KEMENTERIAN KEUANGAN
REPUBLIK INDONESIA

Managing Tax Competition and Investment Incentive: From National to Collaborative Approaches

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Global economic recovery is still uncertain

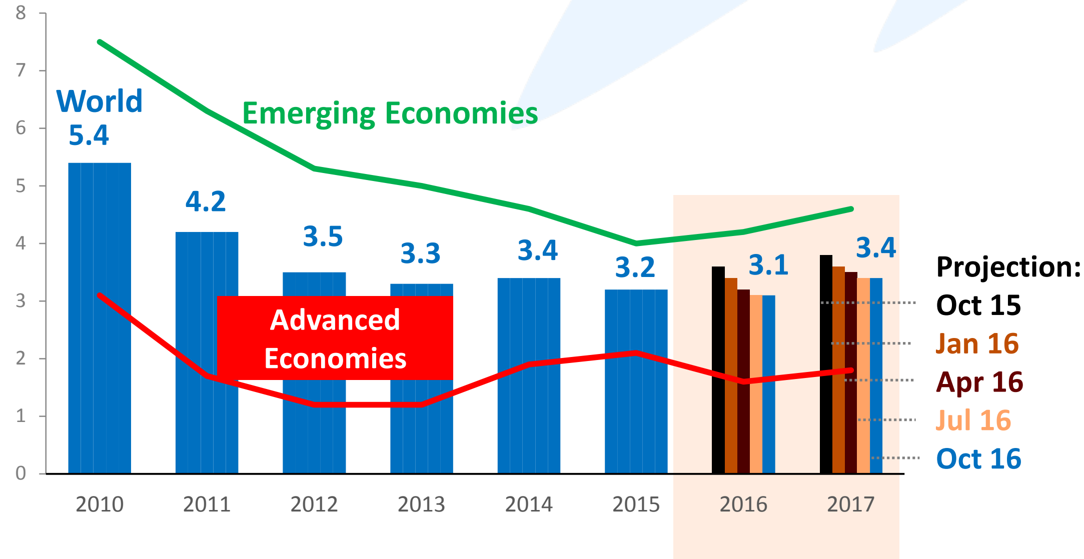
Advanced economies are entering the “secular stagnation” zone, while emerging economies have to deal with the “perfect storm”

Anticipating Major Risks

- **(Remains) Slow recovery of advanced economies**
  U.S., E.U., and Japan growths are unstable; lower than expected inflation; geopolitics uncertainty
- **The divergence of monetary policies**
  Capital flow volatility in EMEs financial market; increase vulnerability of the external portfolio
- **The China economy rebalancing still continues**
  Not only influence the real sector, but also financial. Risky for Asian markets.
- **Commodity prices will not improve significantly in near future**
  Low demand, low price, tight competition, increase protecsionism in advanced economies

