Analysis of BEPS Action Plan 2 Recommendations in Indonesia

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Keywords: Base Erosion and Profit Shifting (BEPS), Hybrid Entity, Hybrid Financial Instrument, Hybrid Mismatch Arrangement, Hybrid Transfer.

Abstract: The purpose of this study is to find out the relevance of BEPS Action Plan 2 Recommendations with Indonesian domestic laws and obstacles if Indonesia adopts BEPS Action Plan 2 recommendations to its domestic laws. This study was conducted with a qualitative approach, with data collection through library and field study. The field study conducted through in-depth interviews with some key informants that represent practitioners, academics, and tax authorities in Indonesia. The result of this study shows that BEPS Action Plan recommendations that are relevant to be applied in Indonesia are Recommendation 1, Recommendation 4, Recommendation 8, Recommendation 2.2, and Recommendation 5.1. Meanwhile, the main obstacle in adopting BEPS Action Plan 2 recommendations in Indonesia is the level of complexity and difficulty in administering those rules. In applying the proposed linking rules, both the taxpayer and the tax authority should have detailed information about the tax treatment of instruments or entities in other jurisdictions.

1 INTRODUCTION

Globalization has given companies access to loans or investments in different countries of the world. Unfortunately, these cross-border transactions sometimes have no economic substance but are designed solely to eliminate or reduce the tax burden. One of the ways that is used is creating a hybrid mismatch arrangement i.e. arrangements that exploit differences in the tax treatment of an entity or instrument under the laws of two or more tax jurisdictions to achieve double non-taxation, including long-term deferral (OECD, 2015). Underlying elements used in hybrid mismatch arrangement schemes are hybrid financial instrument, hybrid transfer, hybrid entity, and dual resident entity (OECD, 2012).

The following example will illustrate the use of a hybrid financial instrument. In Figure 1, A Co (resident in Country A) owns 95% shares in B Co (resident in Country B). B Co issues a hybrid financial instrument (such as perpetual debt instrument) to A Co. The instrument is treated as debt under the laws of Country B so that B Co entitled to deduct the 'interest' payment under the instrument. Meanwhile, the instrument is treated as equity under the laws of Country A, so that the 'dividend' payment in Country A is exempt from tax according to participation exemption regime. Thus, this hybrid financial instrument (arrangement) gives rise to a mismatch called D/NI (Deduction/ No Inclusion) outcome.

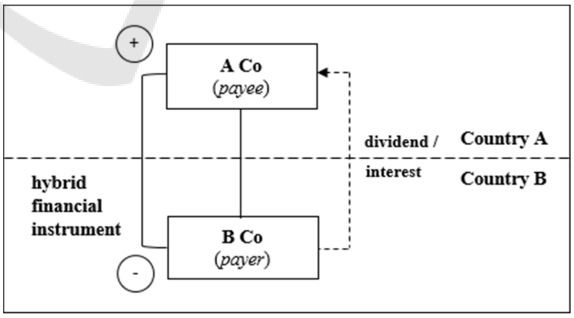

Figure 1: Debt / Equity Hybrid.

The use of hybrid mismatch arrangements will undoubtedly undermine the tax base in the countries where they operate. To overcome this problem, OECD (Organization of Economic Co-operation and Development) and G20 made Base Erosion and Profit Shifting (BEPS) Project that consist of 15 (fifteen) Action Plans. One of them was BEPS

Nessy, E. and Rahayu, N.
Analysis of BEPS Action Plan 2 Recommendations in Indonesia.
In *Proceedings of the Journal of Contemporary Accounting and Economics Symposium 2018 on Special Session for Indonesian Study (JCAE 2018) - Contemporary Accounting Studies in Indonesia*, pages 109-119
ISBN: 978-989-758-339-1

Action Plan 2: Neutralizing the effects of hybrid mismatch arrangements.

Based on further study and examination conducted by the United Nations through Financing for Development Office (FfDO), "Neutralizing the effects of hybrid mismatch arrangements" is one of nine topics that are important to protect tax bases for developing countries (Ault & Arnold, 2015). It is in line with a research conducted by Eberhartinger & Petutschnig (2017) that find out perceptions and opinions of experts in the field of international taxation originating from OECD, BRICS (Brazil, Russia, India, China, South Africa), and developing countries. As a result of the research, BEPS Action Plan 2 is ranked 2nd out of 10 Action Plan (1st rank is Action 8-10 which is considered as one, while Action 1, 11, and 15 are not taken into account) as the most important in the opinion of international tax experts originating from developing countries.

