Edition 12
August 2017

MUC Consulting Group
taxBlitz
Tax & Customs Update

CFC Rules Issued, Stipulation of Dividend Acquisition Time Emphasized

Government gives emphasis to the provision on stipulation of dividend acquisition time for non-listed overseas company controller shareholder resident taxpayers. Dividend stipulated as acquired is called deemed dividend.

This provision known as Controlled Foreign Company (CFC) Rules also strengthens the requirements of tax credit recognition on dividend received by Taxpayers from overseas company whose share is not traded in stock exchange, by requiring the provision of company profit data in the last 5 (five) years.

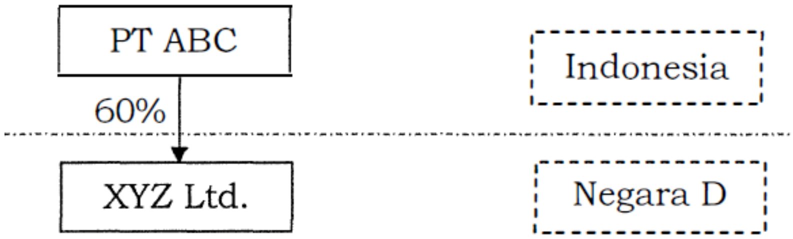
The emphasis related to the CFC is stipulated in the Minister of Finance (MoF) Regulation Number 107/PMK.03/2017 on the Stipulation of Acquisition Time of Dividend by Resident Taxpayers upon Capital Investment in Overseas Business Enterprise (Overseas Enterprise) other than Enterprise Selling its Stock in Stock Exchange.

This MoF Regulation that starts coming into effect since 27 July 2017 automatically replaces the MoF Regulation Number 256/PMK.03/ Year 2008 on Stipulation of Acquisition Time of Dividend by Resident Taxpayer upon Capital Investment in Overseas Business Enterprise Other Than Enterprise Selling Its Stock in Stock Exchange.

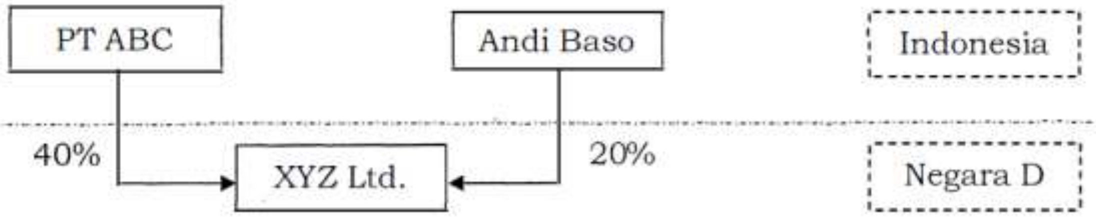
Several things are substantially amended by the issuance of this new policy. First, the basis of tax calculation on dividend in non-stock exchange Overseas Enterprise is expanded. If the previous regulation only targeted the direct controller Taxpayers of non-stock exchange Overseas Enterprise, this MoF Regulation also targets the indirect controller Resident Taxpayers.

Direct Controller

Resident Taxpayers will be considered as direct controller when they have at least 50% shares of paid-up capital of non-stock exchange Overseas Enterprise, either single share ownership or jointly with other Resident Taxpayers. The value of paid-up share equals the value of share issued by non-stock exchange Overseas Enterprise or the value of share having voting rights.



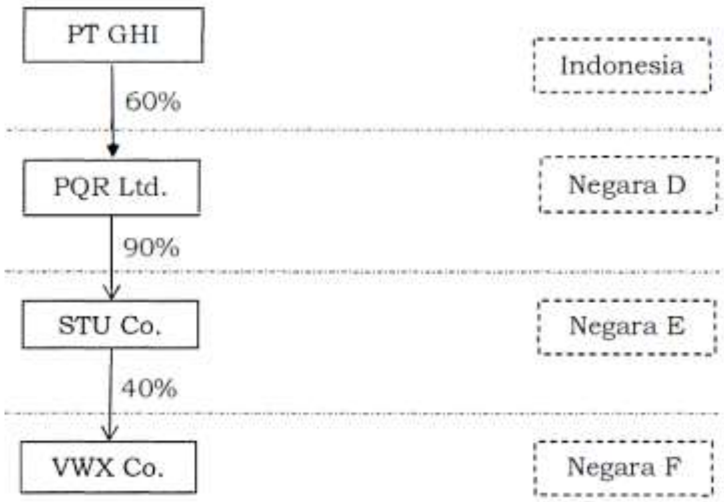
The limit of 50% or more of share ownership also prevails if the share is owned collectively by more than one Resident Taxpayer. Therefore, even if each Resident Taxpayer owns share of non-stock exchange Overseas Enterprise less than 50%, but if it is combined and meeting the minimum limit of 50% of capital investment of non-stock exchange Overseas Enterprise, it is still considered as direct control.



