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Overseas Parent Company Revenue Becomes Permanent Establishment Taxable Income in Indonesia

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ABSTRACT

The tax authority performs tax audits to increase revenue and ensure that taxpayers carry out their tax obligations properly. During the tax audit, there could be a dispute between the taxpayers and the tax authority in interpreting the tax treaty. This paper discusses the dispute over the results of the tax audit conducted by the tax authorities. By using the method of tax court cases in Indonesia, the interpretation of the tax treaty between Indonesian and China cannot be based solely on text. Other sources are needed, such as the UN model and its commentary, and the domestic income tax regulations of the source country. Using some materials to interpret the treaty can prevent tax reduction and tax evasion. The results found that the tax treaty between Indonesian and China only mentions the tax credit method to avoid double taxation, whereas in this case, it is better to use the tax exemption method to avoid double taxation.

Keywords: Income Tax, Interpretation, Permanent Establishment, Tax Treaty

JEL Classification: G38, G40, H20

INTRODUCTION

The company treats income tax payments as expenses. Therefore, the companies maximally reduce the income tax payments. An income tax payment reduction can increase profits after income tax, and finally, increase the firm value (Wahab & Holland, 2012). Companies with large economies of scale, especially those with extensive business activities abroad, multinational companies, will have more aggressive tax avoidance activities (Rego, 2003). The difference in income tax rates in each country will be used by multinational companies to do tax avoidance (Lee & Swenson, 2008) To increase the value of the company, companies need physical and financial assets in implementing the best strategy. Therefore, intellectual capital is needed in the management of these assets (Putra, Wedasari, & Rahmasari, 2020).

The company's strategy as a taxpayer in implementing tax avoidance is certainly contrary to the objectives of the State, to obtain maximum tax revenues. The difference in information between the two parties, the taxpayer and the State, has resulted in each party doing its best to achieve its goals. In this case, the state represented by the tax authority carries out a tax audit to ensure taxpayers do not carry out tax avoidance that is detrimental to state tax revenue. When conducting an audit, there is an objection from the taxpayer on the result of the audit and there is a dispute between the taxpayer and the tax authority. This study discusses disputes over the results of tax audits that have become a decision of the tax court in Indonesia, the decision number PUT-105690.25/2010/PP/M.VIB 2018.

The dispute discussed in this study is a correction to the tax base of income tax on the taxpayer. According to the tax authority in Indonesia, income from a parent company in China must be attributed to the income of permanent establishments (PE) in Indonesia and subject to income tax in Indonesia. The difference in the interpretation of the tax treaty between Indonesia and China (tax treaty) causes the differences in determining whether the income is subject to income tax. This study explains how the arguments given by the taxpayer, tax authority, and panel of judges in determining which country the income is subject to income tax, and also explains the alternative interpretation of the tax treaty and the consequences of the judge's decision. The taxpayer interprets based on the text, and the tax authority and the panel of judges interpret based on the context. This study explains that it is possible to interpret tax treaty by using external sources of the tax treaty, such as domestic tax regulations of the source country, in this case, Indonesia. As a result of the interpretation and the decision of the panel of judges, there is the imposition of income tax at the same source, the same taxpayer, in 2 different countries. This double taxation should be avoided. To prevent this, this tax treaty provides a solution with a tax credit method. In this case, double tax avoidance with the exemption method is better applied than the tax credit method. Income tax regulations in each country in this tax treaty must regulate the tax exemption method if such a case is repeated.

LITERATURE REVIEW

The tax theory firstly introduced by Adam Smith (1776) which explained State raises sources of funds to meet the needs of public goods and services. As a country, Indonesia relies on tax revenue as a source of funds. By referring to the principles of tax collection introduced by Adam Smith, the tax administration in Indonesia carries out a tax audit process to ensure that the taxpayer has reported and paid income tax according to applicable regulations. Tax audits are also carried out on companies with high risk (Santoso & Erlina, 2020). According to the tax theory, a tax audit is the only tool to prevent tax evasion (Kuchumova (Paramonova), 2017). Tax audit must pay attention to existing risks and can reduce tax avoidance by taxpayers. Therefore, it is necessary to implement an audit strategy. The strategies that can be done include (European Commission, 2006):

1. Arresting taxpayers who do tax avoidance in large enough numbers.
2. Preventing taxpayers from doing tax avoidance even though the potential is still small
3. Preventing individual taxpayers by rechecking audited taxpayers.
4. Preventing taxpayers from doing tax avoidance in general, by auditing taxpayers with certain criteria, for example, taxpayers who are indicated to be doing tax avoidance and providing social benefits, such as doing CSR.

