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ABSTRACT

The Indonesia-Netherlands Double Taxation Agreement ("DTA") has been renegotiated and amended several times until the latest amendment which was made in 2015 whereby a new protocol was produced. What is interesting about this new protocol is the requirement to refer to the OECD Commentary in interpreting the DTA articles that are identical and similar to OECD Model, especially in relation to the term "Beneficial Owner". Over the last two decades, the usage of Dutch SPVs in financing structure have triggered many tax disputes between the Tax Authority in Indonesia (the Directorate General of Taxation or "DGT') and the Indonesian taxpayer. The DGT would typically reject the treaty benefit for using WHT exemption for interest payment and impose the 20% WHT rate instead. However, it is in the core interests of the Dutch to maintain its position of being the hub for investors to enter into the European financial market, and therefore it is of much importance for it to secure favorable treaty provisions ,despite the fact that the WHT rate on interest payment has since been amended to 5%. On the other hand, we are all aware that the Commentary is designed as a reference in interpreting the treaty, and shall not be the legal binding instrument, as expressed by the Committee on Fiscal Affairs. On this basis, most of the scholars view that there is no legal binding status of the Commentary to parties signing the DTA. The VCLT (Vienna Convention on the Law of Treaties), though, requires good faith in the interpretation of the treaties, and Indonesia's position on how to interpret the treaty should pave the way for us to recognize that there is no such rejection on referring to the Commentary in interpreting the DTAs.

I. Introduction

The protocol[1] amending the 2002[2] Double Tax Agreement ("2002 DTA" or "DTA" or "Tax Treaty") between the Kingdom of the Netherlands ("the Netherlands" or "the Dutch") and the Republic of Indonesia ("Indonesia") was signed on 30 July 2015 (the "Protocol").[3]

[1] Larking, B. (2005). *IBFD International Tax Glossary 5th Edition.* Amsterdam: IBFD. IBFD Tax Glossary defines Protocol as the signed document containing the points on which agreement has been reached by the negotiating parties preliminary to a final treaty. A protocol is also an agreement reached by the parties to a tax treaty and signed and ratified by them, in addition to an existing tax treaty. The Protocol may be signed simultaneously with the tax treaty or later, and it clarifies, implements, or modifies treaty provision.

[2] The 2002 DTA was concluded on 29 January 2002, entry into force on 31 December 2003 and effectively applied on 1 January 2004.

[3] Protocol Amending the Agreement between The Government Of The Republic Of Indonesia and the Government Of The Kingdom of The Netherlands For The Avoidance Of Double Taxation And The Prevention Of Fiscal Evasion With Respect To Taxes On Income, and Its Protocol, Article 10 of the Protocol:
"Each state shall notify to the other the completion of the procedures required by its law for the bringing into force of this Protocol. It shall into force on the first day of the second month following the later of the dates on which the respective Governments have notified each other in writing through diplomatic channels. The provisions of this Protocol shall for the first time have effect for amounts paid or credited on or after the first day of the second month next following the date on which the Protocol enters into force".

The Dutch government completed its domestic ratification procedures on 10 August 2015 [4], whilst Indonesia completed the procedures on 6 March 2017[5]. The actual ratification of the Protocol was on 14 June 2017 as Diplomatic Notes were sent by the Indonesian Government to the Netherlands Embassy in Jakarta, Accordingly, the Protocol formally entered into force on 1 August 2017, and is effectively applicable for amounts paid or credited on 1 October 2017 for both countries.

Key changes under the Protocol are highlighted in the next chapter. However, what is most relevant to be discussed is the provision of Article 6 – which mandates the insertion before Article I of the protocol of the DTA:

"General

> *Subject to any reservations, observations or positions as the case may be to the OECD Model Tax Convention or its Commentary made by either State, the two States shall interpret the provisions of the Agreement which are identical or in substance similar to the provisions of the OECD Model Tax Convention on Income and on Capital, in accordance with the OECD Commentary thereon at the moment of signing the Agreement and any subsequent clarifying modifications of such Commentary. Especially, the two States shall interpret the term 'beneficial owner' used in the Agreement in accordance with the interpretation thereof as published by the OECD at the moment of signing the Agreement and any subsequent clarifying modifications of such OECD interpretation."*

The author highlighted the term 'beneficial owner' (the "BO") on purpose – as it is the main issue raised by the Dutch authority on some DTA disputes. As we may have been aware, the Indonesian government through the Director General of Taxes (the "DGT") often took the position to negate the benefit of the DTA on most of the interest payments made to the Dutch resident with the basis of argument that the recipient of income is not the BO. We understand that the Dutch government has approached the Indonesian government with the proposal to negotiate an anti-abuse provision in the DTA, however the Indonesian government declined.[6] Later, the BO issue was included as one of the top priority items in the Dutch delegation in negotiating the treaty.

It is a common consensus that the Netherlands is one of the favorite jurisdictions to set up any financing structures for Asian region as it does not impose withholding tax ("WHT") on interest payments. The 2002 DTA introduced an exemption from WHT for certain categories of interest payments. As a result of this exemption, which is unique for Indonesian DTAs, various attractive tax planning opportunities emerged.[7]

To maintain its position as being the hub for investors to enter into the European financial market, the Dutch was willing to renegotiate the DTA and was ready to surrender on the much favorable WHT provisions under the 2002 DTA. It was finally agreed that 5% rate should apply on any interest payments, instead of being fully exempted as per the 2002 DTA. In return, the Dutch insisted that the application of the 5% must be consistently apply by the Indonesian tax authorities through the application of the international tax principles.

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[4] The *Tractatenblad van Het Koninkrijk Der Nederlanded – Jaargang* 2015 Nr. 121.

