KPMG

Tax News Flash

August 2017

Amended Controlled Foreign Company Rules

On July 27 the Ministry of Finance issued Regulation No. PMK-107/PMK.03/2017 ("PMK-107"), which amends the Indonesian Controlled Foreign Company ("CFC") rules. PMK-107 is applicable as per fiscal year 2017 and it revokes PMK-256/PMK.03/2008 and part of KMK-164/KMK.03/2002 regarding the foreign tax credits ("FTC") for dividends paid by a CFC.

The main definition of CFC remains the same. A CFC is a non-listed foreign company, which is at least for 50% (paid-up capital or paid-up capital with voting rights) owned by:

i. An Indonesian taxpayer (company or individual); or

ii. A group of Indonesian taxpayers (companies or individuals).

The most important change under PMK-107 is that now also indirectly owned (non-listed) CFCs will fall under the CFC rules. An indirectly owned CFC is defined as a foreign company, which is held for at least 50% by:

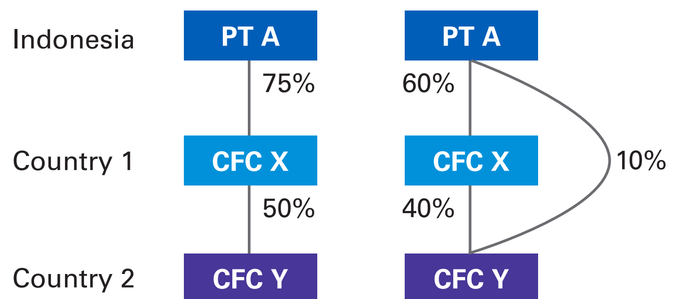
i. Another CFC, or

ii. Various CFCs held by Indonesian taxpayers, or

iii. Various CFCs held by the same or more Indonesian parent companies.

The 50% threshold requirement should be fulfilled as per the end of the fiscal year of the Indonesian taxpayer. For the indirect CFCs, the threshold is determined based on the ownership of the indirectly held CFC. If the indirect CFC is held for at least 50% by another CFC, it will be regarded as an indirectly owned CFC. The threshold is not determined proportionally. If the CFC is held for less than 50% by another CFC, but the Indonesian taxpayer also has a direct stake in it, the percentages of both stakes should be added up. If at least 50% of the CFC is (in)directly owned by the Indonesian taxpayer, the CFC rules apply (see the example on the right below, whereby CFC Y is indirectly held for 40% and directly for 10%).

Examples:



If an Indonesian taxpayer owns a CFC through e.g. a trust or foundation, a "look-through" approach will be applied.

The Indonesian taxpayer has to recognize a deemed dividend from a CFC by the end of the fourth month after the CFC had to submit its local corporate income tax return. In case the CFC is not required to submit a tax return, the deadline for the Indonesian taxpayer is the end of the seventh month after the end of the CFC's fiscal year.

The deemed dividend is calculated based on the effective ownership of the Indonesian taxpayer in the CFC (i.e., proportionally). In example on the left side above the deemed dividend from CFC Y would be 37.5% (i.e., 75% of 50%) of its commercial profits after tax.

If a CFC does actually pay a dividend, this amount can be offset against the previously reported deemed dividend. However, only against deemed dividend of the last five years.

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The regulation provides for a FTC on taxes paid on the actual dividend distributions. So no FTC is given for the underlying corporate tax of the CFC (if any). The FTC is limited by the lower of the following amounts (if dividends are paid from more countries, a per country limitation applies):

i. The foreign income tax that should have been due under the terms of an applicable tax treaty;

ii. The foreign income tax actually paid or payable; or

iii. The proportion of the deemed dividend on the total taxable income (including the deemed dividend) multiplied by the total tax due in the Indonesian's taxpayer tax return.

A taxpayer should attach the following documents of the directly owned CFC together with its Corporate Income Tax return to be able to claim the FTC:

- Financial statements;
- A copy of the Corporate Income Tax return;
- A calculation or list of profits after tax for the past five years; and
- A tax payment or withholding tax slip on the actual dividend paid.

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KPMG Comments:

The amended CFC rules are stricter than before since now also indirectly held CFCs are covered. So taxpayers with multiple tier structures should have a close look at their structure and may want to re-structure.

It should be noted that the Indonesian rules are stricter than the recommendations in BEPS action plan 3. In general CFC rules are anti-abuse rules, which are often used in order to prevent taxpayers from shifting passive income (interest, royalties etc.) to low taxed jurisdictions. Under the Indonesian rules also legitimate investments in foreign active companies (irrespective of the tax rate in the foreign country) are hit. This regulation would discourage Indonesian companies to invest outside Indonesia as the total tax costs would be higher than if they would invest in Indonesia.

There are also various other issues with regard to the provisions of this PMK-107 that Indonesian tax residents, who plan to invest offshore, must be aware of:

- Indonesian groups investing abroad are more or less forced to invest through foreign branch structures (tax credit for the foreign corporate income tax), which in many cases is not an option.
- Any commercial arrangements (e.g., borrowings for the offshore subsidiaries) must be carefully reviewed as some lenders would not allow the subsidiaries to distribute dividends before the loan has been fully paid back. Besides cash flow issues, this may trigger double taxation payment when the actual dividend is paid because there of the five-years limitation for compensating the deemed dividend amount that has been subject to Indonesian corporate tax with the actual dividend received.
- There may be double tax exposure for not being able to claim the withholding tax ("WHT") on the second tier subsidiaries. We refer to the above example in case CFC Y pays a dividend to CFC X. If there is a WHT obligation, CFC Y will issue the WHT slip to CFC X. It is not clear how PT A can claim the WHT amount from Country 2.

We hope that the Indonesian Tax Authority will consider the above considerations and issue further clarifications.

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