

# CHAPTER I

## INTRODUCTION

### 1.1 Background

Tax is a mandatory contribution to the state to be allocated from an individual or legal entity which has the nature of minimum standard requirements to be paid as provided by law, the contribution given shall not be directly rewarded because the funds will be immediately stored for later use on purposes of the state and the public's prosperity.<sup>1</sup> Tax liability is a form of community involvement in public activities by the community and government.<sup>2</sup>

According to Article 1 (1) Law No. 16 Year 2009 regarding General Provisions and Tax Procedures, tax is a mandatory contribution to a country that is indebted by an individual or a legal entity, by not obtaining direct remuneration and used for the purposes of the state for the greatest possible prosperity of the people. Based on P. J. A. Andriani, tax is a public duty to the state that can be imposed owed by those who are obligated to pay under general rules with no immediate reappraisal and whose purpose is to finance general expenditures due to the duty of the state to administer the government.<sup>3</sup> Every state has their sovereignty to tax the income received in that country over both the population and non-citizen of the country. This authority is reflected in the domestic legislation, which is based on the principle of taxation adopted by that country.

---

<sup>1</sup> Russel Butarbutar. *Hukum Pajak Indonesia Dan Internasional*. Bekasi: Gramata Publishing, 2017., p. 2

<sup>2</sup> *Ibid.*

<sup>3</sup> *Ibid*, p.1.

There are several taxation principles commonly adopted by a state in the taxation over income, such as the principle of domicile, source, the principle of citizenship and territorial deeds.<sup>4</sup> If we discussed based on the principle of taxpayer domicile taxed in the country where the taxpayer is domiciled. In general our country applies the principle of worldwide income, which means the income will be taxed in the country domicile either obtained from domestic or abroad.<sup>5</sup> Indonesia is one of the countries that use this principle for the treatment of domestic taxpayers, whereas based on the principle of the source of tax imposed based on where the source of income is domiciled.<sup>6</sup> The country adopts the source of taxation for taxpayers abroad so that it can be said that Indonesia actually adopts mixed principle.<sup>7</sup>

Indonesia is a developing country that adopts various characteristics with other developing countries. The taxation system in our country can be an example or a reflection of the characteristics itself. Generally, developing countries will face almost the same problems as social, economic, political and administrative difficulties in the development of a stable public financial system.<sup>8</sup> It is common knowledge that Indonesia currently regulates weak system of avoidance as well as tax evasion by individual business entities or corporations; usually these entities are either local or multinational. In order to minimize this problem, regular tax regulation is indispensable both domestically and internationally in order to

---

<sup>4</sup> *Ibid*, p. 16

<sup>5</sup> *Ibid*, p. 17

<sup>6</sup> *Ibid*, p. 17-18

<sup>7</sup> *Ibid*, p. 18

<sup>8</sup> Hendarto Oetomo - Olina Rizki - Ngakan Putu. *Tax Treaty is Easy*. Vol. Memahami Perjanjian Penghindaran Pajak Berganda (P3B) . PPM Manajemen. p. 2

provide protection against the interests of tax revenue. The crucial one is tax revenue derived from cross border transaction activities that finance the needs of the government to perform its duties perform its functions as a state organizer.<sup>9</sup> Treaty exist for the purpose collision occurred to the field of taxation jurisdiction between countries with capital and states in need of capital with a stable economic condition, the purpose is that each country from different continents will be able to exercise protection of the right taxation by making an agreement in the field of taxation. Basically it's an agreement that approved by two state to apply modification to the laws and regulations of taxation respectively.<sup>10</sup> The objective of this agreement is to provide inter-state trade facilities and international investment flows, it will also serve as a tool or mediator for both countries in implementing domestic regulations in order to avoid tax evasion activities and avoid international double imposition.<sup>11</sup>

The purpose of the establishment of the tax treaty is to avoid double taxation that burdens the individual or organization when performing business between countries which conduct international transactions, increase the state's capital investment, provide more human resources, and exchange of financial information to prevent tax evasion and provide equal position in the case of taxation between the states who signed the agreement.<sup>12</sup> With its existence, Tax Treaty is expected to facilitate transactions conducted with international trade and

---

<sup>9</sup> Surahmat, Rachmanto. *Persetujuan Penghindaran Pajak Berganda: Sebuah Pengantar*. Jakarta: PT Gramedia Pustaka Utama. 2000., p. 21

