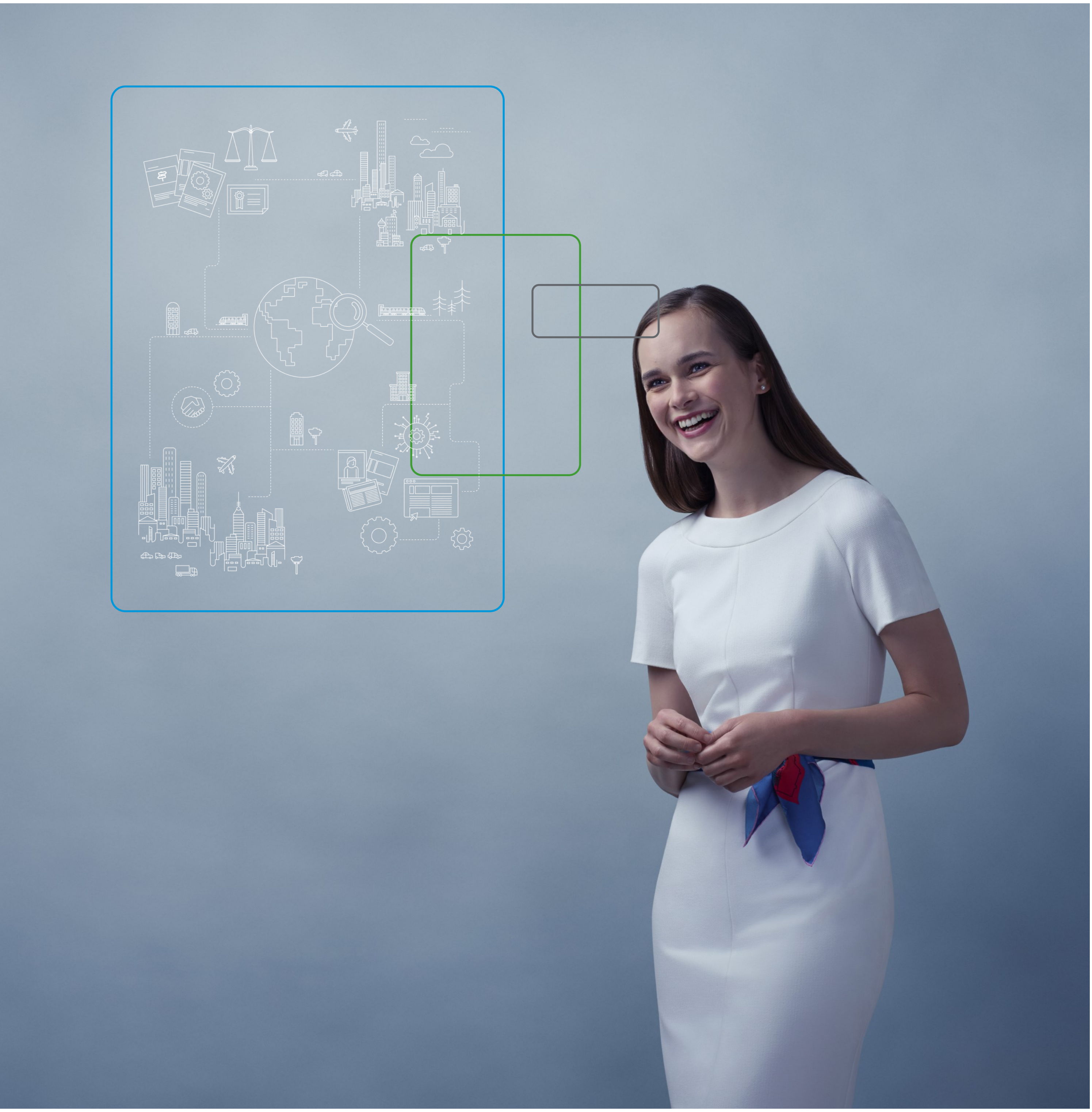

Indonesia ratifies Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion & Profit Shifting

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On 12 November 2019, the President signed Presidential Regulation Number 77 ratifying the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion & Profit Shifting ("PerPres 77"). This represents an important step towards upgrading many of Indonesia's bilateral tax treaties to reflect outcomes of the OECD's Base Erosion & Profit Shifting Project ("BEPS Project").

WHAT IS THE MLI?

The BEPS Project was initiated by the OECD (but then jointly involved the G20 grouping of largest economies) as a result of governments' concerns that multinationals were exploiting gaps and mismatches in tax treaties and domestic tax rules to artificially shift profits to low or no-tax locations where there is little or no economic activity – resulting in base erosion and profit shifting.