Indirect Controller

Furthermore, Resident Taxpayer is deemed as indirect controller when at the next level of capital investment, non-stock exchange Overseas Enterprise—whose 50% or more of share is owned—owns 50% or more share in other non-stock exchange Overseas Enterprise.

This condition also prevails collectively when a group of Resident Taxpayer owns 50% or more of share of non-stock exchange Overseas Enterprise and the non-stock exchange Overseas Enterprise collectively owns 50% or more of share of other non-listed foreign entity.



Deemed Dividend Stipulation Time

MoF Regulation Number 107/PMK.03/2017 also regulates the acquisition time of deemed dividend. The deemed dividend stipulation is conducted at the end of the fourth month since the submission due date of Annual Income Tax Return (ITR) of non-stock exchange Overseas Enterprise in its jurisdiction.

However, if the jurisdiction where the non-stock exchange Overseas Enterprise is located does not oblige the submission of ITR, the government may still determine the deemed dividend at the end of the seventh month and it shall be reported in ITR. Therefore, deemed dividend stipulation depends on the policy of ITR submission in each country where the non-stock exchange Overseas Enterprise operates.

As illustration, if there is a country where the ITR submission due date is on July, the deemed dividend may become valid on November 2017 and is reported as income in 2017 ITR.

Formula of Deemed Dividend Stipulation

In stipulating the deemed dividend, the standard formula that becomes the basis of deemed dividend stipulation is as follows:

Deemed Dividend = % Capital Investment of Taxpayer **x** *Overseas Enterprise's Profit after Tax*

However, if there are some layers of capital investment causing the Resident Taxpayer acting as direct controller of non-stock exchange Overseas Enterprise as well as indirect controller of other non-stock exchange Overseas Enterprise, the formula of deemed dividend stipulation will be adjusted as follows:

Deemed Dividend = (% Capital Investment of Taxpayer **x** *Overseas Enterprise A's Profit after Tax)* **+** *(% Capital Investment of Overseas Enterprise A* **x** *Overseas Enterprise B's Profit after Tax)* **+** *etc…*

Based on this regulation, the Taxpayer may calculate the deemed dividend through dividend received from non-listed Overseas Enterprise for the last 5 (five) years consecutively, since the dividend is received. If the dividend received is more than the deemed dividend, the Taxpayer shall pay the income tax upon the difference. Then, the dividend is reported in the Annual ITR of the Tax Year when the dividend is received.

Tax Credit Requirements

Resident Taxpayer may also credit the income tax already paid or withheld on the received dividend of non-stock exchange Overseas Enterprise in Tax Year when the Income Tax is paid or withheld. Tax crediting may be conducted to:

1. Dividend that is received not exceeding the deemed dividend that may be calculated;
2. Dividend that is received exceeding the deemed dividend that may be calculated; and
3. Dividend that is received from 2 (two) or more countries/jurisdictions.

Tax crediting is conducted by considering the Double Tax Avoidance Agreement (Tax Treaty) as well as calculating the multiplication between income tax payable on taxable income and the ratio between the dividend received and the deemed dividend. Furthermore, upon the received dividend of non-stock exchange Overseas Enterprise of more than one country, the tax crediting is conducted based on each country/jurisdiction.

The Taxpayers crediting income tax on the dividend is obliged to report it to Directorate General of Taxes (DGT). This report must be completed with:

a. Financial report;
b. Copy of ITR, in terms of an existence of obligation to submit Annual ITR;
c. Calculation or details of profit after tax in the last 5 (five) years; and
d. The income tax payment slip or income tax withholding slip on the received dividend of non-stock exchange Overseas Enterprise with direct control.

MoF Regulation Number 107/PMK.03/2017 is the implementation of Base Erosion and Profit Shifting (BEPS) Action 3 recommended by Organization for Economic Co-operation & Development (OECD), that is Strengthening the CFC Rules.

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