Tax Planning for Shipping Company Business Expansion

Sandy Zulfadli
Faculty of Economics and Business, University of Indonesia

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Abstract: Several previous studies have shown that tax planning schemes have significant effects on the valuation of firms in terms of investment decisions for global expansion. This research limits its scope in tax planning, precisely in how to choose the most profitable legal form of business units from taxation aspect, by simulating how much total tax expenses are incurred by the company, whether they conduct business in Singapore with subsidiary, with permanent establishment or without subsidiary nor permanent establishment. The country used as the basis (as the benchmark/example for expansion destination) for this paper is Singapore, as Singapore is frequently used by Indonesian-based companies for expansion destination, due to its close geographical location, corporate-friendly tax regulations, and high legal certainty, connected to its economic and political stability. The research method used in this paper is the qualitative analysis method, with a case study approach using company X, which is based in Indonesia and conducts domestic and international shipping operations. The data used in this paper are primary data such as company profiles, business development plans and financial reports from X company, as well as corporate tax regulations in Indonesia and Singapore. This study finds that a company that conducts its business without subsidiary nor permanent establishment in Singapore, is the most profitable legal form of business unit according to taxation aspect.

1. INTRODUCTION

With its unique geographical location between two continents (mainland Asia and Australia) and two oceans (the Pacific and Indian oceans), Indonesia faces both advantages and disadvantages in business. The Indonesian government currently aspires to make Indonesia as world maritime power. Along with the government’s vision, the private sector moved in the same direction. To encourage maritime connectivity, the government started to provide many incentives to increase private sector participation in supporting government programs. This momentum can be an opportunity for the private sector to develop businesses, especially in the maritime industry.

Researchers see the potential of the maritime industry, with shipping especially still having enormous potential to be developed. Based on data on loading and unloading at Indonesian ports as outlined in Table 1, it can be seen in 2015 that domestic cargo reached 294,309 thousand tons and overseas cargo reached 340,001 thousand tons.

Table 1: Domestic and overseas loading and unloading at the Port of Indonesia from 1988-2015 (thousand tons).

<table>
<thead>
<tr>
<th>Year</th>
<th>Domestic</th>
<th>Overseas</th>
</tr>
</thead>
<tbody>
<tr>
<td>1988</td>
<td>294,309</td>
<td>340,001</td>
</tr>
<tr>
<td>1990</td>
<td>294,309</td>
<td>340,001</td>
</tr>
<tr>
<td>1992</td>
<td>294,309</td>
<td>340,001</td>
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<td>1994</td>
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<td>2002</td>
<td>294,309</td>
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<td>2004</td>
<td>294,309</td>
<td>340,001</td>
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<tr>
<td>2006</td>
<td>294,309</td>
<td>340,001</td>
</tr>
<tr>
<td>2008</td>
<td>294,309</td>
<td>340,001</td>
</tr>
<tr>
<td>2010</td>
<td>294,309</td>
<td>340,001</td>
</tr>
</tbody>
</table>

Source: http://www.bps.go.id/

Several previous studies have shown that tax planning has a significant effect on firm value. Heeti Herawati and Diah Ekawati (2016), said that overall tax planning affects the value of the company. This is in line with research conducted by Mihir A. Desai.
and Dhammika Dharmapala (2007) where their research concluded that tax planning has a positive effect on firm value if the company has a good governance. However, the studies mentioned above used quantitative approach, where it clearly illustrates the magnitude of the influence of tax planning on firm value, but does not explain how tax planning can contribute optimally to company value for shareholders.

The characteristics of the business sector and business processes conducted by the company are the determinants of how the tax planning scheme should be used. On this study, through a case study of X company, the writer will simulate how tax planning be used for shipping company business expansion.

Business expansion usually starts in the selection of the legal form of business unit and choosing the destination country of business expansion. In this step, many aspects should be considered, including the tax saving aspect. The country used as the basis (as the benchmark/example for expansion destination) for this paper is Singapore, as Singapore is frequently used by Indonesian-based companies for expansion destination, due to its close geographical location, corporate-friendly tax regulations, and high legal certainty, connected to its economic and political stability.

