference to interest was intended merely to identify the interest withholding portion of the Act as opposed to the dividend or royalty withholding portion; it was not intended to distinguish between interest and other types of loan related earnings.

Exemptions from Interest Tax. Several exemptions from interest withholding tax have been created by the Act or by administrative decree although, as will be noted, some of the statutory exemptions have been ignored in practice.

The Act exempts all interbank loans from withholding tax. It provides without qualification that withholding tax "shall not be assessed

65. B. USMAN & K. SUBROTO, *supra* note 21, at 111; Kompas, *Pajak atas Bunga, Dividen dan Royalty (v habis)*, 1978 KUMPULAN BINA PAJAK KOMPAS 153, 154 (Dec. 2, 1978); Kompas, *Bunga, Dividen dan Royalty menurut Undang² PBRD 1970, 1976-1977 KUMPULAN BINA PAJAK KOMPAS 74, 75 (Aug. 6, 1976).*

against earnings obtained by a bank arising from claims against another bank.”⁶⁶ Nevertheless, in practice the tax authorities distinguish between interbank loans where the creditor bank is subject to company tax and interbank loans where it is not. Where the creditor bank is domiciled in Indonesia and subject to Indonesian company tax on its Indonesian source income, the tax authorities take the position that the exemption does not apply and that withholding tax is due on all payments of interest, including interest payments to affiliated banks and branches abroad.⁶⁷

The Act exempts from withholding tax interest payable on loans obtained from a government.⁶⁸ Thus, for example, there is no interest withholding tax applicable to loans from foreign export credit agencies.

Interest payments that are disallowed as a business expense for company tax purposes are also exempt, since such payments will in principle be subject to company tax due to non-deductibility of the payment.⁶⁹ Although most interest payments are deductible for company tax purposes, the Company Tax Act provides that interest is not a deductible business expense where, because it is being paid to a foreign creditor that directly or indirectly owns more than 50% of the debtor, such interest is not bargained for at arm's length.⁷⁰ The mere fact that the creditor owns a controlling interest in the debtor does not result in disallowance of a deduction (and therefore exemption from interest withholding tax). In addition to having the requisite ownership interest in the debtor, the creditor must be charging a non-market rate of interest which he would otherwise not be able to charge.

The Minister of Finance has exempted from withholding tax interest earned on negotiable commercial paper, including promissory notes, bills of exchange, and drafts which are traded in a money market.⁷¹ However, the exemption does not apply to interest paid to or for the benefit of a foreigner where such foreigner is not subject to Indonesian company tax on such interest income. Thus, for example, a promissory note on which interest accrues payable to a foreign bank would be subject to withholding tax on payments of interest.

66. Interest, Dividend and Royalty Tax Act, art. 4(2).

67. Dir. Gen. Taxes Letter No. D.15.4/II/D2/1-35/1974 dated Nov. 26, 1974 re penerapan pasal 36 huruf b undang² PBDR 1970; BAPENEK, *supra* note 61, at 148.

68. Interest, Dividend and Royalty Tax Act, art. 4(1).

69. *Id.* art. 4(4). The same rule applies to royalty payments. See discussion *infra* note 85.

70. Company Tax Act, art. 5(2) (iii).

71. Min. Finance Decree No. 335/MK/II/4/1975 dated Apr. 1, 1975 re penegasan tentang tidak dipungutnya pajak atas bunga, dividen dan royalty untuk bunga yang diperoleh dari promes, aksep, wesel dan surat berharga, 23 WARTA C.A.F.I. 85 (Apr. 14, 1975); Dir. Direct Taxes Circular No. SE-20/PJ.222/1980 dated May 9, 1980 re penjelasan lebih lanjut mengenai kebijaksanaan perpajakan, 28 WARTA C.A.F.I. 189 (Aug. 15, 1980).

The Minister of Finance has also exempted from interest withholding tax interest paid on rupiah time deposits of one month or longer placed with banks in Indonesia by a resident individual or company, including foreign residents. But time deposits denominated in foreign currencies or owned by non-residents are not exempt.⁷²

Eurodollar bonds of the Indonesian government placed in London and floating rate notes of the Indonesian government traded on an international market are exempt from withholding tax,⁷³ as are checking accounts, call money, and call deposits in any currency owned by resident individuals or companies,⁷⁴ certain savings schemes,⁷⁵ and bank certificates.⁷⁶

B. Dividend Tax

Indonesia imposes a dividend withholding tax on dividend income derived from companies in Indonesia.⁷⁷ The statutory rate of withholding is 20%.⁷⁸ The maximum allowable rate under the Dutch, French, German, Japanese, and U.K. treaties is 10% in the case of dividends paid by an Indonesian company to a company that holds directly (or indirectly, under the U.K. treaty, or beneficially, under the Japanese treaty) at least one-quarter of the capital (voting shares, in the case of the Japanese treaty, and voting power under the U.K. treaty) of the company paying the dividends. The Dutch treaty requires that the dividend income *not* be subject to tax in the Netherlands, while the U.K. treaty requires that the dividend income *be* subject to tax in the United Kingdom, for the ceiling to apply. Otherwise, the maximum allowable rate is 20% in the case of the Dutch treaty and 15% in the case of the

