NEWS ALERT

No. 6/2019

July 2019

- MoF Regulation No. 93/PMK.03/2019
- GR No. 45/2019

Changes to Controlled Foreign Corporation Rules

MoF Regulation No. 93/PMK.03/2019

With the issuance of MoF Regulation 93/PMK.03/2019 ("MoF-93"), the Minister of Finance has amended certain provisions of MoF Regulation 107/PMK.03/2017 ("MoF-107") regarding controlled foreign corporations ("CFC"). MoF-107 expanded the scope of a CFC to cover indirectly owned CFCs. One of the most important changes in MoF-93 is that the definition of deemed dividend is limited in scope to "certain income," which excludes business profits. The intention is to provide greater certainty and fairness when taxing investments in CFCs.

Below is a summary of the general CFC rules, highlighting the new changes under MoF-93. MoF-93 is retroactively applicable from tax year 2019.

Types of CFCs

CFCs consist of:

- *Directly owned CFC:* A non-listed foreign corporation in which an Indonesian taxpayer, individually or collectively with other Indonesian taxpayers, owns 50% or more of the foreign corporation's paid-up shares.
- *Indirectly owned CFC:* A non-listed foreign corporation which is controlled indirectly by an Indonesian taxpayer through:
  - A directly controlled foreign corporation; or
  - A directly controlled foreign corporation and an indirectly controlled foreign corporation in the preceding level of investment,

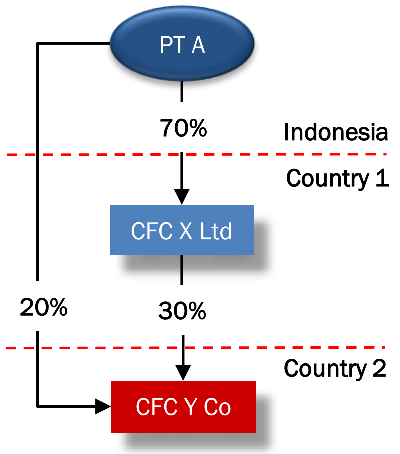
  which owns at least 50% of the paid-up shares at every level of investment.

  An indirectly controlled foreign corporation also includes a foreign corporation in which at least 50% of the paid-up shares are jointly owned by:
  - Indonesian taxpayers and a directly or indirectly controlled foreign corporation;
  - Indonesian taxpayer and another Indonesian taxpayer through a directly or indirectly controlled foreign corporation; or
  - A directly and/or indirectly controlled foreign corporation.

The 50% ownership threshold is determined as of the end of the Indonesian taxpayer's fiscal year.

For an indirectly owned CFC, the 50% threshold is determined based on the ownership of the indirectly owned CFC. Note, however, that if less than 50% of the CFC is held by another CFC in which the Indonesian taxpayer has a direct interest, the shareholdings of other Indonesian taxpayers are combined to determine whether the threshold is met.

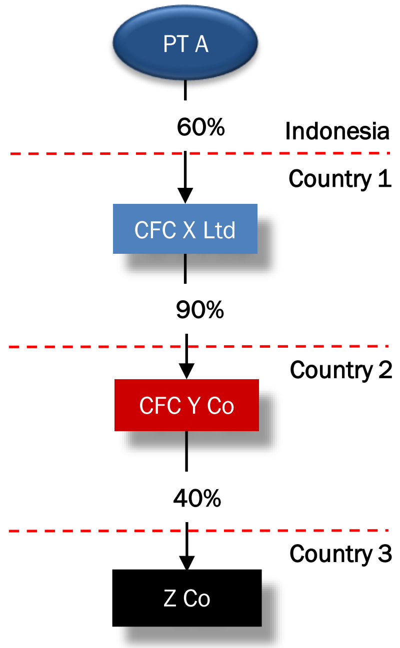
Example 1



PT A has:

- Direct ownership in CFC X Ltd (≥50%)
- Indirect ownership in CFC Y Co (≥50%: 20% direct + 30% through CFC X Ltd)

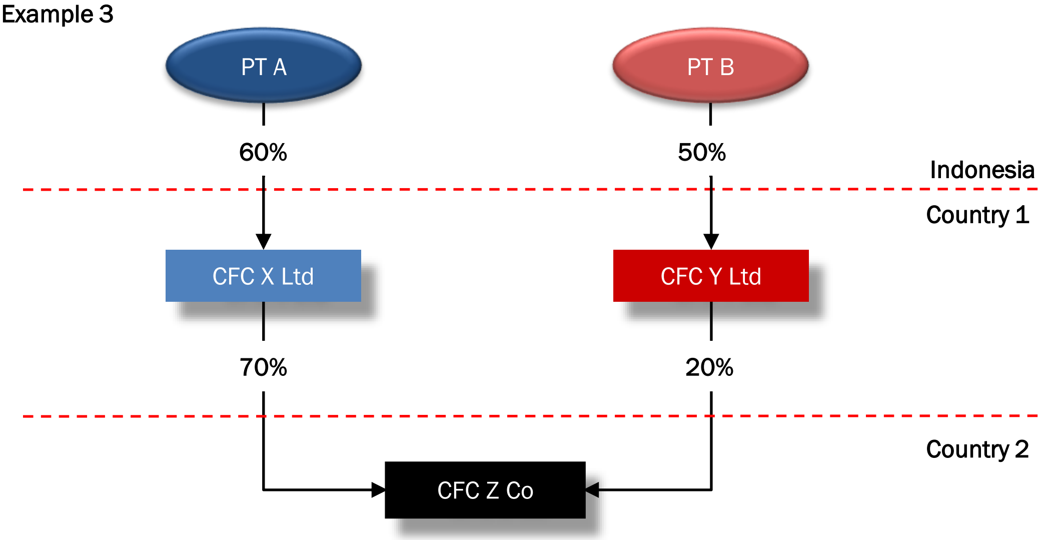
Example 2



PT A has:

