JMM (Jurnal Masyarakat Mandiri)
http://journal.ummat.ac.id/index.php/jmm
Vol. 4, No. 3, Agustus 2020, Hal. 467-474
e-ISSN2614-5758 | p-ISSN 2598-8158
Crossref : https://doi.org/10.31764/jmm.v4i3.2496

REFORMING CONTROLLED FOREIGN CORPORATIONS IN INDONESIA: LESSONS LEARNED FROM BEPS ACTION PLAN AND GERMANY

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ABSTRAK

Abstrak: Meningkatnya aktivitas ekonomi antar negara memberikan ruang bagi perusahaan untuk membentuk perusahaan terkendali yang berada di luar negeri (Controlled Foreign Corporations) sehingga menyebabkan naiknya risiko penggelapan pajak. OECD dan G20 merekomendasikan Base Erosion and Profit Shifting (BEPS) Action Plan agar negara-negara dapat mengadopsi peraturan yang ideal terkait CFC. Oleh karena itu, Indonesia merilis Peraturan Menteri Keuangan no. 93/PMK.03/2019, dimana Jerman juga mengadaptasi peraturan CFC ini melalui German Foreign Transaction Act 1972. Namun, Jerman dinilai lebih berhasil dalam melindungi basis pajk negaranya dalam ruang lingkup CFC. Maka, riset ini dilakukan untuk membandingkan antara peraturan CFC di Indonesia dengan Jerman serta OECD BEPS Action Plan dalam aspek control, kualifikasi pendapatan, serta keringanan beban pajak. Melalui penelitian yuridis-normatif dan pendekatan kualitatif, telah dikemukakan bahwa perbedaan utama tertera dalam lingkup pengendali tidak langsung, kewajiban keterbukaan pemegang saham, spesifikasi yurisdiksi pajak, dan metode keringanan pajak, yang selanjutnya akan diolah sebagai rekomendasi kebijakan untuk memperkuat regulasi CFC di Indonesia.

Kata kunci : Controlled Foreign Corporations; Perpajakan Internasional; Pajak Penghasilan; Indonesia; Jerman; BEPS Action Plan.

Abstract: *The rise of cross-border multinational companies allows the occurrence of Controlled Foreign Corporation (CFC), which consequently gives rise to the risk of tax evasion. The OECD and G20 enacted the Base Erosion and Profit Shifting (BEPS) Action Plan to recommend nations in adopting an ideal policy for CFC. In response, Indonesia promulgated Ministry of Finance Regulation No.93/PMK.03/2019, whereas Germany adopted the German Foreign Transaction Tax Act 1972. However, Germany was deemed more successful in maintaining the tax base of the nation from the conduct of CFC. Hence, this research was conducted to compare the CFC regulation in Indonesia and Germany as well as the OECD BEPS Action Plan, especially in pertaining to the aspect of control, income qualification, and tax relief. Through juridical-normative research and qualitative approach, it is found that the main differences are prevalent in the scope of indirect controller, mandatory disclosure, tax jurisdiction, and method of tax relief, which are incorporated as policy recommendations to further strengthen the CFC regulation in Indonesia.*

Keywords: *Controlled Foreign Corporation; International Taxation; Income Tax; Indonesia; Germany; BEPS Action Plan.*

Article History:
Received : 25-06-2020
Revised : 07-08-2020
Accepted : 09-08-2020
Online : 14-08-2020

A. INTRODUCTIONS

In the rising era of globalization, the current mobility of capital and labor allows enterprises to seize investment opportunities in different locations to maximize profit (Hybka, 2014). One of the strategies includes implementing the concept of Controlled Foreign Corporations (CFC), which signifies the occurrence of a corporate entity that operates outside the jurisdiction of the home country, whereas the controller resides in the home country. The implication is that the corporate entity would be subject to the tax regulation of the country that it is residing in. Consequently, the controllers may target countries that offer tax leniency or even tax haven in the pursuit of tax evasion. In response to the occurrence of CFC, countries should ideally promulgate policies in order to ensure that the controller of the policy would also be subject to the tax regulations inside the home country (Morotomi, 2016).

To guide policy makers, the OECD and G20 released a report titled OECD/G20 BEPS Project Action 3 regarding Designing Effective Controlled Foreign Company Rules in 2015 (BEPS Action Plan) (Gomes, 2018). In pertaining to this, the BEPS Action Plan articulated four shared policy considerations that signified the importance of regulating CFC. First, CFC rules create a deterrent effect by preventing the taxpayers to shift their income to the low-tax jurisdiction. This is important to ensure that the profits generated by a group or corporations remain within the tax base of the parent. Second, the CFC rule is important to ensure fair adjusted prices charged among related parties. In some cases, the interest payment or the calculation of related-parties income transfer does not consider the arm's length principle (Fleming Jr. et al., 2009). Third, any policy about CFC should consider effective rules that do not disproportionately increase compliance costs and administrative burdens. Last, CFC rules are also important to prevent double taxation or double non-taxation and ensure a balance allocation and taxing power.

