



cutting through complexity

KPMG INDONESIA

# Investing in Indonesia

 2015

[kpmg.com/id](http://kpmg.com/id)



# Contents

1. Introduction	1
2. Country Facts and Overview	2
3. Economic Environment	6
4. Infrastructure	12
5. Investment	16
6. Business Structures and Establishment	40
7. Foreign Exchange	46
8. Domestic and Foreign Trade - ASEAN	48
9. Labor and Employment	54
10. Taxation	60
11. Glossary	71

# 1. Introduction

2013 and 2014 were eventful years for Indonesia's economic, investment and political landscapes. In 2013 the country's strong economic fundamentals enabled it to ride out a temporary economic "blip" considered by many to be a necessary correction to cool a rapidly growing economy. In 2014 we saw economic growth slip to the lowest levels since 2009 in a year characterized by a continuation of falling global commodity prices, lifting of fuel subsidies, a strengthening US dollar and depreciating Indonesian rupiah. This resulted in a decline in domestic consumption, the main driver of Indonesia's economic growth.

A new Investment Negative List with a general tightening of foreign investment restrictions was finally released ahead of the 2014 Parliamentary and Presidential elections which heralded a new government taking office, and a President's public recognition of the importance of foreign investment to ensure future sustained economic growth. The tightening of foreign investment restrictions in the previously released Negative List seeming to many to be at odds with the importance of foreign investment.

What is the outlook for Indonesia in 2015 and beyond at a time when the economy is growing at its slowest pace in 5 years, and needs a boost from investment in infrastructure, education and other key sectors? Whilst the immediate view on 2015 could be considered challenging or "mixed", it is reasonable to take a more positive longer term outlook for a country located in the world's fastest growing region; underpinned by the power of optimism and positive sentiment but notwithstanding the likelihood of economic and other policy "hiccups" along the way.

Indonesia has an abundance of foreign capital lining up to invest, but until now has generally failed to convert this to levels of foreign investment other large developing markets like China have been able to attract. "Big deals", too, are less common than in other Asian countries. While deal origination, execution and completion present challenges and risks, a well planned and executed investment in the country can be very rewarding. Having a degree of appetite for risk is fundamental to successfully investing in an emerging economy like Indonesia and reaping the benefits and opportunities from a large, rapidly expanding population and all the upside of a quite remarkable economic growth story. Foreign and local recognition of Indonesia's enormous potential is not a topic of debate.

This publication is intended as a general guide to investing and doing business in Indonesia primarily for new foreign investors looking to enter the Indonesian market, but should also serve as a useful reference document for established foreign and domestic Indonesian investors. Practical insights and other intelligence from KPMG's experience at the transaction "coalface" and through providing transaction, M&A and tax advisory services to foreign and local investors and lenders can also be found at appropriate junctures in this publication.

**Note :**

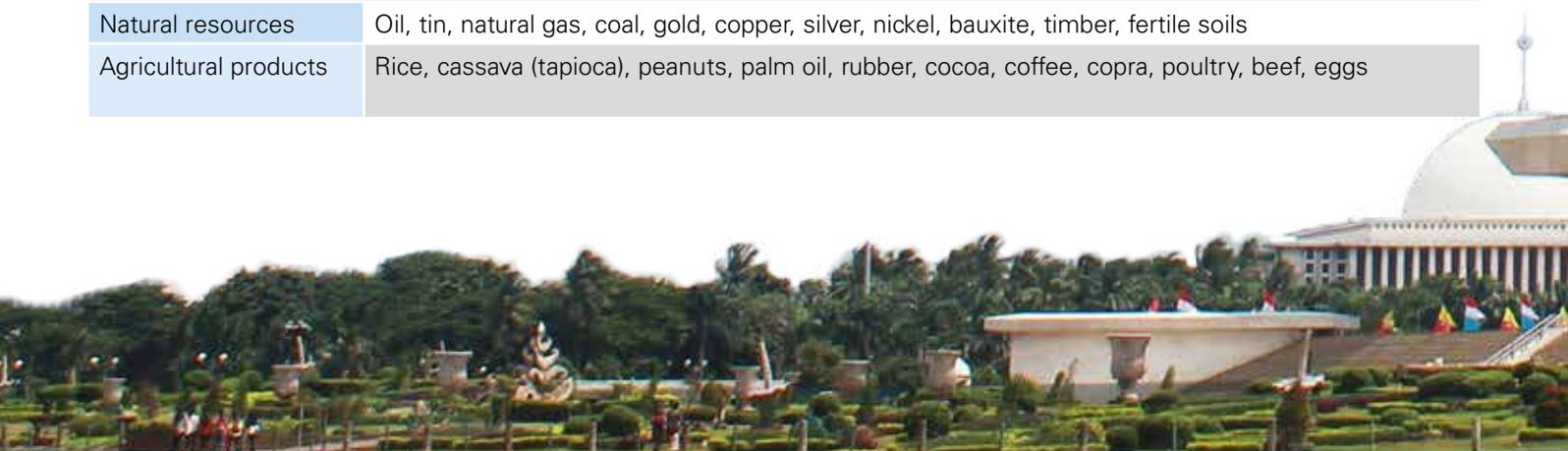
This publication is not intended to be a substitute for formal legal, tax or other professional advice. To the best of our knowledge, laws and regulations referred to throughout the document reflect the position as at 1 January 2015, or later where specifically referenced.



## 2. Country Facts and Overview



Official Name	Republic of Indonesia
Capital city	Jakarta: which is the business and governmental centre
Other major cities and provinces	Surabaya, Medan, Bandung. Surabaya is the second largest city and a major industrial centre and port. There are 34 provinces comprising 508 Regencies, 6,694 Districts and 77,465 villages
Government	Type: Independent Republic Independence: 17 August 1945 Highest Authority: People's Consultative Assembly (MPR)
Geography	Location : Southeastern Asia, archipelago between Indian Ocean and Pacific Ocean Largest Islands : Sumatra, Java, Kalimantan (Borneo), Sulawesi and Papua account for over 90% of total land area. There are also two large groupings of smaller islands, Maluku and Nusa Tenggara Area : 1,904,569 sq km ( 736,600 sq mi). Land: 1,811,569 sq km; water: 93,000 sq km Terrain : More than 17,508 islands; 6,000 are inhabited; 1,000 of which are permanently settled Coastline : 54,716 km
Climate	Tropical, hot, humid, cooler in the highlands
People	Nationality : Indonesian Population : 252 million: >51% under age of 29 (2010-15E annual average growth: 1.4%) Ethnic Groups: 42% Javanese, 15% Sundanese and 43% other ethnic groups Religions : Islam 87%, Protestant 7%, Catholic 3%, Hindu 2%, Others 1%
Language	Bahasa Indonesia (akin to Malay) English is widely spoken by business people in major cities
Currency	Indonesian Rupiah (IDR)
Inflation	Average of 5.1% in 2010; 5.4% in 2011; 4.3% in 2012; 8.38% in 2013 and 8.36% in 2014 Central Bank estimates 4 – 5% in 2015 Forecast between 5.0% - 6.1% over 2011-15
Natural resources	Oil, tin, natural gas, coal, gold, copper, silver, nickel, bauxite, timber, fertile soils
Agricultural products	Rice, cassava (tapioca), peanuts, palm oil, rubber, cocoa, coffee, copra, poultry, beef, eggs





### **The Country**

Indonesia is located in South-east Asia between the Indian and Pacific Oceans and is bordered by Malaysia, Singapore, East Timor and PNG. The main islands of Java, Sumatra, Kalimantan, Sulawesi and Papua feature spectacular mountain ranges flanked by rich coastal plains, fertile valleys and large areas of lowlands. The smaller islands, many of which are uninhabited, are often fringed by brilliant beaches and coral reefs and bedecked with tropical palm trees.

A large percentage of world trade transits the strategically important Straits of Malacca that link the Indonesian ocean littoral to the South China Sea and the larger Pacific Ocean basin.

Indonesia is rich in natural resources, coal, minerals like tin, gold, copper, nickel and bauxite, oil & gas and fertile land to support agricultural products. The archipelago's tropical weather and huge landbank makes it ideal for producing palm oil, rubber, coffee, cocoa and rice, the staple of most of the population. It is these resources, together with the islands' central location between India and the Orient, that have made Indonesia so attractive to foreign traders, rulers and investors both historically and as of today.

### ***The capital city: Jakarta***

Jakarta is the hub of the Indonesian economy where almost all local and multinational corporate head offices are located and business conducted. Mass commuting creates chronic daily traffic congestion in many parts of the city. In addition to the 10 million registered Jakarta residents, another approximately 20 million people enter the sprawling city every day from outlying areas in Greater Jakarta. Traffic jams are unavoidable during peak hours and not uncommon at many other times of the day and early evening.

The Economist Intelligence Unit has released “The Safe Cities Index 2015: assessing urban security in the digital age” report covering 50 cities based on an Index comprising digital and health security, infrastructure and personal safety. Jakarta ranks 50th and is in the bottom 6 places for all 4 indicators. Cities in developing markets typically fall in the bottom half, with the top half of the index generally occupied by rich cities from Europe, East Asia and North America. To put things in perspective, it is relevant that Jakarta is in a “bottom eleven” with Ho Chi Minh City, Bangkok and cities of the BRIC economies. Selected sub-indicators that surface for Jakarta are number of doctors per 1,000 people, incidence of petty crime, population size, poverty (or GDP per head), poor sanitation systems and pollution. Other indicators likely to be relevant indirectly drawn from a comparison to 1st ranked Japan include lack of privacy policies or enforcement, low vigilance of disease outbreaks and natural disasters as well as transport system design and construction. Whilst needs for improvements and remedial action is recognized and are underway to varying degrees, long lead times are involved.

The city’s vibrance is not captured in reports like these, nor the friendliness of the Indonesian people.

### **The people**

The people of Indonesia are culturally diverse reflecting their differing ethnic origins, religions and histories.

With an estimated population of 252 million, Indonesia is the fourth most populous nation in the world after China, India and the USA, as well as the world’s most populous Muslim nation. 51% of the population is below 29 years of age, while about 67% is below 39 years of age. The most populated islands are Java, Sumatra, Sulawesi and Kalimantan. Java, Bali and Madura are the most densely populated with Papua, Kalimantan and many of the smaller islands having low population densities. The most populous cities are Jakarta, Surabaya and Bandung in Java, and Medan in Sumatra. About 53% of the population resides in urban areas, with the annual rate of urbanization estimated at 1.4% over 2010-15.

Most Indonesians are of Malay descent and the largest ethnic group, the Javanese, make up 42% of the total population. The Javanese are pre-eminent in the social elite, bureaucracy and the armed forces. There is also an ethnic Chinese minority whose influence in business is proportionately greater than their numbers. Papua, the eastern half of the island of New Guinea, is peopled by Melanesians.

The official language of the country is Bahasa Indonesia, which is similar to Malay. This is the second language of many rural Indonesians after their local dialect or tongue, of which there are almost 300. English language skills are actively encouraged in recognition of the opportunities English affords to Indonesians in education, commerce and international relations. English is understood by business people in the cities. The country has a 93% literacy rate.

Over 87% of the population follow the Moslem faith, but there are significant minorities of Hindus (centered in Bali), and Christians.

### **The climate**

Straddling the equator from latitude 60°N to 110°S, Indonesia has a typically tropical climate marked by heavy rainfall as well as high humidity and temperatures. Rainfall increases during the monsoon season which typically runs from October to April. The tropical climate is moderated by mountains in large parts of the country. Temperatures generally range from 23° to 33°C.

### **The type of government**

The 1945 Constitution of the Republic of Indonesia provides for independent executive, legislative and judicial functions. The highest authority is the People’s Consultative Assembly (MPR), which meets annually to hear accountability reports from the President and government agencies and provide policy guidance. The MPR includes the House of Representatives (DPR), which has 560 members, and the Council of Regional Representatives (DPD) which has 132 members. Members are elected to five year terms.

The President and Vice-president are elected by direct popular vote. The president is the Chief Executive, the Head of State and Commander-in-Chief of the Armed Forces, and also appoints Cabinet Ministers who are responsible only to him/her.

The country is divided administratively into 34 provinces headed by a Governor and elected provincial assemblies, and hundreds of districts and municipalities headed by a Regent, each with its own elected council assemblies. Governors and Regents are appointed by, and report to, the local assembly or council. These regional governments have responsibility to administer a wide range of matters, including health, education and investment.

In October 2013 the House of Representatives approved the creation of 8 new provinces involving formation of 65 new regions. The mindset at the time was based around bringing government closer to the people, making land ownership processing more accessible and improving prosperity, particularly in under developed border areas. The House's proposal was rejected or set aside, with criticism sighting opening up of regional bureaucracies bringing fresh opportunity for corruption, and costs of financing elections better applied in building infrastructure, education and health facilities: Infrastructure is discussed in Chapter 4. Statistics presented by APINDO (Indonesian Employers Association) showed that 85% of new regions failed to develop due to reluctance of investors to do business in new and geographically remote areas due to legal uncertainty, unclear and conflicting regional regulations as well as hidden fees: regional autonomy is a country investment risk referred to in Chapter 5: Investment.

### The type of legal system

The judiciary is based on the Supreme Court and separate courts for public administration and military, religious and civil matters. A comprehensive system of civil laws has replaced most of the statutes established by the Dutch. In addition, there is an extensive range of decrees and regulations developed and applied by government departments. For foreign investors, the most relevant areas are laws regarding:

- foreign investment
- company law
- business licensing and trade
- taxation and customs
- labor
- land and buildings
- regional regulations.

Certain industries are subject to specific regulations and requirements, including oil & gas, financial services and mining which are covered in Chapter 5: Investment.

Professional advice should always be obtained with regard to contracts and agreements made in Indonesia. One reason is that the civil law provides for certain clauses to apply to all agreements unless specifically excluded. Litigation can be unpredictable in terms of outcomes, protracted and time consuming, and as a result is not commonly an effective route to resolve disputes. The protection provided by agreements of themselves can be limited, and commercial arrangements should be designed, where possible, with safeguards which can operate in the event of later disagreements. Contracts commonly include Indonesian or international arbitration for resolution of disputes. A popular choice is Singapore in accordance with the rules and regulations of the Singapore International Arbitration Centre, where the final, binding arbitral award is automatically ratified in the Indonesian Courts.

Indonesian laws become operative following issuance of implementing regulations, and can be subsequently stipulated in Ministerial and Presidential regulations and decrees. A significant period of time can elapse between new laws being announced, drafted, passed by Parliament and final regulations or decrees being rolled out.

---

#### Sources:

- (1) KPMG Research and Intelligence
- (2) Central Statistic Agency (BPS) website: [www.bps.go.id](http://www.bps.go.id), February 2015
- (3) Central Bank (BI) website: [www.bi.go.id](http://www.bi.go.id), January 2015
- (4) Economist Intelligence Unit (EIU), "The Safe City Index 2015," January 2015
- (5) Jones Lang LaSalle, "Economic Insight Jakarta City Living – Need or Choice," September 2011
- (6) Jones Lang LaSalle, "Investment Case for Indonesia," September 2012

# 3. Economic Environment



## Size and state of the Indonesian economy

Indonesia has a large domestic consumption base, and the country's middle class with increasing levels of disposable income and purchasing power has grown substantially from 38% of the population or 81 million in 2003 to 56.6% or 131 million in 2010. A World Bank report indicated that the middle class grew by 61.73% over this 7 year period, with over 7 million people being elevated to the middle class segment. Quite rightly, the definition of "middle class" is now being re-evaluated and debated, with numbers arrived at by market analysts and the World Bank ranging at various estimates between 44 million (18% of the population) to 146 million (59%). The World Bank's 44 million (18%) middle class "who no longer have to worry about their vulnerability" live on USD4.50 to USD22.50 a day and have consumption patterns starting to resemble those of a typical "middle class".

Controlled wage growth, provided accompanied by a sustained improving employment outlook, should support "the Indonesian consumer story". The large population and consumption base is a fundamental reason why many multinationals rank the country as the foreign investment destination of choice in South-east Asia. Comparisons of Indonesia having the same economic growth and investment potential as the "BRIC" countries are now not so relevant given the major economic downturns in Brazil and Russia and slow down in China. India is the only remaining BRIC country worthy of direct comparison. Indonesia is now being grouped with Mexico, Nigeria and Turkey as one of the MINT countries.

Indonesia's population grew at a rate of 15.8% from 2000 to reach 240 million in 2010 and was 250 million in 2014. It is forecast to be 263 million by 2020. The Central Statistics Agency (BPS) has estimated that between 2010 to 2035 the country's population will grow to over 305 million at 3 million per year. Another report refers to estimates of Indonesia's population exceeding the USA by 2043. The country is the

most populous nation and is also the largest market in South-east Asia. Indonesia's 250 million people make up 40% of the 625 million of combined ASEAN countries.

Indonesia was ranked the world's 16th largest economy with GDP of USD978 billion in 2014 or IDR10,542.7 trillion with GDP per capital IDR41.8 million (USD3,532). Predictions are for Indonesia to be the 7th largest economy in the world by 2030 provided economic growth rates can be achieved by fully taking advantage of the rapidly expanding consumer class, which includes maximizing the country's attractiveness for foreign investment. An April 2014 World Bank report rated Indonesia as already having the 10th largest economy in the world, contributing 2.3% of global economic output. The report assessed economies based on purchasing power parity (PPP) with Indonesia moving up 6 places and passing more developed countries such as Canada, South Korea and Spain. The report found that middle income economies of Indonesia, China, India, Russia, Brazil and Mexico accounted for 32.3% of world GDP compared to a 32.9% contribution of the six largest high income economies: USA, Japan, Germany, France, the UK and Italy. However based on Real GDP, the country ranks 16th with output of USD795 billion in 2014. Other observations referred to an uneven growth rate and widening gap between rich and poor, with real consumption rates in a selected 7 year period for the poorest 40% of households being just over 1% compared to nearly 6% for the richest 20%.

In terms of the financial sector, bank loans were the equivalent of 26% of Indonesia's GDP as at 3Q2013. This is similar to the Philippines, but low compared to China, Singapore, South Korea, Malaysia and Thailand where average debt to GDP in 2012 ran at 99% to 127%. India is 51%. As at 3Q2014, Indonesia's national debt was 34.8% of GDP.

	2010	2013	2018E
<b>Income and market size</b>			
Population (mn)	243	251	263
GDP (Nominal, USD bn)	709	868	1,657
GDP per head (USD)	2,919	3,460	6,300
Private consumption (USD bn)	401	485	964
Private consumption per head (USD)	1,650	1,930	3,660
GDP (International \$ bn at PPP)	1,026	1,293	1,931
GDP per head (International \$ at PPP)	4,220	5,160	7,340
Export of goods & services (USD bn)	175	206	371
Imports of goods & service (USD bn)	154	212	345
<b>Memorandum items</b>			
Share of world populations (%)	4.15	4.16	4.18
Share of world GDP (Nominal, %)	1.13	1.19	1.72
Share of world GDP (PPP, %)	1.35	1.46	1.63
Share of world exports of goods & services (%)	0.96	0.92	1.20

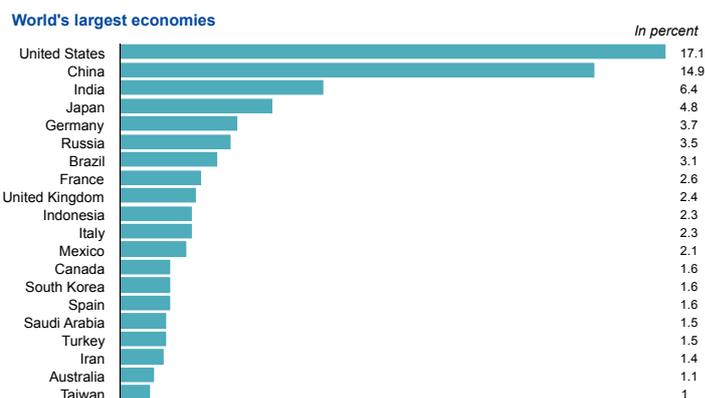
Source: The Economist Intelligence Unit, June 2014

## A historical perspective: 1997 - 2014

### 1997 Asian Economic Crisis and 2008 GFC

Following the 1997 Asian Economic Crisis, Indonesia experienced a period of severe economic and political instability that was compounded by the collapse of the banking system, a function of unrestrained lending and other practices. Ten years later however, following a period of political stability as well as sound economic and financial policy which lowered the national debt from 89% of GDP in 2000 to less than 30% in 2011, Indonesia was less affected by the GFC compared to many neighboring economies, its resilience underpinned by strong domestic spending and relatively low dependence on exports which made up a small 1.7% proportion of the country's GDP.