- Direct ownership in CFC X Ltd (≥50%)
- Indirect ownership in CFC Y Co (≥50%)
- Ownership in Z Co <50% = not a CFC

Example 3



PT A has:

- Direct ownership in CFC X Ltd (≥50%)
- Indirect ownership in CFC Z Co (each level ≥50%)

PT B has:

- Direct ownership in CFC Y Ltd (≥50%)
- Indirect ownership in CFC Z Co (collectively owned ≥50% by Indonesian taxpayers through CFCs (PT A and PT B through CFC X Ltd and CFC Y Ltd)

Deemed Dividends

The Indonesian taxpayer will be taxed on dividends deemed distributed from the CFC. Under MoF-93 a deemed dividend is defined as originating from the following "certain income":

- Dividends, except for dividends received from the CFC
- Interest, unless received by a CFC which is owned by an Indonesian taxpayer which has a banking license. This exception does not apply if the interest is received from an Indonesian resident taxpayer which is a related party to the CFC.
- Rental income from (i) land and/or building, or (ii) other rental income from a related party
- Royalties
- Capital gains

The calculation of deemed dividend is as follows:

- For a directly owned CFC, the deemed dividend is determined based on the shareholding percentage multiplied by the net income after tax on certain income.
- For an indirectly owned CFC, the deemed dividend is determined based on the percentage of ownership in the respective indirectly owned CFC multiplied by the net income after tax on certain income.

Net income after tax on certain income is the gross amount of the certain income after deducting:

- Costs to obtain, collect and maintain the certain income; and
- Any taxes due, paid, or withheld on the certain income.

As before, the deemed dividend from the CFC is recognized by the Indonesian taxpayer at the end of the fourth month after the CFC submits its local corporate income tax ("CIT") return or, if no return is required, at the end of the seventh month after the end of the CFC's fiscal year.

Foreign Tax Credit

A foreign tax credit ("FTC") is allowed on a deemed dividend received from a directly owned CFC, but the amount is limited to the lower of:

- The tax that would have been due under the applicable tax treaty;
- The foreign income tax actually paid or payable; or
- The amount based on the ratio of the actual dividend received to the deemed dividend multiplied by the income tax due on the deemed dividend.

To claim the FTC, the following documents of the directly owned CFC must be attached to the Indonesian taxpayer's CIT return:

- Financial statements
- A copy of the CIT return
- A calculation or list of profits after tax for the past five years
- A tax payment slip or withholding tax slip for the dividend received

Detailed illustrations of CFC arrangements, as well as deemed dividend and FTC calculations, are provided in the attachments to MoF-107 and MoF-93.

Government Regulation No. 45/2019 ("GR-45") was issued on 25 June 2019 and amends GR No. 94/2010. GR 45 provides additional tax incentives for certain pioneer industries in the form of reductions to net or gross income.

The tax incentives offered in GR-45 are set out below.

Eligible Taxpayer	Incentive
Provides new investment or business expansion in labor intensive industries	A reduction in net income at 60% of the investment amount in fixed assets, including land that is used for the core business, which is expensed for a certain period of time
Provides professional placements, apprenticeship, human resource development	A reduction in gross income up to a maximum of 200% from the total cost disbursed for such activities
Provides certain R&D activities in Indonesia	A reduction in gross income up to a maximum of 300% from the total cost disbursed for certain R&D activities which is expensed for a certain period of time.

It is hoped that these incentives will improve labor quality efficiency and encourage innovations in technology.

Further details are expected in a future MoF regulation.

Tax Incentives

Government Regulation No. 45/2019

For additional information, please contact us:

Sony B. Harsono, Managing Partner
sony.harsono@harsono-strategic.com

Dwi Ary Retnani, Senior Partner
dwiary.retnani@harsono-strategic.com

Julius Hardianto, Senior Partner
julius.hardianto@harsono-strategic.com

Suhartono Maridjan, Senior Partner
suhartono.maridjan@harsono-strategic.com

Budi Harnata, Partner
budi.harnata@harsono-strategic.com

Richard William, Partner
richard.william@harsono-strategic.com

Roedy Andrianto, Director
roedy.adrianto@harsono-strategic.com

Terri Shreve, Technical Advisor
terri.shreve@harsono-strategic.com

Toshihiro Asai, Technical Advisor
toshihiro.asai@harsono-strategic.com

Harsono Strategic Consulting
Sudirman Plaza, Plaza Marein 9th Floor
Jl. Jend. Sudirman Kav. 76-78
Jakarta 12910, Indonesia
ph. +62 21 5793 6777
fax. +62 21 5793 6778
www.harsono-strategic.com