72. Min. Fin. Decree No. 210/MK/11/4/1973 dated Apr. 12, 1973 re peninjauan kembali pemungutan PBDR dan pajak kekayaan atas deposito berjangka dan bunganya, B. BOEDIONO, PBDR 167 (1977); as supplemented by Min. Finance Decree No. 489/MK/II/4/1974 dated Apr. 9, 1974, 22 WARTA C.A.F.I. 86 (Apr. 16, 1974); Min. Finance Letter No. S-927/MK.04/1979 dated Nov. 26, 1979, 28 WARTA C.A.F.I. 113 (May 14, 1980) and Min. Finance Letter No. S-291/MK.04/1980 dated Apr. 7, 1980; BAPENEK, *supra* note 61, at 357; Dir. Direct Taxes Circular No. SE-20/PJ.222/1980 dated May 9, 1980 re penjelasan lebih lanjut mengenai kebijaksanaan perpajakan, 28 WARTA C.A.F.I. 189 (Aug. 15, 1980).

73. Min. Finance Decree No. 111/KMK.04/1982 dated Feb. 19, 1982; Min. Finance Decree No. 350/KMK.04/1982 dated May 22, 1982.

74. Min. Finance Decree No. Kep-634/MK/II/10/1970 dated Oct. 9, 1970 re pengecualian hasil jasa giro dari PBDR; BAPENEK, *supra* note 61, at 37 (1981); as supplemented by Min. Finance letter No. S-291/MK.04/1980 dated Apr. 7, 1980, *id.*, at 357; Dir. Gen. Taxes Circular No. SE-20/PJ.222/1980 dated May 9, 1981, 28 WARTA C.A.F.I. 189 (Aug. 15, 1980).

75. Min. Finance Decree No. Kep-615/MK/II/8/1971 dated Aug. 12, 1971, B. BOEDIONO, PBDR 159 (1977); Dir. Gen. Taxes Circular No. SE-20/PJ.222/1980 dated May 9, 1981, 28 WARTA C.A.F.I. 189 (Aug. 15, 1980).

76. Min. Finance Decree No. Kep.815/MK/II/8/1973 dated Aug. 14, 1973, B. BOEDIONO, PBDR 176 (1977); Dir. Gen. Taxes Circular No. SE-20/PJ.222/1980, *supra* note 75.

77. Interest, Dividend and Royalty Tax Act, art. 1b and 1c.

78. *Id.* art. 5(1).

French, German, Japanese, and U.K. treaties. The maximum allowable rate under the Belgian treaty and Canadian treaty is 15% irrespective of the percentage of shares owned.⁷⁹

What Constitutes Dividends. Dividend income is income (1) from shares or other participations in the profit of companies domiciled in Indonesia, whose capital is wholly or partly divided into shares, such as limited liability companies or (ii) from membership or other rights of participation in profits of entities whose capital is not divided into shares but which are nevertheless subject to company tax under the Company Tax Act, such as partnerships.⁸⁰

Indirect distributions of profit, by whatever name, as well as direct distributions, also constitute dividend income. This would include a distribution in a liquidation proceeding to the extent that it exceeds paid-in capital, a distribution of bonus shares or a registration of additional capital for which there has not been a corresponding capital contribution, and a payment by a company to its shareholder to repurchase capital stock to the extent that the amount of such payment exceeds the shareholder's capital contribution for the shares being repurchased.⁸¹

Remittance of Branch Office Profits. The remittance abroad of profit earned by a branch office or other permanent establishment in Indonesia is also deemed by the tax authorities to be a dividend payment within the meaning of the Act and therefore subject to dividend withholding tax.⁸² Arguably, the general limitations on dividend withholding rates set forth in the tax treaties discussed above do not apply to remittances of profit by permanent establishments. Such remittances, in the absence of any other treaty provision to the contrary, are therefore subject to the statutory rate of 20% rather than to the lower treaty rates. However, the treaties do separately provide for lower maximum rates or dividend tax exemptions on the remittance of profit by permanent establishments. The rate is 15% in the case of Belgium and Canada, 10% in the case of France and the Netherlands and exemption from tax in the case of Germany, Japan, and the United

79. Belgian Treaty, art. 10; Canadian Treaty, art. 10; Dutch Treaty, art. 9; French Treaty, art. 10; German Treaty, art. 9; Japanese Treaty, art. 10; U.K. Treaty, art. 11.

80. Interest, Dividend and Royalty Tax Act, art. 1b and 1c.

81. *Id.* art. 3a.

82. *Id.* art. 3b; Dir. Gen. Taxes Circular No. D 15.4/II/ D2/1-35/1974 dated Nov. 26, 1974, BAPENEK, *supra* note 61, at 148 (1981). See also B. USMAN & K. SUBROTO, *supra* note 21, at 113; Kompas, *Pasal 3-b Undang-undang PBDR 1970*, 1980 BINA PAJAK KOMPAS 74, 75-76 (June 6, 1980); Kompas, *Penerapan Pasal 3-b ayat b undang² PBDR 1970*, 1976-1977 KUMPULAN BINA PAJAK KOMPAS 37-38 (May 14, 1976).

