



PERMANENT BUSINESS ESTABLISHMENT IN INDONESIA

The Government of the Republic of Indonesia recently issued Minister of Finance Regulation No. 35/PMK.03/2019 (“**Regulation 35/2019**”) on The Determination of a Permanent Business Establishment (BUT). An increase in the number of cross border business models used in practice which involve foreign tax subjects was one of the reasons why the MOF issued Regulation 35/2019 to provide legal certainty for foreign tax subjects doing business in Indonesia through a BUT regarding their Indonesian tax rights and obligations.

Regulation 35/2019 was drawn up with reference to international practice and benchmarks and came into effect on 1 April 2019. A brief summary of its major provisions is provided below.

Criteria for a BUT under Regulation 35/2019

A business model used by a Foreign Individual or Entity for undertaking *business or activities* in Indonesia which meets the following criteria is deemed a BUT under Regulation 35/2019:

a. It has a place of business in Indonesia

This includes any place, space, facilities or installation, such as for machinery or equipment the Foreign Individual or Entity uses for its business or activities which can be any of the following:

- the domicile of the management;
- a branch office;
- a representative office;
- an office building;
- a factory;
- a repair shop/workshop;
- a warehouse;
- a promotion and sales area;
- a natural resource mining or excavation site;
- a fishery, farm, agriculture, plantation or forestry; and
- a computer, electronic agent or automatic equipment owned, leased or used by the Foreign Individual or Entity to do business through the internet.

The Foreign Individual or Entity does not have to confirm whether it owns or leases or are is legally entitled to use the place of business.

b. The place of business in a. above must be permanent;

A place of business is deemed permanent if it is used continuously and situated in a certain geographical location;

c. The place of business in a. above is used by the Foreign Individual or Entity for undertaking business or activities;

Makarim & Taira S.

Summitmas I, 16th & 17th Fls.
Jl. Jend. Sudirman Kav. 61-62
Jakarta 12190
Indonesia

P: (62-21) 5080 8300, 252 1272
F: (62-21) 252 2750, 252 2751
www.makarim.com

M&T Advisory is an email publication prepared by the Indonesian law firm, Makarim & Taira S. It is only intended to inform generally on the topics covered and should not be treated as legal advice or relied upon when making investment or business decisions. Should you have any questions on any matter contained in M&T Advisory, or other comments generally, please contact advisories@makarim.com

April 2019

A place of business is deemed used for undertaking business or activities if it meets the following criteria: (i) it is available for use so that the Foreign Individual or Entity has unlimited access to undertake business or activities and (ii) the Foreign Individual or Entity undertake its business or activities from that place.

The criteria under c. above are not satisfied if (i) the Foreign Individual or Entity only uses the place of business in Indonesia for storing data and managing data electronically and (ii) the Foreign Individual or Foreign Entity has limited access to operate the place.

The term 'business or activities' here include any activity a BUT engages in to obtain, collect or maintain an income.

Exceptions to the BUT Criteria

Regulation 35/2019 recognizes a number of business models as a BUT despite their not meeting the BUT criteria under Regulation 35/2019, such as:

- a. construction, installation or assembly projects in which a Foreign Individual or Entity is involved in Indonesia including projects the implementation of which are performed outside Indonesia or transferred to local or offshore subcontractors, such as:
 - construction consultancy services which cover the feasibility, planning, design, monitoring, management of construction, survey, technical examination or analysis;
 - construction work which covers the development, operation, maintenance, unloading or re-construction;
 - integrated construction work which covers the design model, engineering model, procurement and implementation;
 - installation or assembling projects related to construction projects; and
 - the installation or assembling project of machinery or equipment.
- b. the provision of services in any form by an employee or other individual, if they are provided for more than 60 days within any 12-month period, if the following requirements are satisfied:
 - the employee or the other individual is employed by a Foreign Individual or Entity or a subcontractor of the Foreign Individual or Entity;
 - the services are provided in Indonesia; and
 - the services are provided to parties in Indonesia or outside Indonesia.
- c. the individual or entity is acting as dependent (non-free) agents if it is acting for and on behalf of a Foreign Individual or Entity provided that (i) it receives instructions for the interests of a Foreign Individual or Entity in undertaking the business or activities or (ii) it does not bear any risk arising from the business or activities. However, an individual or entity shall not be deemed to have a BUT in Indonesia merely because it carries on business in Indonesia through an independent agent or broker where such agent or broker is acting in the ordinary course of their business; and
- d. the agent or employee of an insurance company which is not established and domiciled in Indonesia but receives insurance premiums in Indonesia or bears any risks in Indonesia where the insured party resides, is domiciled or has a presence.

