Policy Brief

Beneficial Ownership Transparency for Trust and Tax Avoidance Loophole in Indonesia

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Beneficial Ownership Transparency for Foreign Trust

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Currently, Indonesia does not yet have adequate regulations regarding Trust. Such regulatory weakness could become a legal loophole that can be exploited by taxpayers to avoid taxes. Many companies or wealthy Indonesians are potentially presumed of entrusting the management of their wealth and assets through Trust in countries that have common law systems, such as Singapore and Hong-Kong. In both countries, on under their laws, placement of Trust by foreign nationals is not taxed. Thats enables the income of Indonesians who place their funds and assets through the Trust not to be taxed, either in Indonesia or in Singapore or in the countries where the Trust is managed. No exception in the extractive industry sector with highly capital and investment.

Although there is no definitive published data yet regarding Indonesia's losses from the loss of potential tax collection by the state due to the practice of using private trusts abroad, and generally in tax havens countries, the amount is presumed to be quite large. As an illustration, even though the Amnesty Tax program in Indonesia (2016-2017) has revealed assets of private taxpayers from abroad amounting to 1,003.87 trillion rupiahs, only around 121 trillion rupiahs has been repatriated to Indonesia. Meanwhile, corporate taxpayers from overseas declarations amounted to 32.89 trillion rupiahs, and only 25 trillion rupiah were successfully repatriated.[4] It is potentially presumed that most of the offshore assets are managed through the use of private Trust and offshore companies in tax haven countries or jurisdictions.

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4) Directorate General of Tax 2017 Annual Report, page 169.

TRUST Arrangement

Trust in generally can be understood as a contractual relationship between Settlors as owners of funds/assets, Trustees as parties who manage funds, and Beneficiaries as parties who receive benefits from managing of funds/assets and investments.

This concept, which originates from the common law system, is unknown in Indonesia, which adheres to the civil law system. In Indonesia, there is a term known as Trust, as regulated in the Banking Law and by the Financial Services Authority Regulation POJK Number 27 of 2015 concerning Bank Business Activities in the Form of Custody with Management (Trust) which was subsequently amended by POJK No. 25/POJK.03/2016. However, this arrangement seems still far from adequate. In these two regulations, only banks meet the arranged requirements that can act as Trustees in Indonesia.

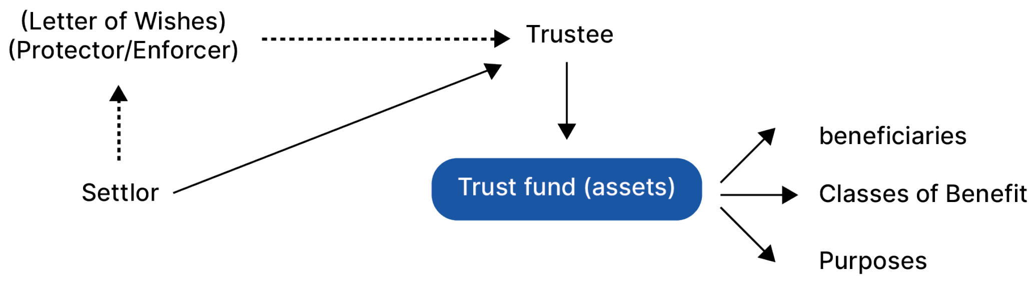
TRUST as Legal Arrangement

In many cases, a person who has the desire to hide their property, usually chooses not to have a bank account, asset or company in their own name, but through legal vehicles - either through legal entities such as companies, foundations and partnerships or other legal arrangements.

In contrast to legal entities that require registration, Trust does not require legal registration; it can be made because someone just wrote a piece of paper to deposit their funds or assets. Trust has no assets. The general purpose of Trust, for example, is to hold and manage shares or assets of a company. The establishment of Trust abroad can simply be aimed at playing the role of the owner of shares or company assets and acting as the ultimate parent company in the structure of the holding company. Or simply put, Trust can be established as a holding company to manage shares.

The concept of Trust is a legal arrangement or legal relationship arrangement between Settlors that transfer funds/ assets to a Trustee with whom it will provide benefits to the final beneficiaries. In their activities, Trustees can act as payment agents, investment agents, and financing agents. All actions taken by the Trustee must be in accordance with the Settlor's instructions contained in the Trust contract. Figure 1 illustrates an overview of legal arrangement of Trust.

Figure 1. Overview of the Trust Scheme



Tax Avoidance through TRUST

Indonesian tax law requires every resident of Indonesia to report all assets owned, either located or originating from within the country or from abroad. If it is proven that he/she is the beneficial owner of the entire assets, then the tax burden that must be borne as a Beneficial Ownership (BO) is following the general rules that applied in Indonesia, among others:

1. Final Income Tax Article 4 paragraph 2 on the profit from Deposit Interest, charged 20%,
2. Bond interest charged 15% for domestic taxpayers and 20% for foreign taxpayers,
3. Dividends received by individual taxpayers are 10%,
4. Income Tax Article 23 liabilities for dividends of 15%,
5. if Beneficial Ownership is a foreign taxpayer, then the rate will be subject to the Income Tax article 26, which is 20% or according to the tax treaty rate.