This research limits its scope in tax planning, precisely in how to choose the most profitable legal form of business units from taxation aspect. So that, the research question is how to choose the most profitable legal form of business units according to taxation aspect. To answer the question, author simulate how much total tax expenses are incurred by the company and how much total profit after taxes, whether they conduct business in Singapore through subsidiary, through branch/permanent establishment, or without subsidiary nor permanent establishment. The results of analysis then compared to each alternatives, to conclude which legal form is the most profitable. Justification shall be applied to the conclusion of this study, so that could be a guidance for other similar companies.

2. LITERATUR REVIEW

In this section the researcher will review theories, regulations and results of previous studies related to tax planning. According to Arikunto, “In all sciences, scientists always begin their research by exploring what has been stated by other experts” (Arikunto, 2016). Several previous studies have shown that tax planning has a significant effect on firm value. Heeti Herawati and Diah Ekawati (2016) in their research journal: The Effect of Tax Planning on Corporate Values, concluded that overall tax planning affects the value of the company. The study reinforces research conducted by Mihir A. Desai and Dhammika Dharmapala (2007) where their research concluded that tax planning has a positive effect on firm value if the company has high governance.

2.1 Tax Planning

1. Tax management as well as general management concepts requires the activities of planning, organizing, implementing and controlling. According to Pohan, “Tax management is a comprehensive effort carried out by tax managers in a company or organization so all matters related to taxation from the company or organization can be managed properly, efficiently, and economically, so can give maximum contribution to the company.” (Pohan, 2017).

2. Tax planning is considered as the starting point of tax management. Tax Planning is a process of organizing a taxpayer's business in such a way that the tax debt for both the income tax and other taxes are in a minimal amount, as long as it does not violate the regulations. Larry Cumbrey et al (1994) stated that tax planning is “The systematic analysis of differing tax options aimed at minimizing the tax liability in current /and future tax periods” (Pohan, 2018).


2.2 Shipping Company

According to Indonesian Shipping Law No. 17 of 2018, “Shipping is an integrated system consisting of transportation in waters, port, safety and security, and protection of the maritime environment”. According to Indonesian Government Regulation No. 20 of 2010 “The National Sea Transport/Shipping Company is an Indonesian legal entity that carries out sea transportation activities
within Indonesian waters and / or from and to foreign ports”. The term shipping company in this research refers to a corporate that wants to conduct business in the shipping industry both domestically and / or overseas.

Overall the products of shipping industry are as follows: shipping services, agency services, charter services, and freight forwarding. Charter services are depend on the agreements. Charter agreements specify the types of services provided, whether bareboat or fully manned. Fully manned service fee, defined whether its time charter or voyage/trip charters.

2.3 Shipping Income Tax Regulation

Indonesian Income Tax Law of 1983 in Article 4 Paragraph (1) Letter stated, “…Taxpayers who are subject to final tax or taxpayers who use Deemed Profit norms as referred to in Article 15”. Meanwhile in Article 15 mentioned that “The Minister of Finance can make a regulation to set a Special Calculation Norm to calculate the net income of certain Taxpayers that cannot be calculated based on Article 16”. Furthermore, Indonesian Minister of Finance Decision Letter Number KMK-416/KMK.04/1996 regulate that net income of shipping income of a domestic shipping company is about 4% of its gross shipping income and effective tax rate is 1.2% of its gross shipping income. As KMK-417/KMK.04/1996 regulate that net income of shipping income of foreign shipping company is about 6% of its gross shipping income and effective tax rate is 2.64% of its gross shipping income (Branch Profit Tax included). These Indonesian shipping income taxes are final, so that all costs connected to shipping income should not be reduced from taxable income, as stipulated in Indonesian Government Regulation No. 94 of 2010 Article 13. Regarding bookkeeping of final and non-final income is regulated in Article 27, in this case must be booked separately, joint cost that cannot be separated in order to calculate Taxable Income, the charge is allocated proportionally.

Singapore Income Tax Act Sections 13A stated, “There shall be exempt from tax the income of a shipping enterprise derived or deemed to be derived from the operation of Singapore ships or foreign ships as hereinafter provided”. Inland Revenue Authority of Singapore stated on its official website, that “approved international shipping enterprises operating ships plying in international waters enjoy tax exemptions on certain types of international shipping income under Section 13F of the Income Tax Act (ITA)”. So that, shipping income of resident shipping company and approved international shipping company, were exempted under Section 13A and/or 13F of Singapore Income Tax Act.