[5] Indonesia. Presidential Regulation No. 24 Year 2017 concerning The Ratification of Protocol Amending the Agreement between the Government of The Republic of Indonesia and the Government of the Kingdom of The Netherlands For The Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, And Its Protocol, Signed at Jakarta on January 29, 2002.

[6] Aidha, Nurul C & Maftuchan, et al. (2019). "How the Indonesia-Netherlands tax treaty enables tax avoidance - An analysis of the treaty and Indonesian court decisions on corporate tax disputes." *Perkumpulan Prakarsa dan SOMO*, ,p. 41.

[7] Houben, Wendy MCP and Drijer, H Hans. (2004). "The New Income Tax Treaty with the Netherlands in Practice", *IBFD-Asia Pacific Tax Bulletin*.

The Dutch then produced the proposal to include the requirement to refer to OECD Commentary in interpreting the term 'BO'.

The Indonesia-Netherlands DTA has been amended several times, along with the changes of domestic tax regulations, and the need in accommodating globalization of different businesses:

1. **1974 DTA:** The original DTA was signed on 5 March 1973, and became formally effective at the end of 1974 ("1974 DTA");
2. **1993 DTA:** There was a discussion to amend the DTA in early 1990s with a protocol amendment on 5 March 1993. This Protocol was ratified on 3 May 1994 and became effective on 1 January 1995 ("1993 DTA");
3. **2002 DTA:** The Indonesia government submitted a formal termination request in March 2000, resulting in the DTA no longer applicable from 1 January 2001[8]. The Indonesian and Dutch government renegotiated the DTA and agreed of the new provisions on 29 January 2002 ("the 2022 DTA"). The 2002 DTA came into force on 31 December 2003, and effectively applied on 1 January 2004; and
4. **2015 DTA:** The 2002 DTA was renegotiated in 2015 and both governments agreed of the new Protocol. Upon completion of mutual ratification process, the 2015 DTA became effective on 1 October 2017.

The revolution and development of the Indonesia-Netherlands DTA show how significant the role of Indonesia is for the Dutch economy and vice versa.

Irrespective of the latest compromise shown by the Dutch on the DTA terms, the over-protective provision proposed by the Dutch government left a big question on whether it is necessary to include in the Protocol a requirement to refer to the OECD Commentary in interpreting the DTA provisions. In addition, we must also ask why the requirement is specifically tagged on to the BO issue.

Although this paper focuses on issues of the Indonesia-Netherlands DTA from an Indonesia perspective, the findings may be applicable to a broader international context, especially in view of the era we are currently in whereby tax practitioner are given signals to apply stricter domestic BO interpretations and the introduction of a BO definition in domestic laws have proliferated. The application of appropriate BO concept is not only relevant in the Indonesia-Netherlands DTA but towards all other applicable DTA.[9]

This paper aims to answer the question on whether it is necessary to specifically include the requirement to refer to OECD commentary in interpreting the DTA provision. It will analyze the position taken by the OECD (in this case the OECD Committee on Fiscal Affairs), the positions of Netherlands and Indonesia, as well as taking into consideration the opinion of relevant experts and/or scholars. It is important to note that the OECD Committee on Fiscal Affairs recognizes that the Commentaries are not legally binding provision, but nevertheless it can be of great assistance in the application and interpretation of the conventions and in the settlement of any dispute.[10]

This paper is opened with an introduction, followed by the discussion on changes made under the Protocol, brief explanation on the BO and taxation issues arising from the financing structure triggering most of tax disputes, considerations in interpreting the DTA provisions and the status of the OECD Commentary, and finished with conclusion and recommendations.

I. Changes made under the Protocol

The Protocol consists of several changes to the 2002 DTA to accommodate concerns from both authorities – these include:

a. Withholding tax ("WHT") rates on dividend payments

The 2002 DTA regulates that a 10% WHT applies to dividends paid by an Indonesian tax resident taxpayer to a shareholder tax resident in the Netherlands in all cases. The Protocol changes the WHT rates as follows:

1. 5% WHT – for corporate shareholder with at least 25% of the capital;
2. 10% WHT – for pension fund that is recognized and controlled according to the statutory provisions; and
3. 15% WHT - for all other cases

b. WHT rate on interest payments

Under the 2002 DTA, a general 10% WHT rate applies to interest payment by an Indonesian resident to a tax resident of the Netherlands. However, several situations could qualify for WHT exemption including in the case if the lender is the Government of the Netherlands, or the interest is in relation to a loan with tenor of at least 2 years, or the interest is in relation to the sale on credit of industrial, commercial, or scientific equipment.

The WHT exemption on these situations gave rise to plentiful tax disputes in Indonesia. The Indonesia government asked for a revision on the WHT rate of interest in setting for the Protocol considering that there are frequent tax treaty abuse on the use of financing structure through the Netherlands. The Protocol increases the WHT rate to 5% on interest in relation to a loan with tenure of at least 2 years or in connection with the sale on credit of industrial, commercial, or scientific equipment.

a) Mode of Application ("MoA")

The 2002 DTA contained the provision on the MoA, which was unilaterally interpreted by the Indonesia government, that in the absent of MoA, the WHT exemption cannot be applied[11]. However, it is noted that similar MoA has been broadly applicable to the numerous DTAs signed by Indonesia that contain a reference to the BO test, but they were never in dispute.