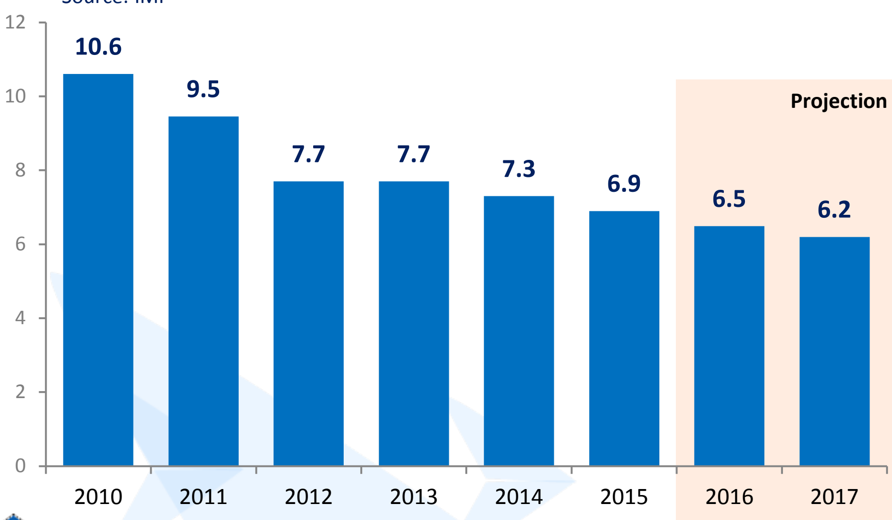
World Growth Projection

Source: WEO IMF



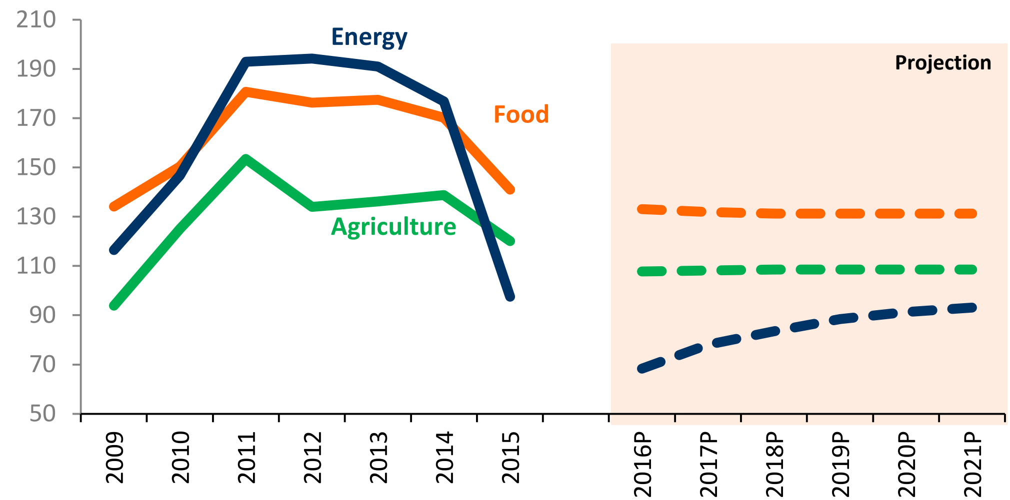
China Growth Projection

Source: IMF



IMF Commodities Index

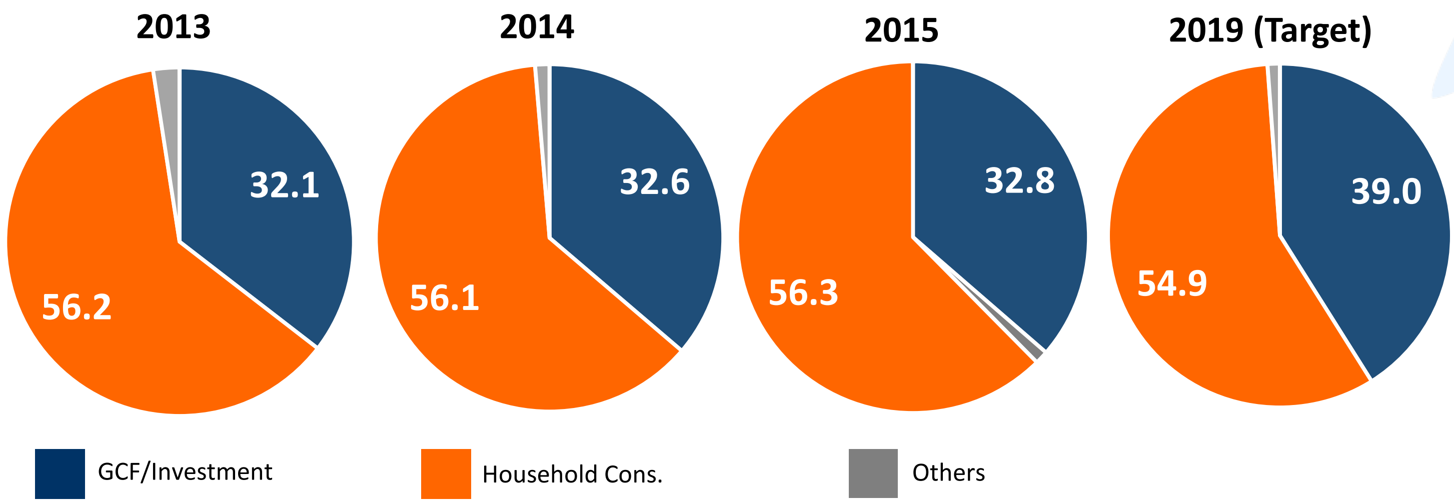
Index in USD: 2005 = 100; Source: IMF

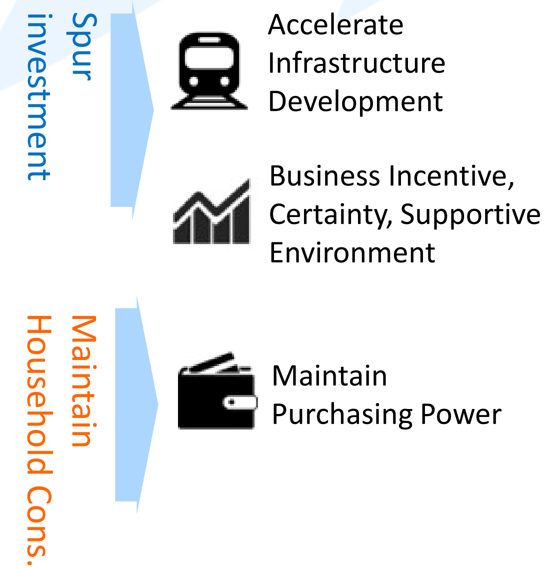


Future growth is geared towards investments

To tackle long term challenges and to create greater competitiveness

Share of Growth Geared Towards Investment





Source: BPS

Maintain **economic stability** to promote strong business and investment climate

Simplify licensing and investment procedures