Tax audits to taxpayers in Indonesia influence taxpayers' compliance as measured by the ability and willingness of taxpayers to report and pay taxes voluntarily (Ompusungu & Trisnawati, 2014), because audits based on income tax returns can reduce the taxpayers' desire to make tax reduction (Penata & Widyawati, 2018). The effect of this tax audit does not differentiate whether the audited taxpayer is a multinational company or not. Multinational companies have information that the tax authorities do not have, so they are more flexible in doing tax avoidance, both legally and illegally (Hanlon & Heitzman, 2010; Lietz, 2013). Besides, with larger economies of scale, multinational companies can develop their activities and can do tax avoidance more freely (Rego, 2003). This fact is supported by the study conducted by Dularif, Sutrisno, Nurkholis and Saraswati (2019) which explains that the tax audit does not reduce the tax evasion of taxpayers. Reducing tax evasion can be done by reducing and implementing norms that invite taxpayers to comply (Nurwanah, Sutrisno, Rosidi & Roekhudin, 2018). Other research explained that with a tax audit, managers will be more conservative in reporting their taxes (Brushwood, Johnston, & Lusch, 2018). The inconsistency relationship between tax audit and tax evasion is explained in research conducted by Mendoza, Wielhouwer and Kirchler (2017), concerning the relationship between tax audit and tax evasion is U-shaped. Although the effect of the audit is not the same in compliance with paying taxes, the selected tax audit can increase state revenues and this is consistent with the case discussed in this study.

An increase in institutional shareholders has a positive effect on tax avoidance (Khan, Srinivasan, & Tan, 2017). Long-term share ownership by institutional shareholders will reduce tax avoidance activities (Khurana & Moser, 2013). For the measurement of tax avoidance, Khurana and Moser (2013) used book-tax-difference (BTD). The multinational companies with most of the shareholder institutions, there is the possibility to evade tax by BTD strategy, as long as institutional shareholders are not for a long time, as explained by Khurana and Moser (2013). It can be presumed that in the long term the tax avoidance strategy for companies with institutional shareholders is not in BTD but in other forms, for example, transfer pricing. In the cases discussed in this paper, the company uses transfer pricing as the tax avoidance strategy. This strategy will increase profits and ultimately add the firm value through rising stock prices (Sunarsih, Dewi, & Kireina, 2019).

Tax avoidance can give a positive value to firm value (Fatkur, Ganis, and Firdausi 2018; Zhu, Mbroh, Monney & Bonsu, 2019), give a negative value to firm value (Chen, Hu, Wang, & Tang, 2014; Ftouhi, Amor & Zemzem, 2014), and does not give any influence on firm value (Desai & Dharmapala, 2009). There are differences in the effect of tax avoidance and firm value because the tax avoidance measurements used are effective tax rates (ETR) and BTD. This measurement is not directly related to how much money (cash) can be saved. Tax avoidance, by reducing tax payments, will provide sufficient cash available for new investments and increase firm value (Ni, Huang, Chiang, & Liao, 2019). Besides, actions in tax avoidance and existing risks also have a different effect on firm value (Inger, 2014). The income of companies' in the US that is not sent back to the US will negatively affect the firm value (Inger, 2014). Thus, the income of the multinational companies is better to withdraw to the resident country, because the income withdrawn has a positive effect on the firm value. In the case of this paper, it is seen that multinational companies from China are doing tax avoidance by withdrawing their income from Indonesia to China and paying taxes in China.

