

## Tax Analysis on Peer to Peer Lending

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**Abstract:** This study describes income tax and value added tax (“VAT”) treatment on Peer to Peer lending (P2P Lending) in Indonesia. This research adopts qualitative approach. This study shows the absence of specific rules on P2P Lending results uncertainty as the transactions may be characterized differently, especially on WHT and VAT. Accordingly, it is suggested to introduce specific tax regulation on P2P lending, especially WHT and VAT treatment for P2P platform company. Indonesia tax authority may consider to apply WHT and VAT treatment on banking institution mutatis mutandis to P2P lending scheme.

**Keywords:** Dual Residence, Capital Gain, Tax Treaty Indonesia - Malaysia

### I. INTRODUCTION

Financial technology (“fintech”) becomes one of alternatives for investor to lend money without tight banking regulation. Due to its flexibility and efficiency from the using of technology, fintech has grown as a new market force. This phenomenon can also be found in Indonesia.

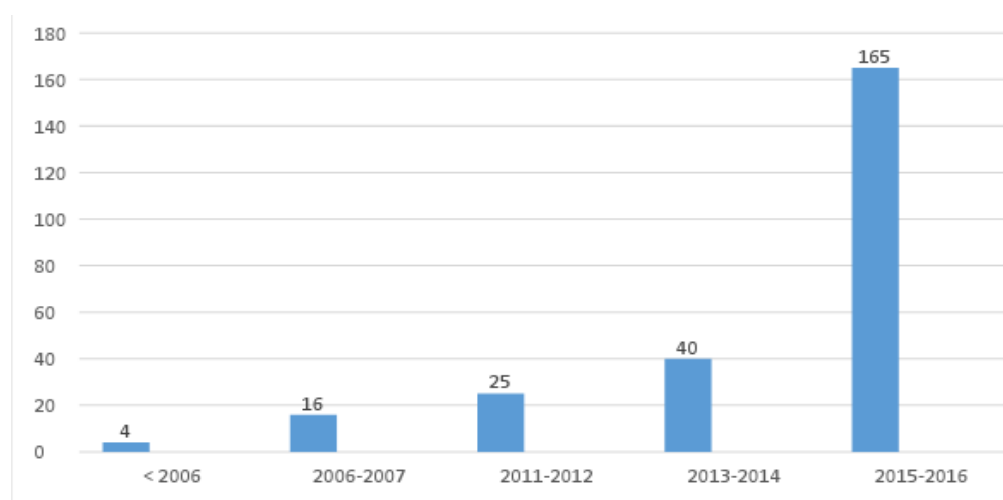


Figure 1 Profile of *Fintech* in Indonesia (Based on Number of Companies)

Source: processed from Financial Service Authority (FSA)

Numbers of fintech companies sharply increase 41 times in 10 years. According to Association of Financial Technology Indonesia (2017), there are active 235 fintech companies. In general, 39% of the largest startup fintech operate in payment system. Moreover, since OJK issued new regulations on P2P, there has been significant increase on online lending activities by 32%. [1]According to FSA (2017), there are 2 main fundamental reasons why fintech sharply increases in Indonesia. First, traditional financial industry can only be accessed by limited people due to strict banking regulation. Traditional financial industry also can not cover certain remote areas. Second, people keep looking for funding alternatives besides traditional financial services as public needs more transparent and democratic financial services as well as efficient cost of fund that covers wide range of society.[2]

FSA issued Regulation Number No. 77/POJK.01/2016 on Information Technology-based Lending and Borrowing Services that provides regulatory framework for P2P industry (“**POJK No 77/2016**”). [3]The regulation states P2P platform requirement, limitation of loan and license requirement, borrower requirements, loan agreement, risk mitigation, IT management and protection for user of platform. However, Indonesian tax authority has not issued specific tax regulation on P2P lending. This means that the P2P uses general tax regulation. Recently, there are complain from P2P lending institutions as general tax regulation results uncertainty as business model under P2P lending may create different challenge to be compare with conventional one. According to the above description, this research aims to analyze income tax and valued

added tax Financial Technology – Peer to Peer Lending (P2P) Lending. The income tax (including withholding tax) and value added tax is chosen as those taxes contributes the biggest tax revenues to government and, on the other hand, biggest tax burden to industry.