Expand the role of **non-bank financial institutions** in the development of **infrastructure financing** alternative

Harmonize investment regulations between central government and local governments

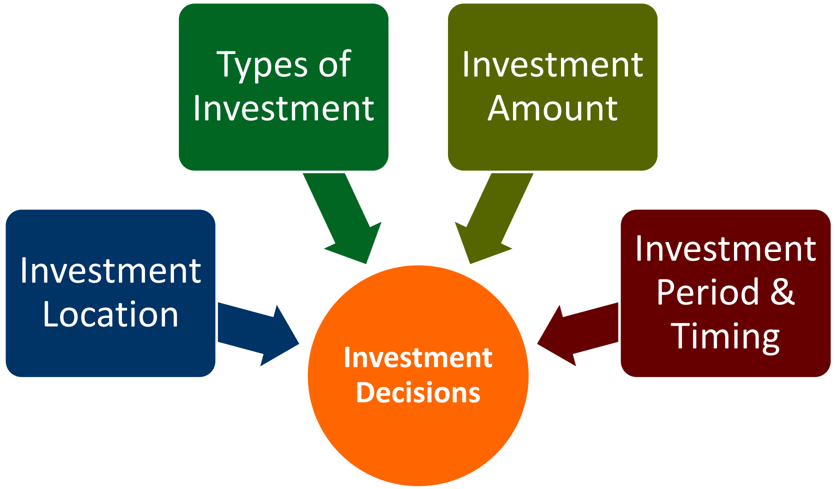
Consistently improve the involvement of **state owned enterprises (SOEs) and Private Sector in infrastructure development**

Increase the **role of banking institutions** in lending rate development, especially for working capital and **investment credits**

Many factors affecting investment decisions. Taxation is only one of the factors.....

