Revision of Regulations regarding Eligibility to Utilise Tax Treaties

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Since 1 January 2010 the requirements to utilise the reduced rates of withholding tax and other benefits available under tax treaties were governed by Director-General of Taxation ("DGT") regulations regarding "Procedures for Applying Tax Treaties" and "Prevention of Tax Treaty Abuse" (DGT Regulations No. 61/PJ./2009 and No. 62/PJ./2009 dated 5 November 2009 and the related rectifications and amendments, most recently DGT Regulations No. 24/PJ/2010 and No.25/PJ/2010 dated 30 April 2010 ("the Previous Anti-Abuse Regulations")).

The Previous Anti-Abuse Regulations required that the underlying transactions or structure were not entered into for the mere purpose of accessing benefits under a tax treaty, that a specified form (Form DGT-1 or DGT-2) be completed and provided by the foreign tax resident, and that certain requirements for substance exist (if the relevant tax treaty specified that the recipient of the income must be the beneficial owner).

On 19 June, the DGT issued a new regulation, PER-10/PJ/2017 – The Procedure for Applying Tax Treaty Agreements ("PER-10"). This revokes the Previous Anti-Abuse Regulations and, in doing so, adds additional requirements whilst resolving one issue that arose from the prior requirement that dividends, interest and royalties (that are usually subject to beneficial ownership stipulations) must be subject to tax in the foreign jurisdiction before the reduced rates of withholding tax under tax treaties could be applied.

When is PER-10 Effective?

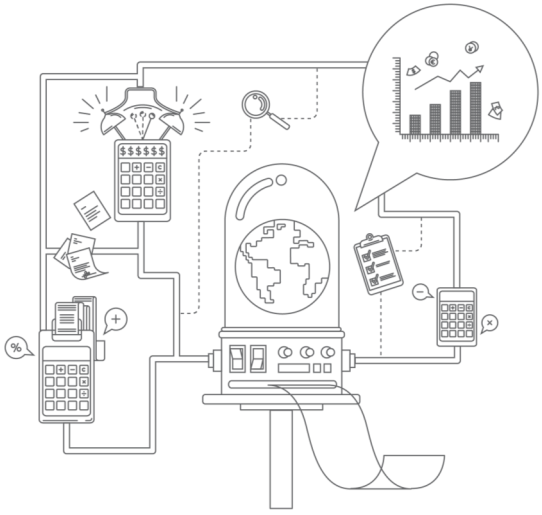
PER-10 is effective from 1 August 2017.

What if there is an existing Form DGT-1/DGT-2? Can these continue to be used?

Form DGT-2 was previously used for banking institutions and parties undertaking capital market transactions in Indonesia through a custodian in Indonesia. Form DGT-1 was used for all other cases. [1]

Under the Previous Anti-Abuse Regulations, Form DGT-2 and Page 1 of Form DGT-1 were a Certificate of Domicile that was valid for 1 year from the date of issue, and Page 2 of Form DGT-1 was valid during the month of issue.

These documents (and any traditional Certificate of Domicile that was issued because the Foreign Tax Authority did not wish to endorse the Form DGT-1/DGT-2) may continue to be used provided these were validly issued under the Previous Anti-Abuse Regulations and the period has not expired.



Accordingly, Form DGT-2 and Page 1 of Form DGT-1 have a maximum validity of 31 July 2018 (assuming it was issued on 31 July 2017) or 12 months from the date of issue, whichever date occurs sooner. Page 2 of Form DGT-1 will not be valid after 31 July 2017 because Page 2 was only valid for the month of issue.

[1] PER-10 expands the users of Form DGT-2 to include pension funds

When are the new Form DGT-1/DGT-2 required to be provided?

The new Form DGT-1/DGT-2 must be provided before the Indonesian party is required to lodge the Withholding Tax ("WHT") Return for the relevant month. This also applies if the use of the tax treaty would result in no withholding tax being due.

If the Form DGT-1/DGT-2 is not provided in time then the Indonesian party should withhold tax in accordance with Indonesia's income law (typically @ 20%).

If the Form DGT-1/DGT-2 is submitted after the Indonesian party has submitted the WHT Return for the tax period, the foreign tax resident can still be granted the tax treaty benefits through a refund of tax which should not be payable in accordance with Minister of Finance Regulation No. 187/PMK.03/2015 concerning "Procedures of Refunds of Excess Tax Payments that Should Not be Payable".

What has changed compared to the Previous Anti-Abuse Regulations?

Consistent with BEPS Action 6 and the recently signed Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion & Profit Shifting (more commonly known as the MLI), PER-10 requires that a foreign tax resident must satisfy additional tests to demonstrate that treaty shopping is not the principal purpose or one of the principal purposes of establishing the structure or entering into the transactions that seek to utilise a tax treaty. PER-10 also strengthens the substance tests that apply where the relevant tax treaty specifies that the recipient of the income must be the beneficial owner.