Based on such observation and comparison, the Netherlands proposed to clarify the issues by specifically limit the use of MoA. The Protocol states that mutual agreement on the MoA of Article 10 (Dividend), 11 (Interest) and 12 (Royalty) is not required for the application of these Articles.

b) The use of the OECD MC Commentary in interpreting the meaning of BO

The Protocol specifically mentions that both authorities shall interpret the provisions of the DTA, in accordance with the OECD Commentary at the moment of signing the DTA and any subsequent explanation

[11] Indonesia. Circular Letter of the Directorate General of Taxes Decree No. SE-17/PJ/2005 concerning Instruction on Treatment of Income Tax on Article 11 Regarding Interests in The Avoidance Of Double Taxation Agreement (P3B) between Indonesia and the Netherlands. This SE No. 17/PJ.05/2005 formalized the position to be taken by the Directorate General of Taxes ("DGT") in applying the interest provision in the Indonesia-Netherlands DTA under which the DGT argues that the 0% WHT option does not apply until both countries have mutually settled the Mode of Application.

related modification.

Based on this provision, there are several points that we can conclude:

1. Both states agree to refer to OECD Commentary for any interpretation of the DTA provisions that are identical or similar in substance to the OECD MC
2. The interpretation adopts ambulatory interpretation[12], and
3. The interpretation applies for all provision in the DTA, especially in relation to the term of BO This will be discussed further in the next chapter.

The Article 6 of the Protocol specifically refers to the issue of BO interpretation. As aforementioned, there have been plentiful tax disputes initiated by the DGT in which the treaty benefit was rejected due to unqualified BO. Article 10, 11, and 12 of the 2002 DTA requires that any benefit of the DTA shall be granted only if the recipient of the income is also the BO of the income.

II. issues of the BO under the DTA

The proposal to include referencing the OECD commentary in interpreting BO indicates that the BO is a critical issue for the application of the Indonesia-Netherlands DTA. To fully comprehend the issue, it is relevant for the author to discuss the meaning of BO and its development under the international tax developments.

A. BENEFICIAL OWNER - INTERNATIONAL PERSPECTIVE

The BO concept, first introduced in 1966[13], is of importance when it comes to determining whether a person is entitled to DTA benefits. DTA normally reduces withholding tax rates or withholding tax exemptions on dividends, interest, and royalties, and are granted where a recipient of such income qualifies as the BO.

Due to the lack of a treaty definition in most treaties, the meaning of BO should be interpreted with recourse to domestic law via Article 3(2) of the OECD Model. Based on this interpretative rule, any term not defined in the DTA shall have the meaning which it has under the relevant domestic law, unless the context otherwise requires. When it comes to the interpretation of BO, there is often no clear meaning under the domestic tax laws in most countries, and it is often difficult to establish the "context"[14] which warrants an alternative interpretation. As a result of these unrealistic presumptions under Article 3(2) of the OECD Model, there is no common understanding as to how the concept should be interpreted. In terms of how the concept should be interpreted, the following two main views shall be recognized:

1. The definition of BO should be construed as an international tax law concept and an autonomous international fiscal meaning (which should not vary from one country to another)[15] ; or

[12] Larking, B. *op.cit.* IBFD International Tax Glossary (IBFD 5th edition, 2005) defines ambulatory or dynamic interpretation in the tax treaty context as the interpretation of a treaty term by reference to its dynamic law meaning from time to time (typically at the time the treaty is being applied), as opposed to the time the treaty was concluded (the latter being commonly referred to as static interpretation). The question which treaty country's domestic tax law should be taken is a point of controversy.

[13] Jinyan Li. (2010). "Beneficial Ownership in Tax Treaties: Judicial Interpretation and the Case for Clarity." *Osgoode Hall Law School Comparative Research in Law & Political Economy Research Paper Series No. 4*. It was believed to have been originated in the United Kingdom and was used to distinguish it from legal ownership in circumstances where the legal ownership was akin to a nominee or agent. Since its adoption into the OECD Model, it has been incorporated into the UN Model Convention and the vast majority of bilateral tax treaties concluded since 1977..

[14] Amongst tax law, there is often also no clear meaning under domestic commercial or general law.

[15] As suggested by Baker, supra note 5, p. 9. The international meaning of the beneficial ownership concept is strongly supported in the literature. See also, inter alia, K. Vogel, Vogel on Double Taxation Conventions (Deventer: Kluwer, 1991), p. 457 and C. Du Toit. (1999). *Beneficial Ownership of Royalties in Bilateral Tax Treaties.* Amsterdam: IBFD., p. 172. Also supported by to P

2. The meaning of the BO definition should – on a country-by-country basis – be derived from the domestic legislation of the contracting states, using the (sometimes unclear) domestic meaning[16] and vague context[17] .

The term 'BO' was introduced in 1977 MC in articles 10, 11 and 12 OECD Model although the term was not defined[18]. The Commentaries to the 1977 OECD Model provided minor guidance on the meaning of BO, but excluded an intermediary, such as an agent or nominee, as a beneficial owner. Subsequent guidance was provided in the 1986 OECD Conduit Companies report[19], that excluded persons as beneficial owners to the formal owner of assets who has very narrow powers, which make such an owner a mere fiduciary or an administrator acting on account of the interested parties.

Important explanations by the OECD could be found in the 2003 amendment of the OECD Commentaries on Articles 10, 11 and 12. The Commentaries on Article 10 of the OECD Model indicates that the concept of BO has been introduced to clarify that the source state is not required to give up taxing rights over dividend income merely because that income is immediately received by a resident of a state with which the source state has concluded a DTA. The term 'BO' is not used in a narrow technical sense, rather, it should be understood in its context and considering the object and purposes of the Convention, including avoiding double taxation and the prevention of fiscal evasion and avoidance[20]. Hence, persons who simply act as a conduit for another person who, in fact, receives the benefit of the income concerned would according to the OECD does not qualify as 'BO'.

Summarizing from the OECD Commentaries, there are two situations in which a person would not qualify as BO. First, the recipient of the income acts as an intermediary, such as an agent or nominee and second, the recipient of the income acts as a "conduit" and has very narrow powers in relation to the income which make such a recipient a mere fiduciary or an administrator acting on account of the interested parties.