Kingdom.⁸³

C. Royalty Tax

Indonesia imposes a withholding tax on royalty income arising in Indonesia.⁸⁴ The statutory rate of withholding is 20%, although the Minister of Finance has occasionally established special lower rates for certain royalties such as foreign flag vessel charterhire.⁸⁵ Also, the tax treaties set the maximum rate below 20%. The maximum allowable rate is 10% under the Belgian, French, German, Japanese, and U.K. treaties, provided that, in the case of the U.K. Treaty the royalty income is taxed in the United Kingdom and the recipient is a resident thereof. The maximum allowable rate under the Dutch treaty is (i) 10% if the royalty is for the use of, right to use, or copyright of scientific work, industrial, commercial, or scientific equipment, or information concerning scientific experience; (ii) 5% if the royalty is for the use of, or right to use, inventions or discoveries in the field of technology and industry (e.g. patent, trademark, design or model, plan, secret formula or process) or for information concerning experience with respect to production and sale; (iii) 20% in any other case. The maximum allowable rate under the Canadian Treaty is 15%,⁸⁶ provided that the royalties are taxable in Canada.

What Constitutes Royalties. Royalty income is defined by the Act to mean a payment of any kind received as a consideration for (i) the use of or the right to use a patent, license, trademark, design or model, plan, trade secret, process, or copyright, (ii) the use of or right to use industrial, commercial, and scientific equipment, and (iii) materials and information concerning commerce and investment generally, and industrial, commercial and scientific experience in particular.⁸⁷

This definition of royalty income has been broadly construed by the tax authorities and by commentators. For example, the Director General of Taxes has ruled that payments of management fees and technical assistance fees for management services or technical advisory services constitute royalties—apparently because they are payments for

83. Belgian Treaty, art. 10(6); Canadian Treaty, art. 10(6); Dutch Treaty, arts. 9(7), 7, and Protocol; French Treaty, art. 10(6); German Treaty, art. 9(6)-(7); Japanese Treaty, art. 10(4)-(5); U.K. Treaty, art. 11(7)-(8).

84. Interest, Dividend and Royalty Tax Act, art. 1d.

85. *Id.* art. 5(1). The rate for foreign flag voyage charter hire is 3%, for time charter hire 2½% and for bareboat charter hire 2%. Dir. Gen. Taxes Circular No. SE-08/PJ.222/1979 dated Apr. 11, 1979 re PBDR atas laba/hasil yang diperoleh dari kapal asing yang beroperasi di Indonesia, 27 WARTA C.A.F.I. 100 (Apr. 30, 1979).

86. Belgian Treaty, art. 12; Canadian Treaty, art. 12; Dutch Treaty, art. 11; French Treaty, art. 12; German Treaty, art. 11; Japanese Treaty, art. 12; U.K. Treaty, art. 13.

87. Interest, Dividend and Royalty Tax Act, art. 3c.

“industrial, commercial or scientific experience.”⁸⁸ One commentator has argued that a payment to a ship repair company abroad for the repair of a vessel abroad is a royalty, and that a payment to a foreign computer service for processing data of an Indonesian company is a royalty—also on the theory that such payments are for industrial, commercial, and scientific experience.⁸⁹

The right to use industrial, commercial, and scientific equipment has also been broadly construed to cover rental payments for the lease of many kinds of equipment from abroad and charterhire for the chartering of vessels from foreign ship owners.⁹⁰

Deemed Royalties. In recent years the tax authorities have decreed that Indonesian companies which are licensed to manufacture or distribute certain products under foreign patents or trademarks will be deemed to be paying the foreign patent or trademark licensor a patent and trademark royalty, and will therefore be liable to pay royalty withholding tax, even though the parties have no written agreement providing for payment of a patent or trademark royalty. The assumption is that a portion of the purchase price paid by the Indonesian company to the foreign company for the goods themselves or for foreign components is in reality a royalty payment. In 1979, for example, the Director General of Taxes ruled that Indonesian manufacturers of foreign soft drinks shall be deemed to be paying the foreign owner of the soft drink trademark a royalty equal to 25% of the price paid for soft drink concentrate, and therefore a royalty withholding tax is payable equal to 5% (.20 x .25) of the concentrate purchase price.⁹¹ Similarly, in 1980 the Director General ruled that an Indonesian manufacturer of foreign cosmetics and pharmaceuticals shall be deemed to be paying to the foreign company a patent and trademark royalty equal to 3% of the wholesale purchase price of the goods, and that therefore royalty with-

88. Dir. Gen. Taxes Letter No. D.15/4/II/B/19-32/1976 dated Sept. 16, 1976 re PBDR atas management fee, BAPENEK, *supra* note 61, at 209 (1981); Kompas, *supra* note 82, at 38-39 (May 14, 1976); Harapan, *Pengertian Royalty, 1976-1977 KUMPULAN PAJAK SINAR HARAPAN 352-355* (10 Feb. 1977). See also Kompas, *Pajak atas Bunga, Dividen dan Royalty, 1976-1977 KUMPULAN BINA PAJAK KOMPAS 46, 49* (June 5, 1976).