In implementing a tax avoidance strategy by transferring income or profit, the multinational companies should consider the existing tax treaty between the source country and the resident country, especially when interpreting the treaty. The interpretation of a tax treaty can be different between the taxpayer and the tax authority and result in a dispute. The Vienna Convention provides a way to interpret the tax treaty. Article 31 (1) of the Vienna Convention on the Law Treaties (VCLT) stated that a treaty shall be interpreted in good faith by the ordinary meaning to be given to the terms of the treaty in their context and the light of its object and purpose. The definition of "context" includes the text in the treaty and also all agreements made concerning the tax treaty process. Because of the tax treaty is an international treaty, its interpretation is also based on international law principles (Lang & Brugger, 2008). Interpreting each tax treaty is very complicated and requires special interpretation (Kysar, 2016). Therefore, other sources are needed in tax treaty interpretation, namely domestic law, senate materials, executive materials, and international materials (Kysar, 2016). If there is ambiquity in the interpretation of the tax treaty, it can be done with a constructive or purposive approach (Smith, 1996). Interpretation by the panel of judges can also resolve disputes on the tax treaty interpretation (Smith, 1996).

In the application of income tax, tax regulations in Indonesia have a regulation that some certain activity businesses, such as construction services, are subject to final income tax (Indonesian Government, 2008b). Imposing of final income tax is at a certain tax rate of total revenues, without deducting the deductible expenditures (Indonesian Government, 2008a). In this condition, taxpayers who have GAAP profit and GAAP loss still pay the income tax calculated from their revenues. This final income tax occurs because of frequent disputes between the taxpayer and the tax authority in determining deductible expenses in a certain business. The application of the final income tax will be easier for taxpayers to calculate the amount of tax payable, and for the tax authority to determine how much tax revenues. When conducting the tax audit, the tax authority only focuses on the amount of revenues received and ignores the expenditures deducted by the taxpayers. The application of this final income tax will benefit efficient taxpayers and harm inefficient taxpayers.

RESEARCH METHOD

This study used a case study method of tax court decisions in Indonesia. This case explains how the taxpayer's strategy to reduce the income in Indonesia by transferring the income to the parent company or its head office abroad (China). The discussion begins by describing the transaction and then explaining the dispute about the transaction. The analysis was carried out by explaining the strategies undertaken to reduce income tax payable and the reasons are given to support the transaction. There is an explanation of how the panel of judges makes decisions. After arguments from taxpayers, tax authorities, and judges, further discussion was held.

Transaction Schema

The decision of the tax court number PUT-105690.25/2010/PP/M.VIB of 2018 resolves disputes over the results of the tax audit by the Directorate General of Taxes (DGT) on the correction of the tax base the imposition of final income tax article 4 paragraph (2) for the October 2010 period in the form of construction services. There are 2 main disputes, namely the difference in the application of the final income tax rate for one part of the construction services, and a head office transaction determined as permanent

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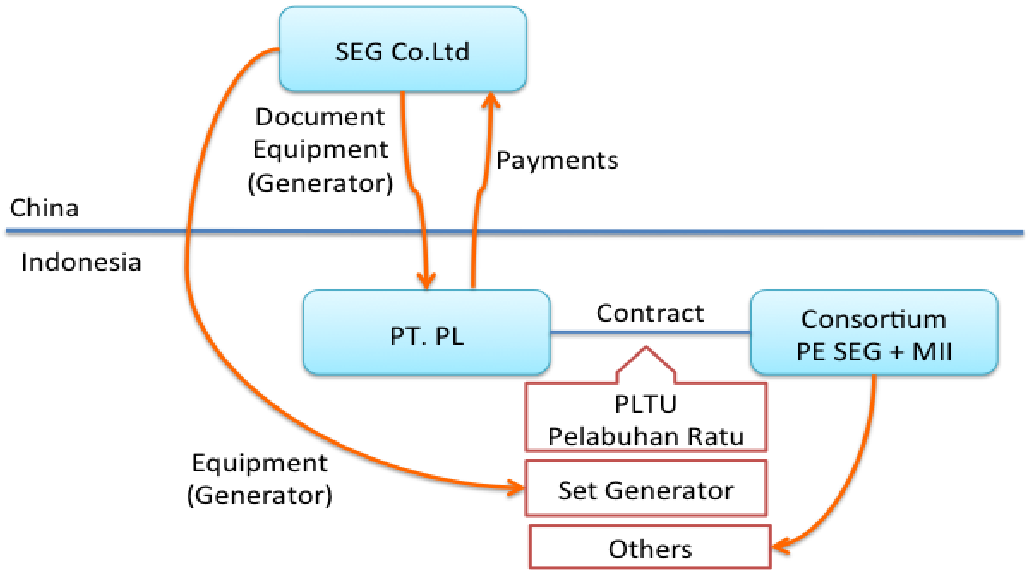
establishment (PE) income in Indonesia. This paper only discusses disputes over the transaction of the head office that is attributed to the income of its PE in Indonesia.