Indonesia as a developing country is likely to be exposed to the risks of base erosion due to hybrid mismatch arrangements. Unfortunately, Indonesia has not specific anti-avoidance rule yet to address hybrid mismatch arrangements. Moreover, there is only one research that discussed BEPS Action Plan 2 in Indonesia. The research is conducted by Yuliati (2015) and only discuss whether Indonesia will apply BEPS Action Plan 2 recommendations. Whereas, in-depth analysis of whether such recommendations are needed to counteract tax avoidance in Indonesia and the consequences of the implementation of these recommendations are necessary. Therefore, this study aims to find out the relevance of BEPS Action Plan 2 recommendations with Indonesian domestic laws and obstacles if Indonesia adopts BEPS Action Plan 2 recommendations to its domestic laws.

This study will help the tax authority and taxpayer to obtain comprehensive understanding about BEPS Action Plan 2 recommendations. This study also can be a consideration for the tax authority to decide whether to adopt the recommendations and if Indonesia will adopt the recommendations, this study can be used to prepare the steps to overcome the obstacles. Therefore, regulations that will be drafted by the tax authorities will be able to counteract the practice of tax avoidance using hybrid mismatch arrangements in Indonesia effectively.

2 LITERATURE REVIEW

2.1 Linking Rules

The role of hybrid mismatch arrangements in aggressive tax planning has been discussed in a number of OECD reports. OECD evaluates a number of policy options such as harmonizing domestic regulations, General Anti-Avoidance Rules (GAAR), Specific Anti-Avoidance Rules (SAAR), and rules specifically addressing hybrid mismatch arrangements. The report also discusses some countries that have introduced specific regulations to address hybrid mismatch arrangements. Then, it is concluded that domestic law which links the tax treatment of an entity, instrument or transfer in the country concerned to the tax treatment in another country appears to hold significant potential as a tool to address hybrid mismatch arrangements that are viewed as inappropriate (OECD, 2012). Therefore, the BEPS Action Plan 2 recommendations use the concept of 'linking rules'.

The concept of linking rules to overcome hybrid mismatch arrangements is also supported by practitioners/ academics in the field of international taxation. According to Thuronyi (2010) and Bundgaard (2013), an approach used in countering cross-border tax arbitrage is the application of 'coordination rules' which rests on the 'principle of correspondence'. Under this principle, tax benefits (deductions or exclusions) are dependent on the tax treatment in another country. For example, to be an interest deduction, the payment must be taxed in the other country. This approach is considered to minimize disruption to domestic laws and more flexible than harmonization of domestic laws. Coordination rules can also be implemented in various mechanisms such as multilateral agreements, directives (for the EU), or unilateral agreements. Unilateral is the most flexible and easiest mechanism to adopt, but it would be more effective if the provision is adopted by substantial number of countries (Thuronyi, 2010).

2.2 Overview of the Recommendations

BEPS Action Plan 2 recommendations consist of two parts. The first part contains recommendations for domestic laws, while the second part contains recommendations for treaty issues (OECD, 2015). With regard to the scope of this study, this section only discusses recommendations for domestic laws.

General overview of the Recommendations can be found in the Appendix section. There are two types of recommendations for domestic laws i.e. specific recommendation and recommended hybrid mismatch rule. Specific recommendations are specific improvements to the domestic law, designed to achieve a better alignment between those laws and their intended tax policy outcomes. These specific recommendations aim to minimize the occurrence of a mismatch, so it is a preventive effort against the existence of double non-taxation or long-term deferral. Whereas recommended hybrid mismatch rules are linking rules that will neutralize the effects of hybrid mismatch arrangements when the arrangement gives rise to a mismatch.

Although adopted unilaterally, the hybrid mismatch rules are intended to be coordinated with laws applied in other countries (Arnold, 2016). The rules consist of the primary rule/ response and the secondary/ defensive rule that has a hierarchy in its implementation. A country is considered as primary country in acting according to the primary rule whenever there is a mismatch in tax outcome, and another country is considered as secondary country that will act according to the secondary rule only if the primary country is not applying the primary rule (Arnold, 2016).