An important factor underpinning the above is that the Indonesian banking industry had become one of the most open and tightly regulated in the world, having undergone dramatic transformation and consolidation. Following the Asian economic crisis, Indonesia liberated its banking system as part of an IMF mandated structural adjustment reform, where USD 39 billion was spent to bail out lenders.



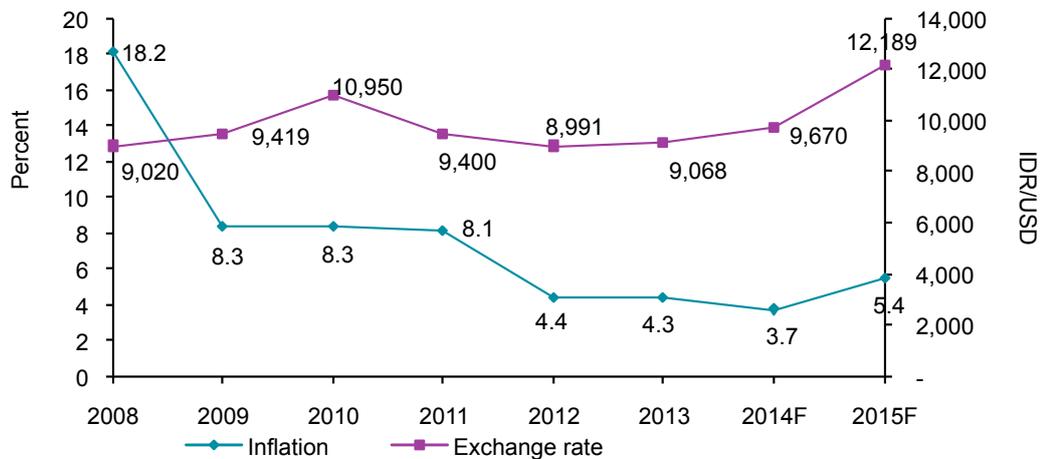
## What happened in 2013?

In 2013 the country's strong key economic fundamentals enabled it to ride out a temporary economic "blip" caused by a combination of declines in demand and pricing of key commodity exports and further pressures on economic growth from a series of economic events and outcomes that "collided": lifting fuel subsidies and electricity tariffs, resulting inflation and interest rate increases, weakening of the IDR and pressures on unemployment. Bankers and economists referred to this as a necessary correction to stabilize or "cool" what had been record economic growth levels and a rapidly growing economy, the condition being a temporary one supported by the country's key, unchanged economic fundamentals. In November 2013 the World Bank gave Indonesia a "vote of confidence" on the basis the country "has what it takes to rise above the current economic uncertainty".

A key outcome of 2013 was that the growing middle class, whose domestic consumption had been driving the greater part of economic growth, started to look a bit "fragile". The Government sent clear messages that consumer spending could no longer be relied on to achieve forecast economic growth and GDP levels, with increases in FDI inflows needed. Industry commentators called for significant efforts to improve the investment climate if sustained economic growth is to be achieved.

## 2014 year in review: a snapshot

## Inflation and exchange rate (2008 - 2015F)



Source : The Economist Intelligence Unit, June 2014

In 2014 we saw GDP growth slip to 5.1%, at its lowest levels since 2009, and a year characterized by continued falling global commodity prices including oil, lifting of fuel subsidies and electricity tariff increases, inflationary and other upwards pressures on corporate cost structures, a depreciating IDR and increasing costs of imported goods. Despite further statutory increases in minimum wages, household consumption declined. Indonesia had entered a period through 2017 where economic growth was forecast by the World Bank to be lower than in recent prior years. It is relevant however that many of the world's other emerging economies were also growing slower. In Indonesia:

- An economic downswing in China and the resulting trend in declining global commodity prices continued to adversely impact Indonesian exports: coal and palm oil account for 60% of these. Declining international commodity prices in recent years is considered to be solid evidence of a break in the cycle of rising prices. A mineral export ban from January 2014 compounded the problem.
- Administered price inflation increased in line with the lifting of fuel price subsidies, higher land freight costs and increases in electricity tariffs to more economic rates. Government structural reform policy to reallocate the fuel subsidy to productive sectors including infrastructure was designed to promote more sustainable economic growth. International oil prices dropping significantly (with the trend expected to continue in 2015) favoured the Indonesian economy in terms of balance of payments with the country a net importer of oil. International oil prices have fallen around 50% since mid-June 2014.
- Typically to keep inflationary pressures under control, interest rates rose. The BI (% period average) for 2015 was forecast to be 7.22% at 31 March 2015, about the same as the average rate of 7.54% in 2014.
- Intense depreciation pressures on the IDR against the USD occurred but relative to currencies in many other South-east Asian countries, the rate of depreciation in 2014 was low or otherwise in line.
- Optimism around the new Government translated to positive sentiment towards improving economic fundamentals in 2015.

Fuel Price							
IDR/litre	2005		2008	2013	2014	2015	
	March	October	May	June	November	1 January	19 January
Gasoline	2,400	4,500	6,000	6,500	8,500	7,600	6,600
Diesel	2,100	4,300	5,500	5,500	7,500	7,250	6,400

Source : Media reports

Average selling price of electricity by type of customers					
IDR/kWh	2009	2010	2011	2012	2013
Residential	589	616	618	632	692
Industrial	644	661	695	710	796
Business	891	934	951	965	1,117
Social	578	624	646	678	757
Government office building	870	953	940	969	1,092
Public street lighting	663	746	792	803	911

Source : PLN Statistics 2013

Provincial minimum wages						
in IDR '000	2010	2011	2012	2013	2014	2015
DKI Jakarta	1,118	1,290	1,529	2,200	2,441	2,700

Source : Directorate General of Industrial Relations and Social

In November 2014, 29 of the 34 provinces published new regional minimum wages for 2015. The overall average Indonesian minimum wage increased 12.8% in 2015, a lower rate of increase than 2014 of 19.10%. Each province sets a minimum wage taking into account assumed needs based on a Decent Living Index: see also Chapter 9 on Labor and Employment.

Note that the minimum wages and Decent Living Indices were set prior to a 30% plus increase in fuel price on 18 November 2014 when the new government removed subsidies for petrol, allowing “prices at the pump” to follow market crude oil price fluctuations. Whether wage levels are actually in line with the real “cost of living” has been at times hotly contested.

### Outlook: 2015 and beyond

Indonesia is not totally immune from spillovers from international developments through both financial and trade channels. Downside risks remain due to ongoing external uncertainties, including the extent and impact of the slowdowns in China’s and Japan’s economies and, to a lesser degree, the ongoing recession in the Euro Area. The “flip side” of the Euro recession is investors switching attention from affected European countries to Indonesia. Much of Indonesia’s historical growth has been built on rising commodity prices and strong domestic consumption. Whilst the manufacturing sector is growing, it still lags behind Thailand, Malaysia, Brazil and Turkey in terms of size and sophistication. Labor laws complicate doing business and discourage value added, labor intensive manufacturing and diversified industrials investments. Infrastructure is inadequate:

- The World Bank has cut its projection for economic growth in 2015 from 5.6 to 5.2%, has made reference to 5.6% GDP growth in 2016.

- BI has projected economic growth in a range of 5.4 – 5.8% in 2015 and higher in the medium to longer term provided macroeconomic and financial system stability is maintained.
- The Ministry of Finance expects inflation to be between 4.5 – 5% in 2015, compared to an annual inflation rate of 7.9% estimated by BI for 2014, and that Indonesia can lift economic growth to 7% in 2016 providing no unforeseen “turbulence” occurs for 2015.

The economic outlook as a whole is subject to potential impacts of a number of factors referred to in this Chapter, including an IDR that has weakened more rapidly relative to most global currencies. A reasonable conclusion is that the current outlook for 2015 could be considered as challenging or “mixed”, with a longer term outlook more positive underpinned by the power of optimism and positive sentiment, notwithstanding the likelihood of economic policy quirks and political “hiccups” along the way. Indonesia is located in South-east Asia and the fastest growing of the world’s three main regions, something that should hold it in good stead going forward.

### Ease of doing business indicators

Indonesia ranked 100th out of 183 in a 2011 Transparency International's Corruption Perception Index. Excessive bureaucracy and a lack of coordination at the ministerial level was considered to be undermining the country's business environment. Also in 2011 World Bank and IFC "Ease of doing business" and "Ease of starting a business" measurements, Indonesia ranked 128th (behind Ethiopia) and 155th out of 185 countries, well below East Asia & Pacific regional averages. On contract enforcement, the country ranked 144th, tied with Malawi.

In the World Bank's "Doing Business 2014" report Indonesia ranked 120th out of 189 countries, up from 128th. The country continued to lag behind nearby developing countries PNG (113th), Pakistan (110th), Sri Lanka (85th) and China (96th). Malaysia ranked 6th on the back of ease of procedures for company registration and permits. Singapore ranked first, other South-east Asian countries included Thailand (18th), Vietnam (99th) and the Philippines 108th up from 138th.

According to the World Bank's "Doing Business 2015", Indonesia is now ranked 114th out of 189 countries. Indonesia is ahead of only India, Brazil and Argentina of the G20 nations, and in South-east Asia is behind Malaysia (18th), Brunei Darussalam (101st), Vietnam (78th), the Philippines (95th) as well as PNG. Again, a primary factor for Indonesia's low ranking is difficulty in establishing and starting a business against a backdrop of inefficiency and a complicated and frustrating bureaucracy.

Investors establishing a company and business in Indonesia need to undertake an average of 10 processes taking on average around two months (52.5 days). The Asia Pacific average is 34.4 days, countries like Singapore and Malaysia running at less than 6 days. In Indonesia there is a need to have dealings with four different ministries and a range of different business licenses, permits and certifications from: 1) Ministry of Law & Human Rights; 2) State Treasury; 3) Ministry of Trade; and 4) Ministry of Manpower. The long awaited implementation of an on-line data base system and "one-stop shop" at BKPM appears to have partly come to fruition, with the Indonesia Investment Coordinating Board (BKPM) announcing that effective 26 January 2015, it had sealed arrangements with 22 Government ministers for all Foreign Investment or "PMA" Company licensing and establishment to be made entirely by BKPM.

The above and other similar indicators however do not measure all aspects of a business environment that matter to companies and investors. Related discussion is in Chapter 6 on Business Structures and Establishment and Chapter 5 on Investment, as well as other chapters throughout this publication.

### Investment Rating

In 2012 Global rating agency Fitch Ratings upgraded the country's sovereign debt to BBB- Investment Grade, an achievement considered to augment Indonesia's ability to attract foreign capital and also stabilize its debt market.

Investment Rating		
Fitch	Moody's	S&P
AAA	Aaa	AAA
AA+	Aa1	AA+
AA	Aa2	AA
AA-	Aa3	AA-
A+	A1	A+
A	A2	A
A-	A3	A-
BBB+	Baa1	BBB+
BBB	Baa2	BBB
BBB-	Baa3	BBB-
BB+	Ba1	BB+
BB	Ba2	BB
BB-	Ba3	BB-
B+	B1	B+
B	B2	B
B-	B3	B-

Note : BBB- Indonesia current investment rating, June 2014

Source: Fitch Ratings, Moody's, Standard & Poors

In November 2014 Fitch Ratings confirmed Indonesia's Sovereign Credit Rating at Investment Grade (BBB-/stable outlook) in recognition of Indonesia's economic stability amid globally uncertain times: underpinning this was the government's decision for macroeconomic stability over higher economic growth. Further improved credit ratings are contingent on strengthening of the investment climate which requires reducing dependency on commodity exports, increase FDI inflows and implementation of structural reforms to promote infrastructure development, eradicating or reducing bureaucratic red tape and aligning minimum wage and productivity growth.



### Population growth, mid-income trap and poverty

There is also however a lower and poor socio-economic class that is growing alongside the middle class. The World Bank estimates that 200 million or 82% of Indonesia's population live on less than USD4 a day, with half of these on USD2. In January 2015 the Central Statistic Agency (BPS) released the latest poverty data with 27.73 million people or 11% of the population living below the poverty line as at September 2014. BPS defines "poor" as living on less than IDR312,328 (USD25) a month. The World Bank sets a higher internationally accepted standard of USD2 per day being the average of the national poverty lines for all countries: if this is applied, as many as another 9 million people would be added to the BPS number for Indonesia. As many as 68 million vulnerable Indonesian people live just above the poverty line according to the World Bank. A commonly held view is that poverty reduction is stagnating.

Current and forecast population growth numbers were presented in Chapter 2. Indonesia needs human resources or capital to develop the nation, however the unqualified and unemployable which the country has to feed are a strain on society. References are being made to risks around the current 250 million population doubling by 2060, and the challenges of providing food, education, health facilities and infrastructure for 500 million people.

Conversely, the huge population and domestic consumption base which is the platform for current economic growth and investment potential, is what makes Indonesia so attractive to investors and one advantage of operating a business in the country.

Economist and media commentators have referred to three interrelated solutions:

- Lower the population growth rate. Calls have been made for more support to programs of the National Population and Family Planning Board (BKKBN)
- Faster economic growth
- Increase access to and quality of education, a typically successful corrective action to lower population growth, but moreover create more employable human capital: refer further discussion in Chapter 9 on Labor and Employment

A World Bank report indicates that Indonesia needs economic growth of 8-9% to provide employment for an estimated 15 million new workers coming on line by 2020 or Indonesians risk being caught in a "mid-income trap", an emerging condition being reported in the media since mid-2014 and characterized by per capita income below USD12,000, low investment, slow manufacturing growth and low industrial diversification.

#### Sources:

- (1) KPMG Research and Intelligence
- (2) Central Statistic Agency (BPS) website: [www.bps.go.id](http://www.bps.go.id), February 2015
- (3) Economist Intelligence Unit (EIU) website: [www.eiu.com](http://www.eiu.com), June 2014
- (4) Fitch Ratings website: [www.fitchratings.com](http://www.fitchratings.com), June 2014
- (5) Moody's website: [www.moody.com](http://www.moody.com), June 2014
- (6) Standard & Poor's websites: [www.standardandpoors.com](http://www.standardandpoors.com), June 2014
- (7) World Bank, "Indonesia: Avoiding the Trap", June 2014
- (8) World Bank, "Doing Business in Indonesia 2014", October 2013
- (9) World Bank, "Doing Business in Indonesia 2015", October 2014
- (10) Fortune Magazine, "The New World of Business", February 2015
- (11) The Borneo Post, "Indonesia Year in Review 2014", 17 January 2015
- (12) Perusahaan Listrik Negara (PLN), "Statistik PLN 2013", June 2014
- (13) Directorate General of Industrial Relations & Social Security Workers website: [www.naker.go.id](http://www.naker.go.id), March 2015
- (14) Discussion with Securities House Economist: March 2015
- (15) BKPM "Monitoring Investment Climate in Indonesia": Seminar 20 May 2015

# 4. Infrastructure



## Overview

Recognizing the pressing need for infrastructure development, the Indonesian government has increased its focus on improving the regulatory environment and stimulating infrastructure spending. Over the past 5 years, infrastructure spending has more than doubled, and more spending is expected over the next few years with the removal of the fuel subsidy allowing reallocation of funds to infrastructure.

Indonesia has a huge task ahead. The World Economic Forum ranks Indonesia's infrastructure as 72nd out of 144 countries, and 4th in the ASEAN region, below Singapore, Malaysia and Thailand.

						
Infrastructure						
Road	6	19	50	72	87	104
Railway	N/A	12	74	41	80	52
Port	2	19	54	77	101	88
Airport	1	19	37	64	108	87
Power	6	39	58	84	87	88

Infrastructure spending in Indonesia (both public and private) remained subdued following the 1997 Asian economic crisis. As a result, Indonesia has poor basic infrastructure and remains under-invested, holding back not only Indonesia's growth potential but also progress in poverty reduction. The symptoms of close to two decades of limited infrastructure investment include increasing road congestion, over utilized airports, weak rail connectivity, an underdeveloped port sector, high inter-island cargo costs, electricity blackouts and poor access to improved sanitation. Population pressures and strong foreign interest in Indonesian commodities give rise to a significant need for infrastructure development in the country.

Unless progress is made, this will be a major barrier to sustained longer term economic growth and development across many industries, as well as to foreign investment. Indonesia's low infrastructure ranking is consistently identified by companies as a constraint on their operations and investment.

### Indonesia infrastructure

Road network	508,000 kilometres of which 56.7% is paved
Toll Roads	<ul style="list-style-type: none"> <li>• 820.2 kilometres (operated)</li> <li>• 936.4 kilometres (construction/land acquisition)</li> <li>• 334.4 kilometres (tender preparation/process)</li> </ul>
Railway network	5,107.8 kilometres, of which 235 kilometres are electrified
Air	296 airports, of which 27 are international airports 5 airports > 3,001 m runway
Maritime	111 ports managed under Pelindo I-IV with 436.5 million ton/m3 loading/unloading
Clean water	<ul style="list-style-type: none"> <li>• 350 regional water supply companies (PDAMs)</li> <li>• 39 non-regional water supply (non-PDAM) of which 18 are limited liability companies</li> <li>• 3,347 million m3 clean water production per year.</li> <li>• 20-40% Non-Revenue Water</li> </ul>
Power	<ul style="list-style-type: none"> <li>• 82% electrification ratio</li> <li>• 49.7 GW/year of which 16% is installed by IPP</li> <li>• 41,749 kmc transmission lines</li> <li>• 878,926 kmc distribution lines</li> </ul>

## Road network and toll roads

Indonesia's road network amounts to 508,000km, of which 287,926km (56.7%) are paved or sealed and 820km are operational toll roads. It is estimated that 90% of all domestic passenger transport and 50% of cargo traffic is carried by road. Indonesia has experienced a rapid increase in the numbers of cars in circulation, with virtually no major investment in toll and other road infrastructure. The rise of the Indonesian economy over the past decade has boosted the number of vehicles by 13.7% (two wheel) / 9.6% (four wheel) % p.a. (CAGR) vs. a 2.9% p.a. growth of paved roads.

The road network is most developed on the islands and main population centres of Java, Sumatra and Bali where over 80% of Indonesia's population live. Mining-related transport (road, rail) infrastructure is more developed in Kalimantan compared to Sumatra.

Despite being given a high priority in government spending programs, road building in Indonesia has progressed at a slow pace due mainly to land acquisition challenges. Only 135km of new toll roads have been developed since 1997-98, although a further 936.4km of new toll roads are being constructed or are in progress of design and land acquisition. Land acquisition challenges are commented on overleaf.

Toll road traffic volume has climbed around 7% over the past 7 years based on the 576km operated by PT Jasa Marga (Persero). A further 244km are operated privately through Toll Road Concession Agreements awarded/supervised by the Toll Road Regulatory Agency (BPJT).

The Government has plans to build 4,621km of additional toll roads, of which 60% are on Sumatera Island as part of its Trans Java and Trans Sumatra highway program.