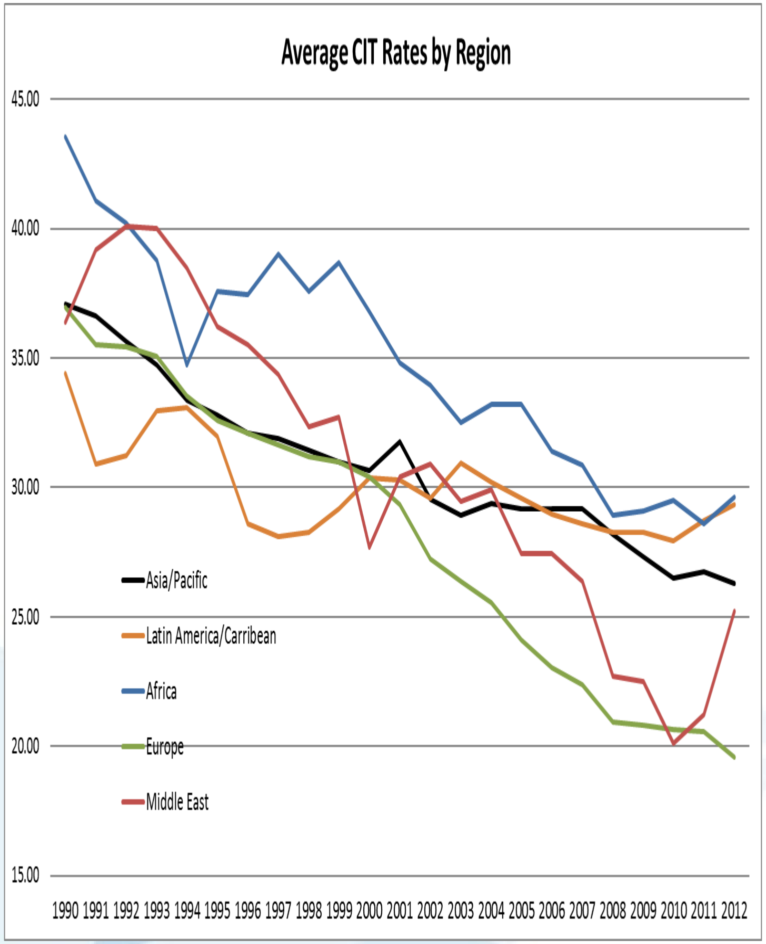
The Worldbank Ease of Doing Business (EODB) indicates factors influencing investment decision, among others:

- Starting a Business
- Dealing with construction permits
- Getting electricity
- Registering Property
- Getting Credit
- Protecting Minority Investors
- Paying Taxes



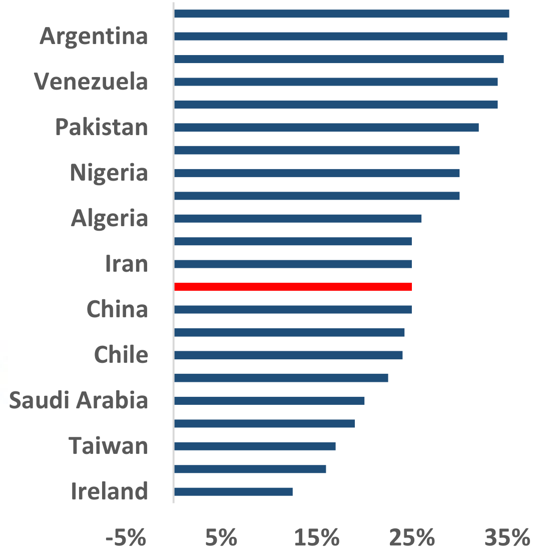
The Worldwide Tax Competition and Investment Incentives

Tax competition has been putting downward pressure on Corporate Income Tax (CIT) rates across the globe…

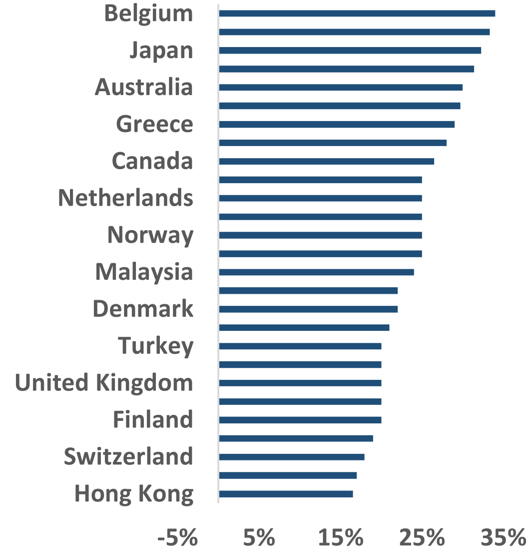


Reduction of CIT rate makes worldwide vs. territorial question less important ….

Worldwide Systems – CIT Rates



Territorial Systems – CIT Rates



A race to the bottom ???