89. Kompas, *supra* note 65, at 155 (Dec. 2, 1978).

90. Dir. Gen. Taxes Circular No. SE-5/PJ.22/1978 dated Feb. 23, 1978 re PBDR atas laba/hasil yang diperoleh dari kapal asing yang beroperasi di Indonesia, BAPENEK, *supra* note 61, at 279 (1981); Dir. Gen. Taxes Circular No. SE-08/PJ.222/1979 dated Apr. 11, 1979, 27 WARTA C.A.F.I. 100 (Apr. 30, 1979). See also Sinar Harapan, *Persoalan Pajak Royalty, 1976-1977 KUMPULAN PAJAK SINAR HARAPAN 493-496* (Sept. 1, 1977).

91. Dir. Gen. Taxes Circular No. SE-03/PJ.222/1979 dated Feb. 1, 1979 re royalty atas hak penggunaan merk dagang industri minuman ringan, 27 WARTA C.A.F.I. 77 (Apr. 2, 1979); Dir. Gen. Taxes Circular No. SE 09/PJ.222/1979 dated Apr. 12, 1979, 27 WARTA C.A.F.I. 134 (June 9, 1979).

holding tax is due equal to 0.6% (.20 x .30) of such price.⁹²

Similar regulations have also been issued with respect to other products, including motor vehicles,⁹³ motorcycles,⁹⁴ industrial electronic equipment,⁹⁵ and household electronic equipment.⁹⁶ All of the deemed royalty regulations have been made retroactive for a period of one or more years, as set forth in the relevant regulation.

Exemptions from Royalty Tax. The Act provides that a royalty payment shall be exempt from withholding tax if it is disallowed as a business expense deduction for company tax purposes, because the payment will already have been subject to company tax by reason of the non-deductibility of the payment.⁹⁷

Although most royalty payments are in fact deductible for company tax purposes, such payments are not deductible where the payments are made pursuant to a non-arms length transaction—either because the payments are made to a foreign person that owns more than 50% of the payor, or for any other reason.⁹⁸ In other words, royalty withholding tax will not be assessed where the amount or method of calculating the royalty is different than it would have been if the royalty were determined in accordance with general customs and practices in the relevant industry where no special relationship exists between the parties.

The mere fact that the recipient owns more than 50% of the payor will not automatically trigger a disallowance of the deduction and an exception from withholding tax, but it will create a presumption to that effect. The Director General of Taxes has established informal guidelines for determining when royalty payments will be deductible, the general rule being that only reasonable royalty payments are deductible by the payor.⁹⁹ What is reasonable can vary, but as a rule of thumb royalty payments to a shareholder are deductible for company tax pur-

92. Dir. Gen. Taxes Circular No. SE-27/PJ.222/1980 dated Aug. 19, 1980 re royalty atas penggunaan hak merk dagang dan patent industri kosmetika, 28 WARTA C.A.F.I. 227 (Sept. 29, 1980); Dir. Gen. Taxes Circular No. SE 31/PJ-222/1979 dated Oct. 17, 1979 re royalty atas penggunaan hak merek dagang/patent industri farmasi, 27 WARTA C.A.F.I. 268 (Nov. 19, 1979).

93. Dir. Gen. Taxes Circular No. SE-7/PJ.222/1981 dated Mar. 14, 1981, 29 WARTA C.A.F.I. 90 (Apr. 16, 1981).

94. Dir. Gen. Taxes Circular No. SE-12/PJ.222/1981 dated Apr. 2, 1981, 29 WARTA C.A.F.I. 116 (May 18, 1981).

95. Dir. Gen. Taxes Circular No. SE-8/PJ.222/1981 dated Mar. 14, 1981, 29 WARTA C.A.F.I. 90 (Apr. 16, 1981).

96. *Id.*

97. Interest, Dividend and Royalty Tax Act, Art. 4.(4). The same rule applies to interest payments. See *supra* note 69.

98. Company Tax Act, art. 5(2)(iii).

99. Dir. Gen. Taxes Circular No. D/15.4/II/D.2/1-9/74 dated Jan. 30, 1974, R. SOEMITRO, VI PERUNDANG-UNDANGAN PAJAK INDONESIA 344 (1976).

poses only to the extent they do not exceed annually 2% of net sales. Royalty payments to an unaffiliated third party are deductible for company tax purposes only to the extent that they do not exceed 5% of net sales.

IV SALES TAX (PAJAK PENJUALAN)

Indonesia imposes a so-called sales tax on the delivery in Indonesia of specified goods and services by certain persons at rates currently ranging from 1% to 20% of the sales price.¹⁰⁰ Three kinds of sales taxes are charged, none of which is strictly analogous to the traditional turnover tax. These are the domestic goods sales tax, the imported goods sales tax, and the services sales tax.

