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NEWS ALERT

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DGT Regulation No.10/PJ/2017 regarding the Procedure for a Non-Indonesian Tax Resident Earning Indonesian Sourced Income to Apply for Tax Treaty Benefits

NEW PROCEDURE TO APPLY FOR TAX TREATY BENEFITS

A new tax regulation (DGT-10) combines rules regarding the procedures for use of tax treaty benefits and the prevention of tax treaty abuse into one regulation

The Director General of Tax ("DGT") has issued Regulation No. 10/PJ/2017 ("DGT-10") regarding the procedure for a non-Indonesian tax resident earning Indonesian sourced income to apply for tax treaty benefits. This regulation takes effect on 1 August 2017 and revokes:

- DGT Regulation 61/PJ/2009, as amended by DGT Regulation 24/PJ/2010, regarding the procedures for use of tax treaty benefits; and
- DGT Regulation 62/PJ/2009, as amended by DGT Regulation 25/PJ/2010, regarding prevention of tax treaty abuse.

DGT-10 revises the Certificate of Domicile ("CoD") forms needed to apply for treaty benefits, i.e., DGT-1 (for non-banks) and DGT-2 (for banks, pensions funds, and persons who receive income relating to publicly traded stocks and bonds). A valid CoD issued under the former regulation can be used until its expiration. Thereafter, a CoD is valid for a maximum of 12 months.

As before, the new CoD forms focus on:

- Tax treaty abuse: Tax treaty benefits are not available if there is evidence of tax treaty abuse; and
- Beneficial owner: The party claiming tax treaty benefits for interest, dividends or royalties must be the beneficial owner of such income.

The tests for determining whether these criteria have been met, as reflected in the new DGT-1 form, are more expansive and stringent than before. Samples of the new forms are discussed below.

More expansive and stringent requirements for non-abuse of a tax treaty and beneficial owner as reflected in the new DGT-1 form

Article 9 of DGT-10 stipulates the requirements for a transaction to be considered as not abusing a tax treaty and focuses further on the substance of the non-Indonesian tax resident. The non-Indonesian tax resident must be able to show each of the following:

- Economic substance with respect to the establishment of the non-Indonesian tax resident or the transaction performed;
- The legal form is in accordance with the economic substance for the establishment of the non-Indonesian tax resident or the transaction;
- Business activities are managed by the non-Indonesian tax resident's own management, who have sufficient authority to conduct the transaction;
- Sufficient fixed and non-fixed assets, other than assets which generate income in Indonesia, to conduct business in the resident country;
- There are sufficient and qualified employees to run the company; and
- The non-Indonesian tax resident must conduct other business activities in addition to merely receiving dividends, interest or royalties sourced from Indonesia.

New DGT-1 form: Evidence for no treaty abuse

This means that the business is actively performed by the non-Indonesian tax resident, as evidenced by the operating expenses incurred and efforts made to obtain, collect and maintain income, including significant activities performed by the non-Indonesian tax resident to conduct its business.

In order for a non-Indonesian tax resident to show no abuse of a tax treaty, the non-Indonesian tax resident must be able to demonstrate that it can meet the necessary requirements. This is shown by answering NO to question 5 and YES to questions 6 – 10 of Part VI of the new version of form DGT-1:

PART VI	TO BE COMPLETED IF THE INCOME RECIPIENT IS NON INDIVIDUAL		
1. Country of registration/incorporation :			(34)
2. Which country does the place of management or control reside?			(35)
3. Address of Head Office :			(36)
4. Address of branches, offices, or other place of business in Indonesia (if any) :			(37)
5. One of the principal purposes of the arrangements or transactions is to obtain benefit under the convention and contrary to the object and purpose of the DTC.	☐ Yes	☐ No	(38)
6. There are relevant economic motives or other valid reasons for the establishment of the foreign entity	☐ Yes	☐ No	(39)
7. The entity has its own management to conduct the business and such management has an independent discretion.	☐ Yes	☐ No	(40)
8. The entity has sufficient assets to conduct business other than the assets generating income from Indonesia.	☐ Yes	☐ No	(41)
9. The entity has sufficient and qualified personel to conduct the business.	☐ Yes	☐ No	(42)
10. The entity has business activity other than receiving dividend, interest, royalty sourced from Indonesia.	☐ Yes	☐ No	(43)

Under the previous regulation, a recipient of income for which the tax treaty does not require evidence of beneficial ownership (e.g. income from services or share transfer) only needed to state that the establishment of the company or transaction structure was not designed merely to take advantage of the tax treaty in order to utilize the tax treaty benefits. However, under DGT-10, the recipient of such income must satisfy each of the above requirements.

