Tax Design and Administration in a Post-BEPS Era: Key Reform Measures in Indonesia

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Abstract

As the initial global initiatives of the G20/OECD BEPS program, comprising 15 Actions and associated recommendations, are in now place, it is essential to understand how each country, particularly at a domestic level, has responded and implemented this cohesive approach. This chapter aims to provide detailed updates with respect to the implementation of OECD recommendations, including substantive legislative changes, in the Indonesian context. It facilitates a better understanding of how the Indonesian government has adapted its domestic measures to align with international standards and what administrative international tax-related reforms are now in place, as well as the challenges and opportunities now before the Indonesian government.

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1. INTRODUCTION

Its government a presidential system, Indonesia is currently the world's third largest democratic country. The Indonesian presidential system takes the form of a "unitary republic" which relies on separation of powers into three parts, namely executive, legislative, and judicial stances. Two decades ago in 1998, Indonesia experienced a major political transition from an authoritarian to democratic country, which was followed in 2004 by the first peaceful direct presidential election in which Susilo Bambang Yudhoyono took office for a five-year term. In 2014, the election of President Joko Widodo as the first president outside the military and political establishment has indicated Indonesia's sustainable political stability. Since these developments, Indonesia has exhibited the dynamics of a growing democracy, a lively parliament, and a strong economic resiliency.

The primary source of Indonesian government revenues is taxation. For instance, in 2016, tax revenue contributed 83 per cent of government revenue (Ministry of Finance (MoF), 2018). The Directorate General of Taxation (DGT) is responsible for achieving this outcome. It is an institution established under the Ministry of Finance - and categorised therefore as a Single Directorate in the Ministry of Finance (SDMOF) by the Organisation for Economic Co-operation and Development (OECD, 2013) - and has three main functions: (i) collecting tax revenue; (ii) formulating tax policy, and (iii) administering tax revenue at the national level. The head office of the DGT is led by a Director General and consists of the Secretariat of the DGT, twelve Directorates, and a Data and Document Processing office. In performing its operations, the DGT is also supported by 31 regional tax offices and 331 tax offices located across the country (DGT, 2015).

In 1983 Indonesia undertook a major reform of its tax system by boldly switching from an official-assessment to a self-assessment system. The latter system granted taxpayers both responsibility and trust since the new law accorded them the responsibility to determine, calculate, pay and report their tax obligations to the tax authority independently. For this reason, the 1983 tax reform represented a crucial starting point for a series of further major changes in tax laws.

Indonesia is one of the world's most populous countries, with a population of over 252 million (BPS, 2017). It is the largest archipelago country in the world, stretching across an area between Australia and the Asian continent, and between the Indian and the Pacific Oceans, encompassing more than 17,000 islands (more than 6,000 of which are inhabited).[4] In terms of economic size, Indonesia's Gross Domestic Product (GDP) ranks 15th among 195 countries, with a figure of USD 932 million in 2017, the largest in southeast Asia. Indonesia's GDP per capita was USD 3,570 in 2016 and the country is categorised by the World Bank as a lower-middle income country.[5] It is worth noting that this figure is double that of the comparable figure in 2007 when the GDP per capita in Indonesia was USD 1,765.[6] Indonesia is currently southeast Asia's only member of the

[4] See United States-Indonesia Society, http://www.usindo.org/information-on-u-s-and-indonesia/about-indonesia/ (accessed on 5 May 2018).

[5] See World Bank, "GDP per capita (current US$)", https://data.worldbank.org/indicator/ny.gdp.pcap.cd (accessed on 9 April 2018).

[6] See CountryEconomy.com, "Indonesia GDP – Gross Domestic Product", https://countryeconomy.com/gdp/indonesia (accessed on 1 May 2018).

G20 but it is not a member of the OECD (OECD, 2016), and it is recognised as one of the six major emerging economies that will account for more than half of all global growth (World Bank, 2011).

Indonesia is currently the 27th largest importer in the world and is also net capital importer. Its inbound foreign direct investment (FDI) capital is roughly five times as large as its outbound capital (International Monetary Fund, 2017). Indonesia's largest export commodity is palm oil, while its largest import commodity is refined petroleum.

2. THE INDONESIAN GOVERNMENT'S RESPONSE TO THE G20/OECD BEPS PROGRAM OF TAX REFORM

It seems safe to say that Indonesia's initial reaction towards the BEPS project has been proactive. Indonesia, represented by the DGT, has been very active in expressing its interest in implementing many of the BEPS project measures and is now in the process of reviewing and refining some of its relevant domestic legislation. For instance, in the initial stage of the project, Indonesia agreed to facilitate a study conducted by the OECD relating to BEPS and has signed a declaration agreement to support this study (Arifin, 2014). In addition to this supportive role, Indonesia also expressed its interest in becoming an Associate Member of the BEPS project. Administratively, Indonesia's joining of the BEPS project comes with the consequence of a contribution payment of approximately EUR 51,000 annually. Initially, the Indonesian Ministry of Finance did not allocate any such membership payment for year 2013. For this reason, on behalf of the Ministry of Finance, the Fiscal Policy Office officially accepted the OECD invitation for Indonesia to become an Associate Member of the BEPS project in late 2013 by indicating Indonesia's readiness to participate in the project as well as the payment for its membership contribution starting in 2014 (Arifin, 2014). Accordingly, Indonesia is one of the Initial BEPS Associates (Ernst & Young, 2016).

Prior to the G20/OECD initiative, BEPS had long been a concern for the Indonesian government. As an early participant in the Global Forum for Tax Transparency and Exchange of Information, Indonesia took the view that BEPS activities can represent a high risk to state tax revenues, tax sovereignty, and confidence in the integrity of the tax system. It is a well-known notion that many international entities and high wealth individuals generally attempt to minimise their tax obligations by arranging their business activities to obtain tax savings and adopt tax planning schemes that exploit the differences in income treatment and tax rates among countries around the globe. While the detrimental impacts of BEPS activities are generally harmful for both developed and developing countries, the negative consequences on the latter appear to be more severe since developing countries, such as Indonesia, generally rely more heavily on tax revenue to finance their public budget.

As a result of this awareness, several robust anti-avoidance legislative measures are already in place in Indonesian tax laws. These involve five areas. First, the Indonesian Income Tax Law (IITL), as last amended by Law No. 36 of 2008, has an extensive definition of income by adopting a "substance over form" principle.[7] Broadly speaking, this provision establishes basic guidance in determining taxable income and can be used as one of the legal measures to address unacceptable tax avoidance and/or tax evasion.