The BEPS Action Plan identified fifteen areas for review and reports were subsequently provided by the end of 2015. One particular concern was how to facilitate timely and efficient adjustment to the thousands of bilateral tax treaties to reflect agreed adjustments to reduce BEPS. The Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion & Profit Shifting ("MLI") is a 'work-around' to avoid the need for each country to undertake bilateral negotiations with each of their tax treaty partners to modify each tax treaty.

That is, where two countries have an existing tax treaty and both have ratified the MLI then the MLI applies to adjust that treaty, subject to each countries' declared "reservations" and optional positions.

Countries signing the MLI (currently 93 as at 19 December 2019) were required to accept certain minimum standards regarding the purpose of covered tax agreements, dispute resolution and prevention of treaty abuse.

WHICH TAX TREATIES ARE EFFECTED & WHEN?

Not all of Indonesia's tax treaties will be effected. Indonesia currently has 70 tax treaties, however, it has only submitted 47 of these to the OECD to be included for the purposes of the MLI – under the MLI these are known as Covered Tax Agreements ("CTA"). Out of 47 treaties declared as CTA by Indonesia, 39 of these countries also chose Indonesia to be included in their CTAs.

The full list of tax treaties, those chosen as CTA by Indonesia and those also included as CTA by the other country are:

	Existing Tax Treaty	Identified as CTA by Indonesia	Other country has also identified the Tax Treaty as a CTA
Algeria	Y		
Armenia	Y	Y	Y
Australia	Y	Y	Y
Austria	Y		
Bangladesh	Y		
Belarus	Y		
Belgium	Y	Y	Y
Brunei	Y	Y	
Bulgaria	Y	Y	Y
Canada	Y	Y	Y
China	Y	Y	Y

	Existing Tax Treaty	Identified as CTA by Indonesia	Other country has also identified the Tax Treaty as a CTA
Croatia	Y	Y	Y
Czech Republic	Y	Y	Y
Denmark	Y	Y	Y
Egypt	Y	Y	Y
Finland	Y	Y	Y
France	Y	Y	Y
Germany	Y		
Hong Kong	Y	Y	Y
Hungary	Y	Y	Y
India	Y	Y	Y
Iran	Y		

	Existing Tax Treaty	Identified as CTA by Indonesia	Other country has also identified the Tax Treaty as a CTA
Italy	Y	Y	Y
Japan	Y	Y	Y
Jordan	Y		
Korea (North)	Y		
Korea (South)	Y	Y	Y
Kuwait	Y		
Laos	Y	Y	
Luxembourg	Y	Y	Y
Malaysia	Y	Y	Y
Mexico	Y	Y	Y
Mongolia	Y		
Morocco	Y		
Netherlands	Y	Y	Y
New Zealand	Y	Y	Y
Norway	Y	Y	
Pakistan	Y	Y	Y
Papua New Guinea	Y		
Philippines	Y	Y	
Poland	Y	Y	Y
Portugal	Y	Y	Y
Qatar	Y	Y	Y
Rumania	Y	Y	Y
Russia	Y	Y	Y
Serbia	Y	Y	Y
Seychelles	Y	Y	Y

	Existing Tax Treaty	Identified as CTA by Indonesia	Other country has also identified the Tax Treaty as a CTA
Singapore	Y	Y	Y
Slovakia	Y	Y	Y
South Africa	Y	Y	Y
Spain	Y	Y	Y
Sri Lanka	Y		
Sudan	Y		
Suriname	Y		
Sweden	Y	Y	Y
Switzerland	Y	Y	
Syria	Y		
Tajikistan	Y		
Taiwan	Y		
Thailand	Y	Y	
Tunisia	Y		
Turkey	Y	Y	Y
Ukraine	Y		
United Arab Emirates	Y	Y	Y
United Kingdom	Y	Y	Y
United States of America	Y	Y	
Uzbekistan	Y		
Venezuela	Y		
Vietnam	Y	Y	
Zimbabwe	Y		

A tax treaty will only be adjusted by the MLI if both countries have ratified the MLI and the tax treaty is included by both countries as a CTA. That is, although Indonesia has submitted a list of tax treaties for 47 countries that it wishes to include as CTA, not all of these countries have included Indonesia within their list (at present) and therefore the MLI will not apply in relation to the existing tax treaty between Indonesia and those countries that have not also included their tax treaty with Indonesia as a CTA.