Further, the 2014 OECD MC updates of article 12, section 12.4 provides negative definition of BO. A person is not the BO because that recipient does not have the full right to use and enjoy the dividend that it receives and this dividend is not its own; the powers of that recipient over that dividend are indeed constrained in that the recipient is obliged (because of a contractual, fiduciary or other duty) to pass the payment received to another person.

It would be relevant also to discuss BO from the court interpretation and case law. However, this paper is not intended to provide in-depths understanding of the BO, but more on the reference to the OECD commentary, hence BO will not be discussed in further details.

Laroma Jezzi. (2010) the Concept of Beneficial Ownership in the *Indofood* and *Prevost Car* Decisions IBFD Vol 64, No.5.

[16] *Ibid*. This would give rise to the further issue of how to reconcile differing understandings of the term in civil as opposed to common law (refer to Jezzi, "the Concept of Beneficial Ownership in the *Indofood* and *Prevost Car* Decisions".

[17] As suggested by R. Fraser and D. Oliver. (2007) "Beneficial Ownership: HMRC's graft guidance on interpretation of the Indofood decision.", *British Tax Review* , p. 51.

[18] Up till today, the term is also not defined in specific treaties, although a few exceptions exist such as the Italy-Turkey and the Germany-Italy tax treaties.

[19] OECD. (1987). Double Taxation Conventions and the Use of Conduit Companies". *Issues in International Taxation No.1: International Tax Avoidance and Evasion.*

[20] OECD (2014), *op.cit*. Paragraph 12 of the Commentaries on Article 10 of the OECD Model.

B. BENEFICIAL OWNER – INDONESIAN interpretation

After the 2002 DTA had been in force for a certain period, the DGT found – in its view – some improper use of the 0% WHT rate for interest, with a special focus in Indonesian bond issuance structures. In combating such improper use, the DGT internally issued several regulations focusing on treaty benefits.

a. Circular letter No. SE-17/PJ.05/2005 formalized the position to be taken by the DGT in applying the interest provision in the Indonesia-Netherlands DTA under which the DGT argues that the withholding tax exemption option does not apply until both countries have mutually settled the MoA of the provision.

b. Circular letter No. SE-04/PJ.34/2005, the DGT stipulates that BO is the rightful owner of income such as dividend, interest, and royalty, either individual or corporate taxpayer, who has the full right to directly enjoy the benefit of such income. Parties other than "beneficial owner" who receive dividend, interest and/or royalty payments from Indonesian source, are subject to 20% withholding income tax under Article 26 of the Indonesian Income Tax Law, withheld by the payer.

c. Decree No. 61 and 62/2009[21] requires that taxpayers to satisfy the following requirements

   1) The income recipient of income is not tax resident of Indonesia;

   2) The administrative requirements have been fulfilled; and

   3) The application of treaty rates would not be abusive.

d. Decree No. 10/PJ/2017[22] requires the usage of Certificate of Domicile for parties claiming treaty benefit. This Decree revokes the earlier Decree No. 61/2009 and No. 62/2009. Decree No. 10/2017 has similar provisions to earlier ones – however the form used is simplified.

C. Financing Structure Triggering Tax Disputes In Which The Dgt Challenged The Bo Status

There have been cases in which the DGT attacked the financing structure by denying the DTA benefit. The WHT exemption under the 2002 DTA on interest payment had all been rejected, instead the DGT applied the 20% domestic WHT rate on the basis that the recipient of interest income is not considered as BO of the

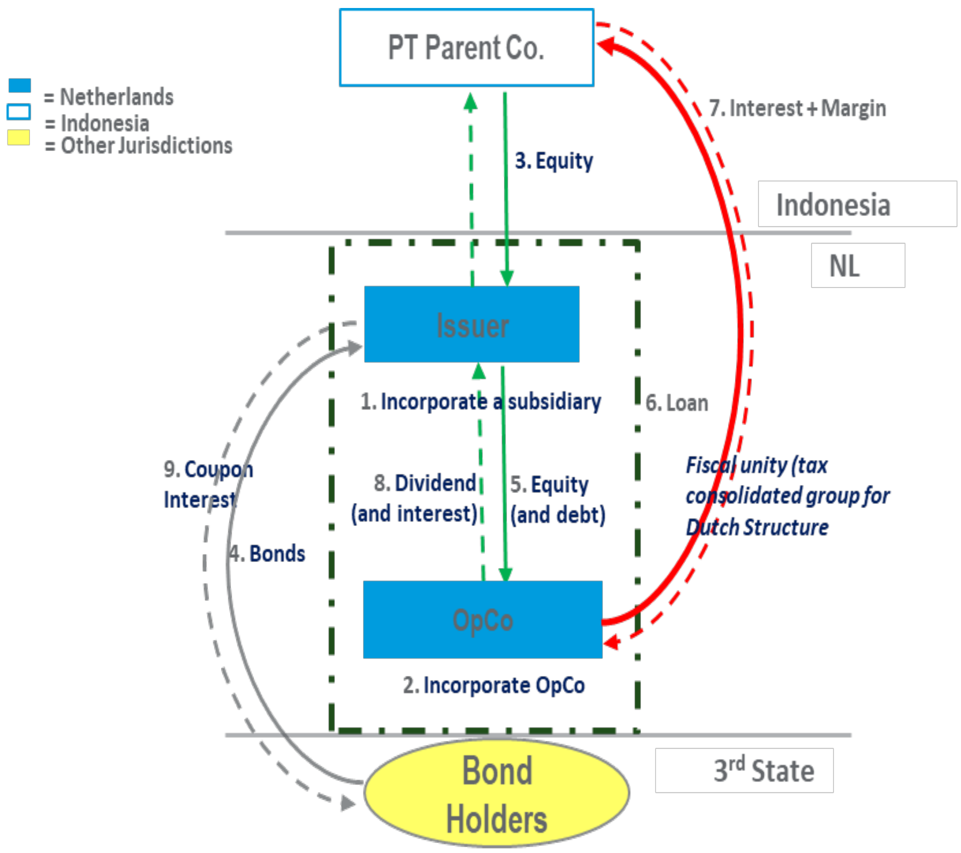
[21] Indonesia. the Directorate General of Taxes Decree No. PER-61/PJ/2009 concerning Procedure for the Application of Agreement on Double Taxation Avoidance, and the Directorate General of Taxes Decree No. PER-62/PJ/2009 concerning Prevention of the Misuse of Agreement on Double Taxation Avoidance.