To neutralize the mismatch in Figure 1 for example, Country B is entitled to apply the primary rule by denying the interest deducted by B Co. However, if Country B does not apply the primary rule (e.g. because it has not adopted this recommendation) then Country A must apply secondary rule by including the dividend received by A Co as an ordinary income and impose the tax.

3 RESEARCH METHODOLOGY

This study is structured with a qualitative approach which is used to explore and develop an in-depth understanding of a problem (Cresswell, 2014). This study is a descriptive research that will provide a detailed picture of a specific situation or phenomenon (Neuman, 2014). In this study, the phenomenon to be described is the relevance of BEPS Action Plan 2 Recommendations with Indonesian domestic laws and obstacles if Indonesia adopts the recommendations of BEPS Action Plan 2.

This study used several techniques and data collection tools as follows:

(a) Library Study

To find out the relevance of BEPS recommendations in Indonesia, library study was conducted by analyzing the various hybrid arrangements that could lead to mismatch based on various books literature, journals, articles and other research. After that, the arrangement is analyzed to determine whether it is possible to be used in Indonesia. Then, researchers conclude whether the recommendations are relevant to be incorporated into Indonesia domestic laws. In addition, this study also analyzes countries that have implemented the linking rules to identify obstacles if Indonesia adopts BEPS Action Plan 2 recommendations.

(b) Field Study

To set up good regulations, engagement from all stakeholders is required. Therefore, this study used field study conducted through in-depth interviews with competent key informants in the field of taxation that represent practitioners, academics, and Directorate General of Taxes (DGT) as the tax authority in Indonesia.

i. Practitioners

Four practitioners interviewed work in tax consultants who often deal with multinational companies so that they understand the schemes of tax avoidance that can be used in Indonesia. They are also familiar with BEPS Project including BEPS Action Plan 2 recommendations so that they can predict what will be the obstacles if Indonesia adopts the recommendations.

ii. Academics

Two academics interviewed are lecturers of international taxation at the University of Indonesia. They understand various alternatives to tackle tax avoidance including BEPS Action Plan 2 proposed by OECD and G20.

iii. Tax Authority

Two personnel represent tax authority interviewed are a staff from Directorate of International Taxation DGT who is responsible for international tax regulation, and a staff from Directorate of Tax Audit and Collection DGT who is responsible for examining related parties and other certain transactions.

Interviews were conducted using semi-structured interviews. After researchers determine a list of questions relevant to the phenomenon to be studied, key informants will be asked to answer these questions. In this way, this study is expected to provide a comprehensive and deep description in understanding the problems of hybrid mismatch arrangement in Indonesia and obstacles if Indonesia adopts BEPS Action Plan 2 recommendations.

From the information obtained based on a literature study, the abstraction of data obtained from the field study, and the patterns which are contained from the data obtained, then researcher drew conclusions which are the answer to the research problems.

In order to make this study focused, the scope of this study will be limited to the following matter:

(a) This study will only discuss the mismatch generated due to differences in classification and tax treatment of an entity or financial instrument (hybrid mismatch arrangement).

(b) This study will only discuss Indonesia domestic law and BEPS Action Plan 2 recommendations: Neutralizing the Effects of Hybrid Mismatch Arrangement for domestic law. This study does not include Indonesia's Double Taxation Convention (tax treaties), and the recommendations of BEPS Action Plan 2 in respect of these treaty issues.

4 RESULTS

4.1 The relevance of BEPS Action Plan 2 Recommendations with Indonesian domestic laws

Based on analysis of various hybrid mismatch arrangement schemes from literature, this study concludes that some schemes are not effective for use in Indonesia so that Indonesia does not need all the set of the recommendations in BEPS Action Plan 2. Therefore, this section will identify arrangements that can involve Indonesia taxpayer so that the recommendation will be relevance to be applied in Indonesia domestic law. While arrangements that cannot be used in Indonesia will make the recommendation be classified as irrelevant.