The table below provides a comparison between the requirements under the two sets of regulations:

	Previous Anti-Abuse Regulations (till 31 July 2017)	PER-10 (from 1 August 2017)
For all types of income	The transaction was not entered into or structure created merely to obtain benefits under a tax treaty	There are relevant economic motives or other reasons related to the establishment of the entity
		One of the principal purposes of the arrangements or transactions is to obtain a benefit under the tax treaty, contrary to the purpose of the tax treaty (in Form DGT-1 and the attachment but not the body of the regulation)
		The entity has its own management to conduct the business and this management has its own authority to undertake the transactions
		The entity has sufficient assets to conduct business other than the assets generating income from Indonesia
		The entity has sufficient & qualified personnel to conduct the business (i.e. based on these activities)
		The entity has business other than receiving dividends, interest, and/or royalties sourced from Indonesia

	Previous Anti-Abuse Regulations (till 31 July 2017)	PER-10 (from 1 August 2017)
Income subject to beneficial ownership requirement – typically dividends, interest and royalties	The entity is not acting as an agent, nominee or conduit	The foreign tax resident is not acting as an agent, nominee or conduit
	The company has its own management who have sufficient authority to undertake transactions	Now applicable to all income – see above
	The company has sufficient qualified employees	Now applicable to all income – see above
	The company is actively engaged in business or trade	Now applicable to all income plus the activity must be in addition to activity that generates interest, dividends or royalties from Indonesia – see above
	The income received from Indonesia is subject to tax in the recipient country	No longer a requirement
		The entity has controlling rights or disposal rights on the income or the assets or rights that generate the income from Indonesia
	No more than 50% of the entity's income is used to satisfy claims by other persons	No more than 50% of the entity's income is used to satisfy claims by other persons
		The entity bears the risk on its own assets, capital and liabilities
		The entity does not have contracts that require it to transfer the income received from Indonesia to residents of a 3rd country (this is per the new Form DGT-1; the wording in the body of PER-10 refers to "another party")

Do note the Form DGT-1 is now a 3-page document and, interestingly, some of the questions listed on the Form (which is in English) are not fully consistent with the criteria listed in the body of PER-10 (which is in bahasa Indonesia). For example Article 8(b)(d) requires that the entity does not have contracts that require it to transfer the income received from Indonesia to another party, whereas Question 5 of Part VII of Form DGT-1 states that the contracts cannot be for transfer of the income to residents of a 3rd country. Form DGT-1 is an attachment to PER-10 and therefore both it and the body of the regulation must be considered. In our view, the most restrictive interpretation should be considered until the Tax Office clarify or otherwise amend PER-10.

Elimination of conflict between Anti-Abuse Regulations and the Hong Kong-Indonesia Tax Treaty

The requirement under the Previous Anti-Abuse Regulations that dividends, interest and/or royalties payable to a Hong Kong tax resident must be subject to tax in Hong Kong created a problem because Hong Kong's territorial taxation system does not tax income that is not earned in Hong Kong. Since dividends and, potentially interest and royalties, payable to a Hong Kong tax resident were unlikely to be subject to tax in Hong Kong therefore full compliance with the Previous Anti-Abuse Regulations would have prevented a legitimate Hong Kong tax resident investor from utilizing the reduced rates of withholding tax under the tax treaty.

These concerns are no longer relevant with the deletion of the "Income subject to tax" criteria from the tests that must be met before dividends, interest and royalties payable to a foreign tax resident can access the reduced rates of withholding tax under a tax treaty.

Other matters

- The new Page 1 of Form DGT-1 and Form DGT-2 require that the foreign tax authority confirm the tax resident status of the foreign tax resident with reference to a period of a maximum 12 months.
- In the event of errors in the application of a tax treaty the foreign tax resident can still be granted the tax treaty benefits through a refund of tax which should not be payable in accordance with Minister of Finance Regulation No. 187/PMK.03/2015 concerning "Procedures of Refunds of Excess Tax Payments that Should Not be Payable".
- Foreign tax resident can make use of the Mutual Agreement Procedure if that receive income from Indonesia but did not receive the stated tax treaties benefits and the Indonesian party did not submit the WHT Return for the relevant period.

Recommended actions

- Clients should ensure that any Form DGT-1 or Form DGT-2 received after 31 July 2017 is compliant with PER-10. That is, although Page 1 can utilise an existing Form DGT-1/DGT-2 (subject to the 12-months validity period of that old Form), the other pages must be the fully completed new Forms, and eligibility to access tax treaty benefits are then determined based on the responses on these new Forms.
- Clients are required to prepare a NIL WHT Evidence (Bukti Potong) and report this in the relevant monthly WHT Returns if the use of a tax treaty results in no WHT being due.
- Clients should consider whether any existing transactions with foreign tax residents remain eligible to access tax treaty benefits and who bears the consequences if the rate of WHT increases.
- Clients that previously deducted 20% WHT when paying dividends, interest or royalties to Hong Kong tax residents should communicate with those parties to determine if it is now possible for them to provide a Form DGT-1 or Form DGT-2 and access the reduced rates of WHT stipulated in the Hong Kong-Indonesia Tax Treaty.

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