



Indonesia Tax Alert October 2024

Gearing up for Pillar Two global minimum tax and subject to tax rule in Indonesia

As a member of the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (BEPS) (“inclusive framework”), Indonesia is on track to implement the Pillar Two global minimum tax (GMT) rules. This new initiative is a part of Indonesia's commitment to global tax reform as stipulated in Article 32A of the Income Tax Law and Article 54 of Government Regulation Number 55 of 2022 regarding adjustment of regulation in the field of income tax and introduces significant changes to the tax landscape, particularly for multinational enterprises (MNEs). The GMT will apply to MNEs operating in at least two jurisdictions and with annual consolidated group revenues of at least EUR 750 million in two or more of the four preceding fiscal years. Two key groups of MNEs will need to closely assess the impact of the GMT in Indonesia: large Indonesia-based MNEs with foreign operations and foreign-based MNEs operating in Indonesia.

Under the GMT, regardless of where operations are located—whether in high-tax jurisdictions, low-tax jurisdictions, tax havens, or jurisdictions offering tax holidays—MNEs have to pay a minimum tax of 15%; if they fall below this threshold, a top-up tax obligation will apply. For GMT purposes, the effective tax rate (ETR) is calculated through a complex formula, dividing “covered taxes” by GloBE (global anti-base erosion) income, which requires various accounting and tax adjustments. Covered taxes are defined by the OECD as taxes recorded in the financial accounts of a constituent entity with respect to its income or profits/share of the income or profits of a constituent entity in which it owns an ownership interest; taxes on distributed profits, deemed profit distributions, and nonbusiness expenses imposed under an eligible distribution tax system; taxes imposed in lieu of a generally applicable corporate income tax (CIT); and taxes levied by reference to retained earnings and

corporate equity, including a tax on multiple components based on income and equity. GloBe income is a standardized measure of taxable income used in the OECD’s Pillar Two framework.

The income inclusion rule (IIR) (serving as a primary rule under the GMT) will be introduced in the first year of implementation, followed by the undertaxed payments rule (UTPR) (serving as a “backstop” rule under the GMT) in the subsequent year. Additionally, Indonesia plans to introduce a qualified domestic minimum top-up tax (QDMTT) (serving as a local rule under the GMT) as a mechanism to address domestic top-up tax. Currently, the Indonesian tax authorities are working on drafting the regulations that will guide the implementation of GMT in Indonesia. The IIR and QDMTT are presumed to become applicable in Indonesia starting 1 January 2025, with the UTPR coming into effect the following year, on 1 January 2026.

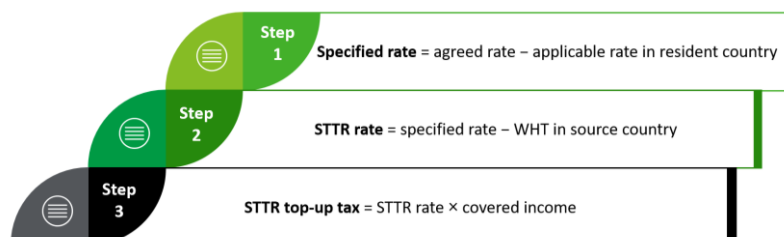
An integral part of the Pillar Two framework that is particularly important for developing countries is the subject to tax rule (STTR) (serving as a priority rule under the GMT). The purpose of this provision is to help developing countries protect their tax base by giving them the right to “tax back” up to 9% where other jurisdictions have not exercised their taxing rights or where income is subject to low levels of taxation. Notably, the STTR takes priority over the GloBE rules and STTR taxes are creditable under those rules.

The STTR is a model treaty provision allowing jurisdictions to impose limited additional taxation on certain cross-border payments between connected companies, where the recipient’s CIT rate is below 9%. It applies to specific types of income (covered income) paid to connected parties, including interest; royalties; payments for distribution rights for a product or service; insurance or reinsurance premiums; guarantee or financing fees; rental payments for industrial, commercial, or scientific equipment; and payments for services. If the STTR applies, the jurisdiction making the payment can impose additional taxes up to 9% on the gross amount of the covered income.