Importantly the USA has not signed the MLI. Therefore, although Indonesia has included the USA in its list of CTA, the MLI will not apply to the USA-Indonesia Tax Treaty. The USA prefers to undertake its own bilateral arrangements that might allow it to keep or take positions that do not reflect the consensus developed through the BEPS Project. Therefore any change to the USA-Indonesia Tax Treaty, for example, will be dependent on bilateral negotiations, or the USA signing and ratifying the MLI and then also choosing the USA-Indonesia Tax Treaty as a CTA.

Although the MLI has been ratified by Indonesia there are a number of administrative steps that must be completed before any tax treaty chosen as a CTA by both Indonesia and the treaty partner will be amended:

- The ratified MLI must be submitted to the OECD, which is acting as the official Depositary. We understand that the Ministry of Foreign Affairs is organizing the submission of Indonesia's ratification to the OECD within January 2020.
- The MLI will enter into force on the 1st day of the month following the expiration of 3 calendar months beginning on the date of deposit of the ratification:
  - ⇒ For countries that have deposited their instrument of ratification with the OECD before Indonesia and are covered in the list of CTA then the MLI will "enter into force" with respect to that country within the end of 3 months from the end of the month of the date of deposit of Indonesia's ratification to the OECD – or 1 May 2020 assuming Indonesia's ratification is submitted in January 2020.
  - ⇒ For countries included in the CTA list that ratify the MLI after Indonesia, the MLI will "enter into force" within the end of 3 months from the end of the month of deposit of that country's ratification to the OECD – but not earlier than 1 May 2020 assuming Indonesia's ratification is submitted in January 2020.
- The MLI is then considered as "entered into effect" and shall have effect for taxes and other matters addressed by the tax treaty as follows (assuming the ratification was submitted to the OECD in January 2020):
  - ⇒ 1 January 2021, in the case of withholding tax at source on amounts paid or credited to non-residents (from 1 January of the calendar year commencing after the date of the MLI entering into force for both countries).
  - ⇒ 1 November 2020, in the case of other taxes (after 6 months from the date of the MLI entering into force).

WHAT PARTS OF TAX TREATIES WILL CHANGE?

If a tax treaty is included by both countries as a CTA and the MLI has entered into force for both countries (i.e. both countries have lodged their ratification documents to the OECD) then the MLI will operate to amend that tax treaty.

The scope of the amendments covers mandatory revisions that all countries accepted as a condition to sign the MLI, and other potential revisions where each country may declare its reservations and make choices regarding certain optional provisions.

Where a country has declared a reservation to a potential amendment under the MLI then that amendment will not be made for the treaties that country indicated were subject to the reservation. It is not relevant if the bilateral treaty partner has not made a similar reservation for that potential amendment. That is, both parties must have the same positive position before a potential amendment under the MLI will be adopted for their tax treaty.

The same principle generally applies for the optional provisions. The optional provision is only recognized as an amendment to the tax treaty if both countries have agreed to that provision.

The mandatory revisions that all countries have agreed to as a condition of signing the MLI are:

- Purpose of a CTA – to include a statement of intent in the preamble of the CTA that the Tax Treaty is to eliminate double taxation without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance.
- Preventing treaty abuse – to include a general anti-abuse rule in the CTA, commonly known as the Principal Purpose Test (PPT).
- Mutual agreement procedure – to include a mechanism to allow a resident taxpayer to seek assistance from their home tax authority when the taxpayer encounters taxation in a tax treaty jurisdiction that is not in accordance with the intended application of the tax treaty.

Indonesia's reservations and optional provisions are listed in PerPres 77. Indonesia may subsequently withdraw its reservations or opt in to certain of the optional provisions.

IMPLICATIONS & ACTIONS

As noted above, it is likely that changes to relevant tax treaties will enter into effect from 1 January 2021 for withholding tax, and 1 November 2020 for others.

Taxpayers involved in cross-border activities that are currently utilizing a tax treaty should consider if that jurisdiction is a signatory to the MLI and if that tax treaty is a Covered Tax Agreement for both Indonesia and the other country. If it is then an assessment should be made regarding the consequences of the amendments arising from the MLI (after the amendments have entered into effect).

This is particularly important if taxpayers are involved in cross-border projects that might involve creation or avoidance of a Permanent Establishment, or the selection of the most appropriate entity to undertake cross-border activities.

The review should not be limited to transactions involving revenue, but also when dealing with non-resident vendors that are utilizing a tax treaty to reduce withholding tax that you need to deduct from payments to them, or to avoid creation of a Permanent Establishment.

For further information please contact:

RSM INDONESIA
Plaza ASIA Level 10
Jl. Jend. Sudirman Kav.59
Jakarta 12190
+62 21 5140 1340
contact@rsm.id
www.rsm.id