What is significant under this regulation is the use of DGT 1 Form that requires the recipient to confirm the following questions:
The creation of the entity and/or the transaction structure is not motivated by reasons to take advantage of the tax treaty;
It has its own management to conduct its business and such management has independent discretion;
The Company employs sufficient qualified personnel;
It engages in active conduct of a trade or business ;
The income originating from Indonesia is subject to tax in its country ; and
No more than 50% of its income is used to satisfy its obligations to other parties in the form of: interest, royalties, or other compensation .

[22] Indonesia. the Directorate General of Taxes Decree No. PER-10/PJ/2017 concerning Procedure For the Application of Agreement on the Avoidance of Double Taxation. In addition to the changes of Form DGT, the new regulation introduces also stricter anti-abuse provision, in which:
No DTA benefit will be granted if transaction or structure is not supported with substance;
If any inconsistent between legal and economic substance – tax will apply substance over form approach.

income.

The common financing structure used by most of the Indonesian company can be illustrated as follows:



Notes:

1. PT Parent Co incorporates a subsidiary in the Netherlands ("the Issuer").
2. The Issuer establish another company in the Netherlands that is engaged in genuine business ("OpCo")
3. PT Parent Co injects an equity to Issuer.
4. Issuer issues Global Bonds.
5. Issuer contributes the Global Bond proceeds to OpCo as equity
6. OpCo lends on this equity to PT Parent Co as a loan.
7. PT Parent Co pays interest + margin to OpCo.
8. OpCo distributes its interest income as a dividend to Issuer
9. Issuer pays coupon to Global Bond holders.

The structure can be further explained below:

1. On the basis that the OpCo is a resident of the Netherlands for corporate income tax purposes, and the loan period is for more than 2 years – PT Parent Co has applied exemption on WHT.

2. We understand that to benefit from the WHT exemption under the treaty, the Issuer should duly complete the Form DGT1 and declare that it qualifies as the BO of the interest income it received from PT Parent Co.

3. In this respect, it is required that no more than 50 per cent of the Issuer's income may be used to satisfy claims by other persons.

4. Due to the *"equity wall"*, the OpCo should duly complete Form DGT1, since not more than 50% of the company's income is used to satisfy claims by other persons because the OpCo is fully funded with equity and has therefore no (debt) claims it should satisfy.

There are at least three landmark cases that we can use as example to review the BO status of the recipient and the approach taken by the Indonesian Court:

	Case number and parties involved		
	PT Transportasi Gas Indonesia VS Director General of Taxes	**PT PLN VS Director General of Taxes**	**PT Japfa Comfeed Indonesia TBK VS Director General of Taxes**
Tax Court Decision	**<u>The Taxpayer won the case at the Court</u>** …. that the onus on the tax authorities to show that a Mauritius holding company receiving interest from an Indonesian company was not **The Beneficial Owner** of the interest had not been met and that therefore the holding company was entitled to the reduced rate of withholding tax provided in the Indonesia–Mauritius treaty. The Court reached a number of interesting and not entirely consistent conclusions about beneficial ownership. the Court held that the meaning of "**Beneficial Owner**" should be determined in accordance with the law of the residence country. This position is the opposite of the US position, namely,	**<u>The DGT won the case at the Court</u>** The DGT disagreed with the WHT exemption on the basis that the recipient (the OpCo) is not the BO of the interest income The DGT issues a tax assessment, and the Contractor challenged the assessment to objection and also appeal to the Tax Court – with the followings: a) There is no definition of BO in Indonesia – NL DTA; b) BO has the meaning not only in a formal definition but also in a substance over form c) Treaty benefits shall be given to the "real title" holder – (Vogel, 1977: 561-562) and the BO are those who are free to determine the use of their income / assets.	**<u>The Taxpayer won the case at the Court</u>** a) The NL government confirms that the company is a resident for NL corporate income tax purposes b) The company also received other income from trading activities, have sufficient employees, independent management, and do not pass its 50% income to another party c) The COD is available Dissenting opinion: a) BO requirements recognize the ultimate persons so the resident may not be the BO. b) Requirements of Article 11(2) and(4) of the DTA

	that the beneficial owner is determined under the law of the source country. The Court also expressed the view that "beneficial owner" should have an international treaty meaning rather than a domestic law meaning. A certificate of residence is proof of residence but is not sufficient to prove beneficial ownership.	d) BO is every person who has funds, which controls customer transactions that give authorization to the occurrence of a transaction and who controls through a legal entity or agreement – BI Regulation No. 11/28/PBI/2009 e) Agent, Nominee, and conduit company are excluded from terminology of BO Indonesia and Mauritius should have agreed on the meaning of "beneficial ownership" at the time the treaty was entered into. Most disturbing, an economic substance-over-form approach should be used to determine beneficial ownership. The Tax Court decides that ""The Issuer" and "The OpCo" are not BO of the income, but it is merely a pass-through or a conduit company.	c) The company was not able to demonstrate that it does conduct other activity. d) The DTA does not provide BO definition. e) It is a tax avoidance scheme.