The promulgation of CFC policies needs to take into consideration upon the balance of opposing indicators. In this regard, CFC policies require balance between repatriating foreign income and competitiveness to attract investors. In this regard, a strong CFC regulation implies the risk of disincentivizing companies to have offshore companies in another jurisdiction. CFC policies should also consider the balance between the protection towards the offshore tax base jurisdiction or protecting both offshore jurisdiction and foreign-to-foreign tax base erosion (Russo, 2017). This consideration is a trade-off because the government must define the income subjected to the CFC rules itself.

In addition to those considerations, there are six building blocks recommendation to design CFC rules (Prettl, 2017) which are: (i) Definition of CFC; (ii) CFC Exemptions and Threshold Requirements; (iii) Definition of Income; (iv) Computation of Income; (v) Attribution of Income; and (vi) Prevention and Elimination of Double Taxation. Therefore, member states are recommended to follow the aforementioned in building their CFC regulations. Among six building blocks, there are two key aspects that need to be focused on in designing a CFC regulation, which are definition of CFC as an entity and definition of income entitled to a CFC rule.

In terms of income qualification, the BEPS Action Plan does not specify explicit recommendations concerning the types of income that are included as the object of taxation in the CFC rules (von Hagen & Prettl, 2017). However, the BEPS Action Plan stated that while income deriving from sales and service revenue generally does not raise any concern towards a CFC regulation, most of the problems arise in the scope of passive income, such as interest, insurance, dividend and royalty income (Ramm, 2015). This becomes a concern because in previous cases, a conduit company in a lower-tax jurisdiction is often incorporated to accumulate their worldwide income. This foreign income might be exempted or credited towards the domestic taxable income through consolidation. In this case, the home country is disadvantaged because the income is not taxable under their jurisdiction.

There are two types of tax relief methods that are widely known to avoid double-taxation, namely the exemption method and the credit method. In this regard, both methods concede that tax relief must be given by the recipient country instead of the source country (Haufler et al., 2014). The two different method has its own consequences, depending on the purpose of the regulation itself. The exemption method acknowledges that part of the foreign income will be exempted from the calculation of the domestic parent entity taxable income, whereas the credit method acknowledges that the tax paid because of the foreign income, can be credited against the domestic tax liabilities after the domestic and foreign income is consolidated and calculated (Lokken & Kitamura, 2012). Although the OECD does not strictly recommend each country to apply a certain set of methods, most of the countries in the world use both credit and exemption methods.

The era of disruption allows an interconnected economy that gives rise to numerous cross-border transactions in the global value chain. While globalization invites developmental advantages, there are also implied risks and challenges, especially in the adaptation and application of tax regulations in correlation with the business activities of multinational corporations. On this notion, the prevalence of income tax is fundamental as one of the sources of state revenue, which subsequently incites economic growth for the nation. Therefore, policy, bureaucracy, and regulations concerning taxation requires continuous development, in order to ensure timeliness and legal certainty in the changing landscape of business activities. However, in the pursuit of maximizing profit, entrepreneurs may establish a Controlled Foreign Corporation (CFC) as an attempt to conduct tax evasion in a foreign jurisdiction that offers less tax obligations to the corporation. Hence, CFC may be incorporated to undermine the prevailing regulation of income tax within the domestic jurisdiction, and consequently causes loss to the home country in the form of tax base reduction (Poterba, 2013). It is reflected from the total tax rate of Indonesia that is notably lower than the ASEAN countries, worldwide, and even Germany.

On this notion, CFC is the phenomenon where offshore companies are created while the controller of the company remains inside the domestic jurisdiction. The International Consortium of Investigative Journalists estimates approximately 214,000 offshore companies were established in various tax haven jurisdictions with many suspicious reasons (Walsh-Führing, 2018). Because of this, nations are challenged in attaining the balance between protecting the tax base from tax evasion as aggressive tax planning may adversely discourage confidence in the overall business and economic growth of the nation.

