RAJAH & TANN ASIA
LAWYERS WHO KNOW ASIA

ASSEGAF HAMZAH & PARTNERS | *Indonesia*

CLIENT UPDATE

28 SEPTEMBER 2015

GOVERNMENT MOVES ON TAX FRONT TO ENCOURAGE GREATER EQUITY CONTRIBUTION TO COMPANY CAPITAL

The Minister of Finance recently issued Regulation No. 169/PMK. 010/2015 (the "**Regulation**") on the ratio of debt to equity in a company's capital (debt-to-equity ratio /"**DER**") for tax calculation purposes. This is significant as Law No. 7/1983 on Income Tax, as lastly amended by Law No. 36/2008, provides that interest expenses are deductible in the calculation of a company's tax liabilities.

The Regulation, which enters into effect in fiscal year 2016, sets the DER at 4 : 1, meaning that interest expenses arising on borrowings incurred to provide company capital will no longer be deductible for tax purposes where such borrowings exceed 80 percent of the company's capital.

The Regulation is mainly aimed at the taxation implications that arise in connection with the proportion of a company's capital sourced using two different methods, i.e., equity versus debt. When a large proportion of a company's capital is provided by borrowings, the company is said to be "thinly capitalized." This may have undesirable consequences from both the perspective of creditors and the revenue authorities (Directorate General of Taxes). For the former, there will be less shareholder capital available to repay the company's debts in the event of insolvency, while for the later, excessive deductions of interest expenses are clearly undesirable.

Thus, as stated by the Ministry of Finance, the Regulation is intended to encourage shareholders to provide a greater contribution to company equity and discourage excessive reliance on borrowing.

The Regulation defines "debt" as interest-bearing short- and long-term borrowings and trade-related debts, while "equity" is defined as both equity and interest-free loans from parties with special relationships.

A number of exemptions are provided, including in the case of banks, consumer finance, insurance and reinsurance firms, oil and gas and mining firms with particular types of contractual relationships with the state, companies that are subject to final tax, and companies involved in infrastructural development.

A similar ruling was first introduced by virtue of Minister of Finance Regulation No. 1002/KMK.04/1984 (but at a tighter ratio of 3 : 1). However, the requirement was put on indefinite hold the following year by Minister of Finance Regulation No. 254/KMK.01/1985. Thus, there have been no DER limits since 8 October 1984 on the amount of interest expenses that may be set off against a company's taxable income, even in the case of loans from shareholders or affiliates.

While DER rules on company capital are quite common in civil law jurisdictions, questions have nevertheless been raised about the precise timing of the Regulation as it has the clear potential to increase the financial burden facing companies at a time when the national economy is experiencing turbulence and the rupiah continues to weaken. It has also been commented that the new policy appears to run contrary to the spirit of the government's recently announced deregulation package.

Our Regional Presence

Our Regional Contacts

RAJAH & TANN | *Singapore*

Rajah & Tann Singapore LLP
9 Battery Road #25-01
Straits Trading Building
Singapore 049910
T +65 6535 3600 F +65 6225 9630
sg.rajahtannasia.com

R&T SOK & HENG | *Cambodia*

R&T Sok & Heng Law Office
Vattanac Capital Office Tower, Level 17, No. 66
Preah Monivong Boulevard, Sangkat Wat Phnom
Khan Daun Penh, 12202 Phnom Penh, Cambodia
T +855 23 963 112 / 113 F +855 963 116
kh.rajahtannasia.com
**in association with Rajah & Tann Singapore LLP*

RAJAH & TANN REPRESENTATIVE OFFICE | *China*

Rajah & Tann Singapore LLP
Shanghai Representative Office
Unit 1905-1906, Shui On Plaza, 333 Huai Hai Middle Road
Shanghai 200021, People's Republic of China
T +86 21 6120 8818 F +86 21 6120 8820
cn.rajahtannasia.com

RAJAH & TANN NK LEGAL | *Myanmar*

Rajah & Tann NK Legal Myanmar Company Limited
Office Suite 007, Inya Lake Hotel No. 37, Kaba Aye
Pagoda Road, Mayangone Township, Yangon, Myanmar
T +95 9 73040763 / +95 1 657902 / +95 1 657903
F +95 1 9665537
mm.rajahtannasia.com

ASSEGAF HAMZAH & PARTNERS | *Indonesia*

Assegaf Hamzah & Partners
Menara Rajawali 16th Floor
Jalan DR. Ide Anak Agung Gde Agung Lot #5.1
Kawasan Mega Kuningan, Jakarta 12950, Indonesia
T +62 21 2555 7800 F +62 21 2555 7899
www.ahp.co.id
** Assegaf Hamzah & Partners is an independent law firm in Indonesia and a member of the Rajah & Tann Asia network.*

RAJAH & TANN | *Lao PDR*

Rajah & Tann (Laos) Sole Co., Ltd.
Phonexay Village, 23 Singha Road, House Number 046/2
Unit 4, Saysettha District, Vientiane Capital, Lao PDR
T +856 21 454 239 F +856 21 285 261
la.rajahtannasia.com

CHRISTOPHER & LEE ONG | *Malaysia*

Christopher & Lee Ong
Level 22, Axiata Tower, No. 9 Jalan Stesen Sentral 5,
Kuala Lumpur Sentral, 50470 Kuala Lumpur, Malaysia
T +60 3 2273 1919 F +60 3 2273 8310
www.christopherleeong.com
**in association with Rajah & Tann Singapore LLP*

RAJAH & TANN | *Thailand*

Rajah & Tann (Thailand) Limited
973 President Tower, 12th Floor, Units 12A-12F
Ploenchit Road, Lumpini, Pathumwan
Bangkok 10330, Thailand
T +66 2 656 1991 F +66 2 656 0833
th.rajahtannasia.com

RAJAH & TANN LCT LAWYERS | *Vietnam*

Rajah & Tann LCT Lawyers

Ho Chi Minh City Office
Saigon Centre, Level 13, Unit 2&3
65 Le Loi Boulevard, District 1, HCMC, Vietnam
T +84 8 3821 2382 / +84 8 3821 2673 F +84 8 3520 8206

Hanoi Office
Lotte Center Hanoi - East Tower, Level 30, Unit 3003,
54 Lieu Giai St., Ba Dinh Dist., Hanoi, Vietnam
T +84 4 3267 6127 F +84 4 3267 6128
www.rajahtannlct.com

Based in Jakarta, and consistently gaining recognition from independent observers, Assegaf Hamzah & Partners has established itself as a major force locally and regionally, and is ranked as a top-tier firm in many practice areas. Founded in 2001, it has a reputation for providing advice of the highest quality to a wide variety of blue-chip corporate clients, high net worth individuals, and government institutions.

Assegaf Hamzah & Partners is part of Rajah & Tann Asia, a network of local law firms in Singapore, China, Lao PDR, Vietnam, Thailand and Myanmar, as well as associate and affiliate offices in Malaysia, Cambodia, Indonesia and the Middle East. Our Asian network also includes regional desks focused on Japan and South Asia.