The above business models in a. to d. must exist continuously for longer than the period stated in the double taxation avoidance agreement (P3B) to be deemed a BUT in Indonesia.

Tax Obligations

Tax Registration Number (*Nomor Pokok Wajib Pajak* or NPWP)

A Foreign Individual or Entity undertaking its business or activities through a BUT must register and obtain an NPWP from the applicable tax office in Indonesia. The obligation to register and obtain an NPWP arises when a Foreign Individual or Entity commences its business or activities in Indonesia, and it must obtain its NPWP within one (1) month.

The Directorate General of Taxation may issue an NPWP even if the Foreign Individual or Entity does not comply with the obligation to obtain one.

The NPWP will be cancelled when the BUT ceases its business or activities in Indonesia.

Taxable Entrepreneur Number (*Nomor Pengusaha Kena Pajak* or PKP Number)

A Foreign Individual or Entity undertaking its business or activities through a BUT must register its business with the local tax office in Indonesia to be named a taxable entrepreneur and obtain a PKP number if it conducts deliver of anything which is considered a tax object under the Indonesian Value Added Tax regulations. An exemption from requiring a PKP number may be granted to a small-scale entrepreneur if its revenue is within that determined by the Minister of Finance. Currently, a small-scale entrepreneur must have delivered Taxable Goods or Services with total gross circulation or gross revenue within one (1) financial year amounting to not more than Rp.4.8 billion under Minister of Finance Regulation No.197/PMK.03/2013.

Its taxable entrepreneur status will be revoked and the PKP number will be cancelled if the Foreign Individual or Entity doing business through a BUT no longer meets the criteria for a taxable entrepreneur.

Double Taxation Avoidance Agreement (*Persetujuan Penghindaran Pajak Berganda* or P3B)

For the purpose of the P3B application, a business model which meets the BUT's criteria under the Regulation 35/2019 will be exempted and will not be deemed a BUT in Indonesia provided that their activities in Indonesia are limited to:

- a. performing preparatory activities such as preliminary activities to ensure they are ready for conducting the essential and significant activities; or
- b. performing auxiliary activities such as additional activities required to expedite other essential and significant activities.

The above exemption does not apply if the Foreign Individual or Foreign Entity are performing the preparatory and auxiliary activities for other party.

In relation to the above, a P3B with certain countries (such as with Netherlands) acknowledges that representative offices which operate in Indonesia on a permit given by the Indonesian Ministry of Finance or the Indonesian Ministry of Trade, shall not constitute a BUT, unless they carry on business activities other than activities which have a preparatory or auxiliary character. In Indonesia, the activities that can be conducted by a representative office is limited to manage the interests of affiliated company or companies in Indonesia or to conduct preparation for the establishment and development of the business of foreign companies in Indonesia. A representative office in Indonesia is not allowed to generate income, to enter into any sale or purchase contract of goods or services with a company or individual in Indonesia or to participate in the management of any form whatsoever of a company, subsidiary or branch office in Indonesia.

The Regulation 35/2019 also provides for the following types of activities of a BUT which are essential and significant:

- a. activities which are the main business or activities of a Foreign Individual or Foreign Entity;
- b. activities which are an inseparable part of the main business or activities of the Foreign Individual or Foreign Entity;

- c. activities which directly generate income for the Foreign Individual or Foreign Entity; or
- d. activities which utilize a significant amount of assets or human resources.

A BUT conducting the above essential and significant activities in Indonesia will be subject to Indonesian tax obligations.

In light of the above summary, it would be interesting to see the application of Regulation No.35/2019 in practice in connection with many P3Bs which Indonesian has signed with other countries. While in general provisions on BUT under Regulation No.35/2019 mostly reflect what has been agreed to under a P3B, more detailed BUT provisions are provided in certain P3B. Despite Regulation No.35/2019 and unless provided otherwise, each P3B should still be binding on and apply to the parties on the basis that Indonesian contract law acknowledges an agreement entered into properly by the parties shall be binding and apply as a law to the parties.

It is hoped that following the issuance of Regulation No.35/2019, disputes can be minimized when determining a business place of a foreign individual or foreign entity undertaking business or activities in Indonesia, room for tax avoidance by BUT companies can be reduced and eventually it gives positive impacts for investment in Indonesia.

* * * * *

M&T Advisory is an email publication prepared by the Indonesian law firm, Makarim & Taira S. It is only intended to inform generally on the topics covered and should not be treated as a legal advice or relied upon when making investment or business decisions. Should you have any questions on any matter contained in M&T Advisory, or other comments generally, please contact your usual M&T contact or advisories@makarim.com.

Contacts:

Evelyn Simanjuntak - evelyn.simanjuntak@makarim.com
Rahayu N. Hoed - rahayu.hoed@makarim.com