Not to mentioned the massive introduction of Unilateral Tax Codes & Incentives worldwide, among others……

Mauritius

<u>Corporate Taxes</u>

Dividend Tax: No
Capital Gains Tax: No
Payroll Tax: No
Real Property Tax: No
Stamp Duty: No
Transfer Tax: No
Anti Avoidance Rules: No

Solomon Island

<u>Corporate Taxes</u>

Dividend Tax:

- ✓ 0% (selective mining company)
- ✓ 20% (resident);
- ✓ 30% (Non Resident)

Interest:

- ✓ 10% (resident)
- ✓ 15% (non resident)
- ✓ Royalti: 15% (nonresident)

Technical Service fee: 20%

Singapore

<u>Corporate Taxes</u>

Capital Gains Tax: No
Dividend Tax: No (at the hand of recipients)
Tax Incentives:

- Various incentives are available for pioneer and expanding companies, financial services, asset securitization, fund managers, international maritime activities, international trading and R&D

(Tax Holiday)

PMK 159/PMK.010/2015 jo. PMK 103/PMK.010/2016

Tax Holiday is granted to: Corporate Tax Payers classified as pioneer industries with minimum investment Rp 1 Trillion.

Pioneer Industries Coverage

- Basic metal industries;
- Oil refinery industries or oil refinery industry and infrastructure, including which use the Public Private Partnership (KPBU)
- Basic organic chemicals industries originating from oil and natural gas
- Machinery industries which producing industrial machinery;
- Processing industries based on agriculture, forestry, and fishery product;
- Telecommunication, Information, and Communication Industries;
- Marine Transportation Industries;
- Economic Infrastructures other than using the Public Private Partnership (KPBU).

Facility and Period of Reduction

- Corporate Income Tax (CIT) Reduction: **max 100%, min 10%.** (for Telecommunication, Information, dan Communication with minimum investment ranging from Rp 500 M to Rp 1 T, maximum reduction of CIT is 50%.
- Reduction periode: **5 to 15 years**. With discretion of Minister of Finance, period of reduction could be up to 20 years.

Reduction of Corporate Income Tax for Investment in Certain Industry Sectors and/or Regions (Tax Allowance)

Tax Payer Qualified for Facilities

- Domestic Corporate Tax Payer
- New investment/expansion
- Fulfilling general criteria.
- Complying with the Indonesia Standard Industrial Classification (KBLI) and the requirement in 1st and 2nd Attachment of Govt Reg. No 18/2015 jo. No. 9/2016

General Criteria

- High investment/export oriented.
- Labour Intensive.
- High local content.

Legal Basis

- Govt. Reg. No 18 2015 jo. No. 9/2016
- MoF Reg. No 89/PMK.010/2015

Facilities

- Investment Allowance 30% from investment.
- Accelerated depreciation/amortization
- Dividend Tax Rate 10% to Foreign Tax Payer.
- Loss Compensation 5 to 10 years.

Industry Sectors

- 1st Attachment (Certain Sectors) : 71 sectors
- 2nd Attachment (Certain Sectors and Certain Regions) : 74 sectors

Tax Amnesty as a policy breakthrough

Expected to be strongly affecting the economy trajectory in both short and long run

Tax Amnesty as the milestone of tax reform

Accelerating Economic Growth through Asset Repatriation, via several transmissions:

- increase domestic liquidity;
- improve the stability of IDR currency;
- create lower interest rate;
- support investment growth.

Expanding Tax Base through more Reliable, Integrated and Comprehensive Database

More reliable calculation of tax revenue potential

Increasing **More Sustainable Tax Collection** in both Short and Long Term

Short Term : Collection from Amnesty Fee

Long Term : Better Tax Collection based on better and larger Tax Database

More reforms are coming

Tax Policy Reform

- Amendment of General Provision and Administration of Taxation Law*
- Amendment of VAT Law*
- Amendment of Income Tax Law
- Amendment of Stamp Duty Law

**currently, Ministry of Finance is working on the Academic Paper of these regulations*

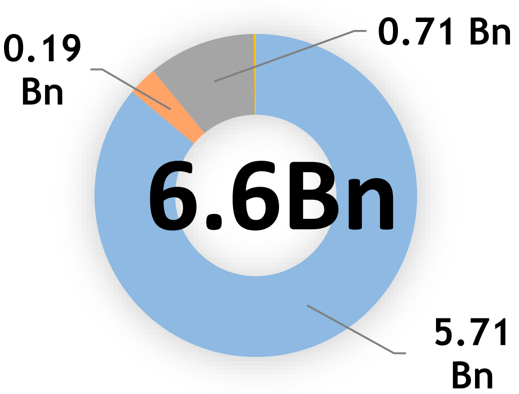
Tax Administration Reform

- More effective and better targeted law enforcement
- Improvement of IT and communication system
- Enhancement of data management
- Improvement of the human resources capacity and capability