## Railway network

The railway system covers 5,107.8km, all of which is narrow gauge; and 235km of which is electrified.

Most of the Indonesian rail network is operated by the state-owned enterprise/PT Kereta Api (Persero), while some freight railways are privately owned and operated in Sumatera and Kalimantan. 220 million people and 27 million tonnes of cargo (of which 60% is coal) travel by rail each year on Sumatera and Java Islands. The development rate of rail tracks over the past 5 years was 1.52% vs 1.57% for passenger movements. Recognizing the importance of rail transport, the Government's plans include improving the

quality of track, e.g., double-tracking of the southern rail line from Jakarta to Surabaya; and connectivity through its "Trans-rail" projects for Java, Sumatra, Sulawesi, Kalimantan and Irian Jaya.

## Air

In February 2015, there were 296 airports, of which 27 are international airports, and 5 airports have runways of more than 3,001m; operated by Angkasa Pura I, Angkasa Pura II and the Directorate General for Aviation.

Key annual statistics include, 173 million passengers, 1,160,818 tons of cargo, and 1.7 million aircraft movements both domestic and international. The growth rate of passengers, cargo and aircraft movements over the past 5 years were 13.7%, 10%, and 11% p.a. respectively. To keep up with the demand, new airports are expected to be constructed (either privately or by AP I/II). Both AP I and II have successfully built and expanded some of the major airports in Indonesia such as Kualanamu International Airport (Medan), which began operations in March 2013, Sultan Hassanuddin International Airport (Makassar), Sepinggan International Airport (East Kalimantan), and Ngurah Rai International Airport (Bali).

## Maritime

As an archipelago comprising more than 17,000 islands, covering an area of over 2 million square kilometers astride the main trade routes between the Indian Ocean and the Pacific Ocean, air and maritime connections are vital to Indonesia and its economy. There are 21,579km of navigable waterways among the larger islands that represent over 90% of Indonesia's land, Sumatra, Java, Madura, Kalimantan, Sulawesi and Irian Jaya.

There are 111 ports operated by the state-owned port corporations, Pelindo I, II, III, and IV under KM 17/2004 and 534 ports managed by the government under KM 63/2002. Of these 645 ports 4 are classified as "Prime" (Jakarta, Surabaya, Medan and Makassar) and 14 are classified as "Class I" including Semarang and Banjarmasin. Prime and Class I ports are defined as suitable for international shipping. The country's largest port, Tanjung Priok, in North Jakarta, is expected to complete the building of Terminal 1 of its Phase I expansion program, in the first half of 2015, increasing maximum draft from 11.5m to 16m and expanding its cargo handling capacity to 6.5 million TEU p.a.

In 2013, marine fleets operating in Indonesia amounted to 17,838 vessels, consisting of 13,120 national vessels, 354 foreign chartered vessels and 4,364 foreign agency vessels. The average growth rate of container handling by terminal yards in Indonesia handled by Pelindo I - IV ports corporations was 35% over the past 5 years. The new President, who made his acceptance speech on a traditional sailing ship in Sunda Kelapa harbor, Jakarta's historical trading port, has stated that the target of Tanjung Priok port in 2017 is approximately 15 million TEUs a year. In addition, the new Government is expected to improve and build 24 seaports and deep seaports as the main component of the "sea toll road" that is one of the main priorities of the new Government.

Tonnage through Indonesian ports amounted to 71,915,789 DWT in 2013, having dropped an average 13.6% p.a. since 2009. This decrease was due to a decrease in international cargo: with domestic cargo growing by 10.9% p.a. over the same period.

Indonesian ports are among the least efficient in South-east Asia in terms of lead times, which are 3 days compared to those of most ASEAN countries, which are only 1 day. Logistics costs from factories to Tanjung Priok ports for a 40ft dry container is USD 579: far higher than logistics costs from factories in Myanmar to port, which are USD 323, Cambodia is in the same range. Corresponding costs in Vietnam are lower again at USD 237.

### Clean water

Installed capacity of the 350 Regional Water Companies (with USD 1.3 Billion of total assets) is 159,043.5 l/s (litres per second) and produce 117,225 l/s for only 55 million people in their serviced areas, which contain an estimated 140 million people. That means only 40% of the population have direct access to clean water. Although there are 8.3 million water connections in Indonesia, half of Regional Water Companies are not considered as being in a "healthy" condition. In addition to that, 70% of Regional Water Companies do not apply Full Cost Recovery (FCR), which makes it difficult for the industry to improve profitability performance. In addition, only 32 Regional Water Companies have a Non-Revenue Water ratio below 20%

The average tariff of the 350 Regional Water Companies is estimated to be around IDR 3,273/m<sup>3</sup> and their average cost of goods sold excluding depreciation and interest is estimated at IDR 3,099/m<sup>3</sup>, which results in an operating surplus of only IDR 174/m<sup>3</sup>. Water tariffs need to use a FCR mechanism both for the 350 Regional Water Companies and the non-Regional Water Companies.

### Power

Growth in the demand for electricity over the next ten years is estimated 8.7% p.a., from 219.1TWh in 2014 to 464.2TWh in 2024. As of mid-2014, Indonesia's electrification ratio was 82%, above the Philippines (70%) but below Malaysia (100%), Thailand (99%) and Vietnam (96%), although some progress has been made since 2008 (62% electrification ratio). The slow progress of the Government's Fast Track Program (FTP) I and II is one of the main reasons for the low electrification ratio. FTP I and II were enacted through Presidential Regulations in 2006 and 2010. The new Government has introduced a new 35GW program as part of its total target for the next five years, of which 24.9GW will be awarded as IPPs.

The progress of FTP I (10,000 MW) was estimated at around 77% as of November 2014 since its enactment in 2006. Most of the delays were caused by contractor performance and permit and land acquisition issues, despite irrevocable and unconditional guarantees on loans (both interest and principle) for FTP I provided by the Government. As part of a strategy to reduce two step loans and in accordance with Presidential Regulation No. 48/2011, the Government is required to provide business viability guarantee letters ("BVGLs") on FTP II projects. However, FTP II progress is also slow due to projects struggling in their preparation stage. For FTP II (17,458MW), under Presidential Regulation No. 48/2011 revised by Minister of Energy and Minerals Resources Regulation No. 21/2013, PLN is responsible for investing in 32% of capacity with the remaining 68% to be available through public bidding by experienced and proven IPP investors under BOT/BOOT/BLT and lease schemes. PLN (a Fortune 500 company) is the main off-taker for the power industry.

There are 40 IPPs in operation (7,743 MW) and 173 (9,584 MW) under development, mainly in Java and Sumatra with coal as the main fuel source. PLN planning is being updated for a 35GW fast track program with an estimated US\$62.8 billion of investment needed over the next 10 years.

Equally important, transmission and distribution grids need to be well prepared and developed. To balance generator construction, PLN estimates that 59,000kmc of transmission and 164,400kmc distribution grids will be required, with estimated costs of USD20.6 billion and USD14.5 billion, respectively.

## Land acquisition is the key challenge underpinning progress

The lack of clear regulations on land acquisition for public use and the provision of land compensation to owners have caused delays to toll road and other infrastructure projects. There has been a long history of informal land ownership in Indonesia that gives rise to any number of individuals claiming the rights to the land during the land acquisition process. The implication of this is the need for an administrative process involving a number of government institutions to resolve land ownership issues, which is problematic.

Another frequent issue encountered is land owners holding on to their land as long as possible to benefit from appreciation in value while a project progresses, which has led to unexpected land cost escalation. Property prices in Indonesia and especially Java and Jakarta are increasing at a rapid rate.

Land acquisition issues have been one of the main obstacles for infrastructure projects in Indonesia. Enactment of Presidential Regulation No.36/2005 concerning Land Acquisition for Infrastructure Development was intended to outline the rules and procedures for infrastructure projects serving public purposes. However, the regulation was not effective due to vagueness in the rules.

The Government has enacted Law No.2/2012 concerning Land Procurement for Development Purposes in Public Interest to improve and put clarity around the land acquisition framework. However, for the Law to be practical, a Presidential Regulation elaborating on the law was required. "Presidential Regulation No.71/2012 concerning Administration of Land Procurement for Development Purposes in Public Interest" was issued on 7 August 2012 and subsequently, in the first week of November 2012, Regulation of BPN No.5/2012 was issued, which sets out technical implementation guidelines and rules. There is anticipation, now that these regulatory developments have occurred, that the prospects of progress being made and additional private funding flows being achieved will be improved.

## "Indonesia to ramp up infrastructure"

### Expenditure plans

Recognizing the pressing need for infrastructure development, the Indonesian government has increased its focus on improving the regulatory environment and stimulating infrastructure spending. Whether this can be achieved or not is open to discussion but what is certain is that long lead times are involved. Indonesia's 2011-2025 Development plan

comprises IDR 4,012 trillion (USD 440 billion) of investment, with IDR 1,786 trillion or USD 196 billion assigned for basic infrastructure and substantial investments planned for roads, railways, ports and power plants.

Under Indonesia's national medium-term development plan for 2015-2019, infrastructure investment has been targeted as requiring up to USD 550 billion for the economy to grow at its full potential. One fifth is allocated to roads/toll roads, around USD 107 billion is part of a connectivity program covering railways, mass transportation, sea transportation and to support airline industry by added more airports. Meanwhile, gas, energy, power, clean water, waste management and information technology investment is estimated at around USD 258.7 billion. Government/regional budgets are expected to fund 22%, and 78% is being sought from State Own Enterprises (SOE), public private partnerships, off balance sheet financing, loans and obligations.

As indicated, more infrastructure spending is expected over the next few years to fill the 22% gap of RPJMN targets.

### Government institutions

In September 2012, the World Bank approved a new project to support the newly established Indonesian Infrastructure Guarantee Fund ("IIGF"), an institution under the Ministry of Finance ("MOF") responsible for providing guarantees for infrastructure projects, or more specifically Public-Private-Partnership ("PPP") projects. With the World Bank's support, IIGF will be able to provide guarantees to leverage private investments in infrastructure projects such as toll roads, bridges, railroads, irrigation canals, wastewater infrastructure, telecommunication towers and power generators, among other undertakings.

PT Sarana Multi Infrastruktur (SMI) was established in 2009 to accelerate infrastructure development in Indonesia. The role of SMI is to become a catalyst in the acceleration of infrastructure development in Indonesia, to provide alternative sources of project financing by working with stakeholders to obtain appropriate financing solutions, to promote PPPs in financing infrastructure projects in Indonesia and to increase the size and capacity of SMI through partnerships with third parties.

The Indonesia Infrastructure Fund (IIF) was established as part of the government's 100-day Priority Program. IIF is an infrastructure financing company, majority privately owned, with initial shareholders being the Asian Development Bank ("ADB"), International Finance Corporation ("IFC"), Deutsche Investitions-und Entwicklungsgesellschaft mbH ("DEG") and PT SMI.

#### Sources:

- (1) KPMG Research and Intelligence
- (2) World Economic Forum 2014-15 and Logistic Performance Index 2014: Indonesia, World Bank
- (3) Ministry of Public Work, Bappenas, Ministry of Finance, Statistic Indonesia, Ministry of Transportation, Ministry of Energy and Mineral Resources, and PT PLN (Persero)

# 5. Investment



## Introduction

Indonesia welcomes foreign investment on its own terms. Government policies aim at ensuring that foreigners work with Indonesians to assist in development of the country's economy and skill-base. There is a general recognition that Indonesia needs the development capital, and the technical and management skills of foreigners.

Government regulation of foreign investment in Indonesia is manifested in a variety of ways, for example:

- approved and monitored through governmental bodies
- companies can employ only a limited number of expatriates, and are required to demonstrate plans for replacement of
- those expatriates by Indonesians (with the exception of expatriate directors and commissioners)
- certain fields of business are closed to investment by foreigners
- foreign individuals are permitted to acquire land or land rights with a number of restrictions.

A "foreign investor" is usually a foreign company incorporated under the laws of its host nation; however foreign individuals are also acceptable.

## Direct and Indirect investment

Law No.25/2007 concerning Capital Investment ("Investment Law") defines investment as Direct investment and Indirect investment. Indirect investments, also known as Portfolio investments, are transactions made through the domestic capital market/stock exchanges of a country. The Indonesian equity market is highly institutionalized, whereby over the period from 2002 to 2014 foreign institutions

generally held around 65-70% of the free-float value of the Indonesian equity market. At 31 December 2014, the foreign portfolio ownership was 72.1% of the Total Free Float Value of the Jakarta Composite Index (JCI).

The Indonesian government encourages Direct investment by foreigners or Foreign Direct Investment ("FDI") in most areas of the Indonesian economy, and less so in others. Foreign investment approvals can be issued either by BKPM in Jakarta or an Investment Board (BPM) in every Province, Investment Institution in Regency Municipality or through Representative Offices of the Republic of Indonesia in several countries.

## Investment Law, Negative List and FDI

The Investment Law regulates FDI by granting a right of entry to foreign businesses through a government licensing procedure principally controlled by BKPM. It specifies that foreign investment shall be in the form of a limited liability PMA Company incorporated in Indonesia, in which the investor goes into partnership with an Indonesian person or entity as shareholders. Foreign investors can hold between 30% to 95% ownership in various industries or even up to 100%, but this varies within sectors and business fields.

Foreigners are permitted to invest with no restriction on the maximum size of the investment, the source of funds or whether the products are destined for export or for the domestic market. This is except in an industry sector which is listed as closed to foreign investment on the Negative Investment List ("Negative List") which attaches to the Investment Law under Presidential Regulation. The principal starting position (not always the case in practice) is that all industry or fields of business are open to foreign investment unless mentioned otherwise in the Negative List. This is provided that certain conditions are fulfilled and foreign investment in an industry is not also regulated in Ministerial or other laws, regulations and decrees.

To invest in Indonesia, an investor must first look at the Negative List which is updated with policy changes every three years under the Investment Law. As indicated, if a business field is not mentioned in the Negative List, it is regarded as 'open' to foreign investment.

In general conceptual terms, the following lines of business are not open to FDI in Indonesia:

- those that are reserved for micro, small, medium enterprises and cooperatives
- those for which a partnership is required
- those for which certain shareholding arrangements are required
- those that may be conducted only in certain locations
- those for which a special license is required

The underlying principle is that if a business within a certain industry can be capably conducted by Indonesians, then that sector will be closed to foreign investment.

Navigating the Investment Law and Negative List together with other regulations, decrees or specific industry laws that can interplay with, override or supercede each other is fraught with danger. Professional advice is recommended together with consultation with government officials at BKPM and/or relevant Ministries that regulate specific industries on how the business field of a particular target or business is categorized.

#### **Negative List: Presidential Regulation No. 39/2014**

On 24 April 2014 the GOI's long awaited modifications to the Negative List became effective under Presidential Regulation No. 39/2014, revoking the previous Negative List under Presidential Regulation No.36/2010.

The 2014 Negative List did not provide for any real liberalization but a tightening of foreign Investment restrictions in key sectors.

There has been closing or tightening of restrictions in oil & gas services, retail trade, transportation, agriculture, small scale power generation, security services, trading and logistics. There has been opening up and some loosening in port facilities and energy, pharmaceutical, fixed line telecommunications and various sectors for investors from ASEAN member states, although these sectors are not typically where significant foreign investment interest has historically been directed. A possible exception is medical clinics and hospital services, and then only a nominal foreign investment limitation increase from 67% to 70% is given and then there are potentially unappealing geographical conditions.

Industry sectors where foreign ownership restrictions have been relaxed or sectors opened up:

- New lines of business have been opened up in Marine affairs and Fisheries and General or "other manufacturing" where requirement for Indonesian partnership is removed
- Sectors now more open to foreign shareholding include:
  - Pharmaceuticals (85% up from 75%)
  - Venture Capital financing (85% up from 80%)
  - Fixed line telecommunications (65% up from 49%)
- Foreign ownership which opened up or levels increased for ASEAN country investors include: market research; production of film promotion facilities advertising; tourism and recreation (motels and golf courses); specialist medical clinics, hospitals and nursing services
- There is higher foreign ownership of 95% to 100% for PPPs
- Port facilities and energy

Where there has been a tightening of limits or closure to foreign investment:

- Investment has been closed in sectors where in most cases the Negative List was previously "silent" and the sectors thus open: Oil & gas construction, on-shore (land) drilling and other supporting services; Retail trade across automotive, non-mini markets or department stores, textiles, garments and toys, cosmetics, footwear, electronics, food & beverage and e-commerce retailing as well as "alternative trading" business fields. In practice, retailing has been closed to foreign investment except for large scale hypermarket format. These new provisions formalize positions being taken in practice by BKPM
- The Foreign investment threshold has been reduced for small scale power generation (1-10 MW), now 49%; and certain offshore oil & gas drilling services business fields to between 49% to 75% (previously 100% and 95%)
- New restrictions have been imposed in various sectors previously excluded from the Negative List and therefore are no longer 100% open to foreign investment:
  - security services (49%)
  - oil & gas construction, offshore drilling and survey services (49% - 75%)
  - distribution, warehousing and cold storage has a new lower 33% limitation. The general position taken by BKPM is that a PMA Company cannot sell directly to end users but only through a 100% owned Indonesian distributor. Onshore distribution here is being distinguished from import and wholesale activity where foreign investors can take up to 100% ownership

### Grandfathering

Grandfathering provisions continue to apply to existing investments regardless that new foreign investment limitation reductions or closures have been introduced in the 2014 Negative List. Laws and regulations in Indonesia when made or enacted are generally not retrospective.

### Publicly listed companies and the Negative List

Based on the Elucidation to Art. 2 of the Investment Law, current practice is that foreign investment limitations and restrictions in the Negative List do not apply to Indirect (or Portfolio) investments, and thus public companies. However BKPM has openly communicated that this position is still subject to review; recent regulatory history is relevant.

In 2013 BKPM Regulation No. 5/2013 regarding Guidelines and Procedures for Capital Investment Licenses and Non-licenses dated 12 April 2013 (“BKPM Reg. No. 5/2013”) introduced new requirements for capital investment regulation and licensing, in particular formalizing prior “rules of thumb” and policies applied by BKPM: refer also Chapter 6 on Business Structure and Establishment under “Minimum investment”.

BKPM Reg. No. 5/2013 aligned with BKPM policy regarding a controlling share ownership in a public company as a Direct investment and not an Indirect or Portfolio investment, thus triggering an obligation to convert to a PMA Company and a potential requirement to comply with the Negative List.

In late 2013 BKPM issued Head of BKPM Regulation No. 12/2013 on “Head of BKPM Regulation No. 5 of 2013 on Guidelines and Procedures for Licensing and Non-licensing matters in relation to Investment”. BKPM Reg. No. 12/2013 revoked the position regulated in BKPM Reg. No. 5/2013 being that a public company did not need to convert to PMA status regardless of it having a foreign shareholder. It is understood that the revocation of this key (and other mostly procedural aspects) of BKPM Reg. No. 5/2013 was due to a recognition that elements of detail in the drafting of the regulation had been overlooked.

