21 February 2020
Global Tax Alert

Indonesia and Singapore sign new tax treaty

Executive summary

Indonesia and Singapore signed a new tax treaty on 4 February 2020 (New Treaty), which will replace the existing tax treaty that has been in effect since 1992 (Current Treaty).

The New Treaty will enter into force upon the exchange of notices of ratification. In Singapore, the provisions of the New Treaty will have effect in respect of taxes chargeable (other than taxes withheld at source) for any year of assessment[1] beginning on or after 1 January in the second calendar year following the year in which the New Treaty enters into force; with regard to taxes withheld at source, in respect of amounts paid, deemed to be paid or liable to be paid (whichever is the earliest), on or after 1 January of the calendar year following the year in which the New Treaty enters into force. In Indonesia, it will become effective on or after 1 January of the calendar year next following the year in which the New Treaty enters into force.

The highlights of the New Treaty include the introduction of capital gains protection and the implementation of the principal purpose test to combat tax treaty abuse.

This Alert summarizes the key changes in the New Treaty.

Detailed discussion

Fiscal domicile (Article 4)

A nationality test is added to the tie breaker rule to determine the tax residency of an individual.

Associated enterprise (Article 9)

The New Treaty adopts provisions equivalent to the latest OECD[2] Model Convention to govern adjustment procedures (with certain limitations[3]).

Dividends (Article 10)

The branch profits tax (BPT) rate for permanent establishments is reduced to 10% from 15%. The New Treaty also clarifies that the reduced BPT rate may not affect agreed clauses under oil and gas production sharing contracts (PSCs) or other mining sector works contracts. The "most favored nation" provision for PSCs is removed in the New Treaty.

Interest (Article 11)

The New Treaty expands the list of government institutions which are exempt from tax in the source country to include sovereign wealth funds and their subsidiaries.[4] The New Treaty discontinues the source country tax exemption for interest on government bonds.

Royalties (Article 12)

The New Treaty reduces the withholding tax (WHT) rate for royalties to 8% or 10%[5] from the Current Treaty WHT rate of 15%. The alienation of certain types of intangible assets is removed from the royalty definition.

Capital gains (Article 13)

The New Treaty introduces a capital gains provision. The provision adopts the latest OECD Model Convention with the following differences:

a. The disposal of shares in a land rich company may be exempt from tax in the source country if:
   - The alienator owns less than 50% of the total issued of shares being alienated.
   - The immovable property is used by the company to carry on its business.
   - The gains arise from the framework of a reorganization, a merger, a demerger or similar operation.
b. Indonesia has the right to tax gains on the disposal of shares in an Indonesian listed company.

Other income (Article 22)

The New Treaty adopts the "other income" provision equivalent to the United Nations Model Convention 2011, as compared to the Current Treaty which contains a clause allocating the taxing right to both countries pursuant to their domestic law.

Exchange of information (Article 26)

This provision reflects the latest OECD Model Convention.

Entitlement to benefits (Article 28)

The New Treaty adopts the "principle purpose test" provision to limit treaty abuse.

Endnotes

1. The term "year of assessment" (YA) refers to the year in which income tax is assessed on the company. The basis period for a particular YA for a company is the financial year ending in the year preceding that YA.
2. Organisation for Economic Co-operation and Development.
3. The corresponding adjustment shall not apply where judicial or other legal proceedings have resulted in a final ruling that one of the enterprises concerned is liable to a penalty with respect to fraud, gross negligence or willful default.
4. The list of eligible entities may be agreed between the competent authorities.
5. The 8% royalty WHT rate applies to payments for the use of, or the right to use, industrial, commercial or scientific equipment, or for any information concerning industrial, commercial, or scientific experience. The 10% royalty WHT rate applies to 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, trade mark, design or model, plan, secret formula or process.

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