

# CHAPTER I

## INTRODUCTION

### 1.1 Background

In this day and age, in order for a nation's government to function other than having a visionary leader and competent staff, as well as good legislative support and legitimacy by the people, the nation needs government income in order to function properly. It is just not to pay the staff's wages, but it is also to support the government infrastructure that are generally goods and services not funded or supplied by the private sector such as defense, roads, bridges and ports, merit services such as hospitals and schools, welfare payments as well as the federal government's welfare programs.<sup>1</sup> To do this, many nations engage in international trade and through taxation of goods and services in order to generate public revenues. As every nation would do this, there is the need to prevent the international double taxation.

Tax treaties represent an important aspect of international trade of many countries. Almost every nation began with the prevention of international double taxation through unilateral means, as it had the advantage of making the provisions relatively easier because there is no need to involve or depend on other countries.<sup>2</sup> In addition, its application is easy because it is fully based on the provisions of the

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<sup>1</sup> "Taxes and Government Revenue," Worldbank.org, Accessed March 14, 2023, <https://www.worldbank.org/en/topic/taxes-and-government-revenue#:~:text=Collecting%20taxes%20and%20fees%20is,services%20for%20citizens%20and%20businesses.>

<sup>2</sup> Jaja Zakaria, S.H., M.Sc., in *Perjanjian Penghindaran Pajak Berganda Serta Penerapannya di Indonesia*, 1<sup>st</sup> Ed. Jakarta, PT. Raja Grafindo Persada, 2005, p. 10

national law of a country. However, there are clear disadvantages as there are aspects of international double taxation that cannot be solved unilaterally concerning the interests and tax systems and laws of other countries. For instance, double taxation that arises as a result of having multiple residents or more commonly known as dual citizenship cannot be solved unilaterally because it involves the interests, systems and tax laws of other countries. In addition, provisions on unilateral double tax avoidance generally only regulate tax avoidance for domestic taxpayers, not stipulating tax avoidance for foreign taxpayers.

As a result of the existence of aspects of double taxation that cannot be solved unilaterally, another effort is needed to prevent double taxation, namely a bilateral tax treaty between the two countries. This is known as the Double Taxation Avoidance Agreement or henceforth known as the DTAA. The DTAA is a treaty signed between two countries, which by eliminating certain aspects of international double taxation, promotes the exchange of goods, services and investment of capital between the two countries. Its main purpose is to divide the rights of taxation the contracting countries, in order to avoid differences, to ensure tax payers' equal rights and security and prevent the international fiscal evasion of tax.<sup>3</sup> The word 'Avoidance' in the Double Taxation Avoidance Agreement means that within the agreement ensures taxpayers do not end up paying taxes twice on the same income according to the mutual agreement made between the two states.

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<sup>3</sup> *Ibid.*

The DTAA is quite commonplace in this day and age of international trade as an effect of how beneficial it is for taxpayers to avoid double taxation and for states to eliminate tax evasion. As of 2020 there are over 3,000 bilateral tax treaties that are in effect and continuously growing.<sup>4</sup> Such treaties are interpreted, applied and based on an agreed upon the international standard from the United Nations Model Taxation Between Developed and Developing Countries (United Nations Model Conventions) and the Organization of Economic Cooperation and Development Model Tax Convention on Income and Capital (OECD Model). The earlier models before the UN models and OECD models were made to ensure if the diplomat of another country is in discussion with another country, the diplomat would not be discriminated against, and these newer agreed models set by the UN and the OECD is to ensure developing nations are not prejudiced against by a developed nation during tax treaty negotiations.

The Double Taxation Avoidance Agreement gives freedoms and force commitments on the two contracting States, however, not on third parties like taxpayers. Be that as it may, tax treaties are clearly planned to benefit taxpayers of the contracting States.<sup>5</sup> Regardless of whether treaties do so rely upon the domestic law of each State. In certain States, treaties are self-executing. That is, when the deal is finished up, it presents freedoms on the occupants of the contracting States. In different states, some extra activity is important (for instance, the arrangements of the deal should be ordered into domestic law) previously benefits under a

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<sup>4</sup> Brian J. Arnold, "An Introduction to Tax Treaties," un.org, Accessed March 13, 2023, [https://www.un.org/development/desa/financing/sites/www.un.org.development.desa.financing/files/2020-06/TT\\_Introduction\\_Eng.pdf](https://www.un.org/development/desa/financing/sites/www.un.org.development.desa.financing/files/2020-06/TT_Introduction_Eng.pdf).

<sup>5</sup> *Ibid.*

settlement can be given to inhabitants of the contracting states. An example would be on an agreed upon tax treaty, the DTAA between two countries could override the domestic taxing statute of a particular country to a certain percentage lower than a nation's national tax act. This is entirely dependable on the assessment which one is more beneficial to the nation contracted, applicable either governed to the provisions of the particular DTAA or the provisions national tax act of a nation.

As all tax treaties have a complex relationship with the domestic legislation in many countries, it is no different with the DTAA. As the international sphere changes, countries progress, democratic leadership changes in each nation, policies change, laws changes, new DTAA's are concluded and existing ones are amended so it is updated to continuing economic trends between contracted states within the treaty. This is no different with Indonesia and Singapore as there are ratifications or changes within their previously agreed upon DTAA. In this case, we shall focus more towards the bilateral relations between Indonesia and Singapore and what they have in common. Based on historical records of Singapore, Indonesia and Singapore established bilateral relations after the establishment of ASEAN in 1967 to be precise.<sup>6</sup> Over the years Indonesia and Singapore have kept a cordial of exchanges of significant level visitation to one another's state, solidified by a solid monetary participation across a wide scope of areas, such as health, defense and environmental sectors.<sup>7</sup> Exchange with Singapore is significant for Indonesia, as

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<sup>6</sup> "Singapore Establishes Diplomatic Relations with Indonesia," History SG, Accessed February 20, 2022, <https://eresources.nlb.gov.sg/history/events/ccdd6bc9-cd18-4acb-9c45-1d60b38d8a79>.