Second, the introduction of debt-to-equity regulations has been explicitly provided for in Article 18(1) of the IITL. This principal provision has provided the Minister of Finance an authorisation to issue a regulation on the debt to equity ratio for the purposes of calculating tax payable in accordance with Indonesian tax law. Third, issues relating to controlled foreign companies (CFCs) have also been anticipated in Article 18(2) of the IITL. According to this specific legislation, the Minister of Finance is authorised to determine when a dividend is deemed to be derived by a resident taxpayer from his or her participation in an offshore company other than a public company, where: (i) the taxpayer owns at least 50 per cent of the paid in capital of the company, or (ii) the taxpayer together with one or more other resident taxpayers own at least 50 per cent of the paid in capital of the company.

Fourth, the Indonesian general transfer pricing guidelines are already in place as stipulated in Article 18(3) and (3a)-(3d) of the IITL. These regulations generally require that transactions between related parties should be carried out in a "commercially justifiable way" and on an arm's length basis. Fifth, like many other countries, Indonesia finds it challenging to examine tax liabilities linked to "related party transactions" and has taken several bold steps to join global initiatives aimed at addressing this issue. However, Indonesia appears to adopt a stricter approach in defining a special relationship for the case of "related taxpayers". According to Article 18(4) of the IITL, a so-called "special relationship" exists when: (i) there is capital participation of 25 per cent or more; (ii) there is control through management or technology; and (iii) there is control through close family relationships.[8]

3. The Adoption of the BEPS Inclusive Framework in Indonesia

The problem of BEPS has been a longstanding global issue and has affected the international taxation field. It takes place worldwide in a way that has a greater impact on developing countries through this profit shifting behaviour (Crivelli, De Mooij and Keen, 2015; Johannesen, Tørsløv and Wier, 2017). Base erosion and profit shifting has been defined as constituting an international tax planning strategy that exploits loopholes and mismatches in the taxation regulations to minimise global tax paid.[9] Therefore, the solution to this issue cannot be merely a domestic approach or uncoordinated strategy (OECD, 2014). It requires comprehensive and collective actions that involve the international community to tackle the BEPS problem.

In responding to the BEPS phenomenon, the OECD has released an Action Plan comprising 15 Actions that can be considered the largest globally-coordinated strategy

[7] According to Article 4 of IITL, income is defined as "any increase in economics capacity received by or accrued by a taxpayer from Indonesia as well as from offshore, which may be utilized for consumption or increasing the taxpayer's wealth, in whatever name and form, including ...".

[8] Similarly, according to the OECD (2012), management, board members, and controlling shareholders are those who can control the terms of a transaction in their favour potentially at the cost of the company.

[9] OECD, "Base erosion and profit shifting", http://www.oecd.org/tax/beps/ (accessed on 28 June 2018).

to combat profit shifting (Marian, 2016). These Actions have then been supported by G20 countries which developed the Inclusive Framework with the OECD. This Framework requires its members to implement four minimums standards of the BEPS Actions (Actions 5, 6, 13 and 14), and to be reviewed and monitored regarding their implementation, and also enables them to work with the OECD and G20 members in designing standards on BEPS problems (OECD, 2017a). By March 2018, 113 countries had signed up to the BEPS Inclusive Framework.

Indonesia, as a member of the G20, has shown its strong commitment to applying the OECD BEPS Actions. Indonesia has become a member of the Inclusive Framework and implemented not only the BEPS minimum standards, but also the other detailed Actions. Indonesia has also been reviewed by the OECD regarding implementation of the BEPS minimum standards, and so far, no recommendations have been made in relation to the implementation, apart from Action 14 that will be reviewed by the end of 2018. The details of Indonesia's responses on the OECD Action Plan are set out further below.

3.1 *Action 5 – Countering Harmful Tax Practices More Effectively*

The OECD began to take action to counter harmful tax practices from 1998 through its *Harmful Tax Competition: An Emerging Global Issue* report in that year (noted in OECD, 2017b). Although the report was published 20 years ago, it is still relevant as the basis for the future strategy in combating harmful tax regimes. This report constituted the foundation for the OECD in establishing the Forum on Harmful Tax Practices (FHTP) and its continuing BEPS Action 5. This Action is dedicated to transforming the effort in countering harmful tax practices by enhancing transparency and preventing non-substantial activities in preferential tax regimes.

In Action 5, the scope of the FHTP's work and the criteria of a harmful tax regime had been determined. The FHTP work comprises the activity and the tax treatment for geographically mobile activities, such as financial services, and arrangements involving the use of intangibles (OECD, 2015d). Therefore, one of the FHTP's objectives is requiring substantial activities for intangible property (IP) regimes. The effort in Action 5 introduced the nexus approach in which the existence of research and development (R&D) activities (as reflected in the proportion of R&D expenditure) are required to be associated with tax incentives (OECD, 2015d). Likewise, Action 5 proposes the criteria for the FHTP in reviewing non-IP regimes, such as headquarters regimes, and funds management regimes, in which apply generally same principles are applied as for IP regimes. The policy regulated in Action 5 is designed to ensure the alignment between the taxation of profit and the associated value-creation activities (OECD, 2015d).

In response to the needs in this area, Indonesia joined the Inclusive Framework and also the FHTP. Consequently, Indonesia is committed to be reviewed regarding the tax facility regime in its jurisdiction. There are various tax incentives in Indonesia; for instance, a tax facility for industry that is classified as a pioneer industry, a reduced tax rate for publicly listed companies and small-medium taxpayers, and a tax holiday for certain industries. For Action 5 purposes, the tax facilities granted by the Indonesian government were classified into publicly-listed company, investment allowance, special economic zone, and tax holiday regimes. These regimes were reviewed by the FHTP and the result stated that all of them were outside the scope of the FHTP's work. Therefore, the OECD (2017b) has declared that no harmful tax regimes exist in Indonesia and no recommendation has been made regarding Indonesia's tax regime in relation to BEPS Action 5.

3.2 *Action 6 – Preventing Treaty Abuse*

Combating profit shifting by preventing multinational enterprises (MNEs) from using tax treaties improperly is considered one of the primary missions of the BEPS project (Miller and Oats, 2016). With respect to that objective, the OECD released BEPS Action 6 which identifies various tax treaty abuse activities, such as treaty shopping in which an international operation is deliberately structured in order to obtain advantage from a specific tax treaty (OECD, 2015e; Miller and Oats, 2016). Action 6 was developed as a response to tax planning strategies by providing recommendations concerning tax treaty design, clarifying that tax treaties are not expected to create double non-taxation, and developing local legal frameworks to inhibit the granting of treaty benefits in improper situations (OECD, 2015e). This Action Plan introduced several minimum standards in developing tax treaties and also provides supplementary provisions for the OECD Model Tax Convention (MTC), which are:

1) a clear expression that declares that the states involved in a tax treaty arrangement intend to prevent tax avoidance or evasion activities;

2) a specific anti-avoidance rule, the limitation on benefits clause (LOB), which restricts the treaty benefit to the appropriate person or company only as stipulated in the tax treaty arrangement; and

3) a general anti-avoidance rule, the principle purpose test (PPT), which examines the intention of the person or company who expects to be granted the treaty benefit.