New DGT-1 form: Evidence of beneficial ownership for income in the form of dividend, interest or royalty

If the income earned is a dividend, interest or royalty for which the relevant tax treaty requires that the recipient be the beneficial owner of the income, the income recipient must also satisfy the requirements stipulated in Article 10 of DGT-10. The non-Indonesian tax resident will be considered as the beneficial owner if it is not acting as an agent, nominee or conduit and meets the following requirements:

- Has control to use or enjoy the income, assets or rights which generate Indonesian sourced income;
- No more than 50% of the non-Indonesian tax resident's income is used to fulfill obligations to other parties;
- Bears the risk on its own assets, capital and liabilities; and
- Has no obligation to "pass-through" all or part of its Indonesian sourced income to another party.

The income recipient of dividends, interest or royalties must be able to demonstrate it is the real beneficial owner, and this is shown by answering NO to questions 1 and 5 and YES to questions 2 – 4 in Part VII of the new version of form DGT-1:

PART VII	TO BE COMPLETED IF THE INCOME EARNED ARE DIVIDEND, INTEREST, OR ROYALTY		
1. The entity is acting as an agent, nominee or conduit	☐ Yes	☐ No	(47)
2. The entity has controlling rights or disposal rights on the income or the assets or rights that generate the income.	☐ Yes	☐ No	(48)
3. No more than 50 per cent of the entity's income is used to satisfy claims by other persons.	☐ Yes	☐ No	(49)
4. The entity bear the risk on its own asset, capital, or the liability	☐ Yes	☐ No	(50)
5. The entity has contract/s which obliges the entity to transfer the income received to resident of third country.	☐ Yes	☐ No	(51)

This is a new section and requires more information than before.

New DGT-2 form: Requirement to specify the type of income earned from Indonesia

The new DGT-2 form requires the non-Indonesian tax resident to specify the type of income earned from Indonesia and other information, as reflected in the second page of the new form. The new information to be provided is:

- The type and amount of income subject to withholding tax under Indonesian law;
- The amount of income subject to withholding tax under the tax treaty; and
- The withholding tax rate under the applicable tax treaty.

This page should be provided to the tax withholder for each remittance/transaction.

Indonesian sourced Income received by a Central Bank or certain institutions

Article 11 of DGT-10 states that:

- The tax treaty can be applied without using form DGT-1 or DGT-2 if the income recipient is a treaty partner government institution, Central Bank or institution named in the treaty, or has been agreed by the Indonesian and treaty partner tax authorities.
- Such income recipient must provide a Certificate of Residence that shows the non-Indonesian tax resident meets the requirements stipulated in Article 6.3 (it is in the English language, is an original or legalized document, contains information on the income recipient, date issued, etc.) or a declaration letter from the tax authority of the treaty partner that states the income recipient is a party that is exempted from imposition of tax in the source country on such income according to the tax treaty.
- The Certificate of Residence or declaration letter can be used for the fiscal year mentioned in the document.

The income recipient as stipulated above should provide the Certificate of Residence or declaration letter to the tax withholder/collector, and it should be renewed every year. However, it is unclear whether this document should be submitted to the tax office or kept by the Indonesian tax withholder.

Reporting procedures for forms DGT-1 and DGT-2

The reporting procedures for forms DGT-1 and DGT-2 are similar to the previous regulations, including:

- The form is to be certified by the competent authority in the country where the non-Indonesian tax resident resides.
- The Indonesian withholding agent is required to prepare a withholding tax slip, even if there is no income tax payable, and submit form DGT-1 and/or DGT-2 with the monthly tax return for the tax period when the tax is due.

Key take away

DGT-10 provides stricter requirements for the utilization of treaty benefits with the issuance of the new CoD forms. Form DGT-1 contains more questions regarding the substance of the income recipient to determine that there has been no abuse of a tax treaty, as well as questions that act as guidance to determine whether the income recipient is, in fact, the beneficial owner of the income.

Careful attention should be given to avoid any mistake or error when answering the questions provided, particularly in the new DGT-1 form. The Indonesian resident, as the tax withholder, should ensure the form is completed by the offshore income recipient. However, the non-Indonesian tax resident is responsible for truthfully and accurately answering the questions in the CoD form.

The Indonesian tax withholder is to submit the CoD together with the monthly withholding tax return, even if no tax is payable under the tax treaty. The failure to do so may result in the non-Indonesian tax resident not being entitled to the treaty benefits.

If, due to incorrect application of a tax treaty or a delay or error in submitting the CoD, tax is withheld at the normal non-treaty rate (20%) rather than the applicable tax treaty rate, a refund of the overpaid tax may be requested.

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