Domestic Goods. This is a tax on the sale by domestic manufacturers (broadly defined to include producers and processors) of tangible, movable goods that are locally produced, processed, or manufactured.¹⁰¹ The tax is charged only on sales by the manufacturer, and thus is levied only at the factory level; sales by wholesale distributors or retail distributors are not subject to tax. It is payable by the manufacturer monthly, based on gross sales for the relevant period, and is usually charged to the customer in the form of a surcharge on the sales price. Sales by hire purchase contract or installment contract, as well as outright sales, are subject to the tax. In principle the tax is charged on goods manufactured for export, as well as for domestic consumption; however, the sales of certain export goods are exempt.

Imported Goods. Indonesia places a sales tax on the importation of foreign goods.¹⁰² It is paid by the importer at the time the goods are cleared through customs and is administered by the Directorate of Customs. It is, in effect, a kind of import duty, although separate import duties may also be payable. The tax is based on the c.i.f. value of the

100. Sales Tax Act. Due to the general nature of this discussion, specific sections of the Act will not be cited in the discussion. Rates applicable to particular goods and services are fixed from time to time by decrees of the Minister of Finance and the Director General of Taxes.

101. Under current regulations, the general sales tax rate on domestic goods is 10%. In addition, there are special rates of 0%, 1%, 2½%, 5%, 7½%, and 20%. Goods classified as "very essential" are subject to 0% rates. Goods classified as "essential" and "semi-essential" are subject to the 1, 2½, 5, or 7½ percent rates. Luxury goods are subject to the 20% rate. Goods not specifically classified in one of the foregoing classifications are subject to the 10% rate. The master decree governing current classification is Min. Finance Decree No. 175 KMK.04/1979 dated Apr. 19, 1979, 27 WARTA C.A.F.I. 103 (May 3, 1979). There are also numerous subsequent modifications.

102. Under current regulations, sales tax rates on imported goods are 0%, 5%, 10%, and 20%. As a general rule the rate applicable to a particular category of imported goods is higher than the rate applicable to the equivalent category of domestic goods, although there are exceptions.

goods, plus any import duties assessed, plus a deemed profit for the importer (usually 5%).¹⁰³

In recent years the Government has established so-called check prices for a wide range of imported goods. Under the check price system, the higher of the check price or declared c.i.f. value is used as the base for determining customs duties and import sales tax. The check prices are revised periodically.

Services. This is a tax on the sale of specified services performed in Indonesia, including the services of most professionals, business intermediaries and contractors.¹⁰⁴ The tax is generally paid by the one who performs the service, but is charged to the recipient of the services. The amount of the tax must be remitted to the government within ten days after the end of the month in which the invoice is paid.

The key for determining whether tax is due is where the services are performed. If they are performed in Indonesia (including the territorial waters of Indonesia), then services sales tax is payable. It is irrelevant whether or not the one who renders the service is resident in Indonesia, the contract is made or payment effected there, or the currency of payment is Indonesian.

In the case of chargeable services some or all of which are subcontracted to third parties, sales tax will be payable twice: once on the invoice to the main contractor, and again on the invoice to the subcontractor.

Special rules have been devised for certain categories of foreign contractors, and for foreign contractors on certain specified projects, under which sales tax is withheld by the recipient of the services at the time of payment of the invoice and then remitted to the government. For example, in the case of certain LNG and refinery expansion projects for Pertamina, the Director General of Taxes has decreed that Pertamina shall withhold a specified percentage of each payment to the

103. For example, if the importation of particular goods is subject to a sales tax of 2½%, if the c.i.f. value of the goods is 1,000, and if customs duties are 20%, then the amount of the import sales tax would be 31.50, as follows:

c.i.f. value	1000
customs duties (20%)	<u>200</u>
Total	1200
Deemed profit (5%)	<u>60</u>
Total	1260

Sales tax (2½% × 1260) = 31.50

104. Notaries, lawyers, consultants, accountants, administrators, brokers, commission agents, auctioneers, contractors (except of food and foodstuffs), planners, maintenance and repair businesses, health care businesses, insurance (except transport) businesses, lessors of movable goods, lessors of immovable property (except housing), advertising and public relations businesses, laundries, and travel agencies are covered. The applicable rate is currently 2½%.

main contractor as a services sales tax. The amount withheld is in addition to any prescribed withholdings for company or other taxes.¹⁰⁵

V

STAMP DUTIES (BEA METERA)

Indonesia imposes stamp duties, some at hefty ad valorem rates based on the value of the underlying transaction, on most documents and documentary transactions. The penalties for failure to stamp are severe. Heavy fines may be assessed,¹⁰⁶ and unstamped documents are not admissible as evidence in an Indonesian court. Also, notaries and other government officials are prohibited from citing unstamped documents in official governmental papers and correspondence.

The following discussion identifies the most important types of documents and documentary transactions subject to ad valorem duties and examines when such documents executed abroad will become subject to such duties in Indonesia.

