

Mechanism of Foreign Income Tax Credit is Clarified

Ministry of Finance revises and affirms the regulation of tax credit on foreign income in order to give certainty and encourage the Taxpayers to claim the benefit of Double Tax Avoidance Agreement (DTAA) or Tax Treaty.

The main arrangement includes among others: the affirmation of the determination of source, types, and amount of foreign income; the determination of the amount of creditable foreign income tax; the arrangement of credit by husband-and-wife performing tax obligation separately; as well as administrative requirements.

These revision and affirmation are stipulated in Minister of Finance (MoF) Regulation Number 192/PMK.03/2018 on Implementation of Tax Credit on Foreign Income, effectively valid per 31 December 2018. By the issuance of this MoF Regulation, MoF Decision Number 164/KMK.03/2002 is revoked and no longer applicable.

Different from the previous regulation that the determination of foreign income source has not been regulated clearly, in MoF Regulation Number 192/PMK.03/2018 such determination along with the affirmation of types and amount of income received from overseas are clarified.

| No | Types of Income | Source of Income | Amount of Income |
|----|---|---|---|
| 1 | Income and profit from transfer of share and other securities | Country where the share or security issuer entity is established/domiciled | Net (income received is deducted by expenses) |
| 2 | Interest, royalty, and rent related to the use of movable assets | Country where the party paying or subject to interest, royalty, and rent is domiciled | Net |
| 3 | Income from rent of immovable assets | Country where such assets exist | Net |
| 4 | Remuneration of service, work, and activity | Country where the party paying the remuneration is domiciled | Net |
| 5 | Permanent Establishment (PE) | Country where PE conducts business or activity | Net |
| 6 | Transfer of right (partially/entirely) in mining or sign of participation in financing or investment in mining business | Country where the location of mining is located | Net |
| 7 | Profit from transfer of fixed assets | Country where fixed assets exist | Net |
| 8 | Profit from transfer of part of PE's assets | Country where PE is located | Net |
| 9 | Income received or earned from trust overseas | Country where the trust is created or established | Net or part of net |

To determine the amount of creditable foreign income tax, the following shall be compared:

1. the amount of income tax that shall be payable, paid or withheld overseas by considering DTAA or Tax Treaty;
2. the amount of foreign income tax; and
3. certain amount.

Only the smallest amount between those items may be credited. Meanwhile the certain amount is calculated based on the following formula:

$$\frac{\text{Amount of Income Received Overseas}}{\text{Amount of Taxable Income}} \times \text{Income Tax Payable on Taxable Income}$$

Still referring to the same policy, the incomes from overseas that can be combined—whether from domestic or overseas—are only those with the same acquisition year as the acquisition year of domestic income.

Meanwhile, for income from Collective Investment Contract (trust), the acquisition year refers to period of tax imposition overseas. The point is that if the income from trust has been subject to tax, the acquisition year is when the income is earned. However, if the income from trust is not subject to tax overseas, the acquisition year can be when the income is received or when the income is earned, depending on whichever comes first.

To prove that the Taxpayer's income has been subject to tax overseas, it can be conducted by showing the payment slip or withholding slip of income tax overseas or copy of other evidences depicting the existence of foreign income tax payment as well as stating the domestic Taxpayer's name and the amount of foreign income tax.

Meanwhile, related to income earned from trust, the Resident Taxpayer can use Annual Income Tax Return submitted by trust or branch/representative of Taxpayer overseas.

Non-Refundable

Other affirmation in the latest regulation is that if the amount of paid foreign income tax is factually bigger than the creditable foreign income tax amount, the overpayment cannot be calculated with income tax payable. Also, such overpayment may not be treated as expense or deduction of income and cannot be refunded.

Meanwhile, if the foreign income tax that has been credited is deducted or refunded to the Taxpayers, such income tax can deduct or compensate the income tax payable in the fiscal year at the time of refund.

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Contact Person:

For further information, please contact the following MUC Consulting Group partners:



Wahyu Nuryanto

Tax Partner

wahyu.nuryanto@mucglobal.com



Meydawati

Tax Partner

meyda@mucglobal.com

MUC Consulting Group, MUC Building, Jl. TB. Simatupang No. 15, Tanjung Barat,
Jakarta, Indonesia (12530)

Tel: +6221 78837111, Fax: +6221 7887666