However, the calculation of the tax burden depends on proving who is the BO of all its assets. The determination of BO is often subject to tax law disputes in the tax court. In the Trust scheme, the determination of BO is the decisive things.

In general, taxpayers are presumed of being able to abuse Trust to avoid income tax for individual taxpayers or corporate taxpayers. There are several schemes on how Trust is used to evade taxes. Tax avoidance through the use of Private Trust (which are generally discretionary) can be done in various ways or schemes, for example as follows:

1) Avoid paying Capital Gains Tax

This can be done by, for example, transferring the management of assets in the form of shares from an Indonesian Settlor to a foreign Trustee, therefore, they can argue (generally for formal legal reasons) that the asset is no longer owned by them. So that they can refuse to pay taxes when they get a profit from the difference in the sale of these shares (capital gain tax).

2) Avoid paying dividend tax by taking advantage and abusing the Double Tax Treaty (P3B)..

The use of foreign trusts can also be related to the practice of abuse of double tax treaty, in particular the avoidance of Controlled Foreign Corporation (CFC) rules. This is done because on the pretext that the assets managed by the Foreign Trust do not belong to them, then their income from dividends or share sales made and managed by the Foreign Trust will be taxed by the country where the Private Trustee is located, and this commonly has a lower tax rate or not even taxed at all

3) Transfer of corporate income to non-taxable entities such as Trust

It can usually be used for charity work which is also controlled by the same individual as the individual controlling the private Trust. In some cases, charitable Trust may be used by the rich to evade taxes rather than for charity purposes.

4) Transfer of profits through complex corporate structure arrangements

The establishment and use of CFCs in tax havens are very commonly presumed. It is also may presumed of being committed by Indonesian companies, for example, companies in the mining and extractive industry sector.

In several cases, these foreign companies that's controlled by their parent company in Indonesia are presumed to generate more profits than their parent company. This should be presumed to have led to a shift in profits from Indonesia to tax havens country.

The leaks of Panama Paper and Paradise Paper, for example, have revealed information about the widespread use of private trusts and shell companies that presumed of transferring assets and income to tax havens countries. Portcullis Trustnet (British Virgin Islands / BVI) Limited, for example, as intermediary, they are connected with 36,275 entities from around the world, including several Indonesian politicians and businessmen, which could reasonably be presumed was in the document. Table 1 illustrates an example of private Trust, obtained from leaked Panama Paper and Paradise Paper documents

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Table 1. Private Trust from Leaked Documents of Panama Paper and Paradise Paper

Private Trustee	Tax Jurisdiction	Settlor	Presumption of Ultimate Beneficial Owner
Portcullis Trustnet (BVI) Limited	BVIs	Global City Holdings Ltd Twin Buffalo Investment Co. Ltd	Garibaldi Tohir
		Far Eastern Hydrocarbons Limited	Abu Rizal Bakrie
		Power Triumph Technology Limited	Achmad Kalla
Mosack Fonseca	BVIs	Attica Finance Ltd.	Sandiaga Uno
Mosack Fonseca	Seychelles	Mayfair International Ltd.	Luhut Binsar Panjaitan

Source: Panama Paper and Paradise Paper, Link: offshoreleaks.icij.org

Box 1. Examples of Cases in the Coal Mining Sector

Case Study. Highland Strategic Holdings Pte., Ltd and Watiga Trust

As stated in its company's financial statements, Toba Bara Sejahtra, since 25 January 2017, has been controlled by Highland Strategic Holdings Pte., Ltd - a company managed by Watiga Trust Pte. Ltd. (Watiga Trust)[5], a Trust manager of a big investor domiciled in Singapore with a controlling stake of 61.79%. The beneficiaries of Watiga are presumed to be corporate lawyers named Matthew Richards and Andrew Lim.[6] Meanwhile, the trustee ultimate beneficial owners from Highlands itself have never been disclosed to the public by the Watiga Trust.[7]

The question of who is the ultimate beneficial owner from Highland is a thought-provoking one, which was also raised by Global Witness.[8] There are few clues to that question. Although managed by the Watiga Trust, however, in controlling Highland, Watiga had to consult with Lynx Asia Partners, an investment consulting firm led by Dicky Yordan and Djamal Attamimi. Both of them are not foreign figures, because currently Dicky also serves as a Director at PT. Toba Bara Sejahtera, while Djamal Attamimi acts as a Commissioner. This fact indicates that the ultimate beneficial owner from Highland is may presumed to be someone who has strong influence and control or at least has a close relationship with PT. Toba Bara Sejahtera.