## **II. THEORETICAL BACKGROUND**

Fintech is one of disruptive innovations in financial services. In general, fintech is addressed to create new system within structure of financial service industry, provisions, and to meet public needs in terms of financial services. Fintech creates transformative innovation in banking, insurance, investment management, security, and other financial sectors.[4] Fintech is actually the combination between financial services and technology that finally changes the business model from conventional to moderate. Fintech appears along with changes in lifestyle dominated by information technology as the consequences of rapid life changes. Fintech provides effective and efficient payment system.

Bank Indonesia (2016) mentioned that fintech is basically considered as merger or hybrid of technology innovation with business model of financial services that is potentially bridging the needs and driving small medium enterprises activities as well as financial inclusion for the public. The presence of fintech can also provide some benefits for the public such as better financial services, various service choices, and affordable costs/prices. Moreover, fintech would simplify transaction chains, safe operating cost, safe capital expenditure, and fix flow of information. Moreover, for the country, the benefits are to drive economic policy transmission, to accelerate transaction turnover, and to support the National Strategy of Financial Inclusion.

Peer to peer landing (P2P) is basically an IT-based innovation serving in financial service industry to intermediate lender and borrower in order to conduct lending and borrowing agreement using Rupiah directly through electronic systems with internet connection. The electronic system is basically electronic devices and procedures to prepare, to collect, to proceed, to analyze, to exhibit, to publish, to deliver, and/or to distribute electronic information in financial service (POJK 77).

P2P lending is conducted online using platform. There are various type of platform, product, and technology to analyze lending. Borrowers and lenders do not meet directly face to face. Peer to peer lending is generally non-collateral lending. Besides intermediating borrowers and lenders, P2P lending also serves as a place where investors could verify all the borrowers registered in the website are highly qualified. Lenders are coming from different backgrounds, while borrowers generally come from individuals, society, and even SMEs that need funding to improve their business. Approval of funding proposal is done through platform.[5]

## **III. RESEARCH METHOD**

This research adopted qualitative-based analysis to analyze the context and facts of peer to peer lending. Using qualitative method, it is expected that all findings can be explained in more details, comprehensive, and accurate. According to the research objectives, it is used descriptive approach to provide comprehensive description about certain social phenomenon, which is income tax treatment on fintech. This research analyses problems within society including, relationships, activities, behaviors, point of views, and protests taking place and giving impacts. Based-on benefit points of view, this research is categorized as basic research.

The basic research is addressed to complement and to support development of academic sciences. Therefore, it is expected to provide comprehensive understanding about tax income treatment on fintech, especially peer to peer lending. This research was conducted during January 2018 to May 2018. This research employs qualitative data collection by observing patters and relationships of the problems. Data will be organized comprehensively, both primary data obtained from in-depth interview and secondary data obtained from literature review. Data organizing will be structured based on interview transcript and other sources to provide comprehensive explanation to readers.

## **IV. ANALYSIS**

### **4.1 Income Tax on P2P Lending**

P2P lending mechanism is outlined as follows:

- Lenders transfers its funds to bank account of fintech platform. From the business law perspective, loan agreement is made between lenders and fintech platform. Under POJK 77, lenders have no direct contact with borrowers.
- Fintech platform conduct risk assessment by reviewing borrowers profile based on information filled in the fintech website. Normally, the communication between the potential borrowers and fintech platform through website. Fintech platform decides to reject or provide loan to the potential borrowers.

- If fintech platform agree to provide loan, the fintech platform transfers loan from its bank to the borrowers' bank account. On the agreed repayment schedule, borrowers transfer the repayment and interest to the fintech platform's bank escrow account.
- Fintech platform transfer the repayment and interest to lenders' bank account.