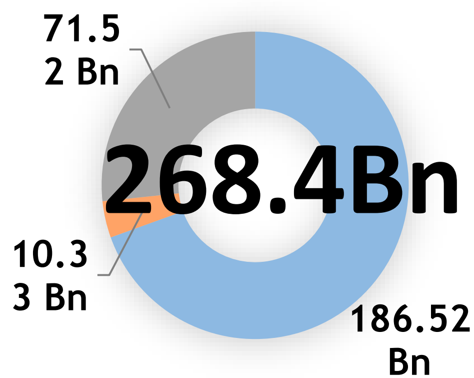
Indonesian Tax Amnesty is one of the most successful in the world

Highlighting a huge potential for expanding Indonesia tax base

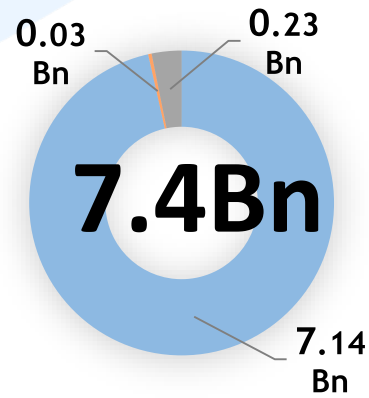
Tax Amnesty Revenue Realization, In US$ (Based On Tax Declaration Letter)



Realization of Asset Declaration from Tax Amnesty, In US$

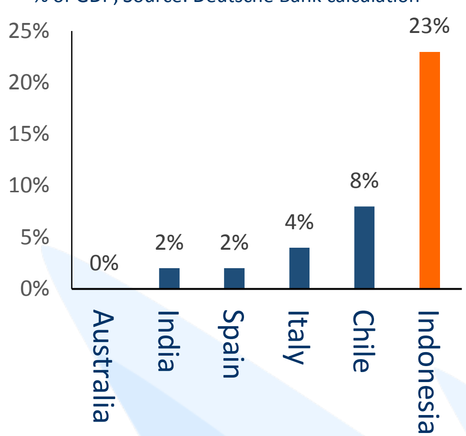


Tax Amnesty Revenue Realization, In US$ (Based On Tax Payment Slip)



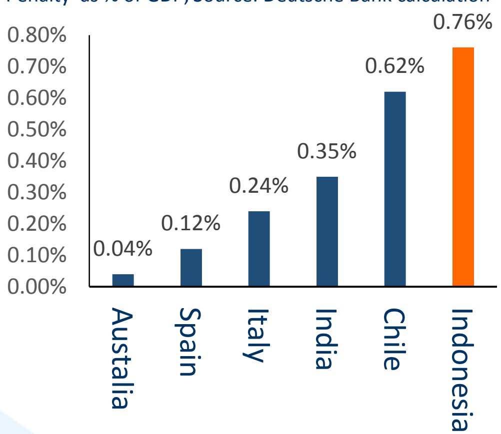
Declared Assets

% of GDP, Source: Deutsche Bank calculation



Revenue From Tax Amnesty

Penalty as % of GDP, Source: Deutsche Bank calculation



Repatriation/ Offshore Declaration by Country Origins

Repatriation

Singapore	77,41T	57,18%
Cayman Islands	16,50T	12,19%
Hong Kong	13,98T	10,33%
China	3,56T	2,63%
Virgin Islands	2,25T	1,66%

Offshore Declaration

Singapore	631,29T	67,36%
Virgin Islands	71,74T	7,66%
Cayman Islands	52,53T	5,61%
Hong Kong	37,89T	4,04%
Australia	32,10T	3,43%

Source: DG Tax

Challenges on Tax Competition and Investment Incentives

Common Issues on Tax Competition and Investment Incentives:

- Race to the Bottom
- Reduce revenue
- Often fail to stimulate investment
- Distort economic activity
- Complicate administration
- Create opportunities for abuse and corruption

Options of measures to tackle the issues:

- Perform evaluation on the tax incentives, ie to:
  - ✓ Calculate their revenue cost and publish as part of annual tax expenditure report
  - ✓ Establish cost-benefit analysis to see if tax incentives create enough investment to offset revenue cost
- Regional Coordination and Cooperation, ie:
  - ✓ EOI on tax incentive;
  - ✓ Apply international standards/initiatives on preventing harmful tax practices

The International Standards/Initiatives to Tackle Harmful Tax Practice

15 BEPS Action Plans

Objective of the BEPS Action Plans:

1. to ensure that profits are taxed where economic activities generating the profits are performed and where value is created, and thus securing country's revenue.
2. to create a single set of consensus-based international tax rules to address BEPS, and hence to protect tax bases while offering increased certainty and predictability to taxpayers.
3. to prevent/Minimize Tax Avoidance

1.Digital Economy

TRANSPARENCY

11. BEPS Data
12. Disclosures
13. TP Doc & CbC Reporting
14. Dispute Resolution

SUBSTANCE

6. Treaty Abuse
7. PE Status
8. TP Intangibles
9. TP Risk & Capital
10. TP High Risk Transactions

COHERENCE

2. Hybrid Mismatches
3. CFC Rules
4. Interest Deductions

15. Multilateral Instrument on Tax Treaty

5. Harmful Tax Practice

BEPS Action Plan 5 : Counter Harmful Tax Practices More Effectively

Action 5 of the Base Erosion and Profit Shifting (BEPS) Action Plan commits the Forum on Harmful Tax Practices (FHTP) to:

a. Revamp the OECD work on harmful tax practices (1998) with a priority on requiring substantial activity for any preferential regime
b. Improve transparency, including compulsory spontaneous exchange on rulings related to preferential regimes.

Preferential Regime → **Potentially Harmful Regime** → **Actually Harmful Regime**

Preferential Regime

- The regime provides tax preferential in comparison with the general principles of taxation in the relevant country, and not in comparison with principles applied in other countries
- Focus on geographically mobile acitivites, ie financial and service activities, intangible provisions. Tax incentives designed to attract investment in plant, building, and equipment are excluded

Potentially Harmful Regime

- Criteria consists of four (4) key factors and eight (8) other factors.

4 Key factors	8 Other Factors
1. No or low effective tax rate	1. An artifical definition of the tax base
2. Ring –fencing of regime	2. Failure to adhere to international transfer pricing principles
3. Lack of transparency	3. Foreign source income exempt from residence country taxation
4. Lack of effective exchange of information	4. Negotiable tax rate or tax base
	5. Existence of secrecy provisions
	6. Access to a wide network of tax treaties
	7. The regime is promoted as a tax minimization vehicle
	8. The regime encourage purely tax-driven operations or arrangements

Actually Harmful Regime

- Economic effect of a regime→ shifting acitivity from other country as primary motivation to conduct business

Tax Regimes reviewed under BEPS Action Plan 5

(as reflected in 2015 BEPS Final Report)

IP Regimes

	Country	Regime	Conclusion
1.	Belgium	Patent income deduction	See the paragraph following this table.
2.	People's Republic of China	Reduced rate for high & new tech enterprises	
3.	Colombia	Software regime	
4.	France	Reduced rate for long term capital gains and profits from the licensing of IP rights	
5.	Hungary	IP regime for royalties and capital gains	
6.	Israel	Preferred company regime	
7.	Italy	Patent box	
8.	Luxembourg	Partial exemption for income/gains derived from certain IP rights	
9.	Netherlands	Innovation box	
10.	Portugal	Partial exemption for income from certain intangible property	
11.	Spain	Partial exemption for income from certain intangible assets	
12.	Spain – Basque Country	Partial exemption for income from certain intangible assets	
13.	Spain – Navarra	Partial exemption for income from certain intangible assets	
14.	Switzerland – Canton of Nidwalden	Licence box	
15.	Turkey	Technology development zones	
16.	United Kingdom	Patent box	

148. The IP regimes listed in Table 6.1 were all considered under the criteria in the 1998 Report as well as the elaborated substantial activity factor. Those regimes are inconsistent, either in whole or in part, with the nexus approach as described in this report. This reflects the fact that, unlike other aspects of the work on harmful tax practices, the details of this approach were only finalised in this report while the regimes had been designed at an earlier point in time. Countries with such regimes will now proceed with a review of possible amendments of the relevant features of their regimes.[2] Where no amendments are made, the FHTP will proceed to the next steps in its review process.