### List of business fields that are closed to foreign investments

Sector	Business Field
Agriculture	Marijuana Cultivation
Forestry	<ol style="list-style-type: none"> <li>Capturing of Fish Species as Stated in Appendix I Convention on International Trade in Endangered Species of Wild Fauna and Flora (CITES)</li> <li>The use (removal) of coral/atoll from nature for construction material/lime/calcium and souvenir/jewelry, also live or dead coral (recent dead coral) from nature</li> </ol>
Energy and Mineral resources	<ol style="list-style-type: none"> <li>Testing and analysis of electrical installations</li> <li>Electrical installation</li> <li>Oil and gas construction services:               <ol style="list-style-type: none"> <li>oil and gas upstream production</li> <li>conduit installation on land</li> <li>horizon/vertical tanks</li> <li>tanks and gas storage installation and marketing on land</li> </ol> </li> <li>Oil and gas drilling services on land</li> <li>Oil and gas supporting services:               <ol style="list-style-type: none"> <li>well operation and maintenance services</li> <li>oil and gas design and engineering services</li> <li>technical inspection services</li> </ol> </li> </ol>
Trade	<ol style="list-style-type: none"> <li>Retail of motorcycles and commercial vehicles</li> <li>Retail trade, namely retail sales in non-minimarkets, non-department stores, textile, games and toys in stores, cosmetic articles, footwear, electronics, mail order houses or via internet (consequently will restrict e-retailing for foreign ownership), and food and beverages</li> <li>Alternative trading, namely alternative trading systems and alternative trading system parties</li> </ol>

Sector	Business Field
Industry	<ol style="list-style-type: none"> <li>1. Chemical Material Industry that can damage the environment, such as: <ul style="list-style-type: none"> <li>• Mercury processed Chlorine Alkali Maker Industry</li> <li>• Pesticide active material industry: Dichloro Diphenyl Trichloroethane (DDT), Aldrin, Endrin, Dieldrin, Chlordane, Heptachlor, Mirex, and Toxaphene</li> <li>• Ozone depleting substances industry: Carbon Tetrachloride (CTC), Methyl Chloroform, Methyl Bromide, Trichloro Fluoro Methane (CFC-11), Dichloro Trifluoro Ethane (CFC-12), Trichloro Trifluoro Ethane (CFC-113), Dichloro Tetra Fluoro Ethane (CFC-114), 'Chloro Pentafluoro Ethane (CFC-115), Chloro Trifluoro Methane (CFC-13), Tetrachloro Difluoro Ethane (CFC-112), Pentachloro Fluoro Ethane (CFC-111), Chloro Heptafluoro Propane (CFC-217), Dichloro Hexafluoro Propane (CFC-216), Trichloro Pentafluoro Propane (CFC-215), Tetrachloro Tetrafluoro Propane (CFC-214), Pentachloro Trifluoro Propane (CFC-213), Hexachloro Difluoro Propane (CFC-211), Bromo Chloro Difluoro Methane (Halon-1211), Bromo Trifluoro Methane (Halon-1301), Dibromo Tetrafluoro Ethane (Halon-2402), R-500, R-502</li> </ul> </li> <li>2. Chemical Material Industry list-1 chemical weapons convention as stated in Appendix 1 of Law No. 9/2008 concerning on the use of chemical materials and the prohibition chemical materials as chemical weapons</li> <li>3. Beverage industry contains alcohol: <ul style="list-style-type: none"> <li>• Liquor</li> <li>• Wine</li> <li>• Beverages containing Malt</li> </ul> </li> <li>4. Manufacture of crumb rubber</li> </ol>
Transportation	<ol style="list-style-type: none"> <li>1. Implementation and Operation of Land Terminals</li> <li>2. Implementation and Operation of Weight Stations</li> <li>3. Telecommunication/Supporting Facility of Shipping Navigation and Vessel Traffic Information System (VTIS)</li> <li>4. Implementation of air navigation services</li> <li>5. Implementation of Motor Vehicle Type Tests</li> <li>6. Passenger land transport on scheduled routes (cross border transport) and unscheduled routes (tourism transport, specific destination transport, specific area transport)</li> </ol>
Communication and Information	<p>Management and Implementation of Radio Frequency and Satellite Orbit Spectrum Monitoring Stations</p>
Culture and tourism	<ol style="list-style-type: none"> <li>1. Public Museums</li> <li>2. Historical and Ancient Heritage (temples, castles, epigraphy, remains, ancient buildings, etc)</li> <li>3. Residential/Traditional Environment</li> <li>4. Monuments</li> <li>5. Gambling/Casinos</li> </ol>

Source: President Regulation No.39/2014, Investment Negative List

**FDI in specific sectors – Negative Investment List**

Sector Heading	Sub-sector Heading	Regulation of PDI
Agriculture	<ul style="list-style-type: none"> <li>Seeding plantation and crop cultivation (area more than 25 Ha)</li> </ul>	<ul style="list-style-type: none"> <li>Maximum 49%</li> <li>Requires a recommendation from Minister of Agriculture</li> </ul>
	<ul style="list-style-type: none"> <li>Seeding plantation and crop cultivation (area less than or equal to 25 Ha); Pig (less than or equal to 125 pigs) and free-range poultry breeding and farming; Plantation product processing</li> </ul>	<ul style="list-style-type: none"> <li>Reserved for micro, small, medium enterprises and cooperatives</li> </ul>
	<ul style="list-style-type: none"> <li>Pig breeding and farming for quantity of more than 125</li> </ul>	<ul style="list-style-type: none"> <li>Allowed in certain location and must not contradict with local regulation</li> </ul>
	<ul style="list-style-type: none"> <li>Use of genetic in agriculture product</li> </ul>	<ul style="list-style-type: none"> <li>Maximum 49% foreign shareholding</li> <li>Requires a recommendation from the Minister of Agriculture</li> </ul>
	<ul style="list-style-type: none"> <li>Plantation business (with and without processing unit or mill) including seedling, and product processing business (area equal to or more than 25 Ha)</li> </ul>	<ul style="list-style-type: none"> <li>Maximum 95% foreign shareholding</li> <li>Requires a recommendation from the Minister of Agriculture</li> </ul>
	<ul style="list-style-type: none"> <li>Horticulture (including cultivation, industry, research and development, agro tourism, etc.)</li> </ul>	<ul style="list-style-type: none"> <li>Maximum 30% foreign shareholding. This conforms with the Horticulture Law which requires divestment by November 2014</li> </ul>
Forestry	<ul style="list-style-type: none"> <li>Non-reptile wild life capturing and propagating; Swallow's nest business in nature; Forest plantation business (sugar palm, pecan, etc.); Pine sap, bamboo, and rattan processing primary industry; Forest processing prime product industry; Mangrove semi finished goods and saw mill - under 2,000 m<sup>3</sup>/year; Resin, eaglewood, shellac, bee, latex, natural silk, and alternative crop plant business</li> </ul>	<ul style="list-style-type: none"> <li>Reserved for micro, small, medium enterprises and cooperatives</li> </ul>
	<ul style="list-style-type: none"> <li>Hunting business, raising wildlife plants, coral raising/ cultivating</li> </ul>	<ul style="list-style-type: none"> <li>Maximum 49% foreign shareholding</li> </ul>
	<ul style="list-style-type: none"> <li>Nature tourism and ecotourism business</li> </ul>	<ul style="list-style-type: none"> <li>Maximum 51% foreign shareholding</li> </ul>
	<ul style="list-style-type: none"> <li>Capturing/taking and distributing reptiles and coral/decorative coral</li> </ul>	<ul style="list-style-type: none"> <li>Requires recommendation from the Minister of Forestry</li> </ul>
	<ul style="list-style-type: none"> <li>Development of technology use on plant and wildlife genetics</li> </ul>	<ul style="list-style-type: none"> <li>Requires a statement on partnership with accredited institution/national institution in research and development area appointed by the Minister of Forestry</li> </ul>
	<ul style="list-style-type: none"> <li>Wood processing industry</li> </ul>	<ul style="list-style-type: none"> <li>Require recommendation on sustainable raw material supply from the Minister of Forestry and compliance with President Degree No.6/2007.</li> </ul>
	<ul style="list-style-type: none"> <li>Timber utilization and forest plant's seed and seeding export and import; Water environment use service business in forest area</li> </ul>	<ul style="list-style-type: none"> <li>Requires 100% domestic capital</li> </ul>

## FDI in specific sectors – Negative Investment List (continued)

Sector Heading	Sub-sector Heading	Regulation of PDI
Marine Affairs and Fisheries	<ul style="list-style-type: none"> <li>Capture fisheries with a fishing ship of 100GT and/or more in capture areas in high seas</li> </ul>	<ul style="list-style-type: none"> <li>Open for foreign shareholding</li> <li>Subject to special licenses/permits from the Minister of Marine Affairs and Fisheries</li> </ul>
	<ul style="list-style-type: none"> <li>Fishery business with a fishing ship above 30GT and in capture areas above 12 miles (Big scale Fishing Business) and Sea Sand Extraction</li> </ul>	<ul style="list-style-type: none"> <li>Requires 100% domestic capital</li> </ul>
	<ul style="list-style-type: none"> <li>Small scale fishery processing business; Capture fisheries with a fishing ship of 30GT and/or in capture areas in 12 miles</li> </ul>	<ul style="list-style-type: none"> <li>Reserved for Micro, Small, Medium Enterprises and Cooperatives</li> </ul>
	<ul style="list-style-type: none"> <li>Marine, brackish water and freshwater fish rearing and hatchery; fishery processing, marketing, and distribution, wholesale fish products, export trade of fish product business</li> </ul>	<ul style="list-style-type: none"> <li>Requires a partnership with small enterprise</li> </ul>
	<ul style="list-style-type: none"> <li>Indonesian Exclusive Economic Zone ("ZEEI") fishing using 100GT ship or above</li> </ul>	<ul style="list-style-type: none"> <li>Requires a special license</li> <li>Compliance with the Ministry of Marine Affairs and Fisheries Regulation Number PER 12/MEN/2009 on Fish Catching Business</li> </ul>
	<ul style="list-style-type: none"> <li>Usage (taking) and distribution of decorative coral/atoll from nature for aquariums</li> </ul>	<ul style="list-style-type: none"> <li>Require recommendation from the Minister of Marine Affairs and Fisheries</li> </ul>
	<ul style="list-style-type: none"> <li>Lifting of valuable items from a Sunken Ship's cargo</li> </ul>	<ul style="list-style-type: none"> <li>Compliance with Presidential Decree Number 19 of 2007 concerning National Committee for Salvaging and Exploiting Valuable Objects Retrieved from Shipwreck</li> </ul>
Energy and Mineral Resources	<ul style="list-style-type: none"> <li>Less than 1 MW power plant</li> </ul>	<ul style="list-style-type: none"> <li>Requires 100% domestic capital</li> </ul>
	<ul style="list-style-type: none"> <li>Small scale power plant (1-10 MW)</li> </ul>	<ul style="list-style-type: none"> <li>Maximum 49% foreign shareholding</li> </ul>
	<ul style="list-style-type: none"> <li>Oil &amp; gas drilling service onshore; Oil and gas upstream production; Installation of pipeline onshore; Horizontal/ Vertical tanks; Installation of onshore oil &amp; gas storage; Well operation and maintenance services; Technical inspection services; Oil &amp; gas design and engineering services; Construction of electrical utility installation; Inspection and testing of electrical installation</li> </ul>	<ul style="list-style-type: none"> <li>Requires 100% domestic capital</li> </ul>
	<ul style="list-style-type: none"> <li>Power plant more than 10MW, power transmission, and power distribution</li> </ul>	<ul style="list-style-type: none"> <li>100% for foreign shareholding with a PPP arrangement during the concession period, otherwise maximum 95% foreign shareholding is applied</li> </ul>
	<ul style="list-style-type: none"> <li>Offshore oil and gas drilling services</li> </ul>	<ul style="list-style-type: none"> <li>Maximum 75% foreign shareholding</li> </ul>
	<ul style="list-style-type: none"> <li>Operation and maintenance of geothermal facility</li> </ul>	<ul style="list-style-type: none"> <li>Maximum 90% foreign shareholding</li> </ul>
	<ul style="list-style-type: none"> <li>Oil &amp; gas and geology &amp; geophysics survey services</li> </ul>	<ul style="list-style-type: none"> <li>Maximum 49% foreign shareholding</li> </ul>
	<ul style="list-style-type: none"> <li>Manufacture of biomass pellets for energy</li> </ul>	<ul style="list-style-type: none"> <li>100% foreign shareholding with an Indonesian partnership cooperation</li> </ul>
	<ul style="list-style-type: none"> <li>Oil and gas construction services:               <ol style="list-style-type: none"> <li>Platform</li> <li>Spherical tanks</li> <li>Conduit installation on sea</li> </ol> </li> </ul>	<ul style="list-style-type: none"> <li>Maximum 75% foreign shareholding</li> <li>Maximum 49% foreign shareholding</li> <li>Maximum 49% foreign shareholding</li> </ul>
	<ul style="list-style-type: none"> <li>Geothermal survey services</li> </ul>	<ul style="list-style-type: none"> <li>Maximum 95% foreign shareholding</li> </ul>
	<ul style="list-style-type: none"> <li>Drilling services of geothermal</li> </ul>	<ul style="list-style-type: none"> <li>Maximum 95% Foreign shareholding</li> </ul>
	<ul style="list-style-type: none"> <li>Construction of electrical generator installation; Electricity consultation service; Operational and maintenance electricity installation</li> </ul>	<ul style="list-style-type: none"> <li>Maximum 95% foreign shareholding</li> </ul>

**FDI in specific sectors – Negative Investment List (continued)**

Sector Heading	Sub-sector Heading	Regulation of PDI
Industrials	<ul style="list-style-type: none"> <li>Salting/drying fish; Processed food (seeds, roots, sago, gnetum gnemon nut); Root peeling and cleaning; Palm sugar; Hand work thread coloring; Cloth printing industry especially Batik and traditional patterns; Hand painted Batik; Knitted cloth (lace); Moslem woman's praying cloth; Rubber curing; Handicraft; Manual/semi mechanical hand tool and hand tool for farming; Clay made household (pottery); Motorcycle maintenance and repairing</li> </ul>	<ul style="list-style-type: none"> <li>Reserved for Micro, Small, Medium Enterprises and Cooperatives</li> </ul>
	<ul style="list-style-type: none"> <li>Food processing (copra, soya sauce, tempe, and fruits industry) ; Milk powder process and condensed milk industry; Printed batik; Forest product processing (rattan processing and rattan, bamboo preserving industry); Mangrove wood industry; Essential oil industry; Tobacco drying and processing; Construction material and spare parts; Medium technology machinery, tools, equipment industry and maritime tourism; Silver jewelry industry; Metal hand craft and non-metal recycle goods</li> </ul>	<ul style="list-style-type: none"> <li>Requires a partnership with small enterprise</li> </ul>
	<ul style="list-style-type: none"> <li>Car maintenance and repair industry</li> </ul>	<ul style="list-style-type: none"> <li>Maximum 49% foreign shareholding</li> </ul>
	<ul style="list-style-type: none"> <li>Cigarette industry</li> </ul>	<ul style="list-style-type: none"> <li>Required to obtain recommendation from the Minister of industry.</li> </ul>
	<ul style="list-style-type: none"> <li>Pulp industry</li> </ul>	<ul style="list-style-type: none"> <li>Requirement to obtain raw material from Industrial Forest plant (HTI) or imported wood chip if supplies from domestic sources are insufficient</li> </ul>
	<ul style="list-style-type: none"> <li>Valuable paper printing industry; essential ink industry</li> </ul>	<ul style="list-style-type: none"> <li>Requires an operational license from the Counterfeit Money Coordinating Agency under the National Intelligence Agency and a recommendation from the Ministry of industry</li> </ul>
	<ul style="list-style-type: none"> <li>Cyclamate and saccharin industry</li> </ul>	<ul style="list-style-type: none"> <li>Compliance with requirements of Indonesia's National Agency for Drug and Food Control ("BPOM") and the Minister of Trade</li> </ul>
	<ul style="list-style-type: none"> <li>Crumb rubber industry</li> <li>Lead smelting industry</li> </ul>	<ul style="list-style-type: none"> <li>Requires 100% domestic capital</li> <li>Requires a recommendation of the State Minister for the Environment and Minister of industry especially for the industry using used car batteries as raw material</li> </ul>
Defense and Security	<ul style="list-style-type: none"> <li>Explosives industry (raw materials and all components)</li> </ul>	<ul style="list-style-type: none"> <li>Maximum 49% foreign shareholding</li> <li>Requires a recommendation of the Minister of Defense</li> </ul>
	<ul style="list-style-type: none"> <li>Production of weapons, ammunition, explosive devices, and war equipment</li> </ul>	<ul style="list-style-type: none"> <li>Requires 100% domestic capital</li> <li>Requires recommendation from Minister of Defense</li> </ul>
	<ul style="list-style-type: none"> <li>Security consulting and provision of security guards; Money and valuable goods transport escorting services; Security equipment implementation, education and training services; Animal provider services; Security system devices and security education and training</li> </ul>	<ul style="list-style-type: none"> <li>Maximum 49% foreign shareholding</li> <li>Requires an operational license from the Republic of Indonesia Police Department</li> </ul>

**FDI in specific sectors – Negative Investment List (continued)**

Sector Heading	Sub-sector Heading	Regulation of PDI
Public Works	<ul style="list-style-type: none"> <li>Construction service under and/ equal to IDR 1 billion contract value</li> </ul>	<ul style="list-style-type: none"> <li>Reserved for Micro, Small, Medium Enterprises and Cooperatives</li> </ul>
	<ul style="list-style-type: none"> <li>Drinking water and toll road business</li> </ul>	<ul style="list-style-type: none"> <li>Maximum 95% foreign shareholding</li> </ul>
	<ul style="list-style-type: none"> <li>Construction service above IDR 1 billion contract value</li> </ul>	<ul style="list-style-type: none"> <li>Maximum 67% foreign shareholding</li> </ul>
	<ul style="list-style-type: none"> <li>Construction consultant service</li> </ul>	<ul style="list-style-type: none"> <li>Maximum 55% foreign shareholding</li> </ul>
	<ul style="list-style-type: none"> <li>Treatment and disposal of non-hazardous waste</li> </ul>	<ul style="list-style-type: none"> <li>Maximum 95% foreign shareholding</li> </ul>
Trade	<ul style="list-style-type: none"> <li>Direct selling through marketing network developed by business partner</li> </ul>	<ul style="list-style-type: none"> <li>Maximum 95% foreign shareholding</li> </ul>
	<ul style="list-style-type: none"> <li>Retail of motorcycles, spare parts, non-minimarkets, non-department store, textiles, games &amp; toys, cosmetic articles, footwear, electronics, online or offline retail shopping, food &amp; beverages; Large trade and property/real estate broker based on fee or contract; Machinery and equipment rental for land transportation, agriculture, construction, and office; Building cleaning service, and others (such as salon, barbershop, dressmaking, photocopy, etc.); Survey and other activities services related to survey; Alternative trading</li> </ul>	<ul style="list-style-type: none"> <li>Requires 100% domestic capital</li> </ul>
	<ul style="list-style-type: none"> <li>Public opinion polling and market research</li> </ul>	<ul style="list-style-type: none"> <li>Maximum 51% foreign shareholding for investors from ASEAN countries</li> <li>Closed for investors from non-ASEAN countries</li> </ul>
	<ul style="list-style-type: none"> <li>Distribution</li> </ul>	<ul style="list-style-type: none"> <li>Maximum 33% foreign shareholding</li> </ul>
	<ul style="list-style-type: none"> <li>Warehousing</li> </ul>	<ul style="list-style-type: none"> <li>Maximum 33% foreign shareholding</li> </ul>
	<ul style="list-style-type: none"> <li>Cold storage</li> </ul>	<ul style="list-style-type: none"> <li>Maximum 33% foreign shareholding for Sumatera, Java, and Bali</li> <li>Maximum 67% foreign shareholding for Kalimantan, Sulawesi, Nusa Tenggara, Maluku and Papua</li> </ul>
	<ul style="list-style-type: none"> <li>Futures brokers</li> </ul>	<ul style="list-style-type: none"> <li>Maximum 95% foreign shareholding</li> </ul>
	<ul style="list-style-type: none"> <li>Large trade of liquor (importer, distributor and sub-distributor), liquor retail business</li> </ul>	<ul style="list-style-type: none"> <li>Must have Business License Certificate (SIUP), Business License Certificate of Liquor Business (SIUPMB), have distribution network and a special place</li> </ul>