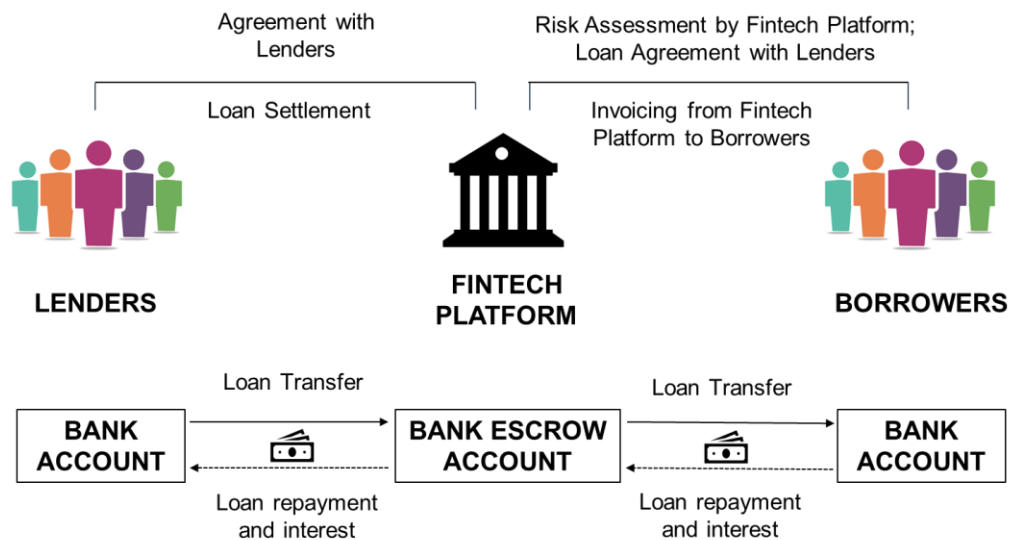


Figure 1 P2P Lending Mechanism

Based on the picture above, the determination of residency for individuals can be done in several stages in the tie breaker rule. The first is seen as a permanent home where a tax subject is. In the case of permanent home cannot solve the dual residence case, then what is next seen is the closest vital interest. That is, seen from the proximity of personal and economic relations in which country. However, in terms of vital interest can not solve the dual residence case, then the next thing that can be used as a determinant is through the approach where the usual Tax Subject is known as habitual abode. If habitual abode cannot split dual residence cases, the next determinant is seen from where the Tax Subject's nationality is. However, in the event that citizenship of tax subjects also cannot break the dual residence case, then the following is through procedures regulated in the Mutual Agreement Procedure or MAP.

Income tax treatment on P2P lending depends on the parties involved and taxpayer category who earn income. According to Law Number 7 Year 1983 that lastly amended by Law Number 36 Year 2008 on Income Tax ("**Income Tax Law**"), Article 2, taxpayer can be categorized to be individual and non-individual taxpayer. Individual includes any inheritance that has not distributed to the heir. The non-individual taxpayer is basically association of persons or capital, including partnership, foundation, private limited liabilities company, and stated owned company. In this regards, parties involved on P2P lending is lender, borrower and P2P platform company. Under POJK No 77/2016, both lender and borrower can be individual and non-individual, meanwhile the P2P platform should be a legal entity. Table 1 summarizes parties involved on the P2P Lending and type of income earned by parties.

Table 1 summarizes parties involved on P2P lending, income/expense received or borne by each party.

**Table 1. Tax Treatment on Fintech**

Parties Involved on P2P Lending	Income/Expense
Platforms (legal entity)	Fee
Lender (financial institution and non-financial institution, including individual lender)	Interest income
Individual and non-individual borrower	Interest expenses

Sources: Tabulation of Tax Regulation

As outlined above, under P2P mechanism, there are two types of income from P2P lending transactions, i.e. (i) fee on services provided by P2P platform company. There are 2 (two) types mechanism on service fee payment to platform: fee is directly deducted on loan transferred to borrower, or fee is paid in the form of reward from interest income received by lenders. Level of reward is determined by platform using credit scoring of borrowers and (ii) interest on loan paid by borrowers on loan. The following is income tax analysis

for each party based on Indonesian income tax regulation. The tax analysis also includes withholding tax mechanism.