Through this Action Plan, it is expected that the treaty benefit will be granted appropriately and the opportunities to employ treaty shopping or other treaty abuse activities can be reduced.

In response to Action 6, Indonesia has implemented this Action by the enactment of Director General Regulation Number 10/PJ/2017 (PER-10/2017), dated 19 June 2017 regarding the implementation procedure for double tax treaties. These new provisions have adopted the minimum standard in Action 6 and announce the requirements to be fulfilled in order to receive treaty benefit. If the person or company is unable to meet the criteria enacted in PER-10/2017, the treaty benefits will be denied for their case.

This measure regulates the criteria that must be met by a non-resident taxpayer (NRT) to obtain tax treaty benefit. In order to enjoy such benefit, an NRT must submit a Certificate of Domicile (COD) using the standard form in PER-10/2017. The form as stipulated in PER-10/2017 consists of a DGT-2 form which is used by a Banking NRT, pension fund NRT, or NRT who receives or earns income from a custodian, and a DGT-1 form which is used by any NRT who does not use DGT-2. In addition, PER-10/2017 also provides the requirement that should be fulfilled by Individual NRTs and Entity NRTs to be considered as beneficial owners. The beneficial owner shall be the individual or entity that does not act as agent, nominee, or conduit and has capacity to undertake their business activity in Indonesia.

The application of PPT and LOB provisions as indicated in Action 6 of the minimum standard will be implemented in Indonesian tax treaties as Indonesia has signed the Multilateral Instrument (MLI). Likewise, such implementation can be discerned in chapters VI and VII of PER-10/2017. The provisions in those chapters constitute the implementation of Action 6 recommendations, albeit that there is no clear expression of the application of PPT or LOB therein. However, the review has nevertheless been scheduled for the implementation of these rules. Chapter VI regulates the COD form and the requirement that an NRT must meet when using those forms. The COD forms shall state that the NRT has economic motives when incorporating their business in Indonesia, and the business must have economic substance in Indonesia. Furthermore, Chapter VII, titled Treaty Abuse, has stipulated the conditions in which treaty abuse is not considered to occur, which are: (i) there is economic substance in incorporating or conducting transactions; (ii) the legal form is aligned with economic substance; (iii) there is a relevant level of autonomy in performance of business through its own management; (iv) sufficient assets are involved in conducting business activity in Indonesia; (v) there are sufficient employees in terms of number and expertise involved in the conduct of business in Indonesia, and (vi) an active business activity exists other than receiving passive income from Indonesia.

3.3 Action 13 – Re-examining Transfer Pricing Documentation

Action 13 introduces provisions for three-tiered standardised transfer pricing documentation, which comprises: (i) the Master File, which contains information about the multinational entity (MNE) as a group; (ii) the Local File, which includes the description of the local entity, and (iii) Country-by-Country Reporting (CbCR), which provides information regarding the financial indicators of the MNE group by tax jurisdiction and lists the MNE's entities as well as its functions in every jurisdiction where the MNE operates (OECD, 2015g). This documentation is required for MNE groups with total consolidated revenue exceeding EUR 750 million.

In this transfer pricing documentation regime, the CbC report is the only document that is included in the BEPS minimum standards. CbC reports will be exchanged among tax authorities that have signed the Multilateral Competent Authority Agreement (MCAA) on the Exchange of CbCR. This agreement specifies the situations and conditions for obtaining and using CbCR. Indonesia signed the MCAA on 26 January 2017, and to April 2018, there have been 52 jurisdictions that have already chosen Indonesia as their country partner for reciprocal exchange of CbCR.

In response to the Inclusive Framework requirement Indonesia had already enacted domestic regulations in implementing Action 13, which are:

1) Minister of Finance Regulation Number 213/PMK.03/2016 (PMK-213/2016), dated 30 December 2016 regarding transfer pricing documentation. This regulation introduces the implementation of three-tiered transfer pricing documentation in Indonesia aligned with OECD Action 13 recommendations; and

2) Director General Regulation Number 29/PJ/2017 (PER-29/2017), dated 29 December 2017 regarding the administration procedures for CbCR. This measure constitutes the detailed regulation for CbCR which defines the entities that are obliged to prepare CbC reports, the requirement for filing CbC reports, and the deadline for filing CbC reports. PER-29/2017 also introduces the obligation to submit notification stating whether such a corporate taxpayer is obliged to submit CbC reports or not. The requirement to submit notification to the DGT is imposed on any constituent entities or members of a business group that conduct an affiliated transaction.

In broad terms, both PMK-213/2016 and PER-29/2017 are aligned with Action 13 recommendations. However, there are several additional measures implemented in adopting this Action due to the specific needs of the Indonesian tax authority. The adjustments are:

1) the obligation to prepare CbC reports is imposed on every Indonesian business group which has total consolidated revenue at least IDR 11 trillion (equal to EUR 750 million), regardless of the existence of any group member abroad. Hence, if the Indonesian business group only operates in Indonesia, it is still required to prepare CbC reports if its consolidated revenue exceeds the CbCR threshold; and

2) the obligation to prepare a CbCR worksheet for an Indonesian Ultimate Parent Entity (UPE) in preparing its CbC reports. The UPE can be considered the entity that controls the other business group members where there is no other entity that will consolidate its financial statements. The CbCR worksheet is required in assisting the Indonesian UPE to prepare its CbC reports and the worksheet must be submitted together with the notification and CbCR submission. Since the worksheet is not part of OECD Action 13 CbCR, it will not be exchanged with other competent tax authorities.

The implementation of Action 13 in Indonesia, particularly for CbCR, has been reviewed by the OECD. The review has led to the acceptance of the domestic law for CbCR in place in Indonesia without any further recommendations by the OECD. Therefore, Indonesia's domestic law has complied with the Action 13 minimum standard.

3.4 Action 14 – Making the Dispute Resolution Mechanism More Effective

Actions taken in combating profit shifting will often result in tax disputes between taxpayers and tax authorities. The dispute can relate to double taxation, tax treaty interpretation, or transfer pricing adjustment. Generally, the procedure to resolve such a dispute has been enacted in Article 25 of the OECD Model Tax Convention through the Mutual Agreement Procedure (MAP) (OECD, 2015h). However, specific action is inevitably needed to provide recommendations for resolving tax disputes effectively, efficiently, and in a timely manner as well as to strengthen the procedure stipulated in Article 25. In this way, certainty and predictability for taxpayers when a tax dispute arises can be ensured (OECD, 2015h).