According to previous researches in Indonesia that were conducted by Istiadi (2013) and Yuliati (2015), the practice of tax avoidance using hybrid financial instruments in Indonesia was conducted by utilizing the difference in the classification of a financial instrument in the payer jurisdiction to get deduction of interest expense and in payee jurisdiction to get exemption. Indonesia does not give participation exemption or other benefits for dividend received from abroad so that Indonesia taxpayer as a payee will not receive benefit of hybrid financial instruments. But, as payer, Indonesia taxpayer can be involved to have deduction from hybrid financial instruments. Therefore, Indonesia is exposed to base erosion due to hybrid financial instrument arrangement so that Recommendation 1 (Hybrid Financial Instrument Rule) is relevant to be applied in Indonesia.

Considering disregarded payment made by a hybrid, a deductible payment can give rise to D/NI outcome when the payment is made by a hybrid entity that is disregarded under the laws of the payee jurisdiction (OECD, 2015). It means the payment is treated just like a payment from a branch to its head office so that it will not be recognized as an income by the payee, but in the jurisdiction where the entity is located, the payment is treated as a deduction. Based on various schemes or arrangements in the literature, the arrangements cannot be used in Indonesia for the following reasons:

(a) As the country where the parent company is located, Indonesia does not have a concept of disregarded entity that will treat a foreign subsidiary same as a foreign branch.

(b) As the country where the subsidiary is located, Indonesia has not hybrid entity that can be treated as disregarded entity, because in Investment Law Number 25 Year 2007, foreign investments are only allowed for corporations.

In addition, Indonesia does not use tax consolidation tax regime in calculating tax, so that it cannot involve the arrangement involving a branch. Therefore, Recommendation 3 is not relevant to be applied in Indonesia.

In the payment made to a reverse hybrid arrangement, the payment received by a reverse hybrid is not tax at all so that it gives rise to D/NI outcome. A reverse hybrid is any person that is treated as transparent under the laws of the jurisdiction where it is established but as a non-transparent (separate entity) by its investor (owner). Treated as transparent means the entity is not taxed in the entity level but in the owner level. Otherwise, treated as non-transparent means the entity will be taxed in the entity level, just like a corporation. With respect to a payment made to reverse hybrid, Indonesia cannot be involved as an intermediary country because there is no transparent entity in Indonesia. Meanwhile, Indonesia taxpayers are able to involve in this arrangement as payer or investor so that Recommendation 4 (Reverse Hybrid Rule) is relevant to be applied in Indonesia.

Besides D/NI outcome, hybrid mismatch arrangements can also give rise to Double Deduction (DD) outcome or also known as double dipping. The underlying elements that can be used are hybrid entity and dual residence entity.

Based on various schemes or arrangements in the literature, the deductible payment made by a hybrid entity cannot be used in Indonesia so that Recommendation 6 (Deductible hybrid payments rule) is not relevant to be applied in Indonesia, for the following reasons:

(a) As the country where the parent company or head office is located:

i. Indonesia does not have a concept of disregarded entity that will treat a foreign subsidiary same as a foreign branch.

ii. according to Minister of Finance Decree Number 164/KMK.03/2002, Indonesia does not allow losses suffered by foreign branches to be a deduction of domestic income. Only profits derived from foreign branches will be included in the income tax calculation in Indonesia.

(b) As the country where the subsidiary or branch is located:

i. Indonesia does not have consolidation tax regime because the tax calculation is done by each business entity even though it is within the same control group (related parties). Accordingly, if any business entity incurs a loss, the loss cannot be offset against the income derived by the other entities.

ii. Indonesia has not a hybrid entity that can be treated as disregarded entity. A hybrid entity or also called 'classic hybrid' is an entity treated as corporate (non-transparent) where it is established but as transparent entity in the owner jurisdiction (Gupta, 2015).

Likewise, the arrangement involving a dual resident entity. The entity utilizes consolidation tax regime or a disregarded entity to offset a loss of the entity into profits of its affiliates in two different countries (Vann, 1998). Therefore, the dual resident entity cannot be used in Indonesia. So, Recommendation 7 (Dual-resident payer rule) is not relevant to be applied in Indonesia.

Mismatch (D/NI outcome) produced overseas, for example by using debt/ equity hybrid in other countries, can be brought into the third country (payer jurisdiction) through the use of a non-hybrid instrument such as an ordinary loan. Since it is imported from other countries, the structure is called an imported mismatch, and the resulting mismatch is called indirect D/NI. In this case, Indonesia is exposed to base erosion due to imported mismatch mainly because Indonesia is a capital importing country. Therefore, Recommendation 8 (Imported Mismatch Rule) is also relevant to be applied in Indonesia.

