

Indonesia Expands Its Anti-Tax-Avoidance Measures: A Development to be Aware of in Tax Planning and Compliance



As readers may be aware, the Indonesian legislation has equipped the tax authority with several specific measures to combat tax avoidance practices, such as controlled-foreign corporation (CFC), transfer pricing, thin capitalisation, and indirect transfer of shares regulations. Nonetheless, these measures are insufficient in some circumstances to combat the ever-evolving creative tax avoidance schemes.

Now, the President has further empowered the tax authority by issuing new measures to combat tax avoidance practices under Government Regulation No. 55 of 2022 on Rules Adjustments in Income Tax (“**Regulation**”), which became effective on 20 December 2022. These measures include formalising the “substance-over-form” principle into a written provision.

What Are the New Measures?

Below is a list of notable new measures under the Regulation:

1. ***The measure for combating unreasonable financial profits or losses based on financial performance comparison***

In the context of related-party transactions, the tax authority is now allowed to recalculate the tax payable based on a comparison of the taxpayer’s financial performance against comparable companies if the taxpayer reports unreasonably low profits or losses within specified periods.

2. ***The measure for combating hybrid mismatch arrangements that create double non-taxation benefits or double deductions***

Under the Regulation, the tax authority may deny the deductibility of payments made to non-residents if:

- (i) the payment is not treated as taxable income by the non-residents; or
- (ii) the payment is also treated as a deduction by the non-residents (creating double deductions),

either of which may arise as a result of two or more countries characterising the arrangements related to the payments differently.

This measure is consistent with the Organization for Economic Cooperation and Development (“OECD”)’s Base Erosion and Profit Shifting (“BEPS”) Action Plan No. 2 and demonstrates Indonesia’s commitment to follow and implement the BEPS Action Plans fully.

3. ***The measure for imposing adjustments based on the substance-over-form principle***

If none of the specific anti-avoidance measures are effective in preventing tax avoidance, the tax authority may impose adjustments based on the substance-over-form principle. The Regulation has formalised the principle into a written provision in the Indonesian tax legislation as an anti-avoidance measure. Due to its nature as the last resort provision, this measure can be considered as the general anti-avoidance rule.

Each of the measures mentioned above will be detailed in a Minister of Finance regulation, which has yet to be issued.

What Does This Mean for Taxpayers?

This means that Indonesia has once again fulfilled its commitment to fully implement the global initiatives promoted by the BEPS Action Plans to combat tax avoidance practices. There will be fewer and fewer legal loopholes for taxpayers to engage in creative tax avoidance, leaving them with no choice but to fully comply with the tax legislation. Taxpayers should be more careful when planning their taxes and ensure that they are not deemed to be engaging in tax avoidance, which may subject them to penalties. This is especially true for corporate taxpayers planning to carry out a corporate restructuring. These taxpayers must ensure that their proposed restructuring scheme complies with the current tax framework, including the Regulation.

Naturally, the spotlight is on the formalisation of the substance-over-form principle, which grants the tax authority significant power. We note that in some cases in the past, the tax authority imposed adjustments based on this principle implicitly. This principle can be broadly interpreted, so its implementation and interpretation can be flexible in practice. Consequently, the detailed procedural rules (which will be in a Minister of Finance regulation) governing the implementation of this principle will be important for ensuring that the tax authority does not abuse its authority and that the taxpayer receives due process of law.

In the meantime, please contact us to obtain advice on managing tax structure, both existing and proposed.

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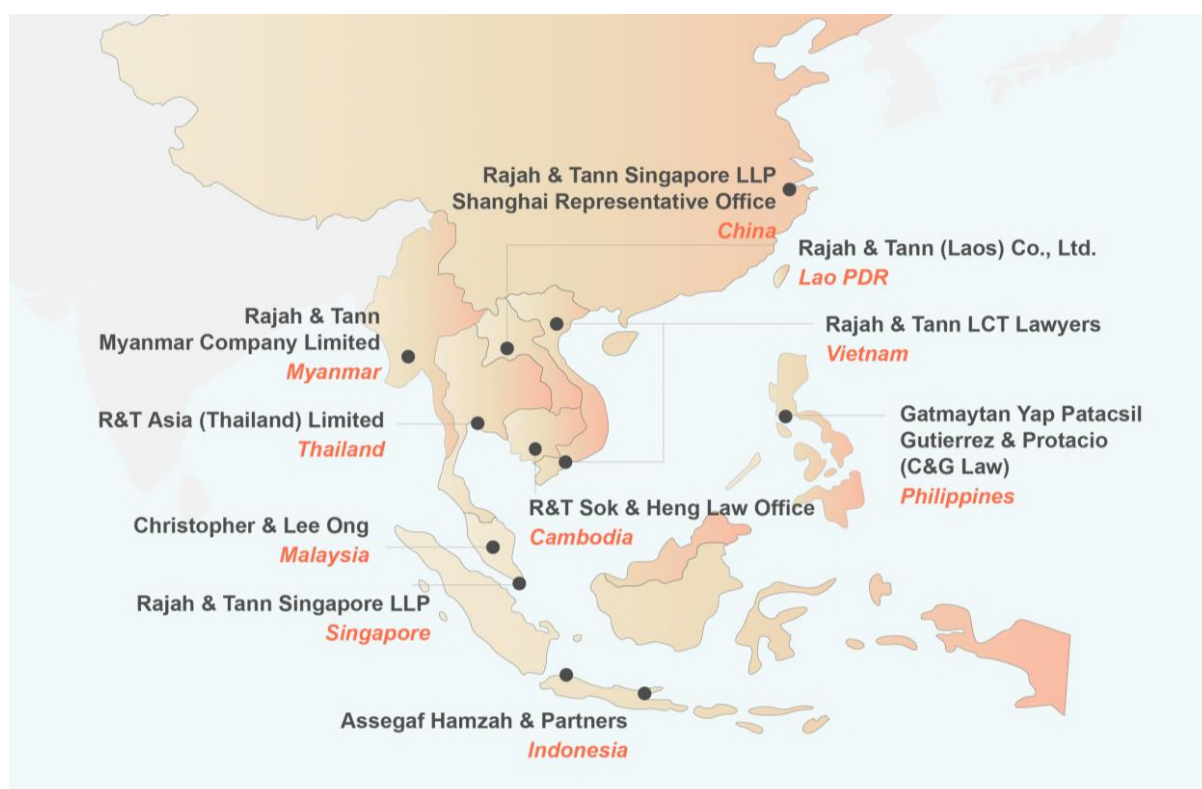
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