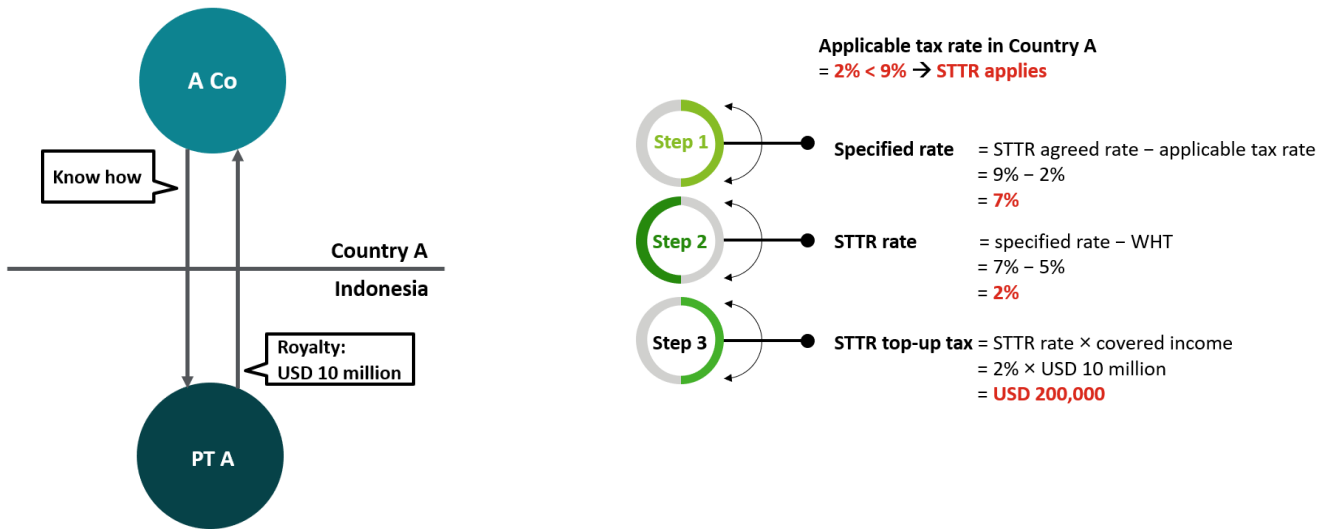
For STTR implementation, on 19 September 2024, Indonesia had signed the Multilateral Convention to Facilitate the Implementation of the Pillar Two Subject to Tax Rule (STTR MLI) that will be integrated into relevant tax treaties without bilateral negotiations. As with other international agreements, the STTR MLI will come into effect once it is ratified under Indonesian laws and regulations. The STTR MLI is expected to affect 29 of Indonesia’s existing tax treaties as shown in the following table:

Armenia	Malaysia	Seychelles
Belgium	Mongolia	Singapore
Brunei Darussalam	Morocco	Spain
Czech Republic	Netherlands	Switzerland
Egypt	Poland	Thailand
Hong Kong (SAR)	Pakistan	Türkiye
Hungary	Portugal	Ukraine
Jordan	Qatar	United Arab Emirates
Kuwait	Romania	Uzbekistan
Luxembourg	Serbia	

The following diagram illustrates the steps for calculating the STTR if the applicable rate in the jurisdiction of residence plus the withholding tax (WHT) rate in the source jurisdiction is less than 9%:



As an example, PT A, an Indonesian taxpayer, pays royalties of USD 10 million to its affiliate, A Co, in Country A. The applicable tax rate on royalties in Country A is 2%, while the Indonesia-Country A bilateral tax treaty provides for a reduced WHT rate of 5%. Under this scenario, the specified rate would be 7% (i.e., 9%–2%) and the STTR rate would be 2% (i.e., 7%–5%). This results in an STTR top-up tax of USD 200,000 (i.e., 2% of USD 10 million). This USD 200,000 would count as covered taxes for A Co when calculating its ETR for Pillar Two purposes.



Assumption:

- Tax imposed on royalty in Country A is 2%
- Based on tax treaty between Indonesia – Country A, Indonesia can impose WHT up to 5%

Deloitte Indonesia comments

Tax regulations on Pillar Two GMT is expected to be issued before 1 January 2025, and the ratification of the relevant tax treaties related to the STTR is anticipated to occur in the near future. As these changes are rapidly approaching, businesses should act now to address their impact. The urgency for comprehensive impact assessments and specialized training has increased and companies need to proactively assess how these new tax regimes may affect their operations so that they can be fully prepared.

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