**a. Income Tax Treatment on Fees Earned by P2P Platform**

The service fee that is earned by P2P platform company meets income criteria under Article 4 Paragraph (1) of Income Tax Law:

*“Tax Object shall be income, namely every kind of addition to economic capacity received or earned by Taxpayers, derived both from Indonesia and outside Indonesia, which may be used for consumption or addition to property of the Taxpayer concerned, in whatever name or form...”*

The service fee earned by P2P platform company is recorded as revenue, which can increase economic capacity of P2P platform company. Thus, based on the above provision, the service fee is subject to income tax. The income tax calculation of the income depends on taxpayer category. As according to POJK 77/2016 the platform should be legal entity (corporation), then income received by the corporation is subject to income tax with the following possible treatment:

- If the platform company's annual gross revenue is not exceeding IDR 4.8 billion (categorized as small, medium and micro enterprise), the income is subject to 0.5% final tax as governed under Minister of Finance Regulation Number 99/PMK.03/2018;
- If the platform company's annual gross revenue is not exceeding IDR 50 billion, the income is subject to tax facility of 50% reduction on normal tax rate, but limited to the net taxable profit based on proportional calculation of gross revenue of IDR 4.8 billion as governed under Article 31E of Income Tax Law;
- Normal tax rate 25% of net taxable profit under Article 17 of Income Tax Law if it does not meet the above criteria.

In general, service fees received by corporation is subject to Withholding Tax Article 23 at 2% of gross payment if the service is included on taxable service as stipulated under Minister of Finance Regulation Number 141/PMK.03/2015. However, service fee received by P2P platform company may be categorized as financial service, which is not subject to WHT Article 23. Ministry of Finance issued Minister of Finance Regulation Number 251/PMK.03/2015 on 31<sup>st</sup> December 2018 that defines financial service as interest or other benefits provided for lending and / or providing financing, including those using sharia-based financing. [6]The financial service should be performed by an business entity that perform lending and / or providing financing, i.e. (i) finance company which is a business entity outside the bank and a non-bank financial institution that is specifically established to carry out activities that are included in the business sector of a financial institution and have obtained a business license from the Minister of Finance and (ii) state-owned enterprises or regionally owned enterprises specifically established to provide financing facilities for micro, small, medium and cooperative businesses, including PT (Persero) Permodalan Nasional Madani. Based on the above regulation, it can be concluded that WHT Article 23 does not apply on the service fee received by P2P platform entity. As results, P2P platform company pay any corporate tax payable through self-assessment mechanism.

**b. Withholding Tax Treatment on Interest Payment**

In general, interest payment is subject to 15% Withholding Tax (“WHT”) Article 23 if the following requirements are met:

- Interest is paid by non-individual taxpayer or individual taxpayer that is assigned to be WHT 23 withholder by Directorate General of Taxation (“DGT”).
- The interest is not paid or payable to a financial service entity which serves as a loan intermediary and/or financing stipulated by the Minister of Finance Regulation.

P2P lending in Indonesia mostly target individual borrower. Based on the Article 23 of Income Tax Law, if the lender is individual, interest payment is not subject to WHT Article 23 as lender commonly is not WHT 23 withholder. However, further analysis is required if the lender is non-individual or certain individual who is assigned by Directorate General of Taxation as WHT Article 23 withholder. The question arisen is whether the interest transferred to P2P platform's bank account is regarded as P2P platform or income of lenders.

Interest payment is in substance is lender's income from its loan to borrower. P2P platform company simply earn fee from its intermediary function. Moreover, in some cases, P2P platform simply deducts fees on the interest payment and transfer the remaining balance to borrower. However, there is possibility that the interest may be regarded as income of P2P platform company as legally the loan is between P2P platform

company and lender. The other justification is that the loan repayment and interest is paid to P2P platform's bank account. Specific tax regulation is required for certainty reason. The following is WHT Article 23 analysis based on existing income tax regulation.

#### **Interest as P2P platform company's income**

Interest income paid by borrower may be regarded as income of P2P platform company as the interest legally made from loan from P2P platform company. Moreover, the loan agreement is made between P2P platform company and borrower. Lender does not have information access to whom the loan is transferred. The arrangement is the same as lending mechanism in banking institution. From this perspective, P2P platform company earn the interest income from borrower. In this regards, WHT Article 23 does not apply on interest payment as referring to Article 23 Paragraph (4) of Income Tax Law, i.e. payment to P2P platform as financial service entity which serves as a loan intermediary is exempt. This means the borrower should not deduct 15% WHT on the interest payment. Further, 15% WHT 23 is payable when P2P platform company make interest payment to borrower.