In a hybrid transfer, a share or a bond is treated as held by two taxpayers in two different jurisdictions. Therefore, the tax withholds from dividend or interest is credited by both taxpayers. OECD recommends that jurisdictions providing relief for taxes withheld in source countries should limit credits according to the proportion of recognized net income. Currently, Indonesia only has a 'per country limitation' for its foreign tax credit method. Therefore, with the existing ordinary credit method used in Indonesia, Recommendation 2.2 is relevant to be applied.

Indonesia already has a CFC rule. Unfortunately, in defining the subject of CFC, Indonesia limits the definition of CFC based on shares participation. In fact, there are some transparent entities such as Limited Liability Company (LLC) in America that do not issue shares in their capital structure. Thus, Recommendation 5.1 on the improvement of CFC rule which also includes reverse hybrid revenues is still relevant to be applied in Indonesia.

Meanwhile, Recommendation 2.1 (Participation exemption), Recommendation 5.2 (Restriction of transparent treatment to an entity), and Recommendation 5.3 (Reporting for transparent entities) is irrelevant because the tax system in Indonesia does not provide participation exemption regime for foreign dividends and does not recognize the existence of transparent entities.

Table 1: The Relevance of BEPS Action Plan 2 Recommendations with Taxation System in Indonesia.

	Relevant	Irrelevant
Hybrid Mismatch Rules		
Recommendation 1	✓	
Recommendation 3		✓
Recommendation 4	✓	
Recommendation 6		✓
Recommendation 7		✓
Recommendation 8	✓	
Specific Recommendations		
Recommendation 2.1	✓	

Recommendation 2.2		✓
Recommendation 5.1	✓	
Recommendation 5.2		✓
Recommendation 5.3		✓

Overview of the relevance of BEPS Action Plan 2 Recommendations are presented above. It can be concluded that Indonesia does not have to adopt all the recommendations in BEPS Action Plan 2, because according to arrangements that can be used in Indonesia, Indonesia only need Recommendation 1, Recommendation 4, Recommendation 8, Recommendation 2.1 and Recommendation 5.1.

4.2 Obstacles if Indonesia adopts BEPS Action Plan 2 recommendations to its domestic law

According to Boer & Marres (2015), the recommendation of BEPS Action Plan 2 as a specific step to overcome hybrid, at least in concept, will be able to counter double non-taxation. However, to adopt a provision, it is also necessary to consider the obstacles that will be faced if Indonesia adopts the recommendation of BEPS Action Plan 2. These obstacles include:

4.2.1 Complexity in Formulating and Implementing Recommended Rules

Hybrid mismatch arrangements are used to exploit different tax treatments on an instrument and entity (OECD, 2015). Thus the recommendations of BEPS Action Plan 2 were made by considering various interactions in various taxation systems used in the world. Therefore, the resulting recommendations are very complex.

As an illustration of the complexity of the BEPS Action Plan 2 recommendations, final reports containing recommendations and examples of hybrid mismatch arrangements reach 458 pages, much more compared to the combined of 14 other Action Plan final reports which only 1500 pages. Thus, it can be said that from all (15) BEPS Action Plan, the final report of BEPS Action Plan 2 is the longest, most comprehensive and complex, as well as difficult to implement (Kuźniacki, et al., 2017).

The complexity of the BEPS Action Plan 2 recommendations is confirmed by all groups of respondents (tax authority, academic, and practitioner).

IW (tax authority):

“Kalau kita mau diakui bahwa kita menerapkan rekomendasi BEPS 2 semuanya itu harus diadopsi. Nah, itu kompleksitasnya luar biasa. Jadi, contoh-contoh yang ada di 2015: Final Report yang 400-an halaman itu harus kita adopsi semua. Nah, itu kompleks, jadi untuk menerapkan itu terlalu rumit, tidak sebanding dengan hasilnya.”