In 2007, the Shanghai Electric Consortium (SEC and MII Infrastruktur) received a contract from PT PL Indonesia (PT.PL) to work on the PLTU (PLTU=electric steam power plant) construction project in Pelabuhan Ratu and this contract was signed on July 25, 2007. The nature of this contract is multiyear and is a turnkey project. The contract agreement explains that the nature of project work includes EPC (engineering, procurement, construction). The agreement among the consortium, namely between the SEC's parent company, SEG Co. Ltd and MII Infrastruktur (MIS), specifies the division of work. SEC undertakes engineering design, all equipment, plants and machinery and major materials as part of the plant and specialist supervision of construction, commissioning, performance test and training as per the provision of the main contract. MIS undertakes all civil constructions and installations of plant and machinery and provide relevant services hereof and all temporary facilities and conduct all contractions of such facilities. The billing and payment process is as follows:
- The SEC issues an invoice to PT.PL and receives payment from PT.PL.
- MII issues invoices to the SEC, and receives payments from the SEC

From this payment process, it was concluded that actually, MII was a subcontractor of the SEC.

To complete this project, the SEC requires equipment (in this case a generator) imported from abroad. The SEC's business license in Indonesia is construction only; there is no trade license. To procure these generators, SEG Co. Ltd, as the parent of PE SEC, supplied generators to Indonesia through PT.PL, not directly to the SEC. The transaction scheme is shown in Figure 1 which explains that the Equipment (Generator) needed in the PLTU project is imported and installed by SEG Co. Ltd with a direct agreement with PT.PAL. The installation of this equipment does not involve PE SEC. This resume of court rulings explains that cash flows on the import and installation of this equipment is from PT.PL directly to SEG.Co.Ltd.

Figure 1. Transaction Schema



Dispute

The import value of the generator and installation cost of this generator, which is a taxable income of Rp. 96,724,681,965 (USD 10,827,674), became a dispute between the taxpayer (SEC) and the tax authority (DGT). According to DGT, the procurement of this generator is the taxable income of the SEC, because the procurement process for this generator is part of the contract. This process has an effective relationship with projects undertaken by the SEC. The Regulation of the Minister of Finance of the Republic of Indonesia Number 153/PMK.03/2009, explained that the implementation of construction includes engineering, procurement, construction, design, and build. SEC has to pay its own income tax on the import of the equipment because it is part of the project. Income tax on contractor's income is final income tax and must be paid upon receipt of income without waiting for the end of the tax year.

According to the SEC, the procurement of these generators is not an income for the SEC, because the SEC's business license is only for construction, not other things such as trading related to procurement. The SEC argued that the import process of this generator is a trading activity. The SEC also explained that this import was carried out by PT.PL and SEG Co. Ltd. (China), not by the SEC and this was supported by an import notification letter (PIB=Pemberitahuan Impor Barang) not belonging to the SEC. The SEC explained its argument based on the Tax Treaty between Indonesian and China (Tax Treaty). Profit from an activity carried out by the taxpayer in China cannot be attributed to the PE in Indonesia if one of the 2 conditions is met, namely it can be proven that the activity is not carried out by the PE **or** the activity has no relationship with the PE. Since this activity was not carried out by the SEC, which is a PE of SEG Co. Ltd., and this fulfills one of the conditions, the import of this generator was not SEC income. Article 7 paragraph (1) of the Tax Treaty is as follows:

> The profits of an enterprise of a Contracting State shall be taxable only in that Contracting State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other Contracting State but only so much of them as is directly or indirectly attributable to that permanent establishment. The provisions of this paragraph shall, however, not apply if the enterprise proves that the above activities are not undertaken by the permanent establishment **or** have no relation with the permanent establishment.