In response to the growth of CFC, there have been several attempts on regulating CFC in the international community. In 2015, the Organization for Economic Co-operation and Development (OECD) and Group of Twenty (G20) initiated the Action Plan on Base Erosion and Profit Shifting (BEPS Action Plan) as a set of recommendations serving as the building blocks for the CFC regulation (D'Ascenzo, 2018). Following this, there are several countries that adopted national policies serving to impose taxation for controllers of the CFC, including Indonesia and Germany as members of the G20. Currently, Indonesia regulates CFC through the Minister of Finance Regulation No. 93/PMK.03/2019, in which the main focus is to ensure that income from foreign activities are repatriated back to the home country (OECD, 2013). On the other hand, Germany also regulates CFC in the German Foreign Transaction Tax Act 1972 (Auß ensteuergesetz, AStG).

In comparison to Indonesia, Germany is deemed to be more successful in implementing a strong CFC regulation as evident in the comparison of Foreign Direct Investment (FDI) outflow between Indonesia and Germany. The FDI outflow reflects the greater access acquired by the domestic player in the international market, which causes the increase of export and foreign exchange. However, this situation also increases the risk of tax avoidance practices by establishment of CFC. From 2014 to 2018, the outward flow of FDI in Indonesia consistently shows a positive number, with the exception of 2016. In the span of five years, the FDI outflow reaches the peak of 8.138,9 million USD due to the application of CFC regulations under the Ministry of Finance Regulation Number 107/PMK.03/2017 (Cahyono & Aisyah, 2020). On the other hand, the German FDI Outflow always shows a positive number. Moreover, the amount of outward FDI is notably constant where almost all the numbers are relatively close to the average investment in the previous 5 years. Therefore, it may reflect the "certainties" as one of the pivotal aspects to enhance economic activities in a country.

Through implementing the juridical-normative research and qualitative approach, this study will illustrate to what extent Indonesia has adopted the BEPS Action Plan recommendation adequately, in comparison with Germany that has also adopted the recommendation and managed to successfully ensure the tax base of the nation (D., 2018). In pertaining to this, this research will focus upon the indicators of BEPS Action Plan and analyze the definition of control, qualification of income, and methods of tax relief. Therefore, this research will conduct a comparative analysis between the BEPS Action Plan, PMK 107/PMK.03/2017, and German Foreign Transaction Tax Act 1972. The result of this research will occur in the form of policy recommendations to strengthen the CFC rules in Indonesia.

B. METHOD

This research is a juridical-normative research (Umar et al., 2018) because this research analyzes international OECD policy recommendations, CFC regulations, and literature regarding this issue. In this regard, juridical-normative research is conducted through researching library materials or secondary data through relevant regulations and literature (Soekanto & Mamudji, 2011). Because this research is a juridical-normative research, therefore this research will incorporate primary legal sources and secondary data (Sugiyono, 2012). The primary legal sources incorporates the legal instruments of Germany and Indonesia, namely Foreign Transactions Tax Act (Auß ensteuergesetz, AStG) 1972, §§7–14 AStG — the statutory body of the German CFC rule and Ministry of Finance Regulation No. 93/PMK.03/2019 (Irewati, 2018). The secondary data will be obtained through library search and desktop review, which will seek to acquire secondary data on regulations, supporting literature, official data from government institutions, and reports. The obtained data will then be analyzed through a qualitative approach. In pertaining to this, the phases of qualitative approach includes issuing the indicators of comparison as a focus of research, retrieving statutory provisions from Germany, Indonesia, and BEPS Action Plan, analyzing the comparative implication of provisions concerning legal control, which consequently result into policy recommendations to strengthen the Indonesian CFC rules.

C. RESULT AND DISCUSSIONS

1. Comparison between BEPS Action Plan 3, Germany, and Indonesia

Germany and Indonesia are both G20 countries that continuously adopt the recommendation BEPS Action Plan 3 in order to accommodate the necessity under international taxation. However, significant differences exist between the CFC rules in Indonesia in comparison with German CFC regulation, namely (i) definition of control, (ii) income qualification, and (iii) method for tax relief in the case of double-taxation might occur (See Table 3).

In regards to the definition of control, Indonesia and Germany have different perspectives towards the scope of controllers. In this regard, the Indonesian CFC regulation defines control through capital participation of more than 50 percent, which may be conducted individually or collectively. On this notion, Indonesia acknowledges indirect controller as collective capital participation amounting to more than 50 percent. In comparison, the German CFC rule provides a more specific action regarding the definition of control, namely that control is not limited to share ownership, but also from other sources that allows influence towards corporate actions of the Company. Therefore, indirect control may also occur in the form of owning shares with special rights. It is also important to note that in order to ensure the identity of the controller, Germany applied an obligation to disclose information in regards to control.

