Wake Up Call

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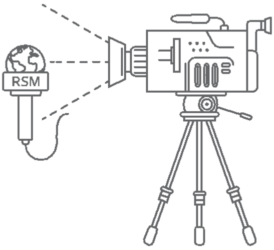
Personal tax residence – misconceptions & implications



Personal tax residence in Indonesia is not based solely on the existence of a work permit and it has broader implications than many are aware.

It is a common misconception that you are an Indonesian tax resident only if you hold a work permit and there is no personal tax if you hold a business visa. In fact, you are a tax resident if you are present in Indonesia for more than 183 days in any 12-months period or are present in Indonesia during the tax year and intend to reside. The existence of a work permit suggests that the 2nd criterion will be met; however, the time test remains relevant and using a business visa is not a legitimate strategy. Someone with their family/home here but working in Singapore each week (for example) is likely to be considered to be an Indonesian tax resident.

These results are potentially modified if you can show tax residence of a country that has a tax treaty with Indonesia. In such cases actual tax residence will be determined by the tax residence tie-breaker tests in the tax treaty (where the permanent home is; centre of personal and economic relations; location of habitual abode). The corollary to this is that it will be difficult to argue against Indonesian tax residence if you are not a tax resident of another country.

Assuming you are an Indonesian tax resident then you should:

- Apply for an Indonesian Tax ID (NPWP)
- Declare and pay tax on your worldwide income
- Lodge a Personal Tax Return that also reports your worldwide assets and liabilities

Indonesia taxes on a family basis and therefore your spouse's income must also be included. Typically this means (with the exception of employment income from a non-family company) that all non-final-taxed income earned by the spouse will be taxed at the 30% rate. A separation of assets agreement does not change this; it only results in the tax being apportioned based on the proportionate share of income.

A potential complication can occur if you pay tax in another country based on assessment rather than withholding. This is because Indonesia only allows a tax credit based on the foreign tax paid during the calendar year. Therefore there can be a timing mismatch between when the income must be reported for Indonesian tax and when the foreign tax credit is available.

In addition, the Controlled Foreign Corporation/deemed dividend regulation will apply if you/your spouse/other tax residents own at least 50% of the shares or voting rights of an overseas company.

If you are a tax resident but have no NPWP then you are subject to Article 21 tax (not Article 26) and your employer should add a 20% surcharge to the standard Article 21 tax rate (i.e. the highest marginal rate becomes 36%, not 30%). This results in a higher cost to the employer or tax to you depending on your employment agreement.

Therefore it pays to understand your tax residence situation. If your expected time in Indonesia is short and you remain tax resident elsewhere then it might be appropriate to assess whether you can use a tax treaty to avoid Indonesian tax residence. Of course you should then continue to comply with that country's taxing rules. If you are an Indonesian tax resident then obtain an NPWP and carefully consider the resulting obligations, remembering that tax authorities will soon be sharing financial account information.

KEY POINTS

- Tax residence is not based on whether you have a work permit.
- Indonesia taxes worldwide income.
- Income is taxed on a family basis.

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