KPMG

GMS Flash Alert

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Indonesia - New Restriction on Allowable Foreign Tax Credit

Indonesia's Minister of Finance has issued Regulation No. 192/PMK.03/2018 ("PMK-192") regarding the implementation of tax credits on overseas income. PMK-192 is more comprehensive than the previous regulation regarding foreign tax credits (FTCs), No. 164/KMK.03/2002 ("PMK-164"), which has now been revoked. PMK-192 is in effect as of 31 December 2018 and applicable starting from the 2018 tax year.

WHY THIS MATTERS

The new regulation will affect taxpayers who are not taxed as non-residents in their home country – U.S. expatriates, for example -- as they will be disadvantaged by the new double tax treaty (DTT) tax rate limitation. Given that the DTT rates for interest, dividends and royalties are between 5 percent and 20 percent while the actual foreign tax paid is likely to be higher, these taxpayers could suffer a significant FTC loss and be required to pay a higher income tax in Indonesia.

Maximum Allowable FTC

According to PMK-164, when calculating the maximum allowable FTC, taxpayers are required to choose the lower of:

- The actual tax paid in a certain country; or
- The portion of tax payable due to income from that country.

Now under PMK-192, there is a third limitation:

- The tax amount under the DTT between Indonesia and the source country, with the assumption that Indonesian tax residents are considered as non-residents and taxed at non-resident rates in the source country. If this amount is lower than the other two options, then the maximum tax credit is limited to this amount. If the DTT states that a certain type of income is only taxable in Indonesia, then no FTC is allowed.

Foreign Losses

PMK-192 clearly states that losses on foreign operations cannot be considered as deductions when calculating taxable income, including business losses from a foreign branch or a foreign representative office.

Trust

PMK-192 includes a definition of "trust" and states that income from a trust should be reported when it is received. The source country of the income is the country in which the trust is established.

If the trust is required to pay foreign tax on its income, then the trust's foreign tax return or evidence of tax paid by the trust can be utilized to claim an FTC against the Indonesian tax payable.

USD Bookkeeping

For companies that conduct their bookkeeping in U.S. dollars ("USD"), any FTCs in other foreign currencies should be converted to USD using the Bank of Indonesia middle rate, or, if unavailable, the daily spot exchange rate on the date when the FTC was payable, paid, or withheld offshore.

KPMG NOTE

- PMK-192 is not applicable for FTCs on dividends paid by a controlled foreign company. Thus, taxpayers should continue to refer to Regulation of the Minister of Finance No. 107/PMK.03/2017, as discussed in the August 2017 edition of our *Tax News Flash*.[1]

- On 9 January 2019, the Directorate General of Taxation issued a press release which states that based on PMK-192 taxpayers are no longer required to attach evidence of the FTC to their annual tax return.[2] However, this is not expressly stated in PMK-192 and therefore taxpayers should still keep the documents in their files for substantiation purposes.

FOOTNOTES

1 Amended Controlled Foreign Company Rules, *Tax News Flash*, August 2017, a publication of the KPMG International member firm in Indonesia.

2 See press release (in Bahasa Indonesian).

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