As described on Inland Revenue Authority of Singapore official website, this following types of payment are not subject to Withholding Tax: dividend payments; payments to Singapore Branches of Non-Resident Companies; Payments made by Banks, Finance Companies and certain Approved Entities; Payments for the Charter of Ships; Other payments.

Agreement between the Republic of Singapore and the Republic of Indonesia for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, in Article 8 Paragraph 2 stated, “Income derived by an enterprise of a Contracting State from the operation of ships in international traffic maybe taxed in the other Contracting State, but the tax imposed in that other State shall be reduced by an amount equal to 50% thereof”.

3 METHODOLOGY

3.1 Research Method

The research method applied in this research is descriptive qualitative research. There are several kinds of qualitative research methods, but in this case the researcher uses a case study approach.

The unit of analysis in this research is a single analysis unit. The object of the research in question is X company, which is a subsidiary of one of the Republic of Indonesia State-Owned Enterprises, formed to run commercial shipping business domestically and internationally.

X company selected as an object, due to its newly established, its well managed profit, and recently plan to expand its business.

3.2 Data Analysis

The data used for this study consist of primary data such as company profiles, business development plans and financial reports from X company, as well as corporate tax regulations in Indonesia and Singapore. Data collection techniques are conducted by interview method and documentation. The instruments of data collection used were recording devices, interview guidelines, checklists and tables.
3.3 Research Model

This research model shows how to choose the most profitable legal form of business units by simulating how much total tax expenses are incurred by the company and how much total profit after taxes remain, whether they conduct business in Singapore with subsidiary, with permanent establishment or without subsidiary nor permanent establishment. Research mind flow model described in Figure 1.

![Figure 1: Research mind flow model](image)

4 ANALYSIS

The characteristics of the business sector and business processes conducted by the company are the determinants of how the tax planning scheme constructed. In this section, through a case study of X company, the author simulate what kind of scheme should be used in tax planning for shipping company business expansion.

Business expansion usually starts in the selection of the legal form of business unit and choosing the destination country of business expansion. In this step, many aspects should be considered, including the tax saving aspect. In this section, the author simulate how much total tax expenses are incurred by the company in three forms of alternatives, whether they conduct business in Singapore through subsidiary, through branch/permanent establishment, or without subsidiary nor permanent establishment (direct business).

X company as the object of this research, in accordance with its Articles of Association the Company shall conduct these following activities:

- a. Carrying inter-port sea transportation.
- b. Transporting passengers, animal and cargos.
- c. Services related business activities.

Wimbo Hapsara as manager strategic planning and business development of X company through personal interview explain that in 2017, X company conduct business only from domestic transaction and gained nett profit about 15.71% of its revenue as shown in Table 2. Due to the recent issues, X company needed to expand its business internationally to maintain the growth of its revenue and for company sustainability. According to the master plan of business development, X company will expand to the countries that considered as international maritime hub, such as: Singapore, Uni Arab Emirates (Dubai), Hongkong, England (London), United States of America (Houston). In 2018, X company projected to earn shipping income from international transaction about 10% of total revenue (Hapsara, 2018).

Table 2: Income statement profile of X company for the year ended Dec, 31 2017.

<table>
<thead>
<tr>
<th>Account Name</th>
<th>Amount (USD)</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Revenue</td>
<td>90,xxx</td>
<td>100%</td>
</tr>
<tr>
<td>Cost of Revenue</td>
<td>80,xxx</td>
<td>81%</td>
</tr>
<tr>
<td>Operating &amp; Other expense</td>
<td>3,xxx</td>
<td>3.36%</td>
</tr>
<tr>
<td>Nett Profit before Taxes</td>
<td>15,xxx</td>
<td>15.71%</td>
</tr>
</tbody>
</table>

Source : X company financial statements for the year ended dec,31 2017 (Processed by author).

Since the destination country of expansion is Singapore, then tax planning should comply to both of Indonesian tax regulations and Singapore tax regulations. Agreement between both countries to avoid double taxation, also had to be considered.