Supreme Court Decision	There is no information if the DGT challenged the Court Decision to the Supreme Court	**<u>The Taxpayer won the case at the Supreme Court</u>** The Supreme Court provides its arguments that: **a)** The company is BO, and the loan period is for more than 2 years; Further, the Supreme Court agrees that based on the Lex Specialis derogat lex generalis, the DTA should apply. DTA is introduced to mitigate any double tax imposition. On the basis that DTA is applicable, and the loan period is for more than 2 years, the WHT exemption under the article 11 paragraph 4 of the Indonesia – NL shall apply.	**<u>The DGT won the case at the Supreme Court</u>** a) There is a strong technical argument for the Supreme Court that the BO of the transaction is not Comfeed Trading BV, but it is the company (JCI), therefore the Supreme Court takes the dissenting opinion raised by Judge Masdi: b) The requirement to get benefit from the DTA that the recipient of income is the BO and is a resident of other contracting state as required by Article 11 paragraph 2 and 4

		b) Certificate of Domicile is available and can be verified by the Judges. Based on the above, the Supreme Court grants the Civil Review application submitted by the company.	c) The BO requirements are regulated under article 4 paragraph 1 and 2 letter (g) of the Decree No. 62/2009 as amended by Decree No. 25/2010 d) COD is not evidence to confirm the BO status e) JCI should be the BO based on the flow of income from the dividend f) Though all domestic requirements have been satisfied in which the COD is submitted – the DGT is able to demonstrate that JCI is the BO of the interest income Based on the above – the Supreme Court decides to grant the Civil Review application and to annul the Tax Court Verdict

The above three decisions made by the court show that there are inconsistencies taken by the Court in determining the BO.

The most obvious comparison would be taken by the Supreme Court on the PLN case at the Supreme Court level and Japfa case at the Tax Court level with the following notes:

PT PLN Case:

1. The Supreme Court **did not** discuss why the SPV was established (OpCO) and was concluded as BO.
2. The Supreme Court **did** discuss that the interest received by the SPV, was not used to settle other claim in the same form of interest – in this case, payment was in the form of dividend.
3. Based on the regulation applicable in 2009, the requirement to pay to other party does not include payment of dividend

The review and analysis exercised by the Supreme Court is based on the domestic approach – especially the requirement to pay to other party. Though the approach departs from the DTA approach i.e., referring to the OECD Commentary on the BO, but the position is taken to respond to the DGT's position.

PT Japfa Comfeed Indonesia case:

1. The Supreme Court fails to review the overall transaction and **did not** discuss the requirements of the BO under the DTA, nor did it discuss its meaning in the context of international tax
2. If the BO is PT Japfa Comfeed Indonesia, the case **would not** satisfy the provision of WHT Art. 26 in the first place as it is domestic transaction and hence the 20% rate shall not be applied.

The Supreme Court decision did not consider similar case at earlier time (PT PLN Case) which is contradictory with the technical position taken the Supreme Court.

III. Considerations In Interpreting The Dta Provisions And The Status Of OECD-Commentary

A. OECD MC AND VIENNA CONVENTION ON TAX TREATY

The expectation on how to interpret international treaties are explained in Articles 31 and 32 of the Vienna Convention on Law of Treaty ("VCLT"). Considering this fact, wherever a treaty is being applied, the VCLT rules are the appropriate framework for its interpretation. A treaty shall be interpreted in good faith in accordance with its ordinary meaning.

Indonesia has not signed the VCLT, however it considers the VCLT as part of customary international law and therefore considers itself bound by its provisions, which codifies basic principles of international law. This expression is included in the DGT Decree No. SE 52/PJ/2021 dated 21 December 2021[23].

[23] Indonesia, the Director General of Taxes Decree No. 52/PJ/2021 regarding General Guidelines on the Interpretation, and Implementation of Provisions in the DTA, dated 21 December 2021

The Committee on Fiscal Affairs acknowledges the special importance of Commentary in the development of international fiscal law. It further states that:

> *"……. Although the Commentaries are not designed to be annexed in any manner to the convention signed by Member countries, which unlike the Model are legally binding international instruments, they can nevertheless be of great assistance in the application and interpretation of the conventions and in the settlement of any disputes"*

The provisions of the OECD MC and its Commentaries clearly state that their rules are not legally binding but might be followed in practice even in case of non-members of the OECD[24]. Despite of its non-binding status, there is no restriction for any parties to refer to the Commentary, especially if the provisions are identical with the OECD MC. The legal binding status may be subject to the reservations, and observations by the countries expressed in the OECD Commentary.

This binding or non-binding status can also be connected to the provision in the VCLT that the treaty should be interpreted in good faith. The way the good faith of the respective country is best measured by referring to the ultimate source of reference, the Commentary.

B. THE DUTCH TAX POLICY IN DTA INTERPRETATION

The Netherlands is a member of OECD countries and therefore, it is without doubt that it must refer to OECD MC when negotiating a treaty with any treaty partners. However, it must be flexible if it is dealing with developing countries which may instead prefer to adopt the UN Model.

There is a formal guideline issued by the Dutch government regarding treaty negotiations under the *Notitie Fiscaal Verdragsbeleid 2011*[25]. Though this guideline does not provide details but only general guidance[26], it is nonetheless relevant for the case as it addresses DTA with Indonesia. The said guidance can be summarized as follows:

1. In 2013, the government is willing to include anti-abuse measures in the treaties to be signed by twenty-three developing countries. Those countries include Ethiopia, Ghana, Kenya, Malawi, Ukraine, Uzbekistan, and Zambia.

