TaxFlash

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Renegotiated Indonesia – Singapore Tax Treaty

On 4 February 2020, Indonesia and Singapore signed a renegotiated tax treaty in Indonesia (i.e. as an amendment to the 1990 Indonesia - Singapore Tax Treaty).

This new treaty will enter into force upon the exchange of ratification documents by both countries. The provisions of the new treaty will then be applicable to amounts paid or credited on or after the 1 January following the entry into force of the new treaty. Assuming that the new treaty is ratified in 2020, then the earliest date of operation of the new treaty will be 1 January 2021.

Many aspects of the new treaty remain the same as the 1990 treaty. These include the general dividend and interest withholding tax (“WHT”) rates of 10%/15% and 10% respectively. However, the new treaty does make some important changes in a number of areas. We have not attempted to analyse all of the changes in this Tax Flash. However, the key changes, at least from the Corporate Taxpayer perspective, are set out below.

1. Decrease in royalty WHT rate

The current WHT rate is <u>15% in all cases</u>. Under the new treaty the WHT rate will reduce to:

a. 10% on payments for the use of, or the right to use, any copyright of literary, artistic or scientific work including cinematograph films, or films or tapes used for radio or television broadcasting, any patent, trademark, design or model, plan, secret formula or process;

b. 8% on payments for the use of, or the right to use, industrial, commercial or scientific equipment, or for information concerning industrial, commercial or scientific experience.

Separately, proceeds arising from the alienation of any of the above royalty-generating assets will no longer be treated as a royalty.

2. Capital Gains

The new treaty adds an article which provides general capital gains tax protection. Essentially, the article provides that the right to tax "capital gains" will be limited to the jurisdiction of residency of the asset seller. This is however subject to the following qualifications:

a. gains from the disposal of immovable property – these may be taxed in the country where the property is located;
b. gains from the disposal of movable property which forms part of a Permanent Establishment ("PE") or a fixed base – these may be taxed in the country where the PE or the fixed base is located;
c. gains from the disposal of ships or aircraft operating in international traffic – these shall be taxable only in the country where the seller is a resident;
d. gains from the disposal of non-listed shares where i) the value of the shares are more than 50% directly or indirectly derived from immovable property, and ii) the seller owns at least 50% of the issued shares of the company. In this case the gain may be taxed in the jurisdiction where the immovable property is located. This is unless the gain from the disposal of these shares arises from immovable property used to carry on the alienator's business or arises out of a corporate reorganisation, merger, or a similar restructuring activity;
e. gains from the disposal of shares listed on an Indonesian Stock Exchange.

3. Branch Profit Tax (BPT)

The entitlement to levy a BPT is now formally included in the new treaty (previously the BPT entitlement was set out in the protocol to the 1990 treaty). The BPT tax rate is also reduced from 15% to 10%.

The rate reduction is not however applicable for production sharing contracts in the oil and gas sector. The Most Favoured Nation BPT rate provisions, previously in the Protocol, also seems to have been discontinued.

4. Interest

As mentioned above, the general interest WHT rate (i.e. 10%) is unchanged in the new treaty. However, amendments do exist for the following:

a. the current WHT exemption in respect of government-issued bonds or debentures will be discontinued;
b. the list of institutions that constitute the "government" (and so can enjoy a nil WHT rate) is to be expanded to several quasi-government financial institutions;
c. there is confirmation that penalty charges due for late payment shall not be regarded as interest.

5. Other Income article

Article 21 of the 1990 tax treaty regarding "Income Not Expressly Mentioned" has been replaced with Article 22 in the new treaty regarding "Other Income". Article 22 provides that income not dealt with in the new treaty shall be taxable only in the jurisdiction of residence. This is unless the income arises in the other jurisdiction in which case the income may also be taxed in the other jurisdiction.

6. **Remittance requirement**

The new treaty repeals Article 22 of the 1990 treaty regarding the “Limitation of Relief”. This provision currently requires that income taxable on a remittance basis (typically the case in Singapore) must be remitted to or received in the Other State in order for the treaty relief to operate.

7. **Anti tax avoidance/MLI**

The new treaty has adopted Article 6 of the Multilateral Instrument (“MLI”) by including the preamble dealing with the purpose of a covered tax agreement as prescribed in the MLI.

The new treaty has also adopted a new Article 28 regarding the Entitlement of Benefits concept. This means that the Principal Purpose Test as prescribed in Article 7 of the MLI regarding the prevention of treaty abuse is also formally included.

As a result, the new treaty appears to represent Indonesia’s first MLI-compliant treaty.

8. **Exchange of Information (EoI)**

In the 1990 treaty the EoI article is limited to taxes covered by that treaty.

Under the new treaty, the EoI will extend to all taxes meaning the treaty covers taxes such as Value Added Tax.

In addition, the respective jurisdictions are required to consider information requests served by either party even where the information provides no tax benefit to the information provider. Further, a Contracting State cannot ignore a request for information simply because the information is held by a bank, financial institution, nominee or person acting in an agency or a fiduciary capacity etc.

This provision follows the EoI article in the 2017 OECD Model Tax Convention.

Conclusion

The amendments to the Singapore treaty are still being considered and further analysis will be required. However, this new treaty is likely to be important to the Indonesian fiscal/investment landscape for a number of reasons including:

a. that investment from Singapore, and Singapore holding structures, continues to be a major source of investment into Indonesia. These investments, both past and prospective, is likely to be impacted by the new treaty;
b. whilst the general dividend and interest WHT rates have not fallen the introduction of more traditional “capital gains tax” and “other income” provisions are likely to be viewed positively from investors’ perspective and put Singapore investors on equal footing with these of other jurisdictions who are also major Indonesian investors;
c. this is the first post-MLI treaty and so arguably provides a template for how future treaties will operate.

We will keep you updated on this important matter including the progress of ratification.

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