"If we want to be acknowledged that we implement the BEPS 2 recommendations, all of them should be adopted. Well, that's an incredible complexity. So, the examples that exist in whole 2015: Final Report consists more than 400 pages should be adopted. Well, it's complex, implement them are too complicated, not worth the results." (Interview with a staff of Directorate of International Taxation DGT, October 23, 2017)

YWN (academics):

“Kalau kita bikin peraturan hybrid kan kompleks, enforcement-nya belum tentu bisa. Kapasitasnya belum bisa memahami peraturan sekompleks ini, menurut saya belum mampu lah. Takutnya malah nanti semakin kompleks dengan adanya interpretasi sehingga nantinya bisa digunakan untuk transaksi lain yang sebenarnya legal tapi akhirnya kena ini.”

“If we make hybrid regulations, it will be complex, the enforcement may not be possible. Our capacity has not been able to understand these complex regulation, in my opinion, we have not been able. I’m afraid it will be more complex with the interpretation so that later it can be used for other transactions that are actually legal but eventually hit this.” (Interview with a lecturer of University of Indonesia, November 10, 2017)

GCT (practitioner):

“Menurut saya tidak mudah nantinya untuk menerapkan primary rule dan secondary rule. Merumuskannya saja bagaimana? Yang di kotak-kotak dalam rekomendasi itu? Apakah bunyinya hanya seperti itu? Kalau saya kok tidak yakin ya yang tertulis di dalam kotak itu sudah cukup.”

“In my opinion, it is not easy later to apply the primary rule and secondary rule. How to formulate them? Are they in the boxes of the recommendation? Do they just sound like that? I'm not sure that's written in the box is enough.” (Interview with a senior manager of Danny Darussalam Tax Center, November 22, 2017)

The same thing is also expressed by the experts of international taxation. Arnold (2016, p. 196) states that the rules are very complex and will be difficult for the tax authorities of many countries, especially developing countries to apply. In addition, Harris (2015, p. 47) also states that the level of complexity and difficulty in administering these rules should not be underestimated.

First, the tax authority (or legislative body) will experience the complexity in formulating the recommendations of BEPS Action Plan 2 into domestic laws in Indonesia. Then, in implementing these rules, both tax authority and taxpayer must know detailed information about the tax treatment of an instrument or entity in other jurisdictions in the world. In order to apply the primary rule of hybrid financial instrument rule, the tax authority in payer jurisdiction must know the tax treatment in payee jurisdiction. Otherwise, to apply the secondary rule, payee jurisdiction must know the tax treatment in payer jurisdiction.

4.2.2 Implementation of the Rules Depends on the Exchange of Information (EOI)

Since the core of the linking rule is considering tax treatment in other countries, coordination among involved countries is essential. Regarding this issues, OECD (2015) states that in applying the rules, the tax authority should only look to the expected tax treatment of the payment under the laws of the counterparty jurisdiction, rather than its actual tax treatment in the hands of the counterparty. But, to determine the expected tax treatment of the payment under the laws of the counterparty jurisdiction, tax authority must know and understand clearly the laws of the counterparty jurisdiction. This is not something that the tax authorities of most countries have much experience (Arnold, 2016). Therefore, it is likely that the tax authorities need to consult and share information with tax authorities in other countries. The argument is strengthened by WN (practitioner):

"Nah, kalau bicara masalah hambatan, hambatan dalam melaksanakannya tentu ada. Karena bagaimanapun kita harus mengetahui di negara lawan transaksinya treatment-nya seperti apa. Nah, kalau bisa dibilang ini hambatan, ini hambatan. Sebenarnya bisa diatasi dengan P3B, kita bisa minta informasi terkait dengan transaksi ini perlakuan pajaknya bagaimana di negara lawan transaksi."

"Well, if we talk about obstacles, of course, there is an obstacle in the implementation. Because after all, we must know the treatment of transactions in counterparty country. Well, if you could say this obstacle, it's the obstacle. Actually, it can be overcome with tax treaty, we can request information related to this transaction and the tax treatment in the counterparty country." (Interview with a tax partner of MUC Consulting Group, November 20, 2017)

In addition, to detect and identify a mismatch, information and reporting conducted in other countries are also required. For example, in case of an imported mismatch, the scheme is involving more than two countries, so that the adoption of this recommendation relies on an Exchange of Information (EOI) that is fast, easy and includes all information required. If the EOI cannot be done, it will be impossible to reveal any imported mismatch.