2. Further, the government is also willing to include the same anti-abuse measures through the Multilateral Tax Convention ("MLI"). In 2017, both the Netherlands and Indonesia signed the MLI, which allows for an anti-abuse provision to be added to the DTA following mutual agreement on a specific provision. The Convention had been ratified by the Netherlands in March 2019 whilst the Indonesian government ratified the same on 28 April 2020 – accordingly, the MLI entered into force on 1 August 2020 for Indonesia.

C. INDONESIA'S POSITION IN INTERPRETING DTA PROVISIONS

There has been no official guidance on how to interpret the provisions of the DTA until 2021. In practice, the taxpayers, the DGT, and the judges at the Indonesian court level have followed the provisions of

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[24] GLUKH, Maryna. (2021). "The OECD Model Tax Convention and its commentaries as a source of interpretation of double taxation treaties in Ukraine." *Juridical Tribune Volume 11, Issue 2*,, p. 263.

[25] Aidha, Nurul C & Maftuchan, et al. (2019)."How the Indonesia-Netherlands tax treaty enables tax avoidance - An analysis of the treaty and Indonesian court decisions on corporate tax disputes." *Perkumpulan Prakarsa dan SOMO*,p. 40.

[26] The guidance is updated regularly from time to time as required.

OECD or UN Commentaries in interpreting the DTA provisions.

The DGT Decree No. SE 52/2021 ("SE-52") regarding Guidance in Interpreting the Provisions of the DTA was issued on 21 December 2021. In the DGT's consideration, the issuance of SE-52 was meant to internally respond to certain questions in relation to the interpretation of DTA provisions to mitigate potential tax disputes. SE-52 aims to provide consistent and similar understanding of the DTA provisions amongst the tax officers.

Point 2.b of the letter stipulates that DTA normally refers to the OECD or UN Model. Some DTAs signed by Indonesia, in addition to standard model provision, may contain also other provisions such as Protocol, Exchange Notes, Memorandum of Understanding.

SE-52 provides important guidance that is consistent with the VCLT that DTA provisions must be interpreted with good faith and parties shall refer to their ordinary meanings in accordance with the context, purpose, and intention of the DTA.

D. SCHOLAR'S VIEW ON WHETHER THE COMMENTERY IS LEGALLY BINDING

The position of the Committee on Fiscal Affairs to the Commentary has invited many scholars to provide their comments – specifically on the interpretation of the position. The suggestion is that the text must not be read whereby we must also understand the status of the Commentary to the MC, the history of the MC, and the position of the respective country adopting the MC like OECD MC.

There was a conference organized by Leiden University in September 2006 on the legal status of the OECD Commentaries. Below is the summary of scholars' view on how the legal status of the Commentary shall be seen and whether it is legally binding[27]:

Scholars' name and position	**Position to support that the Commentary is legally binding for countries signing the DTA[28]**	
	YES	**NO**
Niels Blokker[29] Senior Lawyer at the Department of International Law at the Netherlands Ministry of Foreign Affairs and Professor of International Institutional Law at Leiden	……It is clear that, to the extent that OECD Member countries copy Model Law provisions in their bilateral agreements, it is **considered desirable** that they also follow the interpretations given in the Commentaries….	

[27] Douma, Sjoerd., Engelen, Frank. (2008) "The legal Status of the OECD Commentaries. *Conflict of Norms in International Tax Law Series Volume 1, IBFD*.

[28] It is assumed that the provisions of the DTA are identical or in substance like the provisions of the OECD Model Tax Convention.

[29] Blokker, Niels. (2008) "Skating on thin ice? On the law of international organizations and the legal nature of the Commentaries on the OECD Convention." I*BFD.*

Hugh Thirlway[30] Principal Legal Secretary of the International Court of Justice and former Professor of International Law at The Geneva Graduate Institute of International Studies		….there is no legal reason why an instrument which is itself not binding and even one which so states, could not incorporated by reference in an binding agreement the declaration contained in it, that **it was not intended to the binding**, is not equivalent to a prohibition against treating it, by agreement as binding and that declaration would thus, in the circumstances contemplated, fall or be overridden
Frank Engelen[31] Professor of International and EU tax law at Leiden Law School and fellow of the International Tax Center Leiden. He is also a Tax Partner and Member of the Board of Management at PwC Netherlands and a substitute Judge at the Court of Appeals of The Hague		…..he emphasizes that **he is not and never has been of the opinion** that the recommendation of the OECD Council regarding the OECD Model and Commentaries are as such legally binding on the OECD Member Countries that voted for them….
Hans Pijl[32] Leiden University and Tax Partner at Deloitte		… argues that the Commentaries **are non-binding.**
David Ward QC[33] Partner at Davies Ward Philips & Vineberg.		….it is clear that every OECD Member country understands that the OECD Commentaries **are not intended** to have any binding effect in law, whether international law or domestic or municipal law.

[30] Thirlway, Hugh.(2008) "The role of the International law concepts of acquiescence and estopel", "Afterword."*IBFD*..

[31] Engelen, Frank. (2008) "How 'acquiescence' and 'estoppel' can operate to the effect that the states parties to tax treaty are bound to interpret the treaty in accordance with the Commentaries on the OECD Model Tax Convention."*IBFD*..

[32] Pijl, Hans. (2008). "Beyond legal bindingness." *IBFD*..

[33] Ward, David A. (2008). "Is there any obligation in international law of OECD Member countries to follow the Commentaries on the Model?."*IBFD*..

Friedl Weis[34] Professor of International and European Economic Law. The University of Vienna		…whether the Commentaries must be taken into account under the general rule of interpretation embodied in Art 32 VCLT…
Jhon Avery Jones [35] Special Commissioner of Income Tax, Chairman of the VAT and Duties Tribunals, and Visiting Professor of International Tax Law at the London School of Economics		….Effectively, it means that the Commentaries have " **high persuasive value"** as the Canadian Supreme Court said in Crown Forest" but stop short of being legally binding.
Sjoerd Douma Leiden University	…..there are good arguments that Community law indeed leads to the **obligation for Member States to interpret their tax treaties in accordance with the Commentaries**…	

The above shows that most of scholars consider that the Commentary is not legally binding, and this is so even for those members. However, it is noted that some views believe that if parties agree to adopt the OECD MC, it is expected that they are aware of bindingness of the Commentary.

