Executive summary

On 5 February 2016, the India-Indonesia Income Tax Treaty (the Treaty) entered into force. The Treaty applies from 1 January 2017 for Indonesia and from 1 April 2017 for India and generally replaces the current 1987 India-Indonesia Income Tax Treaty (the 1987 Treaty). This Alert summarizes the key changes from the 1987 Treaty.

Detailed discussion

Resident – Article 4

Under the Treaty, the tie-breaker test for determining residency status of a company will be based on where its place of effective management is situated. If the State in which its place of effective management is situated cannot be determined, the competent authorities of both Countries will attempt to settle the question by mutual agreement.

Permanent establishment (PE) – Article 5

- The threshold for a building site or construction, assembly or installation project or supervisory activities constituting a PE is reduced to 163 days from 183 days.
A drilling rig or working ship used for exploration or exploitation of natural resources would constitute a PE, if so used for a period of more than 183 days.

The scope of an agency PE is expanded to include activities requiring habitually securing orders, wholly or almost wholly for the enterprise itself.

Royalties and Fees for Technical Services – Article 12
The term “Fees for Technical Services” is specifically defined under the Treaty to include payments of any kind, other than those mentioned in Articles 14 (Independent Personal Services) and 15 (Dependent Personal Services) as consideration for managerial or technical or consultancy services, including the provision of services of technical or technical personnel. The tax on royalties and fees for technical services under the Treaty is reduced to 10% from 15%.

Capital gains – Article 13
Indirect transfers of shares of a foreign company would be taxable in India if such shares derive more than 50% of their value directly or indirectly from immovable property situated in India.

Capital gains from direct transfer of shares held in an Indian company will be subject to capital gains tax in India.

Limitation of Benefits (LOB) – Article 24
The new LOB article in the Treaty provides:

A resident of a Contracting State will not be entitled to the benefits of the Treaty if its affairs were arranged in such a manner as if it was the main purpose or one of the main purposes to take the benefits of the Treaty.

The case of legal entities not having bona fide business activities will be covered by the provisions of the LOB article.

Exchange of Information – Article 27 and Assistance in Collection – Article 28
Additional facilitating provisions are introduced under the Treaty to assist in the exchange of information between the Governments of India and Indonesia as well as lending assistance to each other in collection of revenue claims.
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