**FDI in specific sectors – Negative Investment List (continued)**

Sector Heading	side walk vendor liquor business	Regulation of PDI
Tourism and Economic Creative	<ul style="list-style-type: none"> <li>Homestay; Tour agent and guide services; Art studio and gallery</li> </ul>	<ul style="list-style-type: none"> <li>Reserved for Micro, Small, Medium Enterprises and Cooperatives</li> </ul>
	<ul style="list-style-type: none"> <li>Film promotional facility (advertisements, posters, stills, photos, slides, negatives, banners, pamphlets, billboards, etc.)</li> </ul>	<ul style="list-style-type: none"> <li>Maximum 51% foreign shareholding for investors from ASEAN countries</li> <li>Closed for investors from non-ASEAN countries</li> </ul>
	<ul style="list-style-type: none"> <li>Film taking studio, film processing laboratory, film dubbing facility, and film printing and/or duplication</li> </ul>	<ul style="list-style-type: none"> <li>Maximum 49% foreign shareholding</li> </ul>
	<ul style="list-style-type: none"> <li>Film distribution; Viewing/movie theatres; Film taking, editing and subtitling facility; Film making, distribution; Recording studio (Cassette, VCD, DVD, etc.)</li> </ul>	<ul style="list-style-type: none"> <li>Requires 100% domestic capital</li> </ul>
	<ul style="list-style-type: none"> <li>Private museum; Cultural heritage managed privately</li> </ul>	<ul style="list-style-type: none"> <li>Maximum 51% foreign shareholding and compliance with local regulations</li> </ul>
	<ul style="list-style-type: none"> <li>Art gallery and art performance building</li> </ul>	<ul style="list-style-type: none"> <li>Maximum 67% foreign shareholding</li> </ul>
	<ul style="list-style-type: none"> <li>Travel agency; Bar and café; Recreational and entertainment business (sports and golf field), Impresario business services, karaoke</li> </ul>	<ul style="list-style-type: none"> <li>Maximum 49% foreign shareholding</li> <li>Maximum 51% foreign shareholding with an Indonesian small scale business partnership</li> <li>Compliance with local regulations</li> </ul>
	<ul style="list-style-type: none"> <li>Other accommodation services (motel)</li> </ul>	<ul style="list-style-type: none"> <li>Maximum 49% foreign shareholding</li> <li>Maximum 51% foreign shareholding with an Indonesian small scale business partnership</li> <li>Maximum 70% foreign shareholding for ASEAN investors, in certain regions of Indonesia ( located in Java and Bali)</li> <li>Compliance with local regulations</li> </ul>
	<ul style="list-style-type: none"> <li>Golf course</li> </ul>	<ul style="list-style-type: none"> <li>100% foreign shareholding for investors from ASEAN countries, outside Java and Bali</li> <li>Maximum 70% foreign shareholding for ASEAN investors, in Java and Bali</li> <li>Maximum 49% foreign shareholding for investors from non-ASEAN countries</li> <li>Maximum 51% foreign shareholding for investors from non-ASEAN countries with partnership with Micro, Small, Medium Enterprises and Cooperatives</li> <li>Compliance with local regulations</li> </ul>
	<ul style="list-style-type: none"> <li>Restaurant, Catering, Hotel, SPA, Convention, exhibition and incentive tour service</li> </ul>	<ul style="list-style-type: none"> <li>Maximum 51% and compliance with local regulations</li> </ul>
<ul style="list-style-type: none"> <li>Natural tourism out of conservation areas</li> </ul>	<ul style="list-style-type: none"> <li>Maximum 51% foreign shareholding</li> </ul>	
<ul style="list-style-type: none"> <li>Dexterity</li> </ul>	<ul style="list-style-type: none"> <li>Maximum 67% foreign shareholding and compliance with local regulations</li> </ul>	

## FDI in specific sectors – Negative Investment List (continued)

Sector Heading	Sub-sector Heading	Regulation of PDI
Transportation	<ul style="list-style-type: none"> <li>International shipping (excluding sabotage)</li> </ul>	<ul style="list-style-type: none"> <li>Maximum 60% foreign shareholding for investors from ASEAN countries</li> </ul>
	<ul style="list-style-type: none"> <li>Transportation (container, general cargo, dangerous cargo, special cargo, heavy equipment, liquid &amp; gas cargo, plant &amp; animal cargo); Domestic and overseas sea transportation; Ferry; River and lake boat transportation &lt; 30 GT; Port facility (waste storing); Salvage service and/or underwater work; Airport services, Air transportation supporting service (ground handling, cargo and aircraft leasing); Terminal supporting business; Multimode transportation; Non-commercial air transportation; General selling agent (GSA) of Foreign air transport company; Airplane cargo service; Transportation arrangement service; other service related airport</li> </ul>	<ul style="list-style-type: none"> <li>Maximum 49% foreign shareholding</li> </ul>
	<ul style="list-style-type: none"> <li>Unloading/loading cargo (maritime cargo handling service)</li> </ul>	<ul style="list-style-type: none"> <li>Maximum 49% foreign shareholding</li> <li>Maximum 60% foreign shareholding for investors from ASEAN countries</li> </ul>
	<ul style="list-style-type: none"> <li>Crossing harbor and river and lake harbor provision and business</li> </ul>	<ul style="list-style-type: none"> <li>Requirement to cooperate with a company appointed by the government</li> </ul>
	<ul style="list-style-type: none"> <li>Passenger transportation and traditional shipping</li> </ul>	<ul style="list-style-type: none"> <li>Requires 100% domestic capital</li> </ul>
	<ul style="list-style-type: none"> <li>Commercial air transportation</li> </ul>	<ul style="list-style-type: none"> <li>Maximum 49% foreign shareholding. Domestic shareholding must hold majority</li> <li>Requires a special license</li> </ul>
	<ul style="list-style-type: none"> <li>Port facilities (jetty, building, cargo, handling terminal, liquid and dry bulk terminals, Ro-Ro terminal)</li> </ul>	<ul style="list-style-type: none"> <li>Maximum 95% foreign shareholding with a PPP arrangement, otherwise maximum 49% foreign shareholding is applied</li> </ul>
	<ul style="list-style-type: none"> <li>Operation of periodic testing of vehicles; Terminal construction (land passenger transport and general cargo terminal), but not management</li> </ul>	<ul style="list-style-type: none"> <li>Maximum 49% foreign shareholding</li> <li>Requires a recommendation from Minister of Transportation</li> </ul>
Communication and Informatics	<ul style="list-style-type: none"> <li>Community based broadcasting; Telecommunication and internet kiosk; Home and building cable installation</li> </ul>	<ul style="list-style-type: none"> <li>Reserved for Micro, Small, Medium Enterprises and Cooperatives</li> </ul>
	<ul style="list-style-type: none"> <li>Telephone value added service provider (e.g. content service, call center, ring tone, internet service provider, data communication system service, internet connection service, etc.); Network access point; Closed fixed and mobile telecommunication network provider; Internet interconnection service</li> </ul>	<ul style="list-style-type: none"> <li>Maximum 49% foreign shareholding</li> </ul>
	<ul style="list-style-type: none"> <li>Telecommunication device testing agency (laboratory test)</li> </ul>	<ul style="list-style-type: none"> <li>Maximum 95% foreign shareholding</li> </ul>
	<ul style="list-style-type: none"> <li>Fixed telecommunication network; Telecommunication network provider integrated with telecommunication services</li> </ul>	<ul style="list-style-type: none"> <li>Maximum 65% foreign shareholding</li> </ul>
	<ul style="list-style-type: none"> <li>Public radio and television broadcasting agency</li> </ul>	<ul style="list-style-type: none"> <li>Requires a special license (Monopoly only for Public Broadcasting Agency Radio Republic of Indonesia (RRI), Television Republic of Indonesia (TVRI), and Local Public Broadcasting (LPPL))</li> </ul>
	<ul style="list-style-type: none"> <li>Telecommunication tower business activities; Press company, magazine, bulletin; Private and subscription based broadcasting agency</li> </ul>	<ul style="list-style-type: none"> <li>Requires 100% domestic capital</li> </ul>
	<ul style="list-style-type: none"> <li>Private Broadcasting Agency (LPS)*; Subscription Broadcasting Agency (LPB)*</li> </ul>	<ul style="list-style-type: none"> <li>Requires 100% domestic capital and only for business addition and development, maximum 20% foreign shareholding</li> </ul>
<ul style="list-style-type: none"> <li>Mail provider</li> </ul>	<ul style="list-style-type: none"> <li>Maximum 49% foreign shareholding</li> <li>Mail provider must comply with regulations in the postal sector</li> </ul>	



### FDI in specific sectors – Negative Investment List (continued)

Sector Heading	Sub-sector Heading	Regulation of PDI
Finance	<ul style="list-style-type: none"> <li>Leasing and non-leasing financing; Venture capital</li> </ul>	<ul style="list-style-type: none"> <li>Maximum 85% foreign shareholding</li> </ul>
	<ul style="list-style-type: none"> <li>Insurance company (general insurance, life insurance, reinsurance, general insurance adjuster, insurance agent, insurance broker, and reinsurance broker); Actuary consulting company</li> </ul>	<ul style="list-style-type: none"> <li>Maximum 80% foreign shareholding</li> </ul>
	<ul style="list-style-type: none"> <li>Pension fund</li> </ul>	<ul style="list-style-type: none"> <li>Requires 100% domestic capital</li> </ul>
Banking	<ul style="list-style-type: none"> <li>Conventional People's Credit Bank ("BPR"), Sharia BPR and foreign exchange trader</li> </ul>	<ul style="list-style-type: none"> <li>Requires 100% domestic capita</li> </ul>
	<ul style="list-style-type: none"> <li>Foreign and non-foreign exchange bank, Sharia Bank, and Money market brokerage</li> </ul>	<ul style="list-style-type: none"> <li>Compliance with Law No. 7/1992 concerning Banking, Law NO. 23/1999 concerning Bank Indonesia, Law No. 21/2008 concerning Sharia Banking, and their amendments and implementation regulation</li> </ul>
Manpower and Transmigration	<ul style="list-style-type: none"> <li>Agriculture business activity and fisheries in transmigration areas</li> </ul>	<ul style="list-style-type: none"> <li>Requires a Transmigration Implementation License from the Minister of Manpower and Transmigration</li> </ul>
	<ul style="list-style-type: none"> <li>Indonesian workforce domestic placement, supplier and training services</li> </ul>	<ul style="list-style-type: none"> <li>Maximum 49% foreign shareholding</li> </ul>
	<ul style="list-style-type: none"> <li>Indonesian worker placement service</li> </ul>	<ul style="list-style-type: none"> <li>Requires 100% domestic capital</li> </ul>
Education	<ul style="list-style-type: none"> <li>Non-formal education business (e.g. private education services)</li> </ul>	<ul style="list-style-type: none"> <li>Maximum 49% foreign shareholding</li> </ul>
	<ul style="list-style-type: none"> <li>Formal education including early, basic and secondary, and higher education (starting from pre-school to degree/non-degree education program)</li> </ul>	<ul style="list-style-type: none"> <li>Compliance with Law No.20/2003 concerning National Education System and Implementation regulations</li> </ul>

**FDI in specific sectors – Negative Investment List (continued)**

Sector Heading	Sub-sector Heading	Regulation of PDI
Healthcare	<ul style="list-style-type: none"> <li>Pharmaceutical industry, i.e. manufacture of drugs raw materials, and manufacture of finished drugs</li> </ul>	<ul style="list-style-type: none"> <li>Maximum 85% foreign shareholding</li> </ul>
	<ul style="list-style-type: none"> <li>Hospital management and health assistance services (health aid and patient evacuation in emergency situations)</li> </ul>	<ul style="list-style-type: none"> <li>Maximum 67% foreign shareholding</li> </ul>
	<ul style="list-style-type: none"> <li>Calibration testing, health and medical equipment rental, maintenance and repair services; Acupuncture</li> </ul>	<ul style="list-style-type: none"> <li>Maximum 49% foreign shareholding</li> </ul>
	<ul style="list-style-type: none"> <li>Supporting health services (medical equipment rental)</li> </ul>	<ul style="list-style-type: none"> <li>Maximum 49% foreign shareholding (Can be conducted all over Indonesia)</li> </ul>
	<ul style="list-style-type: none"> <li>Specialist nursing treatment services</li> </ul>	<ul style="list-style-type: none"> <li>Maximum 70% foreign shareholding for investors from ASEAN countries, in all capital cities in eastern part of Indonesia except Makassar and Manado</li> <li>Maximum 51% foreign shareholding for investors from ASEAN countries, in Makassar and Manado</li> <li>Maximum 49% foreign shareholding for investors from non-ASEAN countries</li> </ul>
	<ul style="list-style-type: none"> <li>Pharmaceutical drug producer and wholesaler</li> </ul>	<ul style="list-style-type: none"> <li>Requires a special license from the Minister of Health</li> </ul>
	<ul style="list-style-type: none"> <li>Traditional medicine producer and business industry; Pharmaceutical including raw material, wholesaler, and drug store/pharmacy; Health care providers (hospital, health research center); Private maternity hospital; Clinic General Medical services; General hospital; Basic Health Service Facility; Health worker individual practice; Supporting health service (ambulance service, pest control service/fumigation)</li> </ul>	<ul style="list-style-type: none"> <li>Requires 100% domestic capital</li> </ul>
	<ul style="list-style-type: none"> <li>Clinical specialized dental services; Clinical specialized medical services; Hospital services (specialist/subspecialist)</li> </ul>	<ul style="list-style-type: none"> <li>Maximum 67% foreign shareholding</li> <li>Maximum 70% foreign shareholding for investors from ASEAN countries, in all capital cities in Eastern part of Indonesia, except Makassar and Manado</li> </ul>
<ul style="list-style-type: none"> <li>Hospital Services (mental rehabilitation clinic); Supporting health service (laboratory clinic, medical check up clinic)</li> </ul>	<ul style="list-style-type: none"> <li>Maximum 67% foreign shareholding (Can be conducted all over Indonesia)</li> </ul>	



## Foreign investment restrictions

### Fields of activity and local JV Partner

Initial investment proposals to BKPM need to be in fields currently open to foreigners, as do applications for capital or capacity utilization expansion of existing facilities.

Foreign investment will usually require a JV arrangement between the foreign investor and at least one local partner, either from inception of the project, or within a specified period for those companies which have approval to be wholly foreign-owned in the initial stages. The selection of a reliable and understanding local Indonesian shareholder and partner is essential. Unsuccessful foreign investment ventures can be associated with a background of tense relationships between local and overseas foreign shareholders. Once an investment is made, it can be a difficult, costly and painful exercise to extract or divest.

BKPM and industry regulators may maintain lists of potential local partners in certain fields from time to time, while banks, embassies and accounting firms can often provide information of a similar nature. In addition, accounting and investigation services firms can undertake independent, confidential corporate intelligence checks into the background and integrity of prominent or low profile local individuals.

### Minimum investment and equity participation: divestment rules

Foreign investors can hold up to 100% equity initially, except in the industries where the various limitations on maximum foreign ownership exist which vary within sectors and business fields.

The old "Foreign Investment Law" No. 1/1967 through implementing regulation GR 20/1994 expressly provided for where 100% foreign ownership is initially permitted, for the foreign shareholder to divest a minority share to an Indonesian shareholder within 15 years, and that 5% is the intended minimum divestment

The 2007 Investment Law which revoked Law No. 1/1967 is silent on divestment obligations. However, the general view is that implementing regulation GR 20/1994 remains valid, and thus the statutory obligation to divest. However, based on BKPM Circular Letter No. 23/SE/11/2008, a PMA Company established under the 2007 Investment Law is no longer required to divest whilst older companies established pre-2007 Investment Law, with BKPM approval letters containing a divestment obligation, are still required to divest.

In practice, BKPM appears not to be enforcing any divestment obligations for PMA Companies incorporated in the late 1990's operating in a business field where 100%

foreign ownership is permitted and now reaching the 15 year point to divest. The position on divestment obligations is further contained in a 2013 BKPM Regulation.

### *BKPM Regulation No. 12/2013 and divestment requirements*

Regulation 12 removes the requirement in Regulation 5 for a PMA Company which has complied with divestment obligations in the original BKPM foreign investment approval to maintain the shareholding composition of the new Indonesian shareholder. Thus the door is open to temporary divestments and subsequent disposals of shares to a foreign shareholder.

Regulation 12 provides for PMA Companies applying for divestment deadline extensions to furnish evidence that unsuccessful efforts have been made to identify a suitable Indonesian shareholder.

### Legal form

The Investment Law specifies that foreign investment shall be in the form of a limited liability company, *Perseroan Terbatas* (PT), incorporated in Indonesia in accordance with the requirements of the Ministry of Law and Human Rights ("MOLHR"). A PMA Company is a PT company having an approved foreign shareholding. Other forms of companies are addressed in Chapter 6.

### Term Limit

The operating permit for a PMA company is unlimited as long as the "PMA Company" is still active.

### Operations

The Investment Law grants the foreign investor the freedom to manage a company for the term of its permit approval, which includes the right to appoint directors and, if necessary, foreign technicians and managers, where skilled Indonesians are not available. Certain industries only allow expatriate Technical Advisors (with the exception of Board of Directors and Commissioners). More information on obligations around domestic and foreign employees is set out in Chapter 9 on Labor and Employment.

## Industries that are treated separately

### Introduction

Foreign investment in certain industries is not administered by BKPM, but by the relevant Ministry or regulatory authority directly. These industries are oil & gas, banking and non-bank financial institutions including multifinance, securities brokerage and asset management. While BKPM has some role in the approval of mining and forestry licenses, the principal approvals are granted by the Ministry of Energy and Mineral Resources (MEMR) and the Ministry of Forestry. Shipping, sea ports and telecommunications are other industries where regulation of foreign investment and related

approval applications has been complicated by multiple laws, regulations and decrees issued by more than one regulatory authority body or institution.

### Oil & Gas

Under Law No.22/2001 concerning Petroleum & Natural Gas ("the Oil & Gas Law"), the oil & gas sector was administered by two state owned legal entities: BP Migas for upstream operations and BPH Migas for downstream operations. Prior to establishment of BP Migas in 2002, regulation of the oil & gas sector was conducted by the State owned oil & gas company, PERTAMINA.

BP Migas had responsibility for management of the upstream operation of joint cooperation contracts which are predominately in the form of a Production-Sharing Contract (PSC), with the foreign party/contractor responsible to BP Migas for the execution of the operation. BPH Migas had responsibility for granting licenses and supervising the operation of the downstream business.

In November 2012 a Constitutional Court Ruling dismantled the legal basis for upstream oil & gas regulation by BP Migas following application by various prominent organizations on the grounds the 2001 law did not adequately manage the nation's natural resources for the benefit of the Indonesian people. Industry commentators had referred to the disbandment of BP Migas to be negative for investment sentiment at a time when crude oil production is declining. A temporary oil & gas regulatory authority or "Task Force", SKSP Migas, was established at the MEMR. Subsequently, in January 2013 a Presidential Regulation No.9/2013 was issued to establish a special task force, SKK Migas, to replace SKSP Migas.

Under the Oil & Gas Law, the industry is one of two that allows foreign participants to invest in the upstream oil & gas sector through a local branch of an overseas company (called a Permanent Establishment or PE, which is referred to further in Chapter 10 on Taxation).

### Banking

#### Introduction

Effective 31 December 2013, the regulatory and supervisory functions, duties and authority in the banking sector moved from the Central Bank, Bank Indonesia ("BI") to the Indonesia Financial Services Authority (Otoritas Jasa Keuangan or "OJK"). The OJK now regulates and supervises all financial institutions (banking, insurance, and other non-bank financial institutions). BI is responsible for macroprudential regulation and supervision. Both BI and the OJK are generally free from interference from the government.

