

Indonesia issues regulations for determination of permanent establishments

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Executive summary

Indonesia's Minister of Finance (MOF) has issued MOF Regulation No. 35/ PMK.03/2019 (PMK-35), providing guidance to determine whether a permanent establishment (PE) exists in Indonesia. PMK-35 should be viewed as the primary source of guidance from the Indonesian Tax Authority on PE matters to be taken into consideration when performing an Indonesian PE analysis. PMK-35 is effective starting as of 1 April 2019.

PMK-35 appears to closely reflect the OECD¹ guidance in most respects. However, some of the provisions on service and construction project PEs could be read more broadly, particularly concerning subcontracting arrangements. PMK-35 does not specifically address cross-border digital transactions or any expanded digital PE concept. It does not provide guidance on potential changes to PE rules that may arise in conjunction with the OECD Multilateral Instrument (MLI), which has been signed but not yet ratified by Indonesia.

This Alert summarizes key aspects of PMK-35.

Detailed discussion

Types of PE

PMK-35 defines a PE as a place of business² that has a permanent location in Indonesia and is used by the nonresident to run its business and activities. In addition, the following activities may trigger a PE:

- ▶ Construction project, installation or assembly project
- ▶ Services activities exceeding the time test
- ▶ Dependent agent
- ▶ Insurance agent

The following addresses detailed criteria for each of the five types of PE.

Place of business

PMK-35 defines a PE as a place of business that is permanent (e.g., can be used continuously and has a specific geographical location) and used by a nonresident to conduct its business or activities in Indonesia.

The place of business exists if the nonresidents have access to the place without any restriction and the business or activities are performed through that place of business. The term does not apply if the place is only used as a data storage or for the purposes of electronic data processing and the nonresident lacks access to operate the place.

For tax treaty purposes, a place of business does not constitute a PE if the activity is only preparatory (preliminary activities) and auxiliary (additional activities) to support the essential and significant activities. The essential and significant activities cover the following activities of the nonresidents:

- ▶ Core business or activities
- ▶ Integral part of the core business or activities
- ▶ Primary income generating activities
- ▶ Using significant amount of assets or human resources

If the nonresident performs preparatory and/or auxiliary activities on behalf of another person, the above exception does not apply.

Construction, installation, or assembly project

Construction projects cover construction consultation services, construction works and integrated construction works such as design engineering or engineering, procurement and construction. Installation or assembly

projects consist of an installation or assembly project related to the construction works and installation or assembly project of machinery or equipment.

The construction, installation or assembly project in Indonesia also includes construction, installation or assembly project when works are conducted outside of Indonesia and/or they are subcontracted to a local or a foreign subcontractor. Accordingly, any activities performed outside of Indonesia may still be attributed to a PE.

For tax treaty purposes, any construction, installation or assembly project creates a PE if it is conducted in excess of a specific time period stated in a given tax treaty. The time period starts when the nonresident begins the project until it delivers the completed project to the recipient, or it prematurely terminates the project. The subcontractor's time should also be included in the time period.

Service PE

The furnishing of a service by employees or other personnel constitutes a PE only if the service is conducted for a period of more than 60 days within a 12-month period, and meets all of the following conditions:

- ▶ The employee or other personnel is hired by the nonresident or their subcontractors.
- ▶ The service is conducted in Indonesia.
- ▶ The service is rendered to any party.

A tax treaty may specify a different timeframe and covers the period performance of the service's start until its completion, including subcontractor's time.

Dependent agent

An individual or a corporate other than an agent of an independent status is a dependent agent and forms a PE if the dependent agent is acting for and on behalf of the nonresident.

The dependent agent is acting for and on behalf of the nonresident if:

- ▶ It receives instructions for the benefit of the nonresident in conducting its business or activities; or
- ▶ It does not bear the risk of its business or activities.

A nonresident does not have a PE in Indonesia if in conducting its business or activities in Indonesia, it uses an independent agent, broker or middleman, provided such agent, broker or middleman is acting in the ordinary course of its business.

If a dependent agent's activities are preparatory or auxiliary character, the dependent agent does not create a PE in Indonesia.

It should be noted that the standard treaty phrases of "authority to conclude contracts" and "maintenance of stock of goods" are not addressed in PMK-35; accordingly, it is not clear whether PMK-35 is broadening the scope of a dependent agent PE.

An agent or an employee of an insurance company that is not established and is not domiciled in Indonesia, who receives insurance premiums or who bears risks in Indonesia

An agent or an employee of an insurance company that is not established and is not domiciled in Indonesia has a PE in Indonesia if:

- It receives insurance premium in Indonesia
- Or
- It bears risks in Indonesia where the insured party resides, is domiciled or located in Indonesia

In applying a tax treaty, these criteria are not applicable to re-insurance companies.

Endnotes

1. Organisation for Economic Co-operation and Development.
2. The place of business covers any kind of place, space, facility or installation, including machinery or equipment used by a nonresident to conduct its business or activities, which can be in the form of:
 - a) Place of management
 - b) Branch
 - c) Representative office
 - d) Office building
 - e) Factory
 - f) Workshop
 - g) Warehouse
 - h) Sales and promotional space
 - i) Mining or extracting of natural resources
 - j) Oil and gas concession area
 - k) Fishery, farm, agriculture, plantation, or forestry
 - l) Computer, electronic agent, or automatic equipment owned, rented, or used by a nonresident to conduct business through internet

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EYG no. 002369-19Gb1

1508-1600216 NY
ED None

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