However, in the current procedure EOI can be done if taxpayers are already at the tax audit level as said by KBK (tax authority):

"Karena PMK yang baru kan belum ada PER-nya, jadi masih ikut peraturan EOI yang lama di mana EOI bisa kalau pemeriksaan saja."

"Because the new Minister of Finance Regulation does not have the new Director General Regulation yet, so we still follow the old EOI regulation where EOI can only be done in tax audit." (Interview with a staff of Directorate of Tax Audit and Collection DGT, November 20, 2017)

Therefore, if Indonesia wants to adopt the recommendations, the tax authority must also ensure that the regulations enable the EOI process is possible when needed without sacrificing the confidentiality of taxpayer's data.

4.2.3 Administrative and Compliance Costs Become Higher

To formulate and implement such complex rules, it requires intensive socialization and training for tax officials in order to properly implement the rules. In addition, the need to conduct EOI will increase the burden of administration in the form of reliable infrastructure and human resources. Thus, the implementation of this provision raises high administrative costs. This problem is confirmed by IW (tax authority):

"Karena itu tadi, kita kan tidak melihat manfaat punya aturan seperti itu, masalah apa yang mau diselesaikan sehingga kita memerlukan prasarana/infrastruktur untuk berkomunikasi dan sebagainya. Artinya kan tidak sebanding antara effort dengan hasilnya."

"Because of that, we did not see the benefits of having such rules, what problems that will be solved so we have to provide infrastructure to communicate and so forth. This means it is not worth the effort with the result." (Interview with a staff of Directorate of International Taxation DGT, October 23, 2017)

From the taxpayer side, this rules may also increase the compliance cost as to avoid the risk of being corrected, the taxpayer must also ensure the tax treatment in the other country's transactions. Therefore, taxpayers will need to spend consultation fees for experts/consultants in other countries. Issues regarding high administrative and compliance costs are also discussed in similar research conducted by Aleksandra (2014) and Frank (2015).

Therefore, if Indonesia wants to adopt BEPS Action Plan 2 recommendations, the tax authority should make a study about potential tax loss due to hybrid mismatch arrangements. Then the study can be used to consider cost (i.e expense and effort needed) and benefit (i.e. potential tax loss that can be restored) in implementing the BEPS Action Plan 2 recommendations.

4.2.4 The Scope of Structured Arrangements that have not Existed Before

Besides applicable to related parties and taxpayers within the same control group, recommended hybrid mismatch rules are also applied in the case of the hybrid mismatch is priced into the terms of the arrangement or the facts and circumstances of the arrangement indicating that it has been designed to produce a hybrid mismatch, which is called structured arrangements (OECD, 2015). Thus, the scope of hybrid mismatch rules is vast because they are also applied to taxpayers who have no ownership or control relationship at all.

The advantage of this structured arrangement clause is that tax authorities are entitled to take action in case of there are indications about intentional tax avoidance that absolutely has no business purpose by involving parties with no ownership or control relationship. This is different from the arm's length principle currently owned by Indonesia, where the tax authority entitled to reclassify debt into equity in the case of a loan in related party transactions does not meet the fairness and business norms.

However, in practice, it could make the tax authorities become overwhelmed. If previously the tax authority may focus on transactions between related parties, then if this BEPS Action Plan 2 recommendations apply the tax authorities must also consider other transactions conducted not by related parties. In addition, there is a possibility of different interpretations between taxpayers and tax authorities in defining structured arrangements (Aleksandra, 2014). Thus, this clause potentially increases the number of tax disputes.

4.2.5 There is a Potential Loss of Investment Attractiveness

Denmark was a country that has previously applied the concept of linking rules (or also called coordination rules) in its domestic law. According to Bundgaard (2008), coordination rules are effective in addressing hybrid mismatch arrangements (in the literature referred to as tax arbitrage). However, Bundgaard (2008) revealed that perhaps Denmark has lost foreign direct investment as a consequence of its role as 'the policeman of the world's tax systems'.

Therefore, the tax authorities should reconsider when formulating rules in areas such as financial instruments. Instead, financial innovation could be generated benefits other than taxes. However, the use of hybrid financial instruments is also motivated by business reasons such as obtaining low borrowing costs, more flexible funding, raising credit ratings, and so on. Therefore, less favorable rules for innovation in financial instruments can make a country less attractive than other countries, and that is harmful to the economy (Bundgaard, 2008).