The panel of judges decided that the import of generators carried out by SEG Co. Ltd. became SEC income because the import had an effective relationship with the SEC. The panel of judges explained that if one of the alternatives is fulfilled, then the profit from these activities could be attributed to the PE's income.

RESULTS

Permanent Establishment

In this case, there is no dispute regarding the SEC's status as PE of SEG Co. Ltd. The SEC's criteria as PE have been fulfilled under both the Tax Treaty and the Indonesian Income Tax Law. DGT argued that the SEC is a PE from SEG Co. Ltd. so that it could attribute SEG Co. Ltd.'s income to be the SEC's income. The SEC's criteria as a PE in Indonesia are:

1. There is a permanent place of business
2. There are business activities that are carried out wholly or partly.

Tax Strategy

For discussion, this paper first analysis why the SEC does not directly import generators from SEG Co. Ltd. and why it has to go through PT.PL. The application of taxes on these activities is final, which means that regardless of the profit the SEC receives from this project, the income tax imposed is 3% of the revenues. The application of this final income tax does not wait until the end of the tax year. The total contract value is USD 566,984,920 + Rp. 2,205,075,928,417. This contract includes the procurement of a generator of Rp. 96,724,681,965. If the import of generators is carried out directly by the SEC, the tax base for this project will be USD 566,984,920 + Rp. 2,205,075,928,417. If the import of generators is carried out through PT.PL, then the tax base is USD

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566,984,920 + Rp. 2,205,075,928,417 - Rp. Rp. 96,724,681,965. With a Final Income Tax rate of 3%, the SEC will save 3% x Rp. 96,724,681,965 = IDR 2,901,740,459. With an exchange rate of 1 USD = Rp. 8,927.55 at the last time the generator was imported, the income tax that could be saved was USD 325,032.10.

Imported Equipment

According to the SEC, the taxpayer (SEC) could not import because the SEC did not have a permit to import and his business was only construction. Article 3 paragraph (2) Regulation of the Minister of Trade of the Republic of Indonesia number 31/M-DAG/PER/7/2007 states that imports can be carried out without the import license (API=Angka Pengenal Impor) if:

a. Imports are not carried out continuously and are not intended to be traded or are not intended to be transferred; and
b. Imported goods are goods for other purposes in the form of supporting equipment for smooth production or infrastructure development tools.

This Regulation of the Minister of Trade clearly states that the SEC can import the generators it needs. There are no technical or regulatory reasons that force the SEC to import the equipment it needs through PT.PL. There is freedom for the SEC to import these generators directly.

The results of the Panel of Judges' research on this contract document explained that all activities carried out by the SEC started from zero until the project was completed. Thus, generator procurement activities for the benefit of this project are included in the procurement process which is an integral part of the contract and is related to SEC activity. The contract also explains that PT.PL informs the SEC regarding the permits and licenses that must be held, including the import license (API), so the SEC can procure goods for project needs through import.

Tax Treaty Interpreted

The next discussion is the difference in the interpretation of the tax treaty. The taxpayer interprets based on the text in Article 7 paragraph (1) of the tax treaty. If only based on the text, then the taxpayer’s interpretation can be correct. The text explains that the income attribution to the PE is not valid if it can be proven that the PE does not carry out the activities or there is no relationship with the PE. In this case, the taxpayer proves that the procurement activities are not carried out by the PE, but by the parent company. Thus, the taxpayer argues that this procurement activity is not the income of the SEC as a PE. The textual interpretation of the tax treaty by changing the word enterprise and the contracting state associated with this case looks as follows:

> The profits of **SEG Co. Ltd** of **China** shall be taxable only in **China** unless **SEG Co. Ltd** carries on business in **Indonesia** through **SEC** situated therein. **SEG Co. Ltd** carries on business as aforesaid, the profits of **SEG Co. Ltd** may be taxed in **Indonesia** but only so much of them as is directly or indirectly attributable to **SEC**. The provisions of this paragraph shall, however, not apply if **SEG Co. Ltd** proves that the above activities are not undertaken by **SEC or** have no relation with **SEC**.