Foreign Documents Generally. The general rule, set forth in Article 27 of the Stamp Duty Act, is that any document signed abroad which, if signed in Indonesia, would have been subject to stamp duty, must be stamped before it is "first used" in Indonesia for any of the purposes described in articles 15, 16, 17, and 19 of the Act. These provisions prohibit judges, court clerks, notaries and government officials from considering, giving opinions in connection with, executing documents which make mention of, writing upon, legalizing, filing, or registering unstamped documents. Thus, for example, any document signed abroad would have to be stamped before it could be admitted into evidence in an Indonesian court.

In addition to the general rule, there are special rules respecting the stamping of certain specified documents signed abroad (e.g. rental agreements). The most important of these special rules are discussed below.

105. Dir. Gen. Taxes Decree No. 5-33/PJ.531/1980 dated May 21, 1980, 28 WARTA C.A.F.I. 181 (Aug. 4, 1980).

106. Article 22 of the Stamp Act authorizes fines of up to 100 times the applicable duty. However, the Minister of Finance has determined that the maximum fine for non payment of ad valorem duties shall be 20% of such duty, and for fixed duties two times the duty. Min. Finance Decree No. 191/KMK. 04/1979 dated Apr. 28, 1979 re penyederhanaan sanksi sanksi administratif di bidang perpajakan, 27 WARTA C.A.F.I. 109 (May 10, 1979). Further, the various District Chiefs of the Directorate General of Taxes have discretionary authority to reduce any fine to not less than 10% of the applicable duty. Dir. Gen. Taxes Decree No. 204/PJ-33/1980 dated Apr. 9, 1980 re pelimpahan wewenang kepada para kepala kantor wilayah Dir. Gen. Pajak untuk meninjau dan menetapkan kembali ketetapan denda dimaksud pada pasal 22B aturan Bea Meterai, 28 WARTA C.A.F.I. 170 (July 22, 1980).

Rental Agreements. Article 74 of the Stamp Duty Act provides that rental agreements respecting property located in Indonesia shall be subject to duty at the rate of .1% of the total rent. If the period of the rental agreement is more than one year, the duty is based on the rent payable for the entire term. The duty is applicable to agreements for the rental of movable property as well as immovable property and is payable at the time the agreement is signed. If the rental agreement is signed abroad, however, the duty must be paid within four months of signing.

Certain agreements involving the payment of rent are not deemed to be rental agreements within the meaning of the Act and therefore are not subject to duty as rental agreements. For example, rental agreements with licensed lease finance companies which are in reality lease financing agreements in which the lessee is entitled to purchase the leased goods at the end of the lease term for residual value are treated as credit agreements rather than rental agreements and are subject to stamping under the (usually ad valorem) provisions of the Act applicable to credit agreements. However, unlike credit agreements, lease financing agreements are subject to a maximum duty of only 5,000 rupiahs.¹⁰⁷ Voyage and time charters of vessels are also not regarded as rental agreements for purposes of the Act.¹⁰⁸ Rental agreements with the Government as lessee are exempt from duty.¹⁰⁹

Contractors' Contracts. Article 56 of the Stamp Duty Act provides that a contractor's contract with the Government, such as a construction or turn-key contract, is subject to stamp duty at a rate equal to .1% of the contract price. Payment is the responsibility of the contractor and must be effected by the date on which the first downpayment, installment payment, or other first payment of the contract price is made.¹¹⁰ The contract may shift this burden and provide for payment of the duty by the Government, but the contractor remains liable to the extent the duty is unpaid.

107. Min. Finance Decree No. 650/MK/II/5/74 dated May 6, 1974 re penegasan ketentuan pajak penjualan dan besarnya bea meterai terhadap usaha leasing, 22 WARTA C.A.F.I. 111 (May 15, 1974); Dir. Gen. Taxes Circular No. 15.4/III/4-1/1974 dated May 11, 1974 re penegasan ketentuan pajak penjualan dan besarnya bea meterainya terhadap usaha leasing, 22 WARTA C.A.F.I. 119 (May 25, 1974). The ad valorem duty provisions applicable to credit agreements are discussed *supra* at notes 99-105.

108. Usman, *Bea Meterai Kontrak Sewa, 1973-1974-1975 KUMPULAN KARANGAN PAJAK SINAR HARAPAN* 206 (Dec. 4, 1975); SOEDONO POERWODIHARDJO, *ATURAN BEA MATERAI* 84 (1965).

109. Stamp Act, art. 75(5).

110. Dir. Gen. Taxes Letter No. S-722/PJ.33/1980 dated June 19, 1980 re bea meterai pemborongan sesuai dengan Kepres 14A/1980, 29 WARTA C.A.F.I. 1 (Jan. 2, 1981).

The Act does not clarify what is meant by the "Government" and whether contracts between a private contractor and a state enterprise such as Pertamina (the state oil company) are subject to the duty. The better view is that contracts with state enterprises that are legal entities distinct from the Government, such as Pertamina, are not subject to duty.¹¹¹

Credit Agreements. Article 73a of the Act provides that any document executed in Indonesia which evidences a loan by either the Indonesian government or a "credit giving entity" of more than 10,000 rupiahs is subject to a stamp duty of 50 sen per 100 rupiahs (.5%) on the amount of the credit. This rate has been reduced to .1% by administrative decree.¹¹² This Article also provides that a loan agreement that has been signed abroad must be stamped before the document is "used in Indonesia."