Anti-Avoidance Rule

The following are some of the approaches and arrangements that can be used to prevent potential tax avoidance and practices, particularly in the context of the use of the Trust

1) Determination of Beneficial Ownership

As previously explained, in several Double Tax Treaties (P3B), it was presumed that foreign Trusts could obtain benefits or be used to missuse the tax treaties rules. However, the scheme for the use of foreign Trusts can be tested with the ownership of the final benefits (Beneficial Ownership) before being determined as a beneficiary of Double Tax Treaties by the Directorate General of Taxes. The regulation is based on the provisions of anti-avoidance of double taxation, as lastly regulated through the Regulation of the Director General of Tax PER No.25 / PJ / 2018 dated 21 November 2018 concerning Procedures for the Application of Double Tax Avoidance Agreement.[9]

5) PT. Toba Bara Sejahtera Tbk. OFFERING MEMORANDUM Subject to Completion, dated February 23, 2018
6) Trust Business License Number TC000060-1 Singapore
7) Global Witness (2019
8) Global Witnes (2019) browse the following link: https://www.globalwitness.org/documents/19690/Luhut_Pandjaitan_and_the_hidden_buyers.pdf
9) https://www.ortax.org/ortax/?mod=aturan&page=show&id=16572&hlm=

2) CFC Rule

Based on the current CFC rule, a foreign Trust established by an Indonesian resident will become a controlled foreign company for an Indonesian resident because the assets that are transferred to the management of a foreign Trust will be considered a kind of equity according to the applicable CFC rules, namely the Minister of Finance Regulation No. 107/PMK.03/2017 dated 26 July 2017 which has been updated with PMK No. 93/PMK.03/2019.[10] Through this regulation, the use of the Trust scheme can also be tested by the Directorate General of Taxes.

However, because an asset (for example in the form of share or dividend) has been transferred by an Indonesian resident in a position as a Settlor, to a foreign Trust, it is very possible for Indonesian taxpayers to argue that the asset is no longer their own, has been transferred and or is claimed to have been owned by a foreign Trust. At this point there is a gap where the CFC rule does not provide more adequate specific rules.

The Important of Transparency on Beneficial Ownership of TRUST

To date, there is no obligation for a private Trust to publish the ultimate beneficial owner of the companies that they manage. The current legal umbrella for BO disclosure is Presidential Regulation No. 13 of 2018 concerning the Application of the Principles of Recognizing Beneficial Owners of Corporations in the context of Prevention and Eradication of Corruption, Money Laundering and Terrorism Financing Crimes, which is still limited to corporate legal entities,[11] and has not yet reached a form of legal arrangement such as Trust. Meanwhile, the arrangements regarding beneficial owners that exist in the Law no. 8/2010 [12] (Article 20) and POJK No.12-POJK.01-2017 concerning the Implementation of the Money Laundering and Terrorism Funding Crimes Program in the Financial Services Sector and the amendments to the POJK, are also inadequate. This may provides an opportunity for the abuse of the Trust to perform a money laundering case, concealment of assets resulting from corruption, and terrorism financing.

The government also complained about the difficulty in knowing BO from Trust. In fact, the Indonesian tax authorities also admit that there are difficulties in obtaining information about who actually controls the private trust and who is the ultimate beneficiary, especially when there are many layers in the private Trust.

10) PMK Concerning Determination of When Dividends Received and Calculation Basis for Domestic Taxpayers for Capital Participation in Foreign Business Entities Other Than Business Entities Selling Their Shares on the Stock Exchange.https://peraturan.bpk.go.id/Home/Details/112794/pmk-no-107-pmk032017
11) Article 2 paragraph (2) Presidential Regulation No. 13 of 2018 concerning the Application of the Principles of Recognizing the Beneficiary of the Corporation in the context of Prevention and Eradication of Corruption, Money Laundering and Terrorism Funding Crimes
12) Law on the Prevention and Eradication of the Crime of Money Laundering.

Policy Recommendations

1. It is necessary to improve regulations regarding the provisions of corporate transparency by requiring Trustees to disclose the ultimate control holders or ultimate beneficial ownership of the Trusts that they manage. Ideally, all parties related to the Trust scheme such as settlors, trustees, beneficiaries, protectors must be registered.
2. It is necessary to regulate the Trust's obligation to register as an entity registered at the Directorate General of Public Administration Law, Ministry of Law and Human Rights of the Republic of Indonesia. This provision will assist the administrative process and regulation as well as enforcement so that the Trust is more transparent and complies with regulatory provisions in Indonesia.
3. It is important to treat and taxing the Trust like a company. This is very critical considering that Trusts can behave like companies that also generate profits from their activities. Hence, it is fair that Trust are taxed. By doing so, state losses from tax avoidance practices can be prevented.
4. The government needs to amend and improve Presidential Regulation No. 13 of 2018 concerning the principle of recognizing beneficial owners of corporations, by including regulations regarding Trusts and the obligation to report and disclose the BO, as well as provide provisions and guidance to determine the beneficial owners of Trusts, as the elaboration of the principles for deciding the BO of the corporation. The most ideal improvement is through the establishment of the laws. Hence, it can regulate the rights and obligations of corporations and trusts, as well as the imposition of sanctions for non-compliance.

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