Non-IP Regimes

	Country	Regime	Conclusion
17.	Argentina	Promotional regime for software industry	Not harmful
18.	Australia	Conduit foreign income regime	Not harmful
19.	Brazil	PADIS - Semiconductors Industry	Not harmful
20.	Canada	Life insurance business regime	Potentially harmful but not actually harmful
21.	People's Republic of China	Reduced rate for advanced technology service enterprises	Not harmful
22.	Colombia	Foreign portfolio investment regime	Not harmful[3]
23.	Greece	Offshore engineering and construction	Amended
24.	India	Deductions in respect of certain incomes of offshore banking units and international financial services centre	Not harmful
25.	India	Special provisions in respect of newly established units in special economic zones	Not harmful
26.	India	Special provisions relating to income of shipping companies – tonnage tax scheme	Not harmful
27.	India	Taxation of profit and gains of life insurance business	Not harmful
28.	Indonesia	Public/listed company regime	Under review
29.	Indonesia	Investment allowance regime	Under review
30.	Indonesia	Special economic zone regime	Under review
31.	Indonesia	Tax holiday regime	Under review
32.	Japan	Special zones for international competitiveness development	Not harmful[4]
33.	Japan	Measures for the promotion of research and development	Not harmful[5]
34.	Latvia	Shipping taxation regime	Not harmful
35.	Luxembourg	Private asset management company (Société de gestion de patrimoine familial)	Not harmful[6]
36.	Luxembourg	Investment company in risk capital (Société d'investissement en capital à risque) regime	Not harmful[7]
37.	South Africa	Headquarter company	Potentially harmful but not actually harmful
38.	South Africa	Exemption of income in respect of ships used in international shipping	Not harmful
39.	Switzerland – Cantonal level	Auxiliary company regime (previously referred to as domiciliary company regime)	In the process of being eliminated[8]
40.	Switzerland – Cantonal level	Mixed company regime	In the process of being eliminated[9]
41.	Switzerland – Cantonal level	Holding company regime	In the process of being eliminated[10]
42.	Switzerland – Federal level	Commissionaire ruling regime	In the process of being eliminated[11]
43.	Turkey	Shipping regime	Not harmful[12]

Reviewing the Tax Regimes under BEPS Action Plan 5

FHTP Peer Review Methods

- **Written/ Questionaires:**
  - ✓ Self Review
  - ✓ FHTP questions
- Direct Defence at the Forum on Harmful Tax Practice (FHTP)

Harmful tax regime

➔ encourage harmful economic distortionary effect, ie. shifting acitivity from other country as primary motivation to conduct business

Four Indonesian Tax Regimes:

- Tax holidays/reduction regime
- Investment allowances regime
- Special Economic Zones regime
- Public/Listed Company regime

➔ **Non-Harmful Regimes**
(OECD-FHTP; Nov 2016)

Encourage Direct investment with substantial economic activity

The 4 Indonesian tax regimes reviewed under BEPS Action Plan 5
have been concluded as Non-Harmful
by the Forum on Harmful Tax Practice (FHTP) --- [Nov 2016]

The Ways Foward

1. Investor’s investment decision are influenced by many factors.   Taxation (incentive) is only one of them.
2. Good tax policy treats economic decision neutrally. Tax incentive that encourage direct/real investment with substantial economic activity could minimize harmful effect.
3. Countering Harmful Tax Practice can’t be done in isolation. Effective measures in tackling harmful tax practice requires coordination and cooperation
4. At the initial stage:
   - ✓ exchange information, views and experiences among jurisdiction members and tax experts on (incentive) tax regimes are important
   - ✓ South centre could play important role in coordinating the cooperation, including gathering relevant tax experts in the discussion

Thank You

Ministry of Finance, Republic of Indonesia