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Tax alert

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Hong Kong – Indonesia comprehensive double taxation agreement enters into force

Hong Kong signed a comprehensive double taxation agreement (DTA) with Indonesia on 23 March 2010. The DTA entered into force on 28 March 2012 and will have effect in Hong Kong for the years of assessment beginning on or after 1 April 2013.

Background

The DTA with Indonesia was signed in March 2010 (see Tax alert Issue 6 – March 2010), but was only recently ratified by Indonesia. The Indonesian DTA potentially makes Hong Kong one of the more attractive locations for investing into Indonesia. Under the Indonesian DTA, the withholding tax on dividends, interest and royalties is as follows.

	Indonesia Non-treaty Withholding Rate	Treaty Withholding Rate
Dividends	20%	5%[1] / 10%
Interest	20%	0%[2] 10%
Royalties	20%	5%

[1] Withholding tax on dividends is reduced to five percent where the recipient is a qualifying person holding at least 25 percent of the capital of the paying company.

(2) Withholding tax on interest reduced to nil where the recipient is the Government of the Hong Kong Special Administrative Region (HKSAR), the Hong Kong Monetary Authority (HKMA) or a statutory body, or financial establishment appointed by the Government of the HKSAR and mutually agreed upon by the competent authorities of the two Contracting Parties.

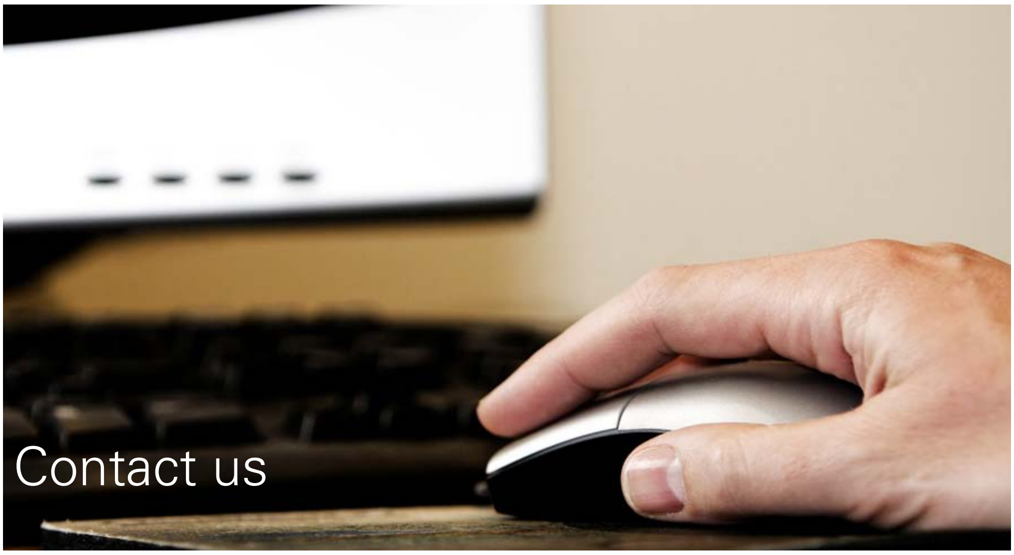
Hong Kong's DTA with Indonesia compares more than favourably with the DTAs signed by Indonesia with Singapore and the Netherlands and as such, we should see Hong Kong considered as a location for direct investment into Indonesia. For instance, the DTAs with Singapore and the Netherlands only provide for a 10 percent withholding tax rate on dividends compared with five percent under the DTA with Hong Kong.

The DTA between Hong Kong and Indonesia provides a complete exemption from withholding tax on capital gains derived from private share transfers, subject to certain limitations. The withholding tax rate on royalties in five percent compared with 15 percent under the DTAs with Singapore and the Netherlands.

Given the favourable nature of the DTA, companies will need to ensure that their investments into Indonesia include 'substance' to avoid denial of benefits under the DTA.

However, a question remains on the application of the DTA with respect to dividend income. For the reduced withholding tax rate of five or 10 percent to apply, Indonesia requires that the income must be subject to tax in the other jurisdiction. As dividends are not subject to tax in Hong Kong, it remains unclear whether the reduced withholding tax could apply to dividends. It is understood that the Hong Kong Inland Revenue Department has sought clarification from their counterparts in Indonesia on this aspect, although the issue has yet to be clarified.

Provided these uncertainties are resolved, Hong Kong should be well placed to become the preferred investment location for investment into Indonesia.



Contact us

For more information, please contact:

Corporate Tax, KPMG China

Khoon Ming Ho
Partner in Charge, Tax
China and Hong Kong SAR
Tel: +86 10 8508 7082
khoonming.ho@kpmg.com

Ayesha M. Lau
Partner in Charge, Tax – Hong Kong SAR
Tel: +852 2826 7165
ayesha.lau@kpmg.com

Chris Abbiss
Partner
Tel: +852 2826 7226
chris.abbiss@kpmg.com

Alice Leung
Partner
Tel: +852 2143 8711
alice.leung@kpmg.com

Jennifer Wong
Partner
Tel: +852 2978 8288
jennifer.wong@kpmg.com

Darren Bowdern
Partner
Tel: +852 2826 7166
darren.bowdern@kpmg.com

Curtis Ng
Partner
Tel: +852 2143 8709
curtis.ng@kpmg.com

Garry Laird
Senior Tax Advisor
Tel: +852 2143 8795
garry.laird@kpmg.com

Charles Kinsley
Principal
Tel: +852 2826 8070
charles.kinsley@kpmg.com

John Timpany
Partner
Tel: +852 2143 8790
john.timpany@kpmg.com

kpmg.com/cn