After modifying the words in Article 7 paragraph (1) of the Tax Treaty, it appears that if one of the conditions is fulfilled, then the DGT tax audit results of SEG Co. Ltd's income from generator trade to Indonesia are not taxed in Indonesia through the SEC. The conditions are:

a. SEG Co. Ltd. can prove that the trading activities of generators are not carried out by the SEC; or
b. The trading activity of the generator has no connection with the SEC.

In this case, only the first condition (a) is met and the second condition (b) is not met. According to the taxpayer, the sentence "or" explains that if only one of the conditions is met, then SEG Co. Ltd's income from trading this generator cannot be subject to income tax in Indonesia through SEC

The opinion of the Panel of Judges is that the word "or" in Article 7 paragraph (1) of this Tax Treaty serves as an alternative. In this case, the SEC must prove that the trading activity of this generator was not carried out by the SEC "or" has no relationship with the SEC. If one is proven, then return to the main sentence, namely SEG Co. Ltd's profit from trading generators to Indonesia can be taxed in Indonesia because it can be attributed either directly or indirectly to the SEC.

DISCUSSION

Interpreting the tax treaty is not only from the existing text, but also using other data and information, such as the UN Model Double Taxation Convention and the internal regulations of the source country of income (Kysar, 2016). This SEC project is a turnkey contract. Commentary Article 7 paragraph (2) no. 10 in the UN Model Double Taxation Convention related to the turnkey project explains that:

> The question is how much of the total profits of the turnkey contract is properly attributable to the permanent establishment and taxable in the country in which it is situated. A member from a developed country said that they knew of instances in which countries had sought to attribute the entire profits of the contract to the permanent establishment. It was their view, however, that only the profits attributable to activities carried on by the permanent establishment should be taxed in the country in which the permanent establishment was situated, unless the profits included items of income dealt with separately in other articles of the Convention and were taxable in that country accordingly.

If this commentary is applied to elaborate this case, it can be interpreted that in the project turnkey, only the profit from activities attributable to the PE can be taxed in the Source Country. If it can be proven that the profit from an activity, which is carried out by the parent company, can be attributed to the PE, then the profit can be imposed in the country where the PE is located. The taxpayer's argument against this commentary in the sentence "… profits attributable to activities carried on by the permanent establishment…". The Taxpayer argues that only profits from activities carried out by the PE can be taxed on the PE. The SEC as the PE does not procure this equipment. It means that the activity does not do by the SEC. The SEC is not subject to tax on this procurement. In this argument, the SEC uses the term "activity" to explain its opinion.

Article 7 paragraph 1 of the UN Model explains:

> If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other State but only so much of them as is attributable to (*a*) that permanent establishment; (*b*) sales in that other State of goods or merchandise of the same or similar kind as those sold through that permanent establishment; or (*c*) other business activities carried on in that other State of the same or similar kind as those effected through that permanent establishment.

Article 7 paragraph 1 explains that the profit attributable to the PE does not have to be made by the PE, because the attribution is related to the force of attraction rule. If it is connected to this case, the profit of SEG Co. Ltd. from the procurement of this equipment can be attributed to the SEC because this procurement is part of the SEC's work in Indonesia.

Article 5 paragraph (1) of the Income Tax Law in Indonesia states that the objects of PE income tax are:

a. …;

b. income from the head office from businesses or activities, sales of goods, or provision of services in Indonesia that are similar to those carried out by a permanent establishment in Indonesia;
c. income as referred to in Article 26 which is received or obtained by the head office, as long as there is an effective relationship between the permanent establishment and the assets or activities that provide the income.