<sup>10</sup> Hendarto Oetomo *Op.Cit*, p. 3

<sup>11</sup> *Ibid*, p. 4

<sup>12</sup> *Ibid*

international investment flows between countries. This treaty can be a medium for two countries to implement the domestic regulations so as to reduce the occurrence of tax evasion practices and avoidance of international double taxation. The principles that used as the foundation regarding taxation are principle of domicile, principle of resources and the principle of nationality. The method of taxation rights in various countries, to avoid multiple taxation among others are:<sup>13</sup>

a) Unilateral Taxation Methods

This method provides the state of the Republic of Indonesia legal force that regulates the society or international body and is unilaterally defined only by the state of Indonesia, in other words no one can regulate other state because geographical authority and sovereignty of Indonesia.

b) Bilateral Taxation Methods

This method considers the interest of both countries written within an agreement (tax treaty) in calculating the tax imposed. Indonesia does not have full authority to apply the amount of tax owed by foreign residents or corporation of the two countries that have entered into an agreement. Thus Indonesian tax regulations do not apply when there is a tax treaty in accordance with *lex specialis derogat legi generali* principal<sup>14</sup>.

---

<sup>13</sup> Russel Butarbutar .*Op.cit.* P.256

<sup>14</sup> Setiawan, A. *Petunjuk Praktis Pemotongan dan Pemungutan PPh*. Bogor: Ghalia Indonesia. 2010., p. 183

*First* of all, methods in applying Tax Treaty are divided into several options such as United Nation Model (UN), Organization for Economic Cooperation & Development (OECD) Model and United States Model. The Article governing the method of avoidance of double taxation in the UN Model is Article 23, which in general is the procedure for the avoidance of multiple taxes conducted juridical. This Article expresses the policies of each country in relation to the treatment of income derived by its "residents" from abroad and on taxes paid or levied in other countries. Basically, this regulation regulates the treatment of "residents" of each country so as not to touch the tax imposition in the state's source. The formulation provided by the United Nation Model consists of exemption and credit method.

*Second*, the multiple avoidance methods adopted by the OECD Model differ slightly from the UN although this model also provides an alternative method of exemption or credit method. Paragraph 1 of Article 23 A of the OECD is not different from the UN Model because OECD model is used as the basis for the preparation of UN Model.<sup>15</sup> The thing that distinguishes these two methods is paragraph 2 which is in the OECD Model of exemption does not include article 12 on royalties. This is reflected in the overall principle of the OECD Model which provides that the right to taxation of royalties be granted entirely to the country of domicile, therefore there is no need for exemption of royalties in the domicile country.<sup>16</sup>

---

<sup>15</sup> Surahmat, Rachmanto. *Op.Cit.*, p. 265

<sup>16</sup> *Ibid*, p. 255

*Third*, the United States Model of the method of avoidance of double taxation differs from OECD and UN Model. Americans apply an ordinary credit with a credit limit known as general limitations.<sup>17</sup> The types of income are incorporated into categories according to their classification.<sup>18</sup> There are 8 income categories, if an income does not fit in a category than said income is included in the category of general limitations.

Approval between the Government of the Republic of Indonesia and the Government of Japan regarding the Avoidance of Double Taxation and the Prevention of Tax Evasion Dealing with Taxes on Income and these are some articles that represent the subjects and objects covered that effective since January 1983.

There are several articles that may be highlighted to view the big line of the content of the tax treaty regulation. First of all as written in Article 2 of the treaty that the subject of the taxes of this agreement are (a) in Indonesia, (i) Income tax and (ii) Company Tax including any tax levied on the source, advance payment or another advance payment of any of the above taxes; (iii) Taxes on Interest, Dividends and Royalties (b) in Japan, (i) the income tax and (ii) the corporate tax. Then article 5 of the agreement regulates regarding the scope of object as it explains the purposes of this agreement, the term “permanent establishment” means a fixed place of domicile in which the business of an enterprises wholly and partly carried on. The term “permanent establishment”

---

<sup>17</sup> *Ibid*, p. 267

<sup>18</sup> *Ibid*, p. 271

includes (a) a place of management, (b) a branch, (c) an office, (d) a factory, (e) a workplace, (f) a farm or plantation (g) mine, oil, gas, a quarry or places for natural resources.<sup>19</sup>

Tax levies to increase revenue on an area has actually been implemented since the British colonial era around the year 1881-1816, also known as *landrent*. Due to the absence of data or the basis of the administration of the collection, the tax is better known as *Landrente*.<sup>20</sup> Tax liability is something that must be paid by the taxpaying community in accordance with the income earned in a certain period or period.<sup>21</sup> Regardless of the individual's occupation employment of a worker, professional or entrepreneur, every income earned is always taxable income. Every citizen has the obligation to pay tax even though the contracting is indirectly obtained from the state. The amount of income earned relates to the amount of tax liability owed to the state.