<sup>7</sup> Francis Chan, "RISING50: Celebrating 50 Years of Bilateral Relations between Indonesia and Singapore," The Straits Times, Accessed February 20, 2022,

Singapore furnishes the connection to exchange with the remainder of the world as it is situated on one of the most active ocean paths in the Strait of Malacca, which fills in as one of the world's fundamental exchanging centers as well as Indonesia's top unfamiliar venture towards numerous affordable undertakings. The equivalent for Singapore as business with Indonesia, for example, exchange and trade is the normal inspiration of the two countries unfamiliar relations as Indonesia's non-oil and gas products to Singapore are the most noteworthy in the locale. Albeit, a few remarkable issues emerge, for example, Indonesia having the “you need us” outlook even with great relations with Singapore and the need for economic cooperation disputes and tax concerns between these two countries which brought upon these two nations to start drafting a bilateral agreement as it also encompasses foreign direct investment activities.

That being said, Analyzing the Double Taxation Agreement especially regarding Foreign Direct Investment or FDI is important in trying to comprehend and interpret the results of the bilateral treaty between two state actors. FDI and taxation goes hand in hand in economic projects that happens between Indonesia and Singapore which is open for interpretation, but exact tax rates in between states need to be interpreted including the effects from outside factors like an accountability system such as comprehensive tax regulations as to reduce any legal exploitation or evasions in regards to international business transactions. In addition, understanding the internal components in both Indonesia and Singapore

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<https://www.straitstimes.com/singapore/rising50-celebrating-50-years-of-bilateral-relations-between-indonesia-and-singapore>.

as a state would be of great interest in analyzing and evaluating for possible solutions as a potential input for the respective states to adopt. Addressing these bilateral issues including internal state factors and external international factors present quite the predicament. Which requires appropriate and ‘win-win’ diplomatic outcomes required by both nations based on their shared history and political relations.

## **1.2 Research Question**

Though the issue of this thesis is content lengthwise and extensive, the writer would focus especially to one of the main affected aspects; Foreign Direct Investment. Secondly, the thesis will mainly focus on the DTAA and the changes going into effect and the events that would influence the main aspect in these timelines as the writer’s study case analysis. Finally, this thesis will also discuss the DTAA and what it encompasses as well as assessing the outcome and effect of the DTAA and seek possible solutions for the treaty and the states involved by evaluating the result of the aforementioned aspects. With this, this writer proposes the following research questions to be explored throughout this thesis:

- 1. What are the factors that influenced the changes in the Double Taxation Avoidance Agreement between Indonesia and Singapore?**
- 2. How are the changes in Double Taxation Avoidance Agreement will affect the growth of FDI between Indonesia and Singapore?**

### **1.3 Research Objective**

This thesis is aimed to understand, explain and analyze the bilateral treaty made with Indonesia and Singapore. Specifically, the bilateral agreement of the Double Taxation Agreement that affects Foreign Direct Investment. Secondly, it is aimed to show how this relationship is held with bilateral relations in the aforementioned timeline, where this treaty has been put into service. Add to that, the variables that contributed to push the need for new changes in the treaty within Indonesia's and Singapore's cooperation through data and reports on its effect towards the aforementioned states while also understanding the problems that were found during the timeline that this thesis would expand upon.

### **1.4 Research Significance**

The writer believes that this is still an issue which is relatively unknown therefore is considered a new and fresh topic as a thesis to be discussed and broadened. This research will accommodate the development on Indonesia and Singapore's relationship while also expanding and analyzing on the impact this has on their bilateral agreement. It is also crucial to understand the significance with Indonesia's changes in tax agreement with Singapore as well as internal state factors due to outside international factors as well as awareness on such issues should be paramount as so that readers gain a better understanding on the previous and new and/or revised treaty. The goal of this thesis would be that the readers may gain significant understanding on the more 'hated' economical aspect which is the

tax system so that the readers may understand, especially for those that pursue political and/or economical focused aspect of the working industry.

### **1.5 Structure of Writing**

The first chapter of this thesis is to introduce the topic of the research, followed by its significance, and criticalness while likewise featuring its objective and ingraining some significant key point issues that are connected with the accompanying chapter.

The second chapter of this thesis is divided into two sections, Literature Review and Theory and Concepts. The Literature Review is utilized as the foundation and a way to establish for responding to the question regarding the factors that influenced both Indonesia and Singapore to change some content of their Double Taxation Avoidance Agreement. Theory and Concepts likewise is used to make sense of the structure that are utilized as a starting point for investigating facts for this research.

The third chapter of this thesis focuses on Methodology as the focal point, which is the technique used to organize this research analysis to ensure reliable valid results that explains their aims and objectives. This also incorporated the research approach, the research method, data collection technique, and data analysis technique in order to compile the information for this thesis.

The fourth chapter of this thesis is the significant focal point of this research. It proposes the information gathered while making arguments as per the theory and concept to address and answer the research question of this thesis.



The fifth chapter of this thesis will be consisting of the conclusion and recommendation where the thesis offers a summary of the research and gives ideas in regards to the eventual fate of the research being referred to.

