“THIN CAPITALIZATION” BECOMES TAX UNFRIENDLY - NEW REGULATIONS

Under Article 18 (1) of Law No. 7 of 1983 on Income Tax (as lastly amended by Law No. 36 of 2008 – “**Income Tax Law**”), the Minister of Finance (“MOF”) is authorized to determine the debt to equity ratio (“**DER**”) of corporate taxpayers for the income tax calculation purposes. To implement this, on 9 September 2015, the MOF issued MOF Regulation No. 169/PMK/010/2015 on the Determination of a Company’s Debt to Equity Ratio for Income Tax Calculation Purposes (“**MOF Regulation 169/2015**”).

Basically, MOF Regulation 169/2015 governs the maximum DER for corporate taxpayers under which borrowing costs (such as: interest on borrowings, costs incurred related to the arrangement of borrowings, etc.) can be deducted in calculating the relevant companies’ corporate income tax. MOF Regulation 169/2015 provides the maximum DER of 4:1. If the DER exceeds the stipulated maximum DER some of their borrowing costs will not be tax deductibles.

The above maximum DER **does not apply** to:

1. banks;
2. financing companies;
3. insurance and reinsurance companies;
4. taxpayers doing business in the oil and gas, general mining, other mining sectors, with production sharing contracts, contracts of work, or mining business cooperation agreements, and those contracts state the maximum DER;
5. taxpayers which income is entirely subject to the final income tax under specific laws and regulations (**Note**: According to Article 4 (2) of the Income Tax Law, the types of business which income is entirely subject to final income tax are, among others, construction services, real estate developers, etc.); and
6. taxpayers which are engaged in the infrastructure business.

The maximum DER under MOF Regulation 169/2015 will apply for calculating corporate income tax as of the 2016 tax year.