Tax officials and experts in the field of taxation are prohibited from divulging, disseminating, or issuing to an unauthorized person. Tax officials and experts in the field of taxation who violate the confidentiality obligations shall be punished with imprisonment and penalty in accordance with Article 41 of the “*Ketentuan Umum & Tata Cara Perpajakan*” (KUP) Module. In the essence international taxes involve any jurisdiction crossing another country or also known as an international aspect contained in the domestic regulations of a

---

<sup>19</sup> Surahmat, Rachmanto. *Op.Cit.*, p. 112

<sup>20</sup> Samudra, Azhari A. *Perpajakan di Indonesia: keuangan, pajak, dan retribusi daerah*. Jakarta: Gramedia Pustaka Utama, 1995. Pp. 25

<sup>21</sup> Hery. *PPh & PPN Mengenal dan Memahami Konsep PPh serta PPN Ditinjau dari Perpajakan Maupun Akuntansi*. Jakarta: PT Grasindo. 2016. p. 39

country on taxes on income including tax treaty. For Indonesia, the scope of international tax covers the various international aspects contained in the Income Tax or PPh (*Pajak Penghasilan*) and its implementation provisions, which includes tax treaties established by Indonesia and partner countries.

The imposition of international taxes as set forth in the 2008 Income Tax Law has the objective of increasing state revenues in the tax sector, safeguarding taxation justice based on the same taxation principle of the same amount of income (horizontal equity) and different taxes on different income (vertical equity).

Then this rule is also made to maintain Capital Neutrality, Capital Importing Neutrality and National Neutrality.<sup>22</sup> However, with such regulations an event of conflict may still occur regardless of clear lines between the tax treaty that has been signed by our government and the domestic regulation. To draw the big line that raised the conflict is due to the implementation of the law themselves.

## **1.2 Formulation of Issues**

In this research, the author will formulate an issue in accordance to the title of the thesis thus also provide an overview in a general way regarding the issue that is going to be reviewed in purpose to make a guidance in discussing the object of the research to achieve the goal that has been expected and the formulation of the legal review in this thesis are

---

<sup>22</sup> Arles Ompusunggu . *Cara Legal Siasati Pajak* . 2011: Puspa Swara., p. 110

1. How are the procedure on application of tax treaty between Indonesia and Japan?
2. How is the application of taxable income deduction from interest expense under Income Tax Law to business entity by the tax authority in Indonesia?

### **1.3 Purpose of the Research**

Purpose of research is to expand the knowledge and insight of fellow researchers or readers regarding bilateral Tax Treaty between the two countries as a way of avoiding the imposition of international taxation by

- 1) Study and analyze the implementation of tax treaty application between Indonesia and Japan.
- 2) Study and analyze the implementation of taxation on loan interest to business entity by the tax authority.

### **1.4 Benefit of the Research**

#### **1) Theoretical Value**

In this theoretical aspect of research is expected to contribute to broadening the legal science engaged in the field of taxation and international law. The expectation is to gain the knowledge and provide broader point of view regarding Tax Treaty and provide broader point of view regarding Indonesia's commitment to the bilateral agreement in order to get a the targeted research and meet the targets to be achieved.

## 2) Practical Value

For practical aspects, this study is expected to provide an analysis of elements along with legal aspects within the taxation area that have national and international engagement. This thesis is also expected to be a learning material of legal writing for the author. This research will have a role in providing through elaboration the practical values and theoretical that will be conducted by the author. Through this learning pattern of the thesis will raise the knowledge and awareness of scientific paradigm and strengthen the cognition on this field of topic to the optimum relevancy. The development of this thesis will pass the process of accumulation, validation and classification scientifically through research and assessment that will be provided. This thesis hopes to have contribution to all parties of science. The preparation of this scientific paper will provide a great opportunity to its authors, readers and the public

### **1.5 Organizations of Writing**

#### Chapter I: Introduction

This chapter will include background of the topic, formulation of issues, purpose of this research and advantage of the research.

#### Chapter II: Literature Review

In this chapter, the author will elaborate broader and deeper explanations of the components of the topic with its understandings

### Chapter III: Research Methodology

Here the author is going to discuss the relation between the method of legal research chosen and the matter discussed in the thesis.

### Chapter IV: Analysis and Discussion

In this part the author will open the core of the topic by making data comparison between the tax payment coming in to the tax of office and the Tax revenue.

### Chapter V: Conclusion and Recommendation

This final chapter will consist of the conclusion of the legal research that has been discussed through all the previous chapters and the author will provide suggestions or advice regarding the thesis as well.

