Indonesia Tax Alert August 2017

Update on Indonesian Controlled Foreign Corporation Rule

The Minister of Finance ("MoF") has issued regulation number 107/PMK.03/2017 ("PMK-107") dated 27 July 2017 to update the implementation of the CFC rule. This regulation revokes PMK-256/PMK.03/2008 ("PMK-256") and some parts of MoF Decision 164/KMK.03/2002 ("KMK-164") on foreign tax credit for dividends paid by a Controlled Foreign Corporation ("CFC"). This new CFC rule is effective starting in fiscal year 2017.

CFC Criteria

The CFC rule is applicable to an Indonesian taxpayer's ownership in a non-listed foreign company. While PMK-256 did not mention direct or indirect ownership, PMK-107 explicitly mentions the criteria of direct and indirect CFC as follows:

- A direct CFC is a foreign company that is owned by an Indonesian taxpayer, or together with other Indonesian taxpayer(s), with direct ownership of at least 50% of the total paid-in share capital.
- An indirect CFC is a foreign company at least 50% of whose shares are collectively owned by an Indonesian taxpayer and a direct or indirect CFC; or collectively owned by an Indonesian taxpayer and another Indonesian taxpayer through direct or indirect CFC; or collectively owned by direct and/or indirect CFC.

The amount of the capital participation is the percentage of ownership measured at the end of the fiscal year of the Indonesian taxpayer, either:

1. Total paid-up capital issued by the non-listed foreign company; or
2. Total paid-up capital with voting rights issued by the non-listed foreign company.

Based on PMK-170, the CFC rule is applicable to multiple layers of subsidiaries, with a 50% threshold criterion applied at each level.

Trust

In the case where the CFC is owned through a trust or similar entity, such trust or similar entity will be looked through irrespective of the type of trust. This implies that a settlor owning a CFC through a trust can still be subject to Indonesian CFC rule as long as there is certain control. In this regard, if this CFC rule is applied, there may be a multiple tax applied, i.e. on the settlor and the trust itself (depending on the type of trust).

Timing of Deemed Dividend

There is no change in relation to the recognition of deemed dividend, i.e. in the 4^{th} month following the end of submission deadline if the CFC has an annual income tax return obligation or in the 7^{th} month following the end of the fiscal year if the CFC has no obligation to submit an annual income tax return or there is no provision on submission deadline of annual income tax return.

Deemed Dividend Calculation

Deemed Dividend is determined based on net income after tax of the direct CFC multiplied by the shareholding percentage in such direct CFC. PMK-170 introduces a new provision to calculate deemed dividend from indirect CFC, i.e. the tax base is the indirect CFC's net income after tax multiplied by the effective shareholding percentage of the direct CFC over the indirect CFC.

It should be noted that the CFC's net income after tax is based on the accounting principle adopted in the CFC's state of residence, and the actual tax paid in that state. Further, such net income also includes other income/ gain derived by the CFC.

Another important feature of PMK-170 is that deemed dividend can be offset against the actual dividend received from the direct CFC within the past 5 consecutive years. In the case that the actual dividend received is greater than the deemed dividend, the discrepancy is subject to income tax and shall be declared in the annual income tax return for the fiscal year when the actual dividend is received.

Foreign Tax Credit

An Indonesian taxpayer may credit the income tax paid or deducted for dividends received from a direct CFC in the fiscal year when the tax is paid or deducted with the following limit, whichever is lowest;

1. The effective tax treaty rate that should be payable/ must be paid;
2. Foreign income tax actually payable or paid;
3. An amount which is calculated based on the proportion of dividend received from the direct CFC and the available deemed dividend, multiplied by the income tax due on such deemed dividend. The income tax due on deemed dividend is calculated based on the proportion of the deemed dividend to the taxable income, multiplied by the income tax payable.

To claim the foreign tax credit, certain documents of the direct CFC must be provided to the DGT.

For more detailed illustration on the definitions and examples of calculations, please refer to the attachment of PMK-17.

Contact Persons

Questions concerning any of the subjects or issues contained in this newsletter should be directed to your usual contact in our firm, or any of the following individuals:

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