Opinion about the investment attractiveness is also submitted by NPS (practitioner):

“Menyelesaikan masalah ini juga nggak gampang. Pertama, peraturan domestik harus dikencangkan, tapi kalau terlalu kencang juga jadinya tidak ada yang datang ke negara itu. Buat apa tax holiday itu, kan supaya menarik. Batasnya mana, kita mau memberikan insentif, tapi kita juga nggak mau kehilangan.”

“Resolving this issue is also not easy. First, the domestic regulations should be tightened, but if it is too tight then there will be no one to come to the country. Why we make tax holiday, it is to attract. Where is the limit, we want to provide incentives, but we also do not want to lose.” (Interview with a senior tax advisor of Assegaf Hamzah & Partners, November 15, 2017)

Regarding the issue of investment attractiveness, there is also another opinion. Marchgraber, as quoted by Tambunan (2016) argues that the enactment of BEPS Action Plan 2 recommendation will not dampen the attractiveness of a country to attract foreign investment. In relation to the Parent-Subsidiary Directive (PSD) for example, if Switzerland continues to allow deduction on payment under hybrid financial instruments, investors in the EU will tax the payment as ordinary income. Thus, if Switzerland has a lower tax rate, it would be more profitable for investors if Switzerland denies the deduction. Otherwise, the payment will be taxed at a higher rate in the investor's country.

Based on those opinions then it can be concluded that Indonesia should adopt BEPS Action Plan 2 recommendations when the recommendations are adopted by substantial number of countries. So, Indonesia would not lose its investment attractiveness. Addressing hybrid mismatch arrangements will help everyone move in the direction of greater worldwide cooperation (Shaviro, 2002). Moreover, a comprehensive solution where all countries implement the same set of hybrid mismatch rules will also result in compliance and administration efficiencies and also a certainty for taxpayers (Ruchelman, 2014).

5 CONCLUSIONS

Based on the result of this study, the following conclusions can be drawn:

(1) BEPS Action Plan recommendations that are relevant to be applied in Indonesia are Recommendation 1, Recommendation 4, Recommendation 8, Recommendation 2.2, and Recommendation 5.1. While other recommendations are not relevant to be applied because the underlying elements of arrangements are not effective for use in current Indonesia taxation system.

(2) The following obstacles need to overcome if Indonesia adopts the recommendations of BEPS Action Plan 2:
   - (a) complexity in formulating and implementing the recommended rules;
   - (b) implementation of the rules depends on the Exchange of Information (EOI);
   - (c) administrative and compliance costs become higher;
   - (d) the scope of structured arrangements that have not existed before; and
   - (e) there is a potential loss of investment attractiveness;

ACKNOWLEDGEMENTS

The first author would like to acknowledge the Indonesia Endowment Fund for Education (LPDP) Ministry of Finance Republic of Indonesia who supported her study and sponsored her for the JCAE 2018 conference.

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APPENDIX

General Overview of the Recommendations

Mismatch	Arrangement	Specific recommendations	Recommended hybrid mismatch rule		
			Response	Defensive rule	Scope
D/NI	Hybrid financial instrument	Rec. 2.1 - No dividend exemption for deductible payments Rec. 2.2 - Proportionate limitation of withholding tax credits	Recommendation 1		Related parties and structured arrangements
			Deny payer deduction	Include as ordinary income	
	Disregarded payment made by a hybrid		Recommendation 3		Control group and structured arrangements
			Deny payer deduction	Include as ordinary income	
	Payment made to a reverse hybrid	Rec. 5.1 - Improvements to offshore investment regime Rec. 5.2 - Restricting tax transparency of intermediate entities	Recommendation 4		Control group and structured arrangements
			Deny payer deduction	-	

		where non-resident investors treat the entity as opaque Rec. 5.3 - Reporting for intermediaries			
DD	Deductible payment made by a hybrid		Recommendation 6		No limitation on response, defensive rule applies to control group and structured arrangements
			Deny parent deduction	Deny payer deduction	
	Deductible payment made by dual resident		Recommendation 7		No limitation on response
			Deny resident deduction	-	
Indirect D/NI	Imported mismatch arrangements		Recommendation 8		Members of control group and structured arrangements
			Deny payer deduction	-	

Source: OECD (2015, p.20)