Action 14 contains the objectives, minimum standard, best practices, and monitoring process for dispute resolution. There are three main objectives for the implementation of Action 14, which are: (i) ensuring that the MAP procedure is employed in good faith and in a timely manner; (ii) ensuring an administrative process for averting treaty disputes and resolving disputes expeditiously, and (iii) ensuring rightful taxpayers are able to lodge an MAP request.

Each of these objectives has been elaborated into minimum standards. Similarly, Action 14 provides the best practices for the minimum standards which could be applied by any countries joining this project. Since Action 14 was included in the BEPS minimum standards, the project has also defined the framework for the Action 14 monitoring process.

As at mid-May 2018, Indonesia has not yet enacted any specific measures in response to Action 14. However, Indonesia has already included Article 25 in almost all its tax treaties. Of 67 tax treaties with other countries, only one treaty does not include Article 25, the treaty with Saudi Arabia (Mulyani, 2016). Furthermore, Indonesia has already put international taxation dispute mechanisms in place for resolving disputes through the MAP, and preventing disputes through Advance Pricing Agreements (APAs). These procedures were enacted separately in Minister of Finance Regulation Number 240/PMK.03/2014 (PMK-240/2014) which regulates the procedure for MAP, and Minister of Finance Number 7/PMK.03/2015 (PMK-7/2015) regarding the procedure for APAs. Even though these regulations were released before the publication of Action 14, generally the content of these measures is directed to Action 14's recommendations. Recently, Indonesian tax authority has been developing new regulations in response to the minimum standard in Action 14.

Regulation PMK-240/2014 specifies the taxpayers who can raise MAP requests, namely Indonesian taxpayers, through the Directorate General of Taxation, and taxpayers in partner countries through the tax authority in the treaty partner country. The MAP will cover double taxation issues due to transfer pricing adjustments, dual residence issues, and disputes in tax treaty application. When the dispute arises, the taxpayer can make a request for the MAP as well as an objection and appeal request to the DGT. However, if the dispute is raised before the tax court and the court has already issued its decision, the taxpayer cannot lodge an MAP request, or in the case of an ongoing MAP request, the process will be stopped. Taxpayers can apply for the MAP in accordance with the timeline as enacted in tax treaties. In general, PMK-240/2014 provides that a dispute should be concluded within three years after the first consultation held between the DGT and the tax authority of the treaty partner country. If the MAP process cannot be completed in three years, the timeframe will be extended as agreed between the DGT and the treaty partner.

Separately, PMK-7/2015 regulates the procedure to prevent disputes through an APA which can be lodged by Indonesian taxpayers and non-resident taxpayers. They must have operated their business in Indonesia for at least three years to be eligible to apply for an APA. By raising the APA mechanisms, there will be an agreement between the DGT and taxpayers or a treaty partner's tax authority regarding the transfer price for affiliated transactions in the future. The result of an APA will cover the transaction over the next three fiscal years in the case of a unilateral APA, or four fiscal years for a bilateral APA. However, an outcome that differs from Action 14 is that PMK-7/2015 does not allow rollback for the period of years before the APA is submitted.

4. THE ADOPTION OF THE OTHER BEPS ACTIONS

4.1 *Action 1 – Addressing the Tax Challenge of the Digital Economy*

BEPS Action 1 specifically responds to the tax challenge created by the digital economy. Profit shifting and tax avoidance activity is exacerbated by the feature of the digital economy of being able to perform business activity without any significant presence (OECD, 2015a). Additionally, flexibility in relocating commercial activity to the most advantageous jurisdiction, transferring assets, and carrying out business remotely have been facilitated by the advance of technology (OECD, 2015a). Consequently, MNEs can avoid taxable presence which results in avoiding taxes in both source and intermediate countries (OECD, 2015a). Therefore, Action 1 offers several recommendations in facing these issues, which are: (i) taxing based on significant economic presence; (ii) imposing withholding tax; (iii) introducing an equalisation levy, and (iv) requiring non-resident taxpayers to register for value-added tax (VAT) purposes where they operate (OECD, 2015a).

Indonesia, as the world's fourth most populated country, constitutes a potential market for digital business. A study by Google and Temasek has found that the number of internet users in Indonesia is predicted to grow from 92 million users in 2015 to 215 million users in 2020 (Google, Inc. and Temasek Holdings (Private) Ltd, 2016). Based on this calculation, Indonesia is considered "the fastest growing internet market in the world". Accordingly, a McKinsey report in 2016 revealed that digital technology could boost the growth of labour and productivity and give added value of USD 155 million for Indonesian GDP by 2025 (Das et al., 2016).

Notwithstanding the rapid growth of the digital market in Indonesia, specific legislation has not so far been enacted in response to the recommendations on Action 1. The current regulations which contain provisions related to taxation of e-commerce are Presidential Regulation Number 74 year 2017 (PERPRES-74/2017) regarding the roadmap for e-commerce in years 2017-2019, Circular Letter of Directorate General of Taxation (DGT) Number 62 year 2013 regarding confirmation of tax treatment for e-commerce transactions (SE-62/2013), and Circular Letter of Directorate General of Taxation (DGT) Number 04 year 2017 regarding determination of permanent establishment (PE) for non-resident taxpayers which provide application or content services through the internet (SE-04/2017).

Regulation PERPRES-74/2017 provides guidance and reference for government, both central and local, for stipulating the provisions and actions to accelerate e-commerce trade in Indonesia. This regulation also provides guidance for stakeholders in conducting a national trade system on an e-commerce basis. Regarding the taxation aspects, PERPRES-74/2017 requires simplification of tax procedures, tax incentives for e-commerce business investors, design of a registration system for e-commerce entrepreneurs, and implementation of equality of tax treatment as between foreign and local e-commerce enterprises. SE-62/2013 sets out the detail of regulation for taxing e-commerce business. This letter provides taxation details both for income tax and value added tax as they relate to e-commerce transactions. Furthermore, this regulation requires the operator or service users to withhold the associated tax depending on the transaction type and the related parties' tax obligations.