E. NEW CASE LAW IN THE SUPREME COURT POST THE PROTOCOL

The Protocol was effectively applicable on 1 October 2017, and it is expected that both jurisdictions will implement the provisions in their domestic laws thereafter.

There are three cases (one of which being the PT Japfa Comfeed Indonesia Tbk vs DGT) decided by the Supreme Court in 2020[36] which are not consistent with the spirit of the Protocol. The Supreme Court annulled the decision taken by the Tax Court on which it does not address the BO issue by referring to the provision required by Article 6 of the Protocol that in resolving BO disputes, interpretation adopted by the OECD Commentary much be referred.

The Supreme Court considered technical arguments made by one of the Tax Court judges who included his dissenting opinion that:

[34] Weiss, Friedl. (2008). "Interpretation of tax treaties in accordance with the Commentaries on the OECD Model Tax Convention under the Vienna Convention on the Law of Treaties." *IBFD*..

[35] Jones, John Avery. (2008)."The binding nature of the OECD Commentaries from the UK point of view." *IBF*D.

[36] See the Supreme Court decision No. 2666/B/PK/PJK/2020 dated 26 August 2020, No. 2697/B/PK/PJK/2020 dated 26 August 2020, and No. 2748/B/PK/PJK/2020 dated 26 August 2022.

1. BO requirements recognize the ultimate persons so the resident (in this case the recipient of income) may not be the BO
2. The company was not able to demonstrate that it does not perform other activity, other than being the interpose company
3. DTA does not provide BO definition
4. It is a tax avoidance scheme

The argument that BO is not defined or discussed in the DTA is misleading. It is not defined under article 3(2) of the DTA, but it is widely discussed in the OECD Commentary[37], in which the Protocol emphasizes that both authorities must consider.

The question on whether the Tax Court is binding with the Protocol to refer to OECD Commentary when reviewing the BO case, is discussed also in the commentary. It is believed that the OECD Commentary is to be used not only by tax administrators and the taxpayers, but the usage of it shall also be extended to the judiciary or the courts[38].

IV.Conclusion And Recommendation

A. Conclusion

Even though it may be easy to conclude that the Commentary is designed as reference to interpret the treaty, it shall not be one of the legal binding instruments, as expressed by the Committee on Fiscal Affairs. On this basis, most of the scholars view that there is no legal binding status of the Commentary to parties signing the DTA.

The VCLT, though requires good faith in the interpretation of the treaties, and the position Indonesian government takes on interpreting the treaty should pave the way for us to recognize that there is no such rejection on referring to the Commentary in interpreting the DTAs. Though there is a precedence that this position is not supported by the latest Supreme Court decision in 2020 given that its verdict derived from interpretation of the BO departs from the interpretation of the Commentary.

The Dutch, being the one that proposed Article 6 of the Protocol, shows that it is their intention as well as position that the DTA must be interpreted by referring to the Commentary, especially the term of BO – as most of cases disputed by the DGT.

Considering the status of bindingness of the Commentary, the Dutch considers that it is necessary to include in the Protocol the provision to refer to the Commentary in interpreting the DTA, specifically on the term 'BO.' In fact, the BO dispute that is resolved at the domestic settlement may not be to an extent represent the justice and fairness. Therefore, it would be useful in certain cases to escalate the issues to the Mutual

[37] See section 3A on the international perspective of BO under the OECD Commentary approach.

[38] OECD. (2014). op.cit. .P. 29.3 of the 2014 OECD Commentary 2014 stipulates that "bilateral tax treaties are receiving more and more judicial attention as well. The courts are increasingly using the commentaries in reaching their decisions. Information collected by the Committee on Fiscal Affairs shows that the Commentaries have been cited in the published decisions of the courts of the great majority of Member countries. In many decisions, the Commentaries have been extensively quoted and analyzed, and have frequently played a key role in the judge's deliberations. The Committee expects this trend to continue as the world-wide network of tax treaties continue to grow and as the Commentaries gain even more widespread acceptance as an important interpretative reference".

Agreement Procedures ("MAP") between two competent authorities in which the effectiveness on referring of the Commentary can be maximized.

B. Recommendation

The Protocol, specifically on the BO requirements, was introduced to ensure that both countries consistently apply the Commentary when it becomes necessary to interpret the DTA provisions. However, it is noted that there is still cases in Indonesia in which the decision made by the Court encourages inconsistent positions taken by the DGT in interpreting the term 'BO.'

For both countries to obtain benefit of this Protocol and also in general treaty application, following recommendations can be considered:

1. Both countries may want to review and discuss the effectiveness of the Protocol provisions and resolve if there are still issues in applying those provision – especially on the interpretation of DTA.
2. Indonesia may want to also review all DTAs signed and if necessary to introduce the same provision in the DTA to provide more certainty for investors in dealing with treaty interpretation – specifically Articles 10, 11 and 12 regarding Dividend, Interest, and Royalty, respectively.
3. Indonesia must also review its positions at both the level of the DGT and the Tax Court in relation to the treaty definition to ensure consistency – it may also be worthwhile to regularly conduct international tax training to the relevant institutions.
4. For the Dutch, it should promote the MAP settlement if any case on DTA interpretation involves taxpayer who is a resident of the Netherlands – this dispute settlement mechanism should be a good forum to align Indonesia to the consensus reached behind Article 6 of the Protocol.

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