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Global Tax Alert

Indonesia broadens list of mergers and restructures eligible for tax-free treatment using tax book value

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Executive summary

Indonesia's Minister of Finance (MOF) has issued MOF Regulation No. 205/PMK.010/2018 (PMK-205), amending MOF Regulation No. 52/PMK.010/2017 (PMK-52) that allows taxpayers to use a book tax base for mergers, consolidations, spin-offs and business take-overs. PMK-205 became effective as of 31 December 2018. PMK-205 aims to increase foreign direct investments in Indonesia and support government policy to create a state-owned holding company.[1] The use of tax book value enables a transferor to transfer assets and liabilities for consideration equal to the existing tax basis without triggering gain or loss. It is therefore an important consideration in some restructuring and spin-off scenarios.

Under PMK-205, the permitted use of tax book value for business restructuring has been expanded to cover two additional scenarios for a business spin-off transaction: (i) the company acquiring the spun-off business is capitalized with at least IDR500 billion (US$35 million) by a foreign investor; and (ii) a state-owned company receives additional capital from the Indonesian Government for the creation of the state-owned holding company. The administrative procedures applicable for the tax book value use on business restructuring remain the same as those under PMK-52.

This Alert summarizes the key aspects of PMK-52 as amended by PMK-205.

Detailed discussion

General overview

In general, a merger, consolidation, spin-off or business take over transaction should be at fair market value. However, taxpayers can use a tax book value if approval is obtained from the Directorate General of Tax (DGT).

Business restructuring using tax book value applies to the following types of transactions:

- Merger
  - Integrating two or more Indonesian corporate taxpayers by transferring the entire assets and liabilities of one company to the other, followed by the transferor entity's dissolution. The transferee (surviving entity) must be the one with a zero, or the lesser, tax loss (i.e., net operating loss) balance; or
  - Business integration between a non-Indonesian tax resident company with an Indonesian corporate taxpayer by transferring the entire assets and liabilities of the nonresident company (transferor) to the Indonesian corporate taxpayer, followed by the transferor's dissolution.
- Consolidation/Amalgamation

Similar to the above merger conditions, but the assets and liabilities are transferred to a new corporate taxpayer and the transferors are automatically dissolved.

- Spin-off
  - Indonesian private corporate taxpayer who transfers its assets and liabilities, must make an Initial Public Offering (IPO) within one year after obtaining the DGT approval on the tax free spin-off.
  - New entity receiving spun-off assets from an Indonesian publicly listed corporate taxpayer, must make an IPO within one year after obtaining the DGT approval on the tax free spin-off.
  - Corporate taxpayer separating the Islamic banking business unit in accordance with the regulatory requirement.
  - Indonesian corporate taxpayer acquiring spun-off assets and liabilities which are capitalized with at least IDR500 billion by the foreign investor.
  - State-owned company receiving additional capital from the Indonesian Government for the creation of a state-owned holding company.

Items (d) and (e) were added by PMK-205.

- Business Take Over

This is applicable to an Indonesian branch of a foreign bank transferring its assets and liabilities to an Indonesian corporate taxpayer and dissolving the Indonesian branch.

Application procedure for business restructuring using tax book value

The application for tax book value use in a merger, consolidation or business take-over transactions should be submitted by the taxpayer receiving the assets (transferee); whereas, for a spin-off, the taxpayer transferring the assets (transferor) is the applicant.

The application should be submitted by the taxpayers within six months after the effective date of the merger, consolidation, spin-off or business take over transaction. The application should include the following:

- A statement letter stating the reasons and purposes of the business restructuring with relevant documents.
- A statement letter explaining that the business restructuring satisfies the business purpose test, supported by relevant documents.
- A tax clearance letter from the DGT for all the taxpayers involved in the business restructuring.

In addition, in the case of item 3(d) above, the transferee of the spun-off transaction must also provide the amended articles of association showing that the additional paid-in capital of at least IDR500 billion has been injected by the foreign shareholder.

If the submission is incomplete, an additional data request will be issued by the DGT. The taxpayers who failed to meet the additional data submission deadline may resubmit its completed application within the six-month time limit to be reconsidered its application.

The DGT will issue an approval or rejection notice within one month of receipt of the completed application by the DGT; however, if no notice is issued within this time period, the taxpayer's application is deemed approved.

Except for a tax loss that cannot be transferred, any tax attributes and tax liabilities of the taxpayer transferring its assets and liabilities in connection with the merger, consolidation, spin-off or business take over transaction are transferred to the transferee

Other considerations

The DGT has the right to revoke the tax book value approval under any of the following conditions:

- The business purpose test could not be met. For example, the taxpayer failed to demonstrate that it has continued the business of the dissolving entity during the five-year period.
- The transferred assets are sold without obtaining the DGT's pre-approval to transfer the assets during the claw back period, i.e., within two years after the restructuring is effective.
- The transferred assets are sold but the DGT rejects a new application to transfer the assets.
- In the case of a spin-off, entities involved do not submit an IPO registration to the Financial Services Authority within one year after obtaining the DGT approval.
- The IPO extension request is rejected by the DGT.
- With respect to an Indonesian branch of a foreign bank, the branch is not dissolved within the designated timeline, i.e., two years after the business take-over transaction.
- Application for extension to dissolve the Indonesian branch of a foreign bank is rejected by the DGT.

If revoked, the assets transfer price must be a market value as of the effective date of merger, consolidation, spin-off or business take over. The DGT will compute an additional tax liability which should be paid and reported on the corporate income tax return for the year in which the DGT revokes its approval of the tax-free treatment.

Endnote

1. State-owned company is a legal entity which is wholly or partly owned by the Indonesian Government to undertake commercial activities.

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