Since the OJK took over, six new banking regulations have been issued, which are effective 1 January 2015. The focus of these new regulations is to: strengthen governance and risk management, increase supervision of smaller rural banks, encourage financial inclusion and improve the financial strength of Sharia banks.

Banking is the only other sector, in addition to upstream oil & gas, which allows foreign investors to invest direct into a local branch. Foreign banks are allowed to open branches in Indonesia; however, the government extends this advantage only to the world's 200 largest banks by assets and only if they have a minimum Standard & Poor's or Moody's credit rating of A. Further, the 300 largest banks in the world by assets can have a Representative Office in Indonesia to perform asset and relationship monitoring or to support a branch opening, but are restricted from offering banking services. No foreign bank branch licences have been issued since 2003; and foreign banks have only been able to enter through acquisition of existing banks.

#### Single Presence Policy

Bank Indonesia Regulation No.8/16/PBI/2006 updated by Bank Indonesia Regulation No. 14/24/PBI/2012 dated 26 December 2012, specifies a 'Single Presence Policy' in respect of Indonesian banks, which provides for no single person, entity or group of companies to own more than 25% or otherwise be a "controlling shareholder" in more than one Indonesian bank.

Exceptions to the 'Single Presence Policy' allowing an investor to be a controlling shareholder in more than one Indonesian bank are:

- the investor is a controlling shareholder in one conventional or commercial bank and one Sharia bank
- the investor is a controlling shareholder in two banks and one of the banks is a JV bank

Ownership structures that do not comply with the 'Single Presence Policy' need to be restructured through merger/consolidation, establishment of an investment holding company or establishment of a holding function.

A shareholder which meets the criteria as a "controlling shareholder" is subject to PBI 14/24/PBI/2012 as set out above, as well as PBI 14/8/PBI/2012 which is summarized below.



### *Shareholding thresholds and limitations*

Pursuant to Bank Indonesia Regulation No.14/8/PBI/2012 concerning Commercial Bank Share Ownership, the maximum amount of bank share ownership for a single shareholder depends on the category of shareholder. Shareholders that are related through share ownership or family ties, or that are deemed to be acting in concert with one another, are treated as a single party in determining the overall ownership cap that applies:

- banks, or a non-bank financial institutions: 40% of a bank's paid-up capital (subject to BI approving a higher amount: see below)
- non-financial institutions : 30% of a bank's paid-up capital.
- individual shareholders: 20% of a bank's paid-up capital (25% if the bank is a Sharia bank).

The New Bank Ownership Rules provide that only those 'non-bank financial institutions' that are: (a) authorized under their constitutional documents to participate in a 'long-term' investment; and (b) governed and supervised by a financial regulator/authority, are permitted to hold up to a 40% stake in an Indonesian bank. A non-bank financial institution which fails to satisfy these two criteria is only allowed to hold up to a 30% stake in an Indonesian bank.

The Central Government is exempted from the limits (as is any agency that is called on to rescue a failing bank). That means the limits do not apply to state-owned banks.

The regulation only affected future transactions. Pre-existing bank shareholders that exceeded the ownership thresholds are not required to divest unless the bank's Good Corporate Governance ("GCG") or "soundness" rating (as determined by Bank Indonesia) was 3, 4 or 5 at the 31 December 2013 cut-off date. GCG ratings range between 1 to 5, with 1 being the best. Foreign investors, (including Singapore's United Overseas Bank and OCBC Bank, HSBC and Malaysia's CIMB and Maybank) which already owned majority stakes in Indonesian banks were not automatically forced to cut their stakes to comply with the new limits. Existing shareholders of Indonesian banks that exceed the limits will be assessed on their financial strength and corporate governance. After 31 December 2013, existing bank shareholders need to sell down to the 40% cap within 5 years if GCG ratings are down graded to 3 or worse on three consecutive assessments.

For foreign or domestic investors that require a shareholding interest of more than 40% or a "controlling interest", application needs to be made to the OJK for approval. The bank must have a soundness rating of at least 1 or 2, financially strong - CAR tier 1 of minimum 6%, be publicly listed and have a recommendation from the bank's home regulator. An Indonesian bank that is acquired will need to sell at least 20% of its shares to the public within five years of the transaction. Additional capital must also be committed by agreeing to buy hybrid debt securities issued

by a local lender that are convertible into equity. A bank that receives approval to own more than 40% of a local bank will first be allowed to reach that 40% threshold. To raise its stake further, the local target bank must be assessed by the OJK to be financially strong and well-governed for three consecutive assessment periods within five years from the time the OJK approves the transaction. Notes accompanying the guidelines suggest that such assessments will be conducted in June and December each year. If the local bank does not meet those criteria, ownership will remain capped at 40%.

### *Foreign investor criteria*

Any prospective controlling shareholder who is a foreign investor must meet the following additional requirements:

- the investor is committed to support the economic development of Indonesia by owning shares in the bank
- the investor has obtained recommendation from the financial services supervisory authority of the country of origin
- the investor is ranked at least: (a) one notch above the lowest investment grade for banks; (b) two notches above the lowest investment grade for non-bank financial institutions; and (c) three notches above the lowest investment grade for non financial institutions.

### *Minimum capital requirements for commercial banks and Capital Equivalency Maintained Assets ("CEMA") for foreign banks*

On 27 December 2012, BI issued Bank Indonesia Regulation No. 14/26/PBI/2012, ("PBI 14") on Business Activities and Office Network in accordance with Banks' Core Capital. PBI 14 categorizes Banks into four types:

1. BUKU 1: each bank whose core capital is less than IDR 1 trillion;
2. BUKU 2: each bank whose core capital is at least IDR 1 trillion and less than IDR 5 trillion;
3. BUKU 3: each bank whose core capital is at least IDR 5 trillion and less than IDR 30 trillion; and
4. BUKU 4: each bank whose core capital is at least IDR 30 trillion.

The PBI 14 BUKU classification is important as it determines: (a) what kind of banking business activities can be conducted by a bank (e.g. ability to conduct business in foreign currency) (b) restrictions on the opening of offices (e.g. ability to invest offshore) and (c) obligations to provide credit and financing to productive businesses (the detailed permissions for each BUKU classification are beyond the scope of this document).

In December 2013, BI issued a new regulation, updating PBI14, setting a minimum capital requirement for commercial banks, to strengthen the country's banking system. Under the new regulation, the OJK requires a minimum 8% capital adequacy ratio for banks with the soundest risk profile (rating 1) and 14% for banks with a risk profile rating 5 (worst). On top of the 8-14%, banks are required to add a capital conservation buffer (an additional 2.5% by 2019). Additionally, the supervisor may impose a Countercyclical Buffer, at a discretionary percentage.

To calculate the minimum capital based on risk profile, the OJK requires banks to implement an Internal Capital Adequacy Assessment Process (ICAAP). The OJK will perform Supervisory Review and Evaluation Process (SREP) on the ICAAP, which includes review of the sufficiency of active supervision from the banks' management; capital adequacy assessment; monitoring and reporting as well as internal controls.

In particular for foreign bank branches operating in Indonesia, the OJK requires maintenance of a portfolio of assets called Capital Equivalency Maintained Assets ("CEMA") which is designed to serve as a liquidity buffer in the event of liquidity/solvency problems (or a "ring fence"). CEMA must be maintained at: (1) a minimum 8% of a bank's total liabilities every month; and (2) a minimum 8% of a bank's total liabilities every month and IDR 1 trillion at the minimum. Foreign branches must comply with the first CEMA requirement by November 2017 and with the second by December 2017.

#### *Micro small and medium business lending*

Banks must comply with a new regulation on provision for loans or financing to micro, small and medium business ("UMKM"), which is by 2015 at least 5% of total financing; by 2016 at least 10% of total financing; by 2017 at least 15% of total financing; and at by 2018 at least 20% of total financing. UMKM financing can include direct financing and indirect financing (executing or channeling by rural banks, syariah banks or non financial institutions). For joint venture banks and foreign branches, UMKM can include export financing (non-oil & gas).

#### *Basel III*

Indonesia, as a member of the Basel Committee on Banking Supervision (BCBS), is committed to adopting the Basel III framework. However, Basel III is only at very early stages of implementation in Indonesia.

BI issued BI Regulation No. 15/12/PBI/2013, effective 1 January 2014 regarding Minimum Capital Requirement. Banks are required to consider an additional Capital

Conversation Buffer progressively starting from 1 January 2016: 0.625%; 1.25% on 1 January 2017; 1.875% on 1 January 2018 and 2.5% on 1 January 2019. Banks are also required to consider a Countercyclical Buffer in Capital starting from 1 January 2016. Domestically-Significant Banks (DSIB) are required to consider a Capital Surcharge starting from 1 January 2016.

BI and the OJK have issued a draft Consultative Paper on Basel III for Liquidity Coverage Ration (LCR) and Leverage Ratio (LR). The Consultative Paper provides for a trial run on LR to commence in first semester 2015 with the effective implementation date being 1 January 2018. The LCR Consultative Paper indicates that implementation will be in stages starting 31 December 2015 targeting to 31 December 2019 for full implementation.

Foreign entrants will need to be mindful of the stringent requirements around Basel III which may involve sizeable investment based on what is being seen in other countries: systems and operational modifications, establishment of new risk management and compliance functions and hiring of rare, qualified resources as well as consulting fees and other costs. Functionality of Basel III will need to be carefully controlled and monitored going forward.

#### **Insurance**

Effective 1 January 2013, the OJK assumed the role of insurance industry regulator.

Since the OJK's formation, the insurance industry started to experience some regulatory changes, some of which are already in effect while others have yet to be fully implemented.

The 'New Insurance Law' (UU No. 40/2014) came into effect on 23 October 2014 replacing the previous Insurance law (UU No. 2/1992). Under both the old law and the New Insurance Law, Indonesian shareholders must hold at least 20% of the issued capital of any joint venture Insurance Business Company ("IBC"), while foreign shareholders can hold up to 80%.

#### ***Shareholding thresholds and limitations***

Under the Old Insurance Law, the Indonesian shareholders of an IBC can be Indonesian citizens and/or Indonesian legal entities fully owned by Indonesian citizens and/or Indonesian legal entities. The New Insurance Law has removed the italicized words meaning that an Indonesian corporate IBC shareholder must now ultimately be fully owned by Indonesian citizens in order to qualify as Indonesian. This now makes unlawful the use of the dual-layer PMA Company structure which foreign entities had previously utilized to ultimately own 100% of an IBC.

Insurance companies have five years in which to either:

- ensure that the shares that must be held by Indonesian shareholders are all directly or indirectly held by Indonesian citizens; or
- conduct an IPO, we presume with a minimum free float of 20%

#### **Single presence policy**

The New Insurance Law also introduced a 'single presence' policy to the insurance sector in Indonesia. This law provides that each party can only be the 'controlling shareholder' of one of each of the following categories of insurance companies:

- Life insurance company
- General insurance company
- Re-insurance company
- Syariah life insurance company
- Syariah general insurance company
- Syariah re-insurance company

The New Insurance Law does not provide further detail on how this new policy will be applied in practice in the event that a party is already, or becomes, the controlling shareholder of more than one entity in each of the relevant categories of insurance companies set out above, apart from specifying that the requirement must be complied with within three years of the New Insurance Law being promulgated.

Relevant OJK regulations need to be rolled out with further details in relation to what is considered a 'controlling shareholder' for the purpose of the New Insurance Law, and how any consolidation or merger requirement will be implemented (including whether pre-existing holdings, prior to the New Insurance Law taking effect, will be grandfathered).

#### **Other major changes introduced in the 'New Insurance Law'**

Other impacts include:

- Insurance and reinsurance companies must separate into a stand alone entity all sharia divisions within 10 years from the enactment of the New Insurance Law, or when the sharia component exceeds 50% of the total insurance portfolio, whichever is the earlier
- The insurance for any asset or risk located in Indonesia must be placed with a local insurer, irrespective of ownership of that asset or responsibility for a risk, unless no local insurer is able or willing to underwrite the risk. This removes the previous concession that allowed foreign entities to purchase insurance from offshore insurers

- A new policy assurance program replaces the existing mandatory guarantee fund, with the aim of providing protection to policyholders in case their insurer is liquidated or has its license revoked
- Insurance and reinsurance companies must optimize domestic capacity. In other words, domestic insurers and reinsurers must provide local reinsurance coverage "as far as possible". The intention is to encourage all insurers and reinsurers (both conventional and Sharia) to assist with the expansion of the local reinsurance market

#### **Minimum capital requirements**

Current regulations require an insurance company's minimum capitalization to be IDR100 billion. Indonesian Ministry of Finance regulation No.53/2012 further requires an insurance company to target its RBC solvency margin ratio at 120% and maintain its solvency margin ratio at minimum 100%. The regulator will require an insurance company to alter its business plan if it fails to exceed the 120% ratio.

#### **Other matters**

The OJK also requires insurance companies directors and commissioners to pass the 'fit and proper' test. This test includes requirements for an insurance company to have at least three directors and three commissioners (at least one independent commissioner).

#### **Other financial institutions**

Effective 31 December 2013 "Other financial institutions" including multi-finance companies (finance, venture capital, infrastructure finance, and microfinance ) pension funds, and securities companies (asset management, underwriting, and brokerage) and other financial services institutions (such as credit insurance institutions, Indonesian export finance agencies and pawn shops) are supervised and regulated by the OJK.

In 2014, the OJK issued 14 regulations covering non-banking financial institutions and capital markets. The OJK has signaled it will issue regulations around pension funds and venture capital in 2015.

Certain, older regulations continue to apply, including Law No. 11 of 1992 on the Pension Fund and Law No. 2 of 2009 on Indonesian Export Financing Institutions.

### **Multi-finance companies**

The multi-finance sector was previously regulated under Presidential Regulation No. 9/2009 on Multi-finance Institutions and MOF Regulation No. 84/PMK.012/2006 on Multi-finance Companies. On 19 November 2014, the OJK issued four regulations which relate to the multi-finance sector:

- OJK regulation No. 29/POJK.05/2014 concerning Arrangement of Multi-finance Company Business
- OJK regulation No. 28/POJK.05/2014 concerning Licensing and Organization of Multi-finance Companies
- OJK regulation Reg. No. 30/POJK.05/2014 concerning Good Corporate Governance for Multi-finance Companies
- OJK regulation No. 31/POJK.05/2014 concerning Arrangement of Sharia Multi-finance Business

These new OJK regulations provide more detailed requirements and definitions around multi-finance companies. OJK 29/2014 defines a multi-finance company as an entity that finances the procurement of goods or services. Permitted business activities include: (i) investment financing; (ii) working capital financing; (iii) multipurpose financing; and/or (iv) any other financing business subject to OJK approval.

Multi-finance companies are prohibited from engaging in banking, issuing promissory notes, or providing security, and they must maintain financial soundness at all times, including: an equity ratio (comparison of adjusted capital and adjusted assets) of 10%, minimum IDR 100 billion equity, and at least 50% of equity must be paid-up capital.

Any party wishing to engage in multi-finance activities must apply for a multi-finance business license from the OJK. The application review period is 30 days. Upon issuance of the OJK License, the company must commence operations within two months.

The maximum foreign shareholding (either direct or indirect) is 85% of the paid-up capital. Multi-finance companies having foreign ownership (whether direct or indirect) must have at least 50% Indonesian-citizen directors. In the event there is an odd number of directors, the number of Indonesian-citizen directors must be greater than the number of foreign-citizen directors.

The primary parties of a multi-finance company, (e.g. controlling shareholders, directors and commissioners) are required to pass the OJK Fit & Proper test (Regulation No. 4/POJK.05/2013), prior to holding their positions.

A multi-finance company with assets of more than IDR 200 billion is required to have: (i) at least three directors; (ii) two

commissioners and at least one independent commissioner; (iii) audit committee; (iv) a function assisting the commissioners in monitoring and ensuring the effectiveness of the internal control system and the implementation of internal and external auditors' duties.

A multi-finance company with assets of less than IDR 200 billion is only required to have two directors.

### **Capital markets and securities companies**

Any party wishing to engage in capital markets activities (e.g. a securities company) must obtain an operating license and approval and registration from the OJK.

The principal regulation governing the capital markets is Law No. 8 of 1995 concerning the Capital Market. There are also implementing regulations issued by the President of Indonesia, the Minister of Finance, the Capital Market and Financial Institution Supervisory Board (BAPEPAM-LK) and the OJK. The Indonesia Stock Exchange (IDX) also issues regulations and rules related to listing of companies and securities trading.

Based on Ministerial Decree No.153/PMK.010/2010 concerning Share Ownership and Equity of Securities Companies, there are several requirements:

- Investment manager, underwriter combined with investment manager, and brokerage combined with investment manager should at least have IDR 25 billion, IDR 75 billion and IDR 55 billion paid-up capital, respectively
- Foreign non-securities financial Institutions may own up to 85% of the paid in capital of JV securities companies
- Foreign securities companies that are licensed or regulated by their respective local regulators may own up to 99% of paid up capital of a JV securities company
- Both foreign and local investors may purchase up to 100% shares of local or JV securities companies both in the primary and secondary market
- Foreign ownership of a private securities company is limited to a foreign legal entity that operates in the financial services sector area or in securities.

## Mining

In January 2009, Law No.4/2009 on Mineral and Coal Mining ("2009 Mining Law") came into effect, replacing Mining Law No.11/1967, which provided for foreign investment in coal and minerals mining in Indonesia to be based on contractual agreements with the GOI. Government Regulation 23/2010, as amended by Government Regulation 24/2012, Government Regulation 1/2014 and Government Regulation 77/2014, is the principal regulation that implements the 2009 Mining Law. Under Law No.11/1967, there were essentially two ways any party could hold exploration and mining rights in Indonesia:

- a Contract of Work or "COW" (for minerals)/ Coal Contract of Work or "CCOW"
- a Kuasa Pertambangan (Mining Authorization or "KP").

No foreign entity could have an equity interest directly or indirectly in a company which held a KP. A KP could only be owned by an Indonesian legal entity owned 100% by Indonesian nationals. In practice however, many foreign entities controlled mining operations of a KP through nominees. Nominee shareholdings were expressly made unenforceable by Law No.25/2007 on Investment, after which many foreign "ownership" arrangements were structured through complex contractual agreements with a KP holder which were designed to give the foreign entity the economic benefit in the mining project albeit without any share ownership in the KP holder.

Unlike KPs, COWs or CCOWs were allowed to be owned by foreign-owned Indonesian entities. Standard forms of contract were developed over the years for each generation of COW, with different generations having different provisions. The most important differences across the generations relate to:

- applicable taxes
- ownership of minerals
- ownership of plant and equipment at site
- divestment requirements.

The 2009 Mining Law provides that no new COWs or CCOWs are to be granted and, instead, both foreign and domestic investors would be granted the same form of license (discussed below). Existing COWs were to remain effective until their expiry but certain terms were required to be amended to be consistent with the 2009 Mining Law by January 2010. This is yet to occur and negotiations between COW mining companies and the GOI/MEMR are continuing. It is expected that the amendments to existing CoWs will include the following:

- the extension of COW or CCOW will be granted in the form of a Special Mining Business License (IUPK)
- the state income should be amended in an effort to increase state revenue

- processing and refining activities are to be conducted onshore
- a reduction of the mining area granted under the COW or CCOW to bring it into line with the maximum mining areas provided for in the 2009 Mining Law. If a COW or CCOW holder is able to provide an activity plan over its larger mining area which satisfies the MEMR that the entire area will be utilized, the MEMR will allow the COW or CCOW holder to retain the larger mining area despite the area limitations in the 2009 Mining Law
- divestment requirements to be in line with the divestment requirements provided for in the 2009 Mining Law
- the priority of utilization of domestic manpower, goods and services

How far reaching the amendments to existing COWs or CCOWs are intended to be is not clear from the law. There is at least the potential for increases in mining cost structures and impacts on general operations.