By contrast, Circular SE-04/2017 is the only measure that has regulated international taxation aspects of e-commerce in Indonesia. To some extent, SE-04/2017 could be regarded as Indonesia's response to the Action 1 recommendation regarding PE determination using a significant economy presence. This implementation corresponds to the category for PE determination for an application or content service provider. As stipulated in this Circular, a PE can be formed as a fixed place of business, including room for sales or marketing, a computer included in a server or data centre, an electronic agent, or any automatic tools owned by non-resident taxpayers, which are used for performing business in Indonesia. The application of these categories to PE determination constitutes a breakthrough in the Indonesian taxation field. While many issues still remain regarding the establishment of a PE involving a computer, server, or Internet Service Provider (ISP), Indonesia has already enacted regulation on this matter by analysing the activity of e-commerce which is carried out through a computer or the internet. Nevertheless, the determination of a PE must take into account the provisions of the tax treaty agreement with the relevant treaty partner and should not override the treaty arrangement.

4.2 *Action 3 – Strengthening CFC Rules*

Multinational companies could design their organisational structure for tax purposes, for instance through establishment of subsidiaries in tax haven jurisdictions, so that the distribution of their earnings from overseas subsidiaries will be deliberately deferred. Such an activity results in postponement of tax payments that causes capital exporting jurisdictions to suffer from deferral of tax revenue (Miller and Oats, 2016). BEPS Action 3 gives recommendations to prevent this strategy by designing effective rules in curbing tax haven abuse involving the use of controlled foreign companies (CFCs) (OECD, 2015b). Miller and Oats (2016) have found that CFC rules constitute the most effective measure in curtailing this problem.

Action 3 suggests that the design of CFC rules ought to provide for: (i) the definition and description of the type of entity constituting a CFC and the extent to which an entity will be considered a CFC; (ii) the CFC exemptions and threshold; (iii) the type of income subject to CFC rules; (iii) procedures on how to calculate the income; (iv) rules for attributing income, and (v) the mechanism on how to prevent double taxation.

As a response to the CFC recommendations, Indonesia has enacted Minister of Finance Regulation Number 107/PMK.03/2017 (PMK-107/2017) considering the determination of the timing for dividend receipt and its computation for a resident taxpayer which owns a share in a foreign company and does not sell their share on the stock exchange. In PMK-107/2017, a resident taxpayer which owns at least a 50 per cent share in a CFC is regarded as receiving income distribution in the form of a deemed dividend on its capital participation in a non-listed overseas company. This provision covers both directly and indirectly owned foreign entities. It also provides some examples on calculating the amount of capital participation and deemed dividend, determination of timing for the deemed dividend receipt, and computation of allowable tax credit.

Further, PMK-107/2017 defines a CFC to consist of:

1) a direct CFC, which constitutes a foreign company that is directly owned by a resident taxpayer or collectively owned with other resident taxpayers, with a minimum total participation of 50 per cent; and

2) an indirect CFC, which is a foreign company that is indirectly controlled by a resident taxpayer through a directly controlled CFC, or directly controlled CFC together with other indirectly controlled CFCs, with at least 50 per cent ownership at each level of share participation (not using proportional calculation of share).

Indonesian resident taxpayers owning such entities must recognise income distribution from the CFC in the form of a deemed dividend. To prevent deferral, the revenue attribution is recognised four months after the last day of the CFC's tax return submissions or seven months after the end of the fiscal year if the CFC is not required to submit tax returns.

Generally, the tax base for the deemed dividend calculation is net income after tax, including other income, under the accounting principle applied in the CFC's jurisdiction. However, the calculation is different depending on the CFC's type:

1) for direct CFCs, the deemed dividend is computed by multiplying the tax base by the percentage share in the direct CFC; and

2) for indirect CFCs, the deemed dividend is calculated by multiplying the tax base of the indirect CFC by the effective percentage ownership in the indirect CFC.

To prevent double taxation, the resident taxpayer can credit the actual tax paid or withheld in the CFC's jurisdiction. A simulation of the calculation has been provided in PMK-107/2017. For taxpayers who claim the tax credit, they must attach the following documents in their annual tax return: (i) financial statement; (ii) copy of CFC's tax return (if any); (iii) calculation or detailed list of profit after tax in the last five years; and (iv) evidence of tax payment or tax withheld for dividend received.

4.3 Action 4 – Limiting Base Erosion Involving Interest Deductions and Other Financial Payments

The objective of Action 4 was to combat the tax planning strategies conducted by MNEs which employ intragroup lending, so that such a group can generate global interest deductions in which the amount of interest exceeds that which would be paid to an unrelated party (Miller and Oats, 2016; OECD, 2015c). In curbing this base erosion through manufactured interest deductions, Action 4 recommends the application of a fixed ratio rule which restricts the interest based on a percentage of interest payment to earnings before interest, taxes, depreciation and amortisation (EBITDA) (OECD, 2015c). However, Action 4 also recognises other approaches, such as a fixed ratio based on assets or equity (widely known as thin capitalisation rules), and a worldwide group ratio.

In relation to this issue, Indonesia has enacted a regulation to curtail excessive interest deductions by taxpayers through the application of thin capitalisation rules. The approach used is a debt-to-equity ratio (DER) pursuant to Article 18, paragraph 1 of the IITL. Even though Indonesia has not implemented the best practice approach as recommended in Action 4, it has developed its own rule for limiting base erosion from intragroup financing activities. As at 2018, Indonesia's legal framework only provides for the application of a fixed ratio using equity (DER) rather than using EBITDA. On this basis, the detailed provisions of the DER were stipulated in Minister of Finance Regulation Number 169/PMK.010/2015 (PMK-169/2015) regarding the determination of a company's debt to equity ratio for income tax purposes, and Directorate General of Taxes Regulation Number 25/PJ/2017 (PER-25/2017) regarding the implementation of PMK-169/2015 and the procedure to report foreign private loans.

Regulations PMK-169/2015 and PER-25/2017 have stipulated a maximum DER of 4:1 for Indonesian taxpayers. Consequently, where a taxpayer's actual DER exceeds the maximum permitted DER, the excess amount of its borrowing cost will be disregarded as a deductible expense for income tax purposes. The taxpayers covered by these provisions are limited liability companies not including banks, financial institutions, insurance companies, mining enterprises, and concerns in other specific areas as stipulated in PMK-169/2015. In addition, the taxpayer must consider the arm's length principle when applying the 4:1 ratio.

