

**March 2021**

- Indonesia-Japan Tax Treaty as Modified by Multilateral Convention



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The synthesized text of the tax treaty between Indonesia and Japan has been released by the government of Japan. This document simply incorporates those provisions of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (“MLI”) which were agreed by both Indonesia and Japan.

**Background of MLI**

The MLI is an international agreement which modifies the selected tax treaties of countries which have signed the MLI without going through the bilateral negotiation process, which usually takes time and effort. It is intended as a way for contracting parties to counter tax treaty abuse.

The MLI was signed in Paris on 7 June 2017 in an effort to prevent base erosion and profit shifting (BEPS) in a synchronized and efficient manner. However, the MLI only applies to “Covered Tax Agreements,” i.e. a tax treaty between parties to the MLI for which both have stated they wish to modify the agreement, in particular the agreed (matched) articles. Indonesia has Covered Tax Agreements with approximately 40 countries, including Japan.

The MLI offers flexibility insofar as countries can choose among alternative provisions offered for certain articles or opt out of MLI provisions (except for the minimum standards). The minimum standards relate to:

- i. purpose of the agreement
- ii. prevention of treaty abuse (principle purpose test)
- iii. mutual agreement procedure

If these minimum standards are already covered by a particular treaty, no change is required. The other tax treaty provisions can be replaced by, modified by, or added to by the MLI provisions.

Indonesia ratified the MLI on 13 November 2019 (Presidential Regulation 77/2019) and it entered into force on 1 August 2020. Japan ratified the MLI on 1 January 2019. With respect to the tax treaty between Indonesia and Japan, the following should be noted:

Date of MLI entry into effect in Japan	For WHT (dividend, interest, royalty)	1 January 2021
	For other taxes levied by Japan	26 June 2021
Date of MLI entry into effect in Indonesia	For WHT (dividend, interest, royalty)	1 January 2021
	For other taxes levied by Indonesia	1 January 2022

There is no legal requirement that the consolidated text of modified treaties be issued. Therefore, the MLI provisions are in effect for other Covered Tax Agreements even though the consolidated text of the treaty between Indonesia and the respective country has not been issued (so long as such countries have deposited the ratification instrument of the MLI).

### Summary of Modifications to the Indonesia-Japan Tax Treaty

For Indonesia and Japan, the MLI provisions which were mutually agreed by both are incorporated into the tax treaty. Below is a brief description of the impact or significance of the changes to the treaty as a result of the incorporation of the MLI provisions.

Tax Treaty Article	Summary of MLI provisions selected by Indonesia and Japan
Preamble	<p><i>Article 6 - Purpose of Covered Tax Agreement</i>                      Emphasizes that the purpose of the tax treaty agreement is to avoid double taxation without creating opportunities for non-taxation through tax evasion, tax avoidance, or treaty shopping.</p>
4.2	<p><i>Article 4 - Dual Resident Entities</i></p> <ul style="list-style-type: none"> <li>• For a person other than an individual which is a resident of both countries, the competent authorities are to consider the place of effective management, where incorporated, and other relevant factors when determining residency. If no agreement is reached by the competent authorities, such person is not entitled to treaty benefits.</li> <li>• MLI Articles 4.1 and 4.3(e) replace the tax treaty provision which regulates the determination of a tax subject, other than an individual, as a resident of one of the jurisdictions in the case of dual residence.</li> </ul>
5.4	<p><i>Article 13 - Artificial Avoidance of Permanent Establishment Status through the Specific Activity Exemptions</i></p> <ul style="list-style-type: none"> <li>• This provision regulates several activities that should not create a PE, provided such activities are of a preparatory or auxiliary character. However, a PE may exist if the business activities are carried on by two related enterprises at the same place, or by the same enterprise or closely related enterprises at two places, if the activities constitute complementary functions which are part of a cohesive business operation.</li> <li>• The purpose of this provision is to address fragmentation of activities conducted by the same enterprise or closely related parties that represent a cohesive business operation which could create a PE.</li> </ul>
5.6.a	<p><i>Articles 12 - Artificial Avoidance of Permanent Establishment Status through Commissionaire Arrangements and Similar Strategies</i>                      Article 12.1</p> <ul style="list-style-type: none"> <li>• A PE could exist if a person is acting in one country on behalf of an enterprise in the other country and in doing so habitually concludes contracts or habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise.</li> <li>• The intention is to expand the scope of PE to include a person that has a principal role in concluding the contracts.</li> </ul>
5.8 and Protocol No. 1	<p>Article 12.2</p> <ul style="list-style-type: none"> <li>• A person who acts exclusively or almost exclusively on behalf of one or more enterprises to which it is closely related shall not be considered to be an independent agent within the meaning of this paragraph with respect to any such enterprise.</li> <li>• The intention is to expand the scope of PE whereby a person who acts exclusively or almost exclusively on behalf of a related company is not considered as an independent agent.</li> </ul>
Inserted in Art. 5	<p><i>Article 15 - Definition of a Person Closely Related to an Enterprise</i></p> <ul style="list-style-type: none"> <li>• A person is determined to be closely related to an enterprise based on relevant facts which show control or if the person holds directly or indirectly more than 50% beneficial interest in the other.</li> <li>• This is a new provision regarding the definition of person closely related to an enterprise for the purpose of Article 5 of the tax treaty.</li> </ul>

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Inserted in Art. 9	<p><i>Article 17 - Corresponding Adjustments</i></p> <ul style="list-style-type: none"> <li>Where one country includes in the profits of an enterprise of that country - and taxes accordingly - profits on which an enterprise of the other country have been charged to tax in that other country and the profits so included are profits which would have accrued to the enterprise of the first-mentioned country if the conditions made between the two enterprises had been those which would have been made between independent enterprises, then that other country shall make an appropriate adjustment to the amount of the tax charged therein on those profits.</li> <li>This provision intends to provide legal certainty for taxpayers claiming corresponding adjustments in the above situation, which normally apply for transfer pricing cases.</li> </ul>
Inserted in Art. 13	<p><i>Article 9 - Capital Gains from Alienation of Shares or Interests of Entities Deriving their Value Principally from Immovable Property</i></p> <ul style="list-style-type: none"> <li>Gains derived by a resident of one country from the alienation of shares or comparable interests, such as interests in a partnership or trust, may be taxed in the other country if, at any time during the 365 days preceding the alienation, these shares or comparable interests derived more than 50% of their value directly or indirectly from immovable property situated in that other country.</li> <li>In the original Article 13 of the tax treaty, a transfer of shares was only taxable in the country where the transferor is a resident. With the MLI provision, gains from a transfer of shares of a non-listed Indonesian company by a Japanese tax resident can be taxed in Indonesia if during the 365 days before the transfer more than 50% of the value was from immovable property.</li> </ul>
Inserted in Art. 28	<p><i>Article 7 - Prevention of Treaty Abuse</i></p> <ul style="list-style-type: none"> <li>A treaty benefit is not granted if one of the main reasons for the transaction or arrangement was to take advantage of the treaty (principle purpose test), unless granting the benefit is in accordance with the purpose of the treaty.</li> </ul>



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