Thus, in the case of a loan to an Indonesian company where the loan agreement is executed outside of Indonesia, a duty equal to .1% of the amount of the loan will be due if, but only if, all three of the following conditions are satisfied:

1. the document evidences a "credit agreement" (*perjanjian hutang piutang*)
2. the foreign creditor is a "credit giving entity" (*badan pemberi kredit*); and
3. the document is to be "used" in Indonesia.

The only documents subject to duty are those evidencing a credit agreement. The Act does not otherwise specify which documents are intended, although the official Explanation of Article 73a declares that a promissory note (*aksep*) can qualify.¹¹³ It is thus clear, in principle, that any document, however labeled, which evidences the extension of credit is subject to duty. However, the Ministry of Finance has determined that notwithstanding Article 73a, commercial paper (including promissory notes) shall be exempt from Article 73a stamp duty, even where such paper is the only evidence of the credit.¹¹⁴ Commercial paper is subject to stamping under other provisions of the Act, discussed below.

111. Kompas, *Bea Meterai Pemborong dan Bea Meterai Kredit*, 1980 BINA PAJAK KOMPAS 87, 88 (July 4, 1980); Kompas, *Bea Meterai Kontrak Borongan*, 1976-1977 KUMPULAN BINA PAJAK KOMPAS 226 (June 17, 1977); R. BIRHANA, PENGETAHUAN PRAKTIS BEA METERAI (1975).

112. Min. Finance Decree No. 238/MK/II/3/75 dated Mar. 4, 1975 re bea meterai atas tanda bukti pemberian credit, 23 WARTA C.A.F.I. 556 (Mar. 8, 1975).

113. 1959 TAMBAHAN LEMBARAN NEGARA 1867.

114. Min. Fin. Decree No. Kep-237/MK/II/3/75 dated Mar. 4, 1975 re bea meterai atas kertas² berharga dalam rangka pengembangan pasar uang dan modal sehubungan dengan pelaksanaan ketentuan pasal 73a aturan bea meterai, 23 WARTA C.A.F.I. 56 (Mar. 8, 1975).

The Act does not define a "credit giving entity." However, the official Explanation of Article 73a specifies that by "credit giving entity" is meant the Indonesian equivalent of the Dutch "*credit instellingen*," that is, an "entity or institution which *regularly* extends credit" (emphasis added).¹¹⁵ A number of examples are given, all of them banking institutions. In our view, this means that loans by private companies which are not banking or financial institutions are exempt from the .1% duty prescribed by Article 73a, and are at most subject to the 25 rupiah duty prescribed in Article 23(1) for documents not otherwise subject to duty (or the relevant duty on notarial paper if the loan agreement is made in the form of a notarial deed).¹¹⁶

Neither Article 73a nor its official Explanation says anything about the meaning of the term "used in Indonesia." However, as noted above, Article 22(1) of the Act provides with respect to documents executed abroad that stamp duties on such documents must be settled before the documents are used in Indonesia in "any manner intended by Articles 15, 16, 17 and 19." Thus, at a minimum, "used in Indonesia" means that the loan agreement must be used in one of the ways specified in those articles. As discussed above, articles 15, 16, 17, and 19 prohibit various government officials from acting on or with respect to unstamped documents. Thus, for example, a loan agreement, though signed abroad, cannot be enforced in an Indonesian court unless properly stamped. The language is also broad enough to reach a number of acts regularly performed in connection with loans by foreign banks to Indonesian borrowers, such as obtaining Bank Indonesia approval of the loan, or requesting an opinion by an Indonesian notary on the validity of the document in Indonesia.

In 1974, the Director General of Taxes issued a circular specifically addressing the question of when a loan agreement is "used in Indonesia," giving the phrase a very broad interpretation.¹¹⁷ The Circular says that *any use whatever* is enough (as examples it mentions obtaining a recommendation, approval, or permit), and that it does not matter whether the document is used in the public or private sector. The Circular also says that article 72(3) of the Act, as well as articles 15, 16, 17, and 19, should be consulted for the meaning of "used in Indonesia." Article 72(3) provides that bills of exchange, checks, promissory notes, and like instruments made abroad must be stamped before they are negotiated, accepted, presented, endorsed, or paid in Indonesia

115. 1959 TAMBAHAN LEMBARAN NEGARA 1867.

116. Kompas, *Bea Meterai Pemborong dan Bea Meterai Kredit*, 1980 BINA PAJAK KOMPAS 87, 88-89 (July 4, 1980).

117. Dir. Gen. Taxes Circular No. 15-4/III/CI/4/35 dated June 24, 1974 re bea meterai atas surat² (tanda bukti) perjanjian hutang piutang yang dibuat di luar negeri, 22 WARTA C.A.F.I. 157 (July 8, 1974).

or before a guarantor may sign them, before any receipt acknowledging payment is given, or before any protest is made against non-acceptance or non-payment.