Regulation PMK-169/2015 provides the criteria in relation to debt and equity used for calculating the DER. Debt includes long term debt, short term debt, and interest bearing trade payable. Likewise, equity is defined in accordance with financial accounting standards, and includes non-interest bearing loans from related parties. Furthermore, PMK-169/2015 and PER-25/2017 elaborate the borrowing costs which are allowed and disallowed for tax purposes. Generally, any borrowing cost in the form of interest, premium or discount, additional cost due to the borrowing arrangement, financial expenses associated with a capital lease, cost due to guarantee of loan repayment, or foreign exchange loss related to borrowing cost shall be allowed as deductible expense. Conversely, the excess amount of borrowing cost when the taxpayer's DER surpasses the maximum allowable DER, including intragroup borrowing cost which is not aligned with the arm's length principle, and any borrowing cost related to non-taxable income or final-taxed income, shall be regarded as a non-deductible expense. In order to give comprehensive guidance, PER-25/2017 provides several simulations for calculating DER and the allowed borrowing cost, including the appropriate adjustment for particular cases. For tax filing purposes, PER-25/2017 requires taxpayers to submit DER calculations and foreign private loan reports (if any) using the form as provided in the regulation and attach these forms in the annual tax return. If taxpayers do not comply with this requirement, the annual tax return will be considered incomplete.

4.4 *Actions 8-10 – Updating Transfer Pricing Guidelines*

The update of transfer pricing guidelines has been effected through Actions 8-10. With the tag line of aligning transfer pricing with value creation, these Actions have been designed to work on three areas, which are: (i) transfer pricing for intangible transactions (Action 8); (ii) risk allocation, the impact of risk allocation on profit, and addressing issues related to the appropriate return on funding by capital-rich companies (Action 9); and (iii) other high-risk transactions which generally do not take place between independent parties, and guidance for commodity transactions (Action 10). These Actions continue to apply the arm's length principle for every transaction conducted between independent or affiliated parties. Additionally, this measure also requires prudent delineation between the legal contract and the actual transaction so that the profit allocation is aligned with the actual business activities.

The current Indonesian transfer pricing regime is based on Article 18, paragraph 3 of the IITL, regarding the authority of the Directorate General of Taxation to redetermine the transfer price of an affiliated transaction using the arm's length principle. Subsequently, based on this article, the transfer pricing guidelines for Indonesian resident taxpayers have been enacted in Director General Regulation Number PER-43/PJ/2010 (PER-43/2010) and PER-32/PJ/2011 which regulate the application of the arm's length principle for affiliated transactions, supplemented by Directorate General Regulation Number PER-22/PJ/2011 and Circular Letter of Directorate General of Taxation Number SE-50/PJ/2013 which provide guidelines for transfer pricing audits. In general, these provisions have adopted the 2010 OECD Transfer Pricing Guidelines, so that there are several differences between Indonesia's domestic rule and BEPS Actions 8-10, including:

1) there is no explicit guidance in the Indonesian regulation regarding intangibles and remuneration for development, enhancement, maintenance, protection or exploitation of intangibles (Hutagaol, 2017);

2) no clear guidance on how to perform risk analysis is provided in the Indonesian domestic rule; and

3) the Indonesian transfer pricing measure has not to date provided specific treatment for commodity transactions.

Recently, Indonesia has been working to revise its transfer pricing regulation pursuant to which the 2017 OECD transfer pricing guidelines will be adopted as well as BEPS Actions 8-10. The new Indonesian transfer pricing rule is expected to be released in the near future.

4.5 *Action 15 – Developing a Multilateral Instrument*

The implementation of the BEPS Action Plan will not be effective without adjustments also being made to the OECD Model Tax Convention and associated bilateral tax treaties. Yet, adjustment on an individual basis of more than 3,000 bilateral tax treaties worldwide in order to adopt the BEPS Action Plan would be infeasible and exceedingly time consuming. Therefore, an innovative approach has been developed in the form of the Multilateral Instrument (MLI) which provides an overarching framework in tackling profit shifting in a harmonised way in accordance with the BEPS Action Plan whilst still respecting tax sovereignty (OECD, 2015i - Action 15). Through implementation of the MLI, bilateral tax treaties will be enhanced by incorporating changes pursuant to the treaty-related Actions, namely Action 2 (neutralising the effect of hybrid-mismatch arrangements), Action 6 (preventing treaty abuse), Action 7 (preventing artificial avoidance of PE), and Action 14 (making dispute resolution more effective). Therefore, the implementation of Action 15 could eliminate, or at least reduce the possibility of the incidence of base erosion and profit shifting, double taxation, or double non-taxation in an effective way and timely manner.

As at March 2018, 78 jurisdictions had already agreed to implement the MLI agreement, not including six other jurisdictions that have also expressed their willingness to join the convention. Indonesia has responded towards this Action by signing the MLI on 7 June 2017. The implementation of the MLI in Indonesia will adjust the following tax treaty articles: (i) Article 3 regarding transparent entities; (ii) Article 4 regarding dual resident entities; (iii) Article 5 regarding eliminating double taxation; (iv) Article 7 regarding the principle purpose test (PPT)/simplified PPT or limitation of benefit (LOB) clause; (v) Article 9 concerning capital gains; (vi) Article 10 concerning PEs in a third contracting state; (vii) Article 13 concerning PEs; (viii) Article 16 concerning the MAP; (ix) Article 17 regarding corresponding adjustments, and (x) Article 35 regarding entry into effect of the MLI.

5. The Adoption of Unilateral BEPS Measures

Indonesia has attempted to adopt some unilateral measures to tackle BEPS issues as set out further below, some of which are currently in progress.

5.1 Diverted Profits Tax

Certain countries have undertaken unilateral moves particularly with respect to the "digital economy". With respect to this, while there is no "diverted profits tax" approach currently in place, Indonesia is currently considering imposition of a withholding tax for e-commerce transactions.

5.2 Tightening of General Anti-Avoidance Rules

While no specific GAAR is currently in place, the Indonesian domestic law adopts an anti-avoidance approach through an emphasis on the "special relationship" concept under transfer pricing and thin capitalisation rules.

For instance, under Article 18(3) of the IITL, the Indonesian tax authority can make adjustments to commercial transactions particularly with respect to income and expenses, and also recharacterise debt as equity. In doing so, the DGT is authorised to determine the taxable income from transactions between related parties in accordance with the principle of common business practices that are not carried out by those in a special relationship. The effect of this approach is somewhat similar to that in Article 9 of the OECD Model Tax Convention although the wording is slightly different. Further, according to Article 16(2) of Government Regulation 80 Year 2007, taxpayers are required to provide transfer pricing documentation. However, no specific guidelines directed at taxpayers were available prior to September 2010 although DGT Regulation PER-39/PJ/2009 implicitly indicates that the OECD Transfer Pricing Guidelines should be adopted. It is worth noting that the OECD guidelines might have no direct impact upon Indonesia since Indonesia is not a member of the OECD. Filling this gap, the DGT for the first time released guidance for taxpayers relating to transfer pricing practices and related party' transactions through PER-43/2010 (see section 7.4.4 above).

