Updated Regulation on CFC Rules (Deemed Dividend)

The Minister of Finance has issued a revision of the regulation related to the Controlled Foreign Corporations (CFC) rules. The revision is under Minister of Finance Regulation Number 93/PMK.03/2019 (PMK-93) dated 19 June 2019 which revised Regulation Number 107/PMK.03/2017 dated 26 July 2017 (PMK-107).

PMK-107 significantly expanded the scope of the previous regulation (256/PMK.03/2008) regarding the recognition of income (as a deemed dividend) from capital participation in CFC that are not listed on a stock exchange. As a consequence of PMK-107 the deemed dividend included a proportionate share of the after-tax profit earned by indirect CFC provided Indonesian taxpayers (together or separately, or via direct CFC) have at least a 50% capital participation. In this regard "capital participation" refers to share capital and/or voting rights.

The PMK-93 revisions do not change the definition of a CFC (i.e. still including both direct and indirect controlled entities) or the timing for recognition of the deemed dividend. The key change is that some forms of income are no longer included when determining the object for calculation of the deemed dividend.

PMK-93 is effective for the 2019 tax year.

PASSIVE VS ACTIVE INCOME

Prior to PMK-93, all the after-tax profit earned by the direct or indirect CFC became the base for determining the deemed dividend for the Indonesian shareholder.

PMK-93 effectively creates an active income versus passive income distinction so that only specified (i.e. passive) income will be subject to the deemed dividend provisions. These are:

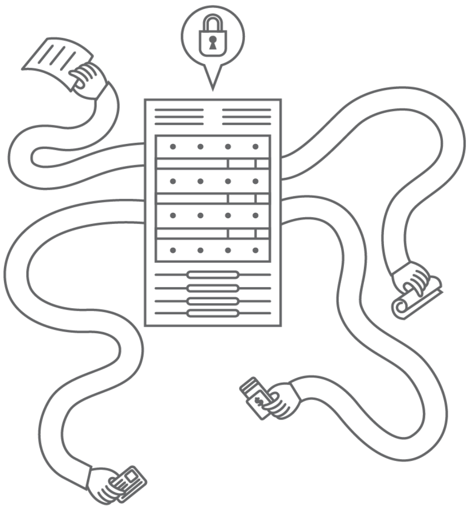
- Dividends, except dividend received from the other overseas direct/indirect CFC;
- Interest income, except if the direct/indirect CFC is owned by an Indonesian bank and the interest income is not received from a related party (Note 1);
- Land/building rental income;
- Other rental income received from a related party (Note 1).
- Royalties; and
- Gains from sale/transfer of assets.

Note 1: "Related party" is defined as per the Income Tax Law (i.e. as per Article 18 (2)).

AFTER-TAX PROFIT FROM PASSIVE INCOME

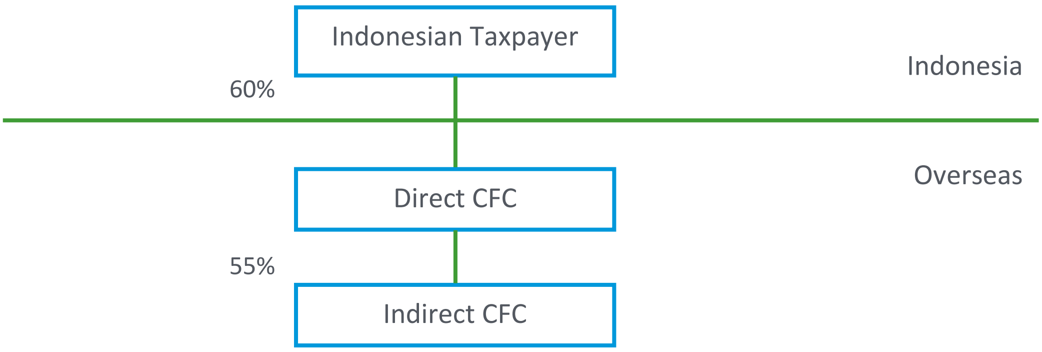
As a consequence of stipulating that only specified income shall be subject to the deemed dividend rules, PMK-93 further states the costs for gaining, collecting and maintaining this income and the related income tax shall be deducted from this income. Therefore it is the after -tax "profit" from the specified income that will become the base for calculating the deemed dividend.

The deemed dividend is then calculated in accordance with the same method as per PMK-107; that is, this after-tax profit is multiplied by the direct or indirect percentage capital participation in the CFC.



As noted above the key elements of PMK-107 that remain are:

- The deemed dividend includes indirect capital participation, which is determined from the percentage of capital participation in the direct CFC multiplied by the percentage of capital participation in the indirect CFC. Below is the example:



  As per the above example, the CFC rules will apply for direct and indirect participation because each entity owns not less than 50% capital participation in the next entity. Therefore the deemed dividend from the indirect CFC will be 60%x55% or 33% of the after-tax profit (or now, under PMK-93, the after-tax profit from specified income).

- The Indonesian taxpayer should recognize the deemed dividend on the 4th month after the due date for submission of the annual corporate income tax return of the CFC (if it has an obligation to report its annual corporate income tax return); otherwise on the 7th month after the end of the financial year of the CFC.

RSM Comments:

- Similar to PMK-107, PMK-93 does not indicate if prior year losses in a CFC can be considered when calculating the deemed dividend.
- Under PMK-93 a deemed dividend could exist even though the CFC's total financial result is a loss (because the focus is on the specified "passive" income).
- PMK-93 does not provide any explanation on how to allocate expenses if the CFC has both specified income and other income. That is, whether direct expenses can be specifically allocated while other expenses are allocated to the specified income based on a percentage equal to total specified income divided by total income.

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