In pertaining to the qualification of income, the Indonesian CFC regulations have made significant progress in 2019 when PMK 93/PMK.03/2019 specified interest, dividend, royalty, and gain on sale from assets as part of the definition of passive income. Although progress has been made, the Indonesian CFC regulation encompasses all forms of passive income without considering the tax rate in the jurisdiction of the foreign company. In comparison, the German CFC legislation stipulates the qualification of income as passive income that derives from jurisdiction of a country that has a 30 percent lower tax rate. Because of this, the German CFC rule gives certainty in differentiating the conduct of tax evasion and the act of conducting business expansion. The implication is that the offshore company will not be considered under the scope of CFC if the company is under the jurisdiction containing a higher tax rate. Provisions such as the German CFC rule limits the possibility of distortion, which is in line with the OECD recommendation stating that tax regulation must consider the balance between protecting the erosion of the domestic tax base, while also not disincentivizing economic growth throughout the business expansion process.

Lastly, Indonesia and Germany adopts a different approach in regards to the method for tax relief to prevent double-taxation. After the promulgation of MOF No.93/PMK.03/2019, Indonesia revoked the exemption method and only applied the credit method. However, Indonesia have yet to regulate foreign tax credit as MOF No.93/PMK.03/2019 does not acknowledge the loss from foreign subsidiaries. As a result, if a foreign company experiences a loss, it cannot be accumulated to reduce the tax base for the parent entity. Implicitly, the government seems to access the benefit if there is a benefit abroad but does not provide any policy to relief the tax burden if the foreign entity experiencing loss.

Moreover, the foreign tax credit in the Indonesian CFC regulations is only applicable for 5 years. Consequently, all taxed deemed dividends that have been paid cannot be credited back if the actual dividend is distributed after a 5 years period. Tax credit may also reduce the company's cash flow if the tax rate where the CFC resides is equal or more than the domestic tax rate. Even though the German CFC regulations also apply the credit method, a company with certain conditions that have been explained above may apply the exemption method.

2. Lesson Learned from BEPS Action Plan 3 and Germany

From the comparative analysis, there are several lessons that are learned from the indicators of (i) definition of control, (ii) income qualifications, and (ii) method of tax relief. In this regard, the following policy recommendations may be applied in order to strengthen the Indonesian CFC regulation:

a. Scope of Control

Controllers should not be limited to capital participation but also encompass prerogative rights that may influence the corporate action of the company. One of the examples may include ownership of shares with special privileges of appointing and dismissing the board of directors. The expansion of the scope of control will broaden the interpretation of indirect controllers.

b. Mandatory Disclosure of Controller

Mandatory disclosure of the controller is required to trace the collective ownership of shares in CFC. On this notion, it is important for the controlling entity to disclose the foreign entity that is directly or indirectly owned in the annual report. Therefore, mandatory disclosure of controllers will increase the transparency of the company structure. In this regard, the disclosed information should not only be limited to the number of share ownership, but also the prerogative rights owned within the foreign entity.

c. Clarification of Tax Jurisdiction

The current MOF No.93/PMK.03/2019 does not limit the scope of foreign tax jurisdiction that is applicable to the CFC regulations. The lack of limitation implies a lack of legal certainty as the controlling entity may establish offshore entities for the sole purpose of business expansion. Because of this, Indonesia should mirror the provision of Germany, which limits the applicability of CFC regulation to solely the low tax jurisdictions.

d. Method of Tax Relief

Currently, Indonesia applies the credit method, which may impose the disadvantage of only taking into account the profit of a business but disregarding the losses. On this notion, the exemption method treats corporations more fairly as the method enacts consistent treatment towards both the condition of profit and loss. In this regard, Germany was capable of enacting the exemption method to only small medium enterprises (SMEs), which allowed leniency and growth. Because of this, Indonesia is capable of adopting both the credit and exemption method, but towards different segmented parties.

D. CONCLUSIONS AND SUGGESTIONS

In pursuit of strengthening the CFC rules in Indonesia, the government should reform MOF No.93/PMK.03/2019 through lessons deriving from BEPS Action Plan and Germany, namely to (i) broaden the scope of control, (ii) impose mandatory disclosure of controller, (iii) clarify scope of tax jurisdiction, and (iv) implementing both the credit and exemption method for tax relief. In this regard, future research may provide statistical analysis regarding the implementation of CFC regulations in Indonesia. This may be conducted through the usage of several parameters such as the changes of foreign investment or the changes of tax repatriated back to Indonesia to ensure a better policy-making process regarding CFC rules by Indonesian government. In addition, it is also important to note that this research may be supported by comparison of other countries aside from Germany in order to illustrate other alternatives in conducting reformations of the current Indonesian CFC regulation.

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