Income in Article 26 of the Income Tax Law in Indonesia are dividends, interest, royalties, rent, income from the use of assets, rewards related to services, jobs and activities, prizes, awards, pensions, regular payments, swap premiums, hedging transactions, debt relief benefits, transfer of assets in Indonesia, and transfer of shares. Referring to Article 26, it can be explained that trade is not included in the object of Income Tax in Article 26.

The SEG Co. Ltd's income from Indonesia comes from trading generators with exports to Indonesia. This trade is not of the same type as that of the SEC's activity (Article 5 Paragraph (1) letter b), but has an effective relationship with the SEC's project (Article 5 Paragraph (1) letter c). If the interpretation only uses one of the provisions, then SEG Co. Ltd's income is not subject to income tax in Indonesia. If the interpretation uses the two provisions of the Article 5 Paragraph 1, letter b and c, the SEG Co. Ltd's income can be attributed to be the SEC's income.

When interpreting Article 7 paragraph (1) of the Tax Treaty by using the domestic regulations of the source country (Indonesia) as an external source, the income of SEG Co. Ltd can be subject to Income Tax in Indonesia. This tax treaty does not explain what SEG Co. Ltd activities can be taxed in Indonesia. As long as it is attributable directly or indirectly to the SEC, SEG Co. Ltd's profits from trading generators to Indonesia may be taxed in Indonesia.

Avoidance Double Taxation
The purpose of the tax treaty is to avoid double taxation and reduce tax evasion. In this case, SEG Co. Ltd's income from trading generators will be subject to income tax twice, first in Indonesia through the SEC and second in China through SEG Co. Ltd. To solve this problem, there should be tax regulations in China to provide tax credit or tax exemption facilities for income tax paid in Indonesia. In addition to China, the Indonesian government must also have regulations for tax credits or tax exemption for this case. Without a tax credit or tax exemption facility for cases like this, the tax treaty function to avoid double taxes on the same tax object would not be implemented.

Article 23 paragraph 2 of the tax treaty states:

> Where a resident of China derives income from Indonesia the amount of tax on that income payable in Indonesia in accordance with the provisions of this Agreement, may be credited against the Chinese tax imposed on that resident. The amount of the credit, however, shall not exceed the amount of the Chinese tax on that income computed in accordance with the taxation laws and regulations of China

In this case, SEG Co. Ltd may credit income tax paid in Indonesia for the selling of equipment to PT.PL. This credit mechanism can be seen in the tax regulations in China. There is a big possibility that this income tax credit is smaller than the income tax paid because the tax mechanism for this income in Indonesia is different from that of in China. In practice, there will be difficulties in issuing credit, because this tax payment is not on behalf of SEG Co. Ltd., but on behalf of the SEC as PE. Another method to solve this problem is the exemption method. If there is no exemption method in China's tax regulations, it is necessary to pay attention to considering the application of this method.

The choice of this method can be a full exemption approach or exemption with a progression approach (Kurniawan, 2017).

Regarding the tax treaty, it is certain that the income tax regulations in Indonesia and China only have a credit method to avoid double taxation. Based on this case, the two countries can start to examine whether the exemption method to avoid double taxation is necessary to be implemented in each country.

CONCLUSION

Tax audit by the tax authority can arise to dispute and one of the reasons is difference in the interpretation of the tax treaty. The interpretation of the tax treaty must be based on good intentions and in accordance with its objectives, namely avoidance of double taxation, not for tax reduction, such as transferring income to another country. In the tax court case that is discussed, the taxpayer interprets the tax treaty more heavily based on text. The panel of judges interprets the tax treaty based on the context and uses other sources. Use of the domestic regulations of the source country as another source can be used to interpret tax treaty.

The case discussed causes double taxation, in which the parent company's income is subject to income tax in China and in Indonesia through its PE. The tax treaty only includes the tax credit for avoiding double taxation. In this case, the tax exemption method is more suitable for tax avoidance in China, because the tax paid in Indonesia uses the name PE (SEC) and not the parent company (SEGCo.Ltd.).

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