

TaxFlash

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The DGT has issued new rules which make it much tougher for taxpayers to claim withholding tax relief under Indonesia's tax treaties. The new rules are designed to combat perceived tax treaty abuse by some taxpayers.



Tough new rules for claiming tax treaty relief for Indonesian withholding tax

There are continuing signs that the Directorate General of Taxation ("DGT") is aggressively tackling perceived tax avoidance arrangements. On 5 November 2009, two regulations were released (DGT Regulations 61 and 62) setting out new procedures which must be followed for reduced rates of withholding tax to apply to payments made to non-Indonesian residents, who are residents of countries with which Indonesia has entered into tax treaties. The rate of withholding tax under the tax treaties is lower than the rate that applies where the recipient of the income is a resident of a country with which Indonesia does not have a tax treaty.

To claim tax treaty relief, the non-resident recipient of the income must obtain a Certificate of Domicile ("COD") from the tax authority in its home country, and establish that it is the beneficial owner of the income. The new rules under Regulations 61 and 62 make it significantly harder for non-residents to meet these requirements.

To obtain treaty relief, the DGT regulations now require "an entity or individual", that is the owner of the income, to demonstrate that it is not considered to be misusing the tax treaty, by satisfying these tests:

- a. For individuals, that they are not receiving income as an agent or nominee.
- b. An institution that is explicitly named in the tax treaty or one that has been agreed to by the Competent Authority in Indonesia and its treaty country partner.
- c. An offshore company (*WPLN*) which earns income through a custodian from share or bond transactions made on the Indonesian Stock Exchange (except interest and dividends), that is not an agent or nominee.
- d. A company whose shares are listed on any Stock Exchange and traded regularly.
- e. A Bank, or
- f. Any other company which meets the following requirements:
 1. the establishment of the company in the tax treaty partner country and the way the transaction is structured/schemed, are not merely done to enjoy tax treaty benefits.
 2. the business activities are managed by the company's own management which has sufficient authority to carry out the transaction.
 3. the company has employee(s).
 4. the company has activities or active business.
 5. income derived from Indonesia is taxable in the recipient's country.
 6. the company does not use more than 50% of its total income to fulfil its obligations to other parties, such as interest, royalty, or other payments.

Types of income payments which are subject to reduced or zero withholding tax rates under Indonesia's tax treaties are:

- Interest
- Dividends
- Royalties and
- Service Fees
- Capital gains taxes and branch profits tax

Therefore, the new rules potentially apply to a broad range of taxpayers.

The other significant change under the new regulations is that a COD must be obtained by the non-resident each time it receives income of a type subject to Indonesian withholding tax. The COD must be provided to the payer by the time it lodges its monthly tax return for the period in which the income is paid ie, the 20th of the following month.

The only exception to this requirement is where the recipient of the income either:

- Is a non-resident bank; or
- Derives capital gains from sales of shares and bonds listed on the Indonesian stock exchange and held through a custodian.

In these cases, the COD obtained by the recipient remains valid for 12 months.

Another important feature of the new regulation is that the COD must be in a form approved by the DGT. It is not yet certain how tax authorities in other countries will respond to requests from non-resident taxpayers for CODs in the form prescribed by the DGT.

The new COD requirements will be difficult for taxpayers to comply with in practice, especially the requirement that they be obtained monthly. To obtain a COD, a number of specific questions must be answered, based on which the DGT will be able to determine whether or not the income recipient satisfies the beneficial ownership requirement.

On a more positive note for taxpayers, we believe the release of the new regulations removes the previous limitation on the activation of the new Netherlands tax treaty. Under that treaty, a zero withholding tax rate applies to interest paid to a Netherlands resident.

Another positive development relates to share transactions on the Indonesian stock exchange, which currently attract tax at a rate of 0.1% of the transaction value, and for bonds traded in the Indonesian stock exchange, which are subject to final withholding tax at a higher rate..

The new form of COD implies that where gains are made by a non-resident with a COD from one of Indonesia's tax treaty partners, they can enjoy capital gains tax relief for shares and bonds listed on the Indonesian stock exchange.

In another concession, the DGT acknowledges that where a non-resident taxpayer is unable to satisfy the COD requirements when it receives income, so that a higher non-treaty withholding tax rate applies, the non-resident will be able to claim back a refund of the overpaid tax if it is later able to meet the COD requirements. Unfortunately, the procedure for obtaining such refunds has not yet been explained.

There are numerous technical issues arising from the new regulations, where the application of the regulations remains uncertain. Further clarification is required from the DGT, including potential errors with some of the requirements which the new format COD state need to be satisfied to be eligible for treaty relief.

To summarise, for most taxpayers, the new regulations will impose more onerous requirements which will be difficult to comply with, in practice. For Indonesian taxpayers paying income subject to withholding tax to non-resident recipients, special care will need to be taken, and new procedures put in place, before automatically applying lower withholding tax rates on the basis of tax treaty entitlements to relief. Under the DGT's compliance approach, in the event of a future audit, any failure to obtain the correct COD documentation and compliance with other administrative requirements will leave the payer of the income exposed to payment of the withholding tax shortfall and associated penalties.

In effect, from 1 January 2010, it will be very difficult in practice for Indonesian payers of income to non-Indonesian recipients, to be able to provide treaty relief from any withholding tax that is due for payment on that income. Payers will need to satisfy themselves that recipients can meet all requirements under the new regulations so that treaty relief applies.

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