While the definition of "related parties" in Indonesia seems stricter than in other typical jurisdictions, this regulation highlights several general considerations to be taken into account in determining whether the pricing of related party transactions satisfies the arm's length principle. In doing so, the regulation provides certain steps to be carried out in examining whether the pricing of related party transactions is fair and in accordance with common business practices. An amended version of this regulation - DGT

Regulation Number PER-32/PJ/2011 - revoked the hierarchical approach in selecting the transfer pricing method as suggested previously in the former regulations and adopts the "most appropriate method" stance instead. In addition to this, while the transactional net margin method is no longer considered the method of last resort, this regulation requires taxpayers to justify the process of selection of their adopted method.

An attempt to tighten the anti-avoidance rules is also reflected in Regulation PMK-169/2015 which deals with thin capitalisation rules (see section 7.4.3 above). This regulation adopts a "4:1 debt-to-equity ratio" in addressing BEPS issues. It means that borrowing expenses relating to debt exceeding the ratio are not be deductible. It is worth noting however that this debt-to-equity ratio does not apply to certain institutions (e.g., banks, financial institutions, insurance and reinsurance businesses, oil and gas and mining industries, infrastructure industries, and industries that are subject to final income tax).

Finally, other anti-avoidance measures can also be found under Article 18(2) of the IITL regarding the Controlled Foreign Corporations (CFC) rule (recall section 7.4.2 above). As indicated earlier, the Ministry of Finance (MoF) is authorised to determine when a dividend is deemed to be accrued by a resident taxpayer. Under this provision, an Indonesian resident shareholder is taxed on the "deemed dividend" if in the relevant year these earnings have not been distributed. That is, the qualifying Indonesian resident shareholders will be deemed to have received the dividends from the CFC at a time determined in accordance with the following criteria: (i) in the fourth month after the CFC has to file its annual income tax return; or (ii) in the seventh month after the end of the fiscal year if the CFC is not obliged to file an annual tax return or no deadline is applied for lodgement of the annual tax return.[10] The amount of the deemed dividend is calculated proportionally based on the shareholding percentage and applied to the after-tax profit of the CFC.

5.3 Automatic Exchange of Information

In response to the prerequisites for implementing automatic exchange of information (AEOI) by September 2018, Indonesia as an initial step issued Government Regulation in Lieu of Law Number 1 Year 2017 (PERPU 1/2017) in May 2017 as the primary legal basis for EOI.[11] This regulation - upgraded and converted to Law Number 9 Year 2017 in August 2017 (LAW 9/2017) - provides a legal basis for the Indonesian tax authority to access both local and foreign customer information data from financial sectors such as banking, capital market, insurance, and other financial institutions.

Following this primary authority, on 31 May 2017, the Ministry of Finance (MoF) issued MoF Regulation Number 70/PMK.03/2017 concerning Technical Guidance on Financial Information Access for Taxation Purposes (PMK-70/2017). With respect to its implementation, this regulation covers two areas: (i) international agreements, and (ii) domestic taxation. It also establishes two types of EOI: automatic and upon request. The former is performed periodically, systematically, and continuously at a certain time in

[10] See Regulation PMK-107/2017.

[11] It is worth noting that if no primary legislation had been in place by 30 June 2017, the Indonesian government would have been categorised by the Global Forum as a country that has "failed to meet its commitment".

relation to certain information based on the Common Reporting Standard (CRS). The details of information that need to be automatically reported are the identity of financial account holders, identity of financial institutions, financial account numbers, financial account balances, and income related to the reported account. With respect to the reciprocal nature of the EOI, the Indonesian Competent Authority is authorised to lodge a written request for an EOI to a corresponding partner country or jurisdiction in cases where a resident taxpayer is suspected of being non-compliant.

In general, the technical guidance addresses four issues: (i) subjects, i.e., entities that are required to submit information; (ii) the mechanism on how information reporting is carried out; (iii) confidentiality concerns, and (iv) imposition of sanctions.

6. ADMINISTRATIVE INTERNATIONAL TAX-RELATED REFORM

The Indonesian government has taken several bold steps to strengthen its revenue administration, some of which are related to international tax reform. One of the recent major administrative tax reforms undertaken by the Indonesian government was a tax amnesty programme, which ran for nine months between July 2016 and March 2017. Under Law Number 11 Year 2016, by offering both tax incentives and immunity from prosecution, this programme aimed to make it attractive for non-compliant taxpayers to declare their offshore and/or domestic assets to the Indonesian tax authorities. With tax revenue collected of close to 1.08 per cent of Indonesian GDP (i.e., IDR 134.99 trillion of approximately IDR 2.5 quadrillion), some considered this programme to be one of the most - if not the most - successful tax amnesty programmes in the world. In terms of the value of assets declared, although less than one million Indonesian taxpayers joined the programme, a figure equal to 40 per cent of Indonesian gross domestic product (GDP) was declared by the participants. These figures imply that tax non-compliance remains rampant in Indonesia.

It is believed that the introduction of the AEOI procedures as proposed by the OECD, which Indonesia is planning to implement by September 2018, was one of the factors that motivated taxpayers to participate in the programme. Following the end of this programme, to address the underlying flaws within the tax system, the Indonesian government issued a law to equip the tax authority with a right of access to financial information for taxation purposes on May 2017 (i.e., PERPU 1/2017, as noted in section 7.5.3 above).[12] This legislation requires financial institutions to lodge a report on financial data to the DGT.