The framework of the licensed based system in the 2009 Mining Law is applicable to both foreign and local investors including State-owned enterprises, Regional State owned enterprises, Indonesian limited liability companies (including foreign investment companies (PMA)) and Co-operatives. The law is built around the granting of a Mining Business License Area ("WIUP") and Mining Business License ("IUP") from a regional/provincial government or the central government. WIUP areas for coal or metal minerals are granted through a competitive tender process administered by the relevant level of government, and WIUPs for non-metal minerals or rocks by direct application to the relevant level of government. Once the WIUP has been awarded, an IUP for coal or the relevant mineral is granted to the winner. Which level of government (central, provincial or regional) has authority to award the WIUP and IUP depends on a range of factors including the geographical location of the mine, the location of any captive jetty and refining/processing facilities, and whether the entity has any foreign ownership. Separate Exploration and Production Operation licenses are issued, with the holder of an Exploration IUP being guaranteed to receive a Production Operation IUP automatically issued, provided certain conditions are met.

In April 2015, the MEMR issued a Circular Letter containing a formal Instruction for all local governments to transfer administrative authority over IUPs of all foreign owned (PMA) companies by 14 October 2015.

The 2009 Mining Law requires all existing KPs to be converted to IUPs. The MEMR maintains a "Clean and Clear List" which provides some comfort that an IUP has been validly issued and does not overlap with other mining contracts or licenses, but not whether it is free of other competing land uses.

The 2009 Mining Law removed the legal certainty provided under the contract-based COW system when replaced by the license based IUP regime leaving investors open to changes in government policy. There has been significant regulatory uncertainty following the issuance of the New Mining Law, and there remains a lack of clarity around the operation of the law and various subsequent implementing regulations. In practice, mining companies have reacted in a range of different ways from doing nothing until more clarity is obtained, to aggressively restructuring mining activities and operations to comply with their interpretation of the law.

Key implementing regulations for the 2009 Mining Law issued to date (and the areas key subjects which they regulate) are:

- Ministerial Regulation No.18/2009 on “Change of investment terms in COW and CCOW companies” dated 19 August 2009 - requirements for COW and CCOW holders to obtain approval of MEMR to certain corporate actions, including changes in shareholding
- Ministerial Regulation No.28/2009 on “Implementation of Mineral and Coal Mining Services” dated 30 September 2009 as amended by Ministerial Regulation No.24/2012 - requirements for mining companies when using service providers, with the key principle being that preference must be given to local/national service providers over foreign-owned providers
- Ministerial Regulation No.34/2009 on “Preferential supply of domestic Mineral and Coal demands” dated 31 December 2009 - obligations of mining companies to sell a certain percentage of their production to the domestic market
- Government Regulation No.22/2010 on “Mining area” dated 1 February 2010 - umbrella regulation setting out the determination of mining areas within Indonesia (including Peoples Mining Area, WUPs and State Reserve Areas)
- Government Regulation No.23/2010 on “Mining business activities” dated 1 February 2010 as amended by Government Regulation 24/2012, Government Regulation 1/2014 and Government Regulation 77/2014 - umbrella regulation setting out general requirements for holders of mining business license
- Government Regulation No.55/2010 on “Supervision, consultation and guidance on mining activities” dated 5 July 2010 - intergovernmental arrangements regarding the supervision of the mining sector within Indonesia
- Ministerial Regulation No.17/2010 on “Determination of the reference price for Mineral and Coal sales” dated 23 September 2010 - requirements for mining companies to sell their coal/minerals with reference to a Government benchmark price
- Government Regulation No.78/2010 concerning Reclamation and Post Mining dated 20 December 2010 - umbrella regulation governing obligations of mining companies to carry out reclamation and rehabilitation work at completion of mining activities
- Ministerial Regulation No.1/2014 concerning Adding Value to Minerals Through Processing and Refining Activities dated 11 January 2014 - requirements for mining companies holding licenses for mineral production to carry out onshore processing prior to export.
- Ministerial Regulation No.27/2013 concerning Procedures and Determination of Shares Divestment Price, and Change of Investment in Mineral and Coal Mining Business Activities dated 13 September 2013 - requirements for foreign shares divestment and change of investment in mining companies.
- Ministerial Regulation No.32/2013 concerning Procedures of Granting of Special Licenses in Mineral and Coal Mining Business Activities dated 19 November 2013 - procedures for obtaining mining business license for trading and transportation, and mining business license for processing and refinery.
- Ministerial Regulation No.28/2013 concerning Procedures of Tender of Mining Business License Area and Special Mining Business License Area in Mineral and Coal Mining Business Activities dated 13 September 2013 - tender procedures for mining business license area.

Majority or wholly foreign-owned companies holding an IUP need to gradually divest shares of the mining company to an Indonesian participant (being Central/Regional Governments, Central/Regional Government owned companies or 100% Indonesian owned private companies) starting 5 years from commencement of production, such that by the end of the 10th year from when production starts, the foreign shareholding is no greater than 49%.

At the time of writing, media reports are indicating that the New Mining Law is being revised by the GOI to regulate certain new matters (e.g. the authority of governors in regards to permitting process, better access of state-owned companies in obtaining mining permits as well as grouping of mining commodities that are considered to have strategic importance to the country). It will be interesting to see what happens next with the hope these changes will improve and provide some regulatory certainty around the mining investment climate in Indonesia.

### Other industries

Forest concessions are issued to Indonesian companies for specified activities, such as industrial estate forestry, natural wood forestry and rattan wood forestry. A number of forestry activities are restricted to domestically owned businesses.

Other industries where foreign investment regulation is to varying degrees under the control of Ministries through Ministerial Regulations, decrees or other authorities include shipping, construction, sea ports, telecommunications, healthcare and pharmaceutical and now plantations with the introduction of a new "Law on Plantations" effective October 2014, replacing the existing 2004 framework. Designed to attract more investment in the plantation industry sector, legal uncertainty in the drafting is having the opposite effect with an Implementing Regulation on foreign investment needing to be issued: this is expected to articulate the extent of changes, if any, to the current 95% foreign ownership level.

As indicated, navigating the Foreign Investment Law, Negative List and other regulations, Ministerial decrees or specific industry laws that also can regulate foreign investment is fraught with danger without professional advice and support.

A good example of this is the shipping industry where some or all of the following (depending on the sector) may need to be considered in addition to the Negative List:

- the Negative List and ASEAN country exemptions referred to in the Negative List
- Law No.17/2008 regarding Shipping
- Government Regulation No.20/2010 concerning Water Transport
- Government Regulation No.9/1999 concerning Commodities future trading and Decree No.33/2001 concerning Implementation and Utilization of Sea Transport
- Presidential Decree No.61/1988 concerning Financial Institutions
- Presidential Instruction No.5/2005 on National Sailing Industry empowerment and Ministry of Transportation Regulation
- Regulation No.71/2005 which applies the principle of Cabotage
- Discussions with BKPM and the Ministry of Transportation.

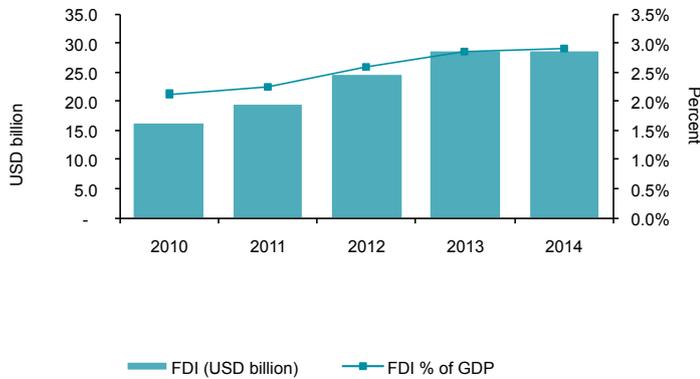
### Composition of FDI: Country of origin and Industry

Indonesia FDI by sector 2014 - 2015									
No	Sector	Investment value (IDR trillion)	Investment value (USD million)	No. of project	No	Sector	Investment value (IDR trillion)	Investment value (USD million)	No. of project
1	Mining	46	4,816	820	1	Mining	50	4,665	950
2	Motor Vehicles & Other Transport Equipment Industry	35	3,732	342	2	Food Industry	34	3,140	1,054
3	Metal, Machinery & Electronic Industry	31	3,327	679	3	Transport, Storage & Communication	32	3,001	333
4	Chemical and Pharmaceutical Industry	30	3,142	430	4	Metal, Machinery & Electronic Industry	27	2,472	986
5	Electricity, Gas & Water Supply	21	2,222	156	5	Chemical and Pharmaceutical Industry	25	2,323	578
6	Food Industry	20	2,118	797	6	Food crops & Plantation	24	2,207	586
7	Food crops & Plantation	15	1,605	520	7	Motor Vehicles & Other Transport Equipment Industry	22	2,061	442
8	Transport, Storage & Communication	14	1,450	198	8	Construction	15	1,384	199
9	Paper and Printing Industry	11	1,169	103	9	Electricity, Gas & Water Supply	13	1,249	221
10	Non Metallic Mineral Industry	8	874	138	10	Real estate, Industrial Estate & Business Activities	13	1,168	387
11	Others	39	4,162	5,429	11	Others	52	4,860	6,896
	<b>Total</b>	<b>270</b>	<b>28,618</b>	<b>9,612</b>		<b>Total</b>	<b>307</b>	<b>28,530</b>	<b>12,632</b>

Source: BKPM website: [www.bkpm.go.id](http://www.bkpm.go.id), January 2015

Note: The data tabled above from BKPM excludes investments in the oil & gas, banking, non-banking financial services, leasing, investment for which investment approvals and licenses are granted and issued by the relevant Ministry or regulatory authority. Portfolio and Household investment is also excluded.

### Foreign Direct Investment 2010 - 2014



Source: BKPM website: [www.bkpm.go.id](http://www.bkpm.go.id), January 2015

The Japanese have been heavily investing in Indonesia since the 1970's and generally have not been dissuaded by economic blips or bumps, regulatory or other country investment risks. A softening of inflows in 2014 was attributable more to domestic economic conditions and the political landscape in Japan. With domestic organic and acquisition growth opportunities shrinking, Japanese corporates are actively looking for expansion opportunities abroad. The Japanese know emerging markets well, and are well received in South-east Asian countries like Indonesia, Thailand and Vietnam which the Japanese generally prefer to China.

Foreign investors from many countries typically structure transactions through group holding companies or other entities in Singapore for tax structuring and other reasons, thus distorting to some degree the ranking of Singapore in the foreign investment stakes.

In terms of industries, foreign investment in the mining sector through M&A has dramatically declined in recent years due to regulatory uncertainty and falling commodity prices. The composition of foreign investment in 2013 and 2014 is believed to be largely comprised of existing capacity expansions by a few large players in this highly capital intensive Industry and not new FDI.

BKPM classifies investment into three categories: FDI, Domestic Direct Investment or "DDI" and Non-direct Investment which includes foreign and local domestic expenditure on housing and commercial buildings, transportation, machinery and heavy equipment. Both FDI and DDI will comprise the following investment types:

- M&A
- Greenfield
- Existing capacity expansions (which also require BKPM approval and licensing)

As indicated, historical economic growth levels have largely been driven by domestic consumption with investment making up around 30% of the Indonesian economy (China: 48% in 2014). It is relevant that foreign investment through M&A will represent only a portion of total reported FDI, with the balance being capacity utilization expansions undertaken by foreign companies on their existing investments in Indonesia and new Greenfield investments.



Total reported FDI inflows were relatively flat in 2013 and 2014 in USD currency. In IDR terms (as reported by BKPM), a 14% increase of IDR37 trillion was achieved due to depreciation of the IDR against the USD. The data compiled and presented each year by BKPM excludes investments in the oil & gas, banking, non-banking financial services, leasing and investments where investment approvals are granted and licenses issued by the relevant Ministry or regulatory authority (Portfolio and Household investment is also excluded).

### Foreign investment and market entry

Foreign investors have a number of options in terms of market entry:

- Share acquisition (Buy-out majority and minority) through M&A
- Asset acquisition deals or transfer through M&A
- Greenfield through establishment of a PMA Company
- Partnership arrangements under distribution agreements with an Indonesian distributor or importer

Analysis and discussion of the benefits, risks, challenges, opportunities and pitfalls surrounding each of the above is outside the scope of this publication. The steps involved in establishment of a PMA Company, a Representative Office and other less common options are addressed as part of Business Structures and Establishment in Chapter 6.

### Country investment risks and practical insights

#### *Country investment risks*

Political instability and economic uncertainty together with some other country risks that prevailed post-Asian Economic Crisis and in the years leading up to the 2008 GFC largely disappeared some time ago, with the major remaining ones being:

- Regulatory risk around foreign investment and other laws; underpinned by
- Legal uncertainty from unclear, conflicting laws and regulations and delayed law changes. This also applies to the tax regime; and
- A judicial system still in need of significant reform. Enforcing rights under contracts and agreements in the Indonesian courts is not a preferred route for foreign or Indonesian investors (refer Chapter 2 and "The type of legal system").

In addition, a lack of adequate infrastructure, crucial to sustained long term economic growth, including basic road, as the platform for other primary and secondary infrastructure, continues to hamper development across the country, as well as adversely impacting cost structures and the international competitiveness of Indonesian companies. Investment in education and healthcare is also crucial to maintain sustained levels of economic growth.

A new key country investment risk that emerged post GFC, when the Indonesian economic growth story really took flight, is a human capital shortage which is restricting Indonesian companies from reaching their potential, and is now a potentially key constraint to economic growth. This is a function of deficiencies in the formal and tertiary education sectors which would benefit from investment by foreign higher education strategic corporates and PE Houses. Also, continuing rapid population growth, a reducing rate of poverty reduction and increase in the number of Indonesians living below the poverty line, are restraining economic growth by stagnating domestic consumption in the lower income class.

Foreign currency risk has resurfaced as a potential country investment risk when in 2013 the IDR encountered some volatility before progressively depreciating through 2014, adversely impacting the operating performance of foreign exchange risk exposed Indonesian companies.

Corruption is still endemic in government and some other circles, but not uncommonly viewed by many foreign investors as being manageable, particularly those which have had a presence in Indonesia or Asia for a long time. A potential exception exists if an investor needs to formally comply with Foreign Corrupt Practices Act (FCPA) or UK Anti-bribery Act (UKBA) due diligence (but even then adverse findings can have remedial options). What are considered common practices forming part of day-to-day business in Indonesia in order to "get things done" might not pass corporate governance standards in developed Western markets. Efforts by recent governments to tackle corruption have generally been commended. It is slightly ironic that a myriad of local Indonesian Anti-bribery and corruption laws, regulations and decrees administered by various different regulatory authorities are actually more onerous than the corresponding FCPA and UKBA.

In 1999 the GOI implemented Law No.22/1999 regarding Regional Governance or the "Regional autonomy Law" designed to decentralize certain powers to the regencies. This has adversely impacted companies operating in ENR sectors and remote geographical locations through double taxation or local regulations conflicting with higher central government law. Recent reports from the Home Affairs Ministry refer to 780 problematic regulations out of 13,000 most relating to implementation of local taxes.

Uncompetitive labor laws create challenges for employers, particularly those operating in highly labor intensive industries. The revised Law No.13/2003 on Labor imposes onerous obligations on employers in the areas of the ability to involuntarily terminate and severance benefits: refer to Chapter 9.



### *Practical insights and observations*

Indonesia has an abundance of foreign capital lining up for investment, but a relative lack of readily identifiable targets and deals to invest in. For a combination of reasons, deal origination, execution and completion presents significant challenges right across the transaction cycle for foreign and local investors alike. Sustained investment interest and transaction activity are accompanied by high deal execution risks which translate into volatile country FDI inflows. It is common for transaction and due diligence timetables to experience slippage, and the rate of deals “falling over” or aborting is high. Reasons include overcooked pricing or pricing mismatch, transactions structuring complications and other “deal breakers” or deficiencies found in due diligence.

Despite all the challenges and frustrations, for foreign investors that “get it right” by finding the right local Indonesian partner, and the right “best fit” target at the right price, a not uncommon story is that a multinational’s Indonesian investment can be its most profitable and favorite in South-east Asia.

Many global and local PE firms, foreign strategic corporates and international Trading Houses from diverse countries (with Japan and Korea featured prominently) have prioritized Indonesia as one of their “Top 3” preferred FDI destinations in South-east Asia, if not the destination of choice. A number of governments have also openly signaled that Indonesia is their country’s preferred investment destination.

Post GFC, the large international PE Houses generally started to shift attention away from China and India finding those countries’ investment landscapes too difficult, crowded or overpriced, with better opportunities and less competition for foreign capital in South-east Asia. There are indications that investment activity by global PE Houses in Indonesia may finally be gaining some momentum and traction in 2015 after a slow start. Local PE Houses have been active to varying degrees for many years.

2014 and 2015 has seen the potential for M&A deal origination opportunities with Indonesian targets slowly starting to surface and become more visible, in what is still however a seller’s market. The passing of time has seen prospects of opportunities opening up for foreign investors in large, diversified family owned Indonesian private company groups as the aging patriarch or a key decision-maker becomes resigned to the fact that immediate family succession options are “stretched too thin,” and there being no option but to divest certain businesses, many of which are well performing despite perhaps not getting the management attention they deserve. Previous “willingness to sell” barriers may finally be starting to alleviate within these often large diversified groups. A “prodical son” or daughter returning from overseas studies and/or business experience is usually more approachable and commercial than his or her father, also bringing home a recognition that partnering with the right foreign Investor can deliver scale, expertise, a new customer platform or other values to a business operating in a competitive Indonesian domestic environment to preserve is longevity.

To conclude, there are risks and challenges in investing and doing business in this emerging, high growth market, and Indonesia continues to be a difficult country in which to do business, relative to Western or more developed Asian markets. A successfully planned and executed investment however can be very rewarding. Foreign investors, of course, take a country’s investment risk profile into their overall investment models and decision-making policies. Indonesia is no different. To successfully invest in Indonesia and reap the benefits from a large, rapidly expanding population and all the upside of a quite remarkable economic growth story, having a degree of risk appetite is fundamental.

---

#### Sources:

- (1) KPMG Research and Intelligence
- (2) Bloomberg, March 2015
- (3) Discussion with Investment Banking Equity Analyst: March 2015
- (4) Indonesia Investment Coordinating Board (BKPM), “Domestic and Foreign Direct Investment Realization in Quarter IV and January – December 2014,” 28 January 2015
- (5) Indonesia Investment Coordinating Board (BKPM) Press Release, “Domestic and Foreign Direct Investment Realization Steadily Increased, Beyond the Annual Target of 2014,” 28 January 2015

# 6. Business Structures and Establishment



## The Company Law

The Company Law issued in 1995 stipulates the legal framework for companies. Previously, business was regulated by the provisions of the Indonesian Commercial Code and Indonesian Civil Code. These were drafted in the last century based on Dutch Colonial Law. The 1995 Company Law was most recently amended by Law No.40/2007 concerning Limited Liability Company (“the Company Law”).

## Legal entities for doing business

There are a number of legal forms of entities that can engage in business in Indonesia:

- Sole Proprietor: proprietor has unlimited liability
- General Partnership (FA or “Firma”): partners have joint and several unlimited liability
- Limited Partnership (CV): silent partners are liable to the extent of their capital contribution, while managing partners have unlimited liability
- State-Owned Corporation (BUMN): company owned by the government and reliant upon the state to fund any deficit
- Branch of a foreign corporation: foreign companies cannot, in most cases, establish operations in Indonesia through a locally-registered branch; banking and upstream oil & gas being the only exceptions
- Limited Liability Companies (PT): shareholders have limited liability.