If the Director General's interpretation of "used in Indonesia" is correct, then a loan agreement between a foreign bank and an Indonesian borrower should probably be stamped prior to any filing with Bank Indonesia or submission to local counsel for a legal opinion, and perhaps even prior to its delivery to the Indonesian borrower. Even if the document used in Indonesia is a copy rather than an original, it should be stamped because the copy is being used to evidence the making of a loan.¹¹⁸ It has been suggested, however, that the mere holding of the document in Indonesia by the local party to the contract does not constitute use in Indonesia for purposes of stamping.¹¹⁹

Commercial Paper. Chapter 9 of the Act (articles 69-73) regulates stamp duties on commercial paper. It provides that all bills of exchange, checks, promissory notes, and similar paper not otherwise subject to duties under other sections of the Act, except for "short term paper," shall be subject to a stamp duty of 5 sen per 100 rupiahs (.05%) if issued or payable in Indonesia. In the case of bills, notes, and like instruments made abroad, the stamp tax must be settled before the document is negotiated, accepted, presented, endorsed, or paid in Indonesia, or before a guarantor signs it, or before any receipt evidencing payment is issued, or before any protest is made for non-acceptance or non-payment.

Despite the .05% statutory rate, the Minister of Finance has established a flat rate of only 25 rupiahs on long term commercial paper and only 5 rupiahs on short term paper.¹²⁰

Insurance Policies. Insurance policies are subject to different stamp duties, some of them ad valorem, depending on the type of insurance and the duration of the policy.¹²¹ For example, freight insurance is charged duty at the rate of 0.10 rupiahs for each 1,000 rupiahs of coverage. Insurance policies issued abroad with respect to persons

118. Kompas, *Meterai Surat Perjanjian Kredit Luar Negeri, 1973-1974-1975 KUMPULAN BINA PAJAK KOMPAS* 148, 149 (Oct. 11, 1974).

119. See *id.*

120. Min. Finance Decree No. Kep 1100/MK/II/7/1974 dated July 30, 1974 re bea meterai atas kertas² berharga dan surat pemberitahuan penutupan perjanjian jual beli surat efek dalam rangka pasar uang dan modal, 22 WARTA C.A.F.I. 182 (Aug. 7, 1974); Dir. Gen. Taxes Circular No. D.15.4/III/01/5-50/1974 dated Sept. 12, 1974 re bea meterai atas kertas² berharga jangka pendek sebagai dimaksud dalam psl. 69 ayat 3 ABM 1921, 22 WARTA C.A.F.I. 224 (Sept. 27, 1974).

121. Stamp Act, arts. 61-68.

resident in, or property located in, Indonesia must be stamped prior to the time such policies are delivered to the insured party.¹²²

Others. Ad valorem duties are assessed on various other documents as well, including deeds of hypothecation of immovable property or vessels (0.1%),¹²³ bills of sale for immovable property (1.0%),¹²⁴ bills of sale for vessels (0.1%),¹²⁵ registration of vessels (0.1%),¹²⁶ and share capital (.5% - 1%, depending on whether the capital has or has not been paid in).¹²⁷

VI CONCLUSION

Indonesia is a country in which practice can vary significantly from formal rules. Although an attempt has been made throughout this article to cite practice, as well as rules, the reader is cautioned that this Article should be used as an introduction only, and not as a basis for Indonesian tax planning. Different interpretations of the rules, and different practices, may be encountered in actual transactions. Moreover, the rules themselves are not systematically published for general consumption, and therefore no description can be warranted as complete even with respect to the regulations cited. While the author has compiled over the past twelve years a large collection of tax regulations, it is impossible to determine in all cases whether particular regulations are the only ones applicable to a given subject or even whether such regulations are always still in force. The reader who looks into the English language materials on Indonesian tax law (*supra* note 1) will thus find descriptions of particular Indonesian taxes which differ in some respects from the description in this Article.

122. *Id.* art. 66.

123. *Id.* art. 52(1); Min. Fin. Decree No. Kep. 236/MK/II 3/1975 dated Mar. 4, 1975 re bea meterai atas surat pembebanan hipotek, 23 WARTA C.A.F.I. 56 (Mar. 8, 1975).

124. Stamp Act, art. 53.

125. *Id.*; Min. Finance Decree No. Kep-241/MK/II/3/1975 dated Mar. 4, 1975 re bea balik nama atas kapal dan bea meterai atas akta balik nama kapal, 23 WARTA C.A.F.I. 57 (Mar. 10, 1975).

126. 1924 Transfer Duty Ordinance, art. 1; Min. Finance Decree No. Kep. 241/MK/II/3/1975 dated Mar. 4, 1975; 23 WARTA C.A.F.I. 57 (Mar. 10, 1975).

127. Stamp Act, arts. 93-95; Min. Finance Decree No. Kep. 239/MK/II/3/1975 dated Mar. 4, 1975 re bea meterai modal sebagai dimaksud dalam pasal 93, 94, and 95 aturan bea meterai 1921, 23 WARTA C.A.F.I. 57 (Mar. 10, 1975).