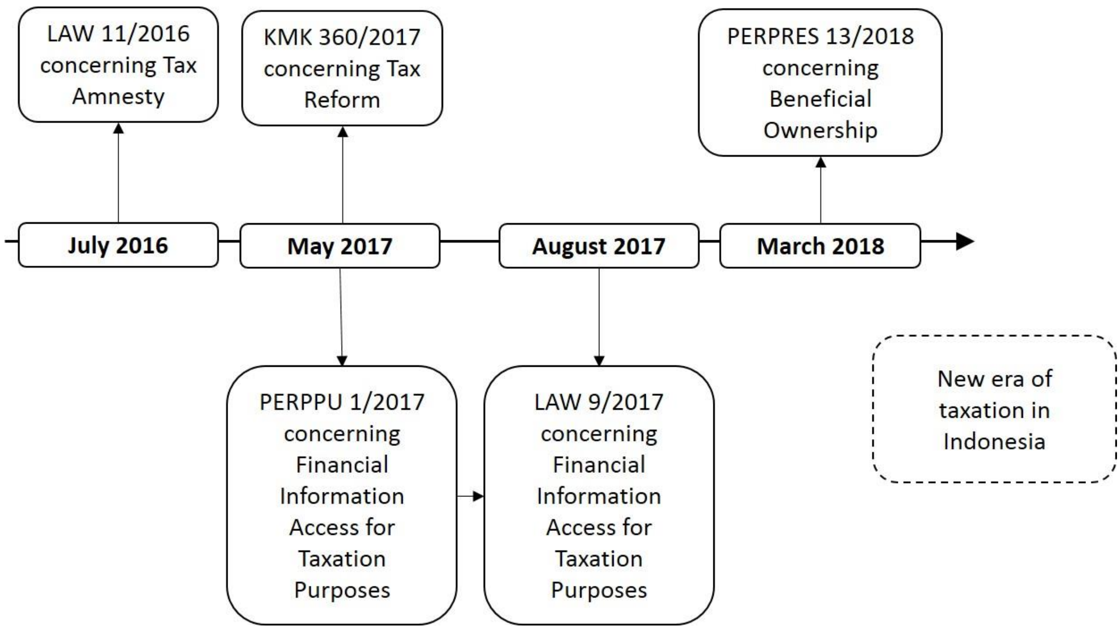
In addition to ongoing administrative tax reform undertaken over 2017 entailing five areas (i.e., organisation, human resources, information technology and data base, business process, and regulations),[13] a major driver of current administrative tax reform has been the enactment of Presidential Regulation Number 13 Year 2018 (PERPRES 13/2018) concerning Principles of Recognizing the Beneficiaries of Corporations in Preventing and Combating Money Laundering and Criminal Acts of Terrorism. In general, this regulation requires corporations to provide details of beneficiary

[12] Converted to LAW 9/2017 on August 2017.

[13] See Decree of Minister of Finance Number KMK-360/KMK.03/2017 regarding Tax Reform (KMK 360/2017). It is worth noting that with respect to regulations, Indonesia is currently considering amending its tax laws: general provisions, income tax, and VAT.

information, defined as any individual who may appoint or dismiss the board of directors, board of commissioners, administrators or supervisors of the corporation. In addition, individuals who have the ability to control corporations are regarded as deriving the benefits of the corporation, whether directly or indirectly, and are the true owners of the funds or shares of the corporation. So far, beneficiary practices are closely related to the phenomenon of illicit financial outflows between jurisdictions. In this sense, taxes can be the reason for the beneficial owner to disguise the origin, control, or the amount of benefits received and terminate the chain of ownership to avoid or evade the tax burden. Thus, it is hoped that this regulation will not only be capable of preventing and eradicating money laundering and terrorism financing activities, but also preventing any attempts made by taxpayers to "escape" from their tax liabilities through tax avoidance and tax evasion practices. To summarise, these administrative reforms can be depicted as follows:

Figure 7.1: Recent Administrative Reforms in Indonesia



7. FUTURE INTERNATIONAL TAX REFORM

While developing countries generally rely on tax revenue for their state-building, it is a widely accepted belief that the tax base in this context has been eroded by both illegal tax evasion and legal tax avoidance by MNEs. For this reason, Indonesia has actively participated in the global forum for tackling BEPS issues, for instance by becoming a member of the G20 working group, joining the Inclusive Framework for BEPS and the FHTP, and becoming an MLI signatory along with 66 other countries. As a result, Indonesia is expected to apply the BEPS Action Plan consistently, and ensure its implementation in domestic measures aligned with international standards. However, there are some challenges and opportunities in the future of the international taxation field in Indonesia.

7.1 Challenges

Indonesia is highly reliant on tax revenue as the source of income for its national budget. In the past five years, more than 70 per cent of total government revenue has been collected from taxation. Apparently, this trend will be ongoing for the next several decades. On the one hand, Indonesia is considered to be a net capital importing country so that it should provide facilities to attract inbound investment. On the other hand, the international trend in company income tax rates is one of decline and this could affect the Indonesian tax system.

The lack of administrative resources, particularly competent staff in the area of international tax practice, and burdensome tax provisions are present in Indonesia as in many other developing countries (see, for example, Sandford, 2000; Fuest and Riedel, 2010; Ring, 2017). Moreover, inadequate transparency has resulted in asymmetric information between tax authorities and taxpayers which has undermined the effectiveness of tax collection (Fuest and Riedel, 2010; Ting, 2014). This suggests that enhancement of the tax transparency regime is inevitably needed in the future. In addition to this, Indonesia also needs to take several bold steps to improve both the internal capabilities and the effectiveness of its tax administration, some of which are already in progress.

7.2 Opportunities

There are still several BEPS Actions which have not been implemented in Indonesia, for instance Action 7 and Action 12. Indonesia could consider adopting these Actions through its domestic rules and tax treaties. Additionally, Indonesia could adopt the recommendations in Action 1 in its income tax and VAT law proposals to address the rapid growth of Indonesian e-commerce business arising from the digital economy.[14]

On the other hand, Indonesia also needs to consider its strategy to attract foreign investment without sacrificing its statutory tax rate. There are several ways in which incentives could be offered to investors by the Indonesian government, for instance by providing tax holiday schemes for particular industries, or establishing safe harbour policies for ensuring certainty in transactions entered into with affiliated foreign entities.

Since Indonesia is a net capital importer, it seems important to protect its tax base from any profit shifting activity. The government should consider strengthening Indonesia's tax treaties to preserve the taxing rights of Indonesia as the source taxation country. The application of simplified PPT or LOB provisions as agreed in the MLI has provided a potential advantage for Indonesia in protecting its tax base. In addition to that, Indonesia could renegotiate those treaties which it is considered undermine Indonesia's taxing rights by implementing a specific model aligned with domestic law (International Monetary Fund, 2017). Alternatively, Indonesia could follow global trends in which there has been a shift from a "worldwide income" approach (as currently applied in the Indonesian tax regime) to a territorial tax system which offers simplicity and greater disincentives for tax dodging activities (International Monetary Fund, 2017).

[14] Ibid.

In response to the demands on experienced staff in the international tax practice and transfer pricing areas, Indonesia could consider steps to enhance their skills by providing training in the international taxation area, or secondment to other countries or international organisations involved in the international taxation field. In addition, Indonesia should enhance its tax transparency regime to reduce the information disparity between the tax authorities and taxpayers. The first steps in building this transparency regime were actually taken with the release of the CbCR regulation in December 2016. However, Indonesia could further consider implementing the BEPS Action 12 recommendations which require taxpayers to disclose their tax planning strategies through mandatory disclosure rules. The implementation of mandatory disclosure rules could provide more relevant information for tax authorities in curbing tax avoidance whilst preventing MNEs from deliberately reducing their tax base or shifting their profits out of Indonesia. By doing so, it would be possible to deal further with the problem of BEPS in Indonesia.

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