Before simulating how much tax savings from each legal form of a business unit, it is necessary to arrange several assumptions to simplify the financial profile of each alternative to make it easier to compare. The assumptions arranged by the author are as follows:

- Direct business (conduct shipping business without subsidiaries nor branch/permanent establishment) are allowed by expansion destination country.
- Projected total revenue in this case are about 120 million US Dollars. Which is 105 million US Dollar shipping revenue from domestic transaction, 10 million US Dollar shipping revenue from expansion/international transaction, and 5 million US Dollar other revenue that object of regular rate of Indonesian Tax Income.
- Direct cost of all alternatives assumed to be equal. In this case author used percentage of X company financial profile that is 81% of total projected revenue earned in each countries.
- Projected operating and other expenses incurred in Indonesia assumed to be constant of all alternatives, which is according to X company financial profile, that is 3.36% of total projected revenue.
- There are extra operating expenses to run Branches or Subsidiaries, and both assumed to be equivalent. In this case, author assumed the percentage is about 5% of projected expansion revenue.
- All nett profit of Subsidiaries declared as dividend, and transferred to parent company after deducted by dividend withholding tax.
- Fiscal adjustments only from shipping income that considered to be final, deducted by direct costs and operating & other expenses that cannot deducted regarding to shipping income.

Due to assumptions above, projected operating and other expenses in Indonesia are 3.36% of 120 million US Dollars or $ 4,032,000 of all alternatives. Extra operating expenses whether expansion conducted through Branch or Subsidiary are 5% of 10 million US Dollars or $ 500,000.

### 4.1 Expansion through Subsidiary

Expanding business through subsidiary means forming a new entity in the destination country and becomes resident company of destination country. The consequences are revenues, direct costs and operating expenses incurred in the destination country reported as separate entity. Profit from subsidiaries that has been earned transferred to the parent company by dividend.

According to Singapore Tax Regulations, Shipping income of resident companies are exempted from Income Tax, as well as dividend payments are not subject to Withholding Tax, so that no taxes to be charged in Singapore. Since projected shipping revenue from Singapore is US$10 million, direct costs assumed is US$8.1 million and operating and other expenses assumed are US$500 grand, then Nett profit after taxes in Singapore is US$1.4 million, and all transferred as dividend to parent company.

Dividend from Singapore Subsidiary, is reported in Parent Company financial statements as overseas nett income that object of regular rate of Indonesian Corporate Income Taxes, so total Indonesian commercial nett profit before taxes is US$ 18,268,000, specifc calculation is described in Figure 2.

#### 4.2 Expansion through Branches

Expanding business through branches means conducting business in the destination country without forming new entity, only placed a permanent establishment and registered as tax subject in destination country. In this form, revenues, direct costs and operating expenses...
incurred in the destination country reported all in central company financial statement. Any taxes that incurred regarding revenue are deducted over the commercial net profit that earned in destination country, and the rest is called as Branch Profits. Branch Profit frequently transferred to central company after deducted withholding tax (if any).

Since shipping income are exempted from income tax under Section 13A and/or 13F of Singapore Income Tax Act, then in this form of business unit there is no taxes to be charged in Singapore too. So that, the total Branch Profit to be transferred to the central company is equal to US$1,400,000.

4.3 Expansion through Direct Business

Expanding business through direct business means conducting business in the destination country without forming new entity nor register a permanent establishment. In this form, revenues, direct costs and operating expenses incurred in the destination country reported all in central company financial statement. Any taxes that incurred regarding revenue are become overseas tax credit in Indonesia.

Actually this form similar to conduct business expansion through Branches, however there is one difference that is the absence of extra operating and other expenses. Since Singapore tax income on a quasi-territorial basis, as long as X company afford to run this business remotely/virtually, International transaction is better be runned from Indonesia.

Simulation of X company Income Statement described in Figure 4. Commercial net profit before taxes is become US$ 18,786,000. After fiscal adjustment of US$ 17,986,000, the Indonesian Taxable Income which is the object of regular rate is US $ 782,000 and the Corporate Income Tax payable is equal to US$ 195,000. According to calculations above, total tax expenses over total projected revenues are US$ 1,575,500 and total profit after taxes is US$ 17,192,500.