#### **Interest as lender's income**

Interest payment from borrower may be regarded as lender income from its loan. P2P platform company only administer bank escrow account to receive repayment and interest payment from borrower. P2P platform company may deduct fee from the interest income received from lender. The remaining balance is transferred to lender. In this respect, WHT Article 23 treatment is as follows:

- a. 15% WHT Article 23 applies on the interest payment to individual lender or non-financial institution lender. The 15% WHT Article 23 is payable when (i) the interest is paid or (ii) the interest is due according to loan agreement. However, the 15% WHT Article 23 cannot be imposed properly. According to POJK 77, P2P platform company cannot disclose lender information to borrower, meanwhile the borrower is required to mentioned lender identity, including tax identification number (Nomor Pokok Wajib Pajak or "NPWP") of lender in the WHT Article 23 slip. Accordingly, although 15% WHT Article 23 is payable on the interest payment, the borrower administratively cannot issue the WHT Article 23 slip.
- b. 15% WHT Article 23 does not apply on the interest payment to financial institution lender. According to Article 23 Paragraph (4) of Indonesia Income Tax Law, interest paid or payable to a financial service entity which serves as a loan intermediary and/or financing stipulated by the Minister of Finance Regulation is exempted from WHT Article 23.

#### **4.2 Value Added Tax on P2P Lending**

As governed under Law Number 8 Year 1983 as lastly amended by Law Number 42 Year 2009 on VAT and Luxury Sales Tax ("VAT Law"), taxable services rendered by a VATable entrepreneur in the Indonesian customs area is subject to 10% VAT. VATable entrepreneur is individual or non-individual taxpayer that deliver taxable services or goods. The taxpayer is obliged to register as VATable entrepreneur if its gross turn over within one year is exceeding IDR 4.8 billions. Meanwhile, Taxable services means all services, unless the service is not taxable service or exempt from VAT based on the VAT Law.

Referring to Article 4A Paragraph (3) of VAT Law, financial service is not subject to VAT. The financial service is defined as follows:

1. fund raising services from the community in the form of giro, time deposit, deposit certificate, saving, and/or other similar forms;
2. services of fund placement, fund borrowing, or fund extension to other parties by using letter, telecommunication facilities or bearer's draft, cheque, or other facilities;
3. financing services, including financing based on the sharia principle, in the form of:
  - a) leasing with option right;
  - b) factoring;
  - c) credit card business; and/or
  - d) consumer financing;
4. loan allocation services based on law on pledge, including syariah and fiduciary pledge; and
5. underwriting services.

The above financial service includes banking intermediary service, which is not subject to 10% VAT. The same VAT treatment should be applied on intermediary function of P2P platform company. However, due to the absence of VAT regulation on P2P lending, the intermediary service of P2P platform company may be treated differently to bank intermediary service. In a bank institution both funds from lender and loan for borrower are recorded as bank's liabilities and assets, while in P2P platform company, both funds from lender

and loan is not recorded in the balance sheet. The different accounting report on the transactions may reflect different substance of transactions.

## V. CONCLUSION

The absence on specific tax regulation on P2P lending results uncertainty. The above discussion shows the interpretation on general tax regulation regarding to P2P lending transaction may result different tax treatment, both on WHT and VAT. In this regard, it is recommended for tax authority to issue specific tax regulation on P2P lending. P2P platform company in substance functions as intermediary company between investor and lender, which is similar to banking institution. The main difference between P2P platform company and bank is the using of technology, size of funding and borrower target. Accordingly, it may be considered to apply WHT and VAT treatment on banking institution *mutatis mutandis* to P2P platform institution.

By applying WHT treatment on interest payment to banking institution (*mutatis mutandis*), interest payment borrower to P2P platform institution is not subject to WHT Article 23, while interest payment from P2P platform to borrower is subject to final WHT at 20%. VAT on P2P platform company as intermediary between borrower and lender should also not subject to 10% VAT. By applying the same WHT and VAT treatment, there will be fairness for P2P platform company.

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