

## Indonesia releases amendments to the anti-tax treaty abuse rules

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### Executive summary

On 21 November 2018, Indonesia's Director General of Taxation (DGT) issued DGT Regulation No. 25/PJ/2018 (PER-25) revising the anti-tax treaty abuse rules in Indonesia. PER-25 is effective as of 1 January 2019.

PER-25 is intended to simplify the administrative procedures for a nonresident to obtain treaty relief. However, it also contains some changes to the tests to be met by nonresidents receiving Indonesian source income, which may create uncertainties in application of the rules in some cases. Failure to comply with the conditions would mean treaty protection cannot apply - for example dividends, services, interest and royalties, would be subject to the 20% statutory withholding tax.

PER-25 includes the introduction of a new treaty claim form (Form DGT), a simplified procedure for the nonresident to provide Form DGT to Indonesian counterparts and also some modifications to both the anti-tax treaty abuse and beneficial ownership tests.

This Alert discusses key aspects of PER-25.

## Detailed discussion

### One Form DGT for all nonresident income recipients

Unlike the previous regulation, there is only one Form DGT, which applies to all types of non-Indonesian residents.

Form DGT still requires a nonresident to obtain certification from the competent tax authority where the income recipient is a resident. In lieu of the certification by the competent tax authority in Form DGT, a Certificate of Residence (CoR) from the competent authority can be used, provided the following requirements are satisfied:

- ▶ The document must use the English language.
- ▶ It must contain information concerning the name of the nonresident income recipient, issuance date, and the applicable tax year (at a minimum).
- ▶ It must bear the name and signature of the authorized tax officer of the competent tax authority of the treaty country, or sign/stamp that is equal to the signature of the tax officer and the name of the tax officer, as commonly used.

In the event that the nonresident uses a CoR, it must complete Form DGT, other than the Part II of Form DGT, which is the certification from the competent tax authority.

### Submission of Form DGT

PER-25 alters the manner for submission and validation of Form DGT and CoR as follows:

- ▶ The nonresident provides Form DGT and CoR (if required) only **once** to the first Indonesian withholding agent once PER-25 takes effect (on or after 1 January 2019).
- ▶ The withholding agent will submit Form DGT and CoR to the DGT via its website (or other channels determined by the DGT). The Indonesian withholding agent should receive an Electronic Receipt Note from the DGT, which should be forwarded to the nonresident.
- ▶ When the nonresident has transactions with multiple parties in Indonesia, the nonresident only needs to provide the copies of the Electronic Receipt Note to the other Indonesian withholding agents.

The Form DGT does not require the amount of income that is received from Indonesia to be declared. Therefore, Form DGT remains valid over a period of up to 12 months (the tax period as stated in Form DGT) for all payments made

by Indonesian payors. Unlike the previous regulations, the 12-month period does not have to be on a calendar basis, however, whether a future period may be certified depends on each country's tax authority rules.

### Additional requirement of tax treaty abuse tests

In the view of the DGT, tax treaty abuse does not exist if all of the following conditions are satisfied:

- a. If the nonresident has the following:
  - Economic substance in the establishment of the entity and execution of the transaction.
  - The legal form is the same as the economic substance in the establishment of the entity or the execution of the transaction.
  - The business activities are managed by its own management and the management has sufficient authority to carry out the transactions.
  - There are fixed assets and non-fixed assets (other than the assets generating income from Indonesia), which are adequate and sufficient to conduct business activities in that treaty country.
  - It has sufficient employees with the expertise and certain skills in accordance with its line of business.
  - It has activities or an active business other than receiving income in the form of dividend, interest, royalty from Indonesia; **and**
- b. There is no arrangement of transactions either directly or indirectly with the objective to obtain benefits from the income tax treaty, such as:
  - Reduction of tax burden; and/or
  - Double non-taxation in any country or jurisdiction;
 which contradicts the purpose and objectives of the income tax treaty.

It is unclear whether the purpose of Item b above is an attempt to replicate the principal purpose test recommended under the OECD<sup>1</sup> BEPS<sup>2</sup> Action 6 and in the multilateral instrument (MLI). However, the new provision makes it clear that there is an overarching purpose test which could:

- ▶ Lead to significant uncertainty in practice.
- ▶ Require detailed consideration of the “purposes and objectives” of a treaty.
- ▶ Involve an interesting interaction with the MLI.

### Change to Beneficial Ownership (BO) test

In an attempt to prevent conduit transactions, the BO tests also must be satisfied where the treaty article requires the recipient to be the beneficial owner of the Indonesian income. One of the BO tests deals with whether the nonresident uses 50% or more of its income to fulfil obligations to other parties. Unlike the prior rules, a distribution of profits as dividends to shareholders does not constitute an excluded payment for this purpose.<sup>3</sup>

As a result, questions will be expected as to the eligibility of a treaty claim in certain structures when an initial recipient of Indonesian income passes the income in the form of dividends to its shareholders.

### Change to declaration required to be made by banks and pension funds receiving income – confirming status of beneficial owner

The new Form DGT includes an additional question in Part III, to be completed by banking institutions and pension funds. These recipients must confirm that the beneficial owner is a tax resident of the same jurisdiction as the bank or pension fund itself.

Banks and pension funds receiving Indonesian income should review this change carefully.

### Refund mechanism of tax

The nonresident can claim for a refund in connection with the application of tax treaty relief, through the Indonesian withholding agent, under one of the following situations:

- ▶ Misapplication of the tax treaty benefits, due to administrative mistake, withholding error, typing error, or miscalculation of the tax withheld.
- ▶ Late submission of required documentation.
- ▶ Issues resolved under Mutual Agreement Procedure.

However, in practice, the refund claim may be difficult.

### Transitional provision

Forms DGT-1 and DGT-2 remain valid until 31 December 2018.

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### Endnotes

1. Organisation for Economic Co-operation and Development.
2. Base Erosion and Profit Shifting.
3. The excluded income consists of granting of remuneration to employees and other costs commonly incurred by a nonresident in carrying on its business.

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