X Company in Indonesia Income Statement
For the year ended December 31, 20xx

a. Shipping revenue from domestic $ 105,000,000
b. Shipping revenue from Branch $ 10,000,000
c. Other revenue (Object of regular rate) $ 5,000,000
d. Total Revenue (a+b+c) $ 120,000,000
e. Direct Cost (Indonesia & Singapore) $ 8,100,000
f. Gross Profit (d-e) $ 11,900,000
g. Operating & Other Expenses $ 9,900,000
h. Operating & Other Expenses incurred in Branch (5%) $ 495,000
i. Commercial Nett Profit Before Taxes (f-g-h) $ 2,150,292
j. Positive fiscal adjustment (95.83% of e+g+h) $ 97,014,000
k. Negative fiscal adjustment $ 200,000
l. Fiscal Nett Profit (i+j-k) $ 200,292
m. Indonesian Income Tax (Regular rate 25%) $ 190,292
n. Indonesian Shipping Income Tax (Effective rate 1.2%) $ 1,180,000
o. Total Tax expenses (m+n) $ 1,570,292
p. Profit after taxes (i - n) $ 16,697,708

Figure 4: Income statement simulation over expansion through Direct Business (Processed by the author).
5 CONCLUSION

According to previous analysis, author compared profit after taxes of all alternatives. The resume results of all alternatives shown by Table 3.

Table 3: Resume of income statement simulations.

<table>
<thead>
<tr>
<th>Alternatives of legal form</th>
<th>Tax Expenses (US$)</th>
<th>Profit After Taxes (US$)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Subsidiary</td>
<td>1,801,682</td>
<td>16,466,318</td>
</tr>
<tr>
<td>Branch/Permanent Establishment</td>
<td>1,570,292</td>
<td>16,697,708</td>
</tr>
<tr>
<td>Direct Business</td>
<td>1,575,500</td>
<td>17,192,500</td>
</tr>
</tbody>
</table>

Source: Processed by author.

Author finds that conduct business expansion through direct business (without subsidiary nor branch/permanent establishment), becomes the most profitable legal form of business unit, connected to the result of simulations that earned the largest profit after taxes over all alternatives. The difference between profit after taxes of expansion through Direct Business and Branch/Permanent Establishment is equal to US$ 494,792, which is US$5,208 lower than the absences of extra operating & other expenses assumed to this case. Amount of US$5,208 defined as the tax gap over the absences of extra operating & other expenses. It seems that the gap not too significant, but shows that there are differences caused by the absences, and the amount will increase by the amount of extra operating & other expenses assumed for other alternatives.

If the assumptions about direct business cannot be applied due to local government policies, then the most profitable legal form is to carry out business expansion through branches / permanent establishment. The difference between profit after tax X company which carries out business expansion through subsidiary and through branches / permanent establishment is US $ 231,390. This difference describes the tax saving caused by effective shipping rates of 1.2% of gross revenue earned by branch / permanent establishment, taxed lower than a regular income tax rate (25% of dividend earned from Subsidiary). As long as Branch Profit are greater than 4.8%, there will always be tax savings occurred over tax planning. Based on the simulation steps carried out in the previous section, the author recommends that company’s manager take these steps to provide relevant information for stakeholder, regarding tax planning aspect for shipping company business expansion especially in choosing the legal form of business unit.

The results of the research on the development of Teaching Materials for Problem Based Learning Strategy include: 1) student worksheet; 2) learning strategy material; and 3) problem-based evaluation instruments.

Student worksheets are developed to help students understand the teaching material for learning strategies. Student worksheets are designed to adopt problem-based learning steps which include: 1) problem orientation; 2) learning organization; 3) individual or group investigations; 4) development and presentation of problem solving results; 5) analysis and evaluation of the problem solving process.

Teaching materials designed include: 1) learning theory in learning; 2) basic concepts of learning strategies; 3) 21st century learning strategies; 4) learning approach; 5) learning methods and techniques; 6) learning models; 7) teaching factory; 8) strengthening character education.

Evaluation instruments designed include: 1) problem-based problem instruments; and 2) assessment guidelines.

REFERENCES