As indicated, a PT company formed with a foreign shareholder in accordance with the requirements of the Investment Law and BKPM rules and regulations is referred to as a PMA Company, and PTs with domestic investment status are known as Domestic investment companies or “PMDN”. A “PT Biasa” is the term given to a local Indonesian private company administered by the MoT which is unlikely to be directly relevant to foreign investment. A customs Master List regulated by BKPM provides Import Duty relief and incentives on import of machinery and equipment for initial and capacity expansion investments made by PMA and PMDN companies. An older Dutch form of limited liability company, known as NV, still exists but no new companies are formed in this way.

For foreign investors, a PMA Company is the only form permitted under the Investment Law. However, foreigners may have a presence other than through a direct investment, and this is discussed later in this Chapter.

## Establishment and application procedures for incorporation of a PMA

The provisions relating to the PT are contained in the Articles of Association (“AoA”) formed by the Notarial Deed of Establishment.

The AoA contained in the Deed address, among other things:

- Rights and duties of shareholders
- Rights and duties of commissioners and directors
- Name of the company, its purpose, duration, domicile
- Authorized capital and the division into shares
- Number of shares taken by founders
- Dividends.

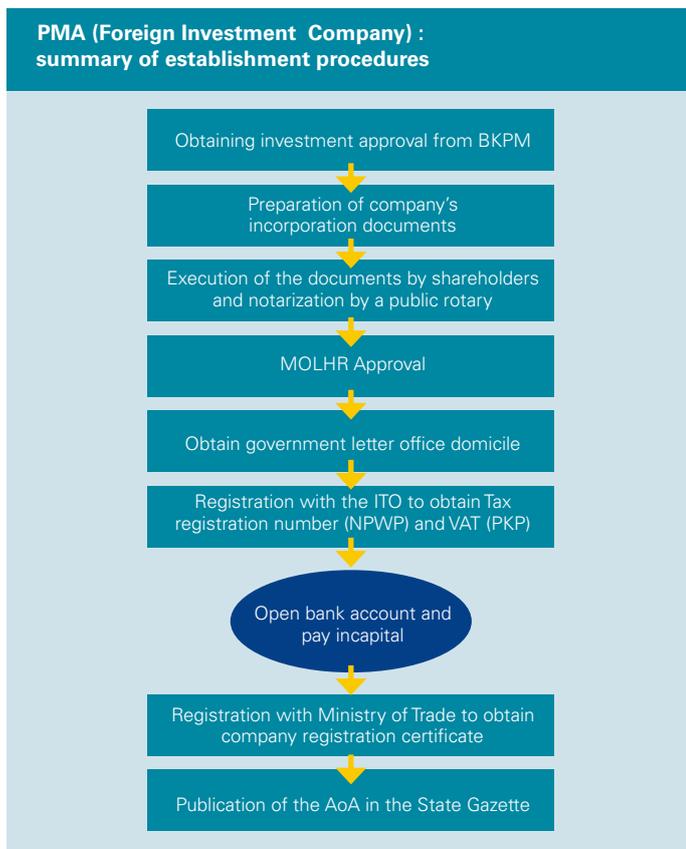
Once the nature of the project and size of investment have been established, registration must be made with BKPM. Historically the registration needed to be supported by a description of the proposed business activities and with copies of:

- Notarized AoA for both foreign and local parties, or a copy of a passport for individual shareholders
- Tax payer registration number (NPWP) including Letter of Domicile; and operating license (SIUP) of local party
- Letter of Power of Attorney ("PoA") from shareholders
- Documentary evidence of receipt of capital being paid-up by shareholders.

Now the process can be fast-tracked as follows:

- All of the above are covered in a Statement Letter(s) from shareholders
- The Notary attends the offices of the MOLHR for registration processing.

The summary of establishment procedures below reflects this process.



Notes:

- (1) In practice, publication of the AoA in the State Gazette can take up to 12 months, however this is procedural only and does not impact establishment or ability to carry on a business
- (2) The procedures for establishing a PMDN are the same as a PMA company.

The indicative time frame for establishment and incorporation of a PMA Company (same for PMDN) has in recent years typically been around 3 to 4 months. New On-line procedures at BKPM (see below) and involvement of MOLHR approval are intended to reduce establishment timelines going forward, but to date these developments have not translated to any significant shortening of the process.

As part of recent informal BKPM announcements in May 2015, times involved for processing business license applications for manufacturing and services sector companies have reduced by up to 2 weeks, down to ranges of 12 to 23 and 9 to 18 days, respectively.

### On-line Company Folders: foreign investment and licensing application

Effective 1 October 2014, all PMA (and PMDN) companies are required to create their own on-line company folder at BKPM. After this date, applications submitted to BKPM will only be processed for companies with on-line folders.

Additional time is needed for BKPM to process applications submitted after 1 October for companies without On-line company folders.

### Licenses and permits

If a project meets with BKPM approval, an initial investment approval will be issued, which permits the process of the establishment of the company to get started until it obtains legal status from the MOLHR and is registered in the Company Registry with the MoT. To establish a PMA Company, it is necessary to apply to BKPM for a Principle License and then a Permanent Business License. These licenses will enable the company to apply for other necessary licenses: Import licenses, permit for factory location, work permits for expatriates and Nuisance Act Permit. The Principle License normally has up to a five year validity (which can be extended). The Principle License can only be used until the PMA Company reaches the commencement of commercial operations or production.

The official date of commencement of commercial operations is triggered by the issuance of a Permanent Business License (IUT). An IUT is active as long as a company is still operating. Prior to commencement of commercial production, a Quarterly Activity Report must be submitted in standard format to BKPM and Bank Indonesia ("BI") detailing, among other things, disbursements of foreign currency financing approved in the BKPM application. Bi-annual reports are required after the IUT is issued.

An important aspect of the investment application process is the compilation and approval of the BKPM Master List, which details the imported capital equipment and initial raw materials required, as inputs to the proposed investment. The imported items must be verified as suitable and relevant for the proposed project. Only items on the approved Master List are available for Import Duty relief and other concessions that will be documented in Exemption Certificates on imported equipment or materials.

BKPM Reg No. 5/2013 regarding Guidelines and Procedures for Capital Investment Licenses and Non-licenses dated 12 April 2013 ("BKPM Reg. No. 5/2013") has modified the license profile under BKPM's authority which is now authorized to issue:

- Principle License
- Business License
- Principle License for Expansion
- Business License for Expansion
- Principle License for Amendment
- Business License for Amendment
- Principle License for Company Merger
- Business License for Company Merger
- Branch Office License
- Foreign Company Representative Office License
- Foreign Trading Company Representative Business License ("SIUP 3A").

Non-license matters are no longer administered by BKPM. In terms of licencing of importers, BKPM has been given authority over issuance of General Importer Identification Numbers (API-U) and Product Importer Identification Numbers (API-P) for PMA Companies (MoT for PT Biasa companies): refer further discussions on Customs registration in Chapter 8.

### **Deed of Establishment, Authorized and Paid-up capital**

The Deed of Establishment requires the approval of the MOLHR, which will ensure that the terms do not contradict the Company Law, or other laws, regulations and policies. The MOLHR has issued standard forms of Establishment Deeds to simplify approval requirements. There are requirements that at least 25% of the Authorized capital must be subscribed at the time of a company's establishment, and all issued shares must be fully paid up before the Operation Permit is obtained. The Company Law stipulates minimum authorized share capital to be IDR 50 million, of which at least 25% must be issued and fully paid up.

In practice, as a general guide BKPM has historically required share capital for a small to medium sized company engaged in trading activities, for example, to have share capital in a range of USD100,000. There are no formal thin capitalization rules in Indonesia, however a "general rule of thumb" that has been applied by BKPM is 1/3:equity and 2/3:debt. This has varied depending on the nature of business and scale of investment. Investors in the manufacturing sector typically are expected to have a debt to equity ratio of 3:1 or less, while those in the agricultural or mining sectors may have ratios of 6:1 or greater. The expansion of existing facilities funded with retained earnings, new equity or loan capital also requires approval by BKPM.

Incorporation is not finalized until MOLHR approval is entered in the public register by the Court of Justice, and a notice published in the State Gazette; this can take up to one year to happen, but will not impede a company's ability to commence and carry on normal business activity. Care must be taken during this establishment phase, as the directors will be jointly and severally liable on a personal basis for their dealings with third parties.

The Deed of Establishment can be drafted by a lawyer or a notary, and a notary public will attend to the requisite approvals and registrations.

#### *BKPM Reg No. 5/2013: New Investment Rules*

BKPM introduced new investment rules through Regulation No. 5 of 2013 which became effective 27 May 2013. There are new capital investment registration requirements and procedures but foremost a formalizing of minimum investment and the above "rules thumb" adopted by BKPM not specifically reflected in previous BKPM Regulations:

- Article 22 expressly stipulates minimum capital investment thresholds for PMA (more than IDR10 billion) and PMDN (IDR500 million) Companies
- For PMA Companies:
  - Minimum paid-up capital is IDRR2.5 billion (as indicated, informal BKPM policy has been 1:3 Equity/Debt ratio of total Authorized Capital)
  - Shareholder equity is (more than) IDR10 million.



### On-going accounting and reporting requirements

There is a public register of PT companies maintained by the Ministry of Trade ("MoT"), and there are annual corporate filing obligations. Companies are required to keep accounting records and prepare annual financial reports in accordance with Indonesian Financial Accounting Standards (or "SAK" which consists of PSAK and ISAK as well as regulations issued by the OJK for entities subject to its supervision) which are adopted from International Financial Reporting Standards. It is relevant however that no private company search function exists in Indonesia and, as corporate filing obligations are not strictly enforced, the level of compliance by private companies can be low.

The BOD is required to present an Annual Report (that includes the financial statements of the company) after it has been examined by the BOC at a General Meeting of Shareholders ("GMS") within six months of the company's financial year end. Generally, financial year ends are the same as the calendar year; however companies are allowed to have a different financial year. The Establishment Deed may impose other obligations.

The Company Law requires annual and extraordinary GMSs in accordance with the AoA. Unless stated to the contrary in the Establishment Deed, shareholders will hold one vote for each share, and a simple majority is all that is needed for voting purposes. The Company Law prohibits the directors from voting on behalf of shareholders. Directors acting as proxies of the shareholders will have no voting rights.

Tax regulations require the books to be maintained in Indonesian language and IDR currency. However in certain cases companies may seek permission from the MoF to maintain records in other languages and USD currency.

In addition, the following types of companies are required to present audited financial statements to the regulating government ministries:

- Publicly-listed companies
- Companies involved in accumulating funds from the public (such as banks and insurance companies)
- Companies issuing debt instruments
- Companies with assets of IDR 25 billion or more (see below)
- Bank debtors whose financial statements are required by the bank to be audited
- Certain types of foreign entities engaged in business in Indonesia that are authorized to enter into agreements
- Certain types of state-owned enterprises.

A PMA Company is required to have a physical office address. The Indonesian authorities do not recognize virtual offices.

### Shareholders and Directors, employees

A company must have two shareholders upon establishment, even for a PMA initially permitted 100% foreign ownership.

Article 33 of the Investment Law expressly prohibits or deems unenforceable nominee arrangements in making investments in limited liability companies. Any agreement and/or statement providing for share ownership in a limited liability company to be for and on behalf of another party is null and void. In practical terms, in the event relationships breakdown between a real foreign owner and a local Indonesian nominee shareholder, the foreign investor effectively "has nothing" in terms of legally enforceable rights. Such nominee arrangements are not uncommon in Indonesia.

Companies may have one or more directors, one of which must be the President Director. The Board of Directors ("BOD") oversees the day-to-day operations. The directors are usually full-time employees of the company or a related party or group company. Under the Company Law, a company is also required to have a Board of Commissioners ("BOC"). These are non-executives who oversee the activities of the directors. They supervise the corporate governance aspects of the company and the policies of the BOD. Under certain circumstances they may perform some executive functions on a temporary basis if all the members of the BOD have been dismissed or there are no members of the BOD available for whatever reason. Minimum requirements are one BOD and one BOC member, and these cannot be the same person. Both the Director and Commissioner can be foreign or Indonesian nationals. The Director must be an Indonesian resident.

There are no written regulations, but BKPM may impose a requirement of a minimum of 5 local employees.

### **Financial statements and statutory filing and audit obligations**

Companies over a certain size and foreign-owned companies are required to prepare annual statutory financial statements in accordance with Indonesian Financial Accounting Standards which have generally converged with IFRS with the process having commenced in 2006. The first wave of an adoption process was completed in 2011 with full IFRS implementation in 2012. The following were gaps between IFRS and SAK as at 1 January 2012:

- IFRS 1 “First-time adoption of IFRS”
- IAS 41 “Agriculture”
- IFRIC 15 “Agreements for the Construction of Real Estate”

The new and revised IFRSs, which were effective for financial statements beginning on or after 1 January 2013 and which are effective for financial statements on or after 1 January 2015 in Indonesia, are listed below:

- IFRS 10 “Consolidated Financial Statements”
- IFRS 11 “Joint Arrangements”
- IFRS 12 “Disclosures of Interest in Other Entities”
- IFRS 13 “Fair Value Measurement”
- IAS 1 (2011 version) “Presentation of financial statements”
- IAS 19 (2011 version) “Employee Benefits”
- IAS 27 “Separate Financial Statements”
- IAS 28 “Investment in Associates and Joint Venture”

A new IFRS, which was effective for financial statements beginning on or after 1 January 2014 but not yet adopted by SAK, is IFRIC 21 “Levies”.

The Company Law, as well as regulations issued by the MoT, set out requirements for the filing of annual financial statements. Filings are required within six months of an entity’s financial year end. These statements are to be filed at the MoT.

Under Article 68 of the Company Law, financial statements of a private company with assets and/or turnover exceeding IDR 50 billion are required to be audited. Furthermore, MoT decree No.121/MPP/Kep/2/2002 regarding “Submission of annual financial statements” stipulates that a private company with assets of at least IDR25 billion is required to submit annual financial statements (audited) to the MoT at the latest 6 months after financial year end. Under the Company Law, the appointment of a statutory auditor needs to be ratified at an Annual General Meeting of Shareholders.

According to MoT No.121/MPP/Kep/2/2002 concerning Submission of Company Annual Financial Statements, every PMA Company must submit annual audited financial statements to the Directorate of Business Development & Regulations of the MoT.

### **Loss of limited liability**

The Company Law stipulates that a company must have at least two shareholders to retain its limited liability status. If a company is left with only one shareholder and this situation persists for six months or more, then that shareholder will be liable for the company’s liabilities and losses, and the company may be dissolved.

### **Options open to foreigners other than incorporating a PMA company**

#### **Background**

In Chapter 5, the opportunities for non-Indonesians to seek approval for investment in sectors open to foreigners was discussed. Foreigners can also have a business presence in Indonesia through entities other than PMA companies. These options are set out below.

#### **Representative office**

Trade promotion can be encouraged through the establishment of a Representative Office. The representative, who may be an expatriate or an Indonesian national, is not usually permitted to carry out any direct business activities, such as accepting orders, bidding for tenders, importing, exporting, signing contracts or distributing. The activities of a Representative Office are restricted to the issue and collection of information, and the provision of assistance to local agents and distributors as well as marketing and promotional activities.

An exception applies to Representative Offices of foreign companies engaged in construction services. Foreign companies have been allowed for some time to provide construction services in Indonesia in a Joint Operation (“JO”) with a local construction company. In a recent development, “Minister of Public Works Regulation No. 10/PRT/M/2014 concerning Guidelines on License Issuance for Foreign Construction Company Representative Office” articulates various qualifying criteria including: completion of at least one construction project in 3 years; JO arrangement; for construction implementation and planning projects, the composition of total construction value undertaken by local Indonesian and foreign partners.

Representative office applications are generally made to BKPM. Some foreign investors initially enter the Indonesian market through a Representative Office, and later as business opportunities grow, apply for establishment of a PMA Company in order to commence proper trading activities.

Care must be taken in establishing a Representative Office due to the possibility or risk that group company transactions otherwise not taxable in Indonesia may become assessable due to the existence of a Permanent Establishment or “PE” for tax purposes. This is discussed further in Chapter 10 on Taxation.

#### **Branch**

The oil & gas sector and foreign bank branches were addressed in Chapter 5. No foreign bank branch licenses have been issued since 2003.

#### **Agent or distributor**

A foreign company that wishes to sell its products in Indonesia will usually appoint one or more Indonesian agents or distributors. The agent or distributor may apply for a work permit for the employment of an expatriate, who is familiar with the foreign company’s products.

#### **Technical assistance or franchise agreement**

A local company may sign a contract with a foreign party to supply technical assistance and management services or support. It would be normal for the local company to employ foreign experts, supplied in accordance with the agreements, and for fees to be charged based on an agreed mechanism or structure.

#### **Government contracts**

Where technology or expertise is not available domestically, the GOI can enter into contracts with foreign companies. A company would normally enter into a contract in conjunction with local contractors, or may act as a subcontractor to a local contractor. The contract permits the company to establish a presence in Indonesia for the purpose of undertaking a project.

---

#### Sources:

- (1) KPMG Research and Intelligence
- (2) Law No. 40/2007 concerning Limited Liability Company
- (3) BKPM website: [www.bkpm.go.id](http://www.bkpm.go.id)
- (4) BKPM “Monitoring Investment Climate in Indonesia”: Seminar 20 May 2015

# 7. Foreign Exchange



## Introduction

The IDR is freely convertible into foreign currency and Indonesia has no restrictions on foreign exchange and the repatriation of funds. Though Indonesia does not restrict the transfer of foreign currency to or from foreign countries, incoming investment capital inflows require approval. Moreover, all foreign exchange transactions between an onshore entity and an offshore counterparty must be reported to Bank Indonesia ("BI"). Foreign banks, JV banks and more than 30 national banks are licensed to carry out foreign exchange transactions.

## The Currency Law

The Indonesian Parliament passed Law No.7/2011 concerning Currency ("the Currency Law") in June 2011 requiring mandatory use of the IDR for all domestic transactions conducted in Indonesia. Exemptions include certain transactions related to the state budget, income and grants from/to foreign countries, "international trade transactions", foreign currency savings in banks and international financing transactions which can be open to broad interpretation in practice. In the absence of an implementing regulation scheduled to have been issued in June 2012, most investors, banks and business owners have been relying on a Ministry of Finance Guidance Note that limited the operation of the law to cash transactions.

On 31 March 2015, BI Regulation No. 17/3/PBI/2015 ("PBI 17/3") was issued which expressly provides for parties to transact in IDR on a broad range of domestic Indonesian transactions, and clarifies uncertainty in the Currency Law on international financing and other commercial transaction exemptions.

Some of the key requirements and exemptions are:

- Application to non-cash (effective 1 July 2015) as well as cash transactions (at odds with the Guidance Note)
- Pricing to be stated or "quoted" in IDR in addition to payments made
- Foreign currency loans by onshore banks for "export and other activities" are exempted provided the lending is permissible by law.

At the time of writing, the Currency Law and resulting potential adverse implications on how companies conduct business is the subject of considerable concern.

## Other currency matters

The IDR is not allowed to be transferred out of Indonesia; however it may be transferred from residents to non-residents within Indonesia for amounts up to IDR 500 million without any documentation. However, a non-resident entity must state the reason for the transfer. Both residents and non-residents may hold foreign currency accounts in Indonesia.

For any incoming or outgoing transaction above USD 10,000 or equivalent, both parties must report the reason for the transaction to BI. For resident domestic individuals or entities, a Tax Identification Number (NPWP) is also required.

Margin trading of foreign currency against the IDR is strictly prohibited in the onshore market.

## Repatriation of capital, profits and remittance of royalties and fees

While there are no current foreign exchange rules restricting the movement of funds to and from Indonesia, certain reporting requirements exist. The remitting company must submit a report of the transfer to BI, with the amount stated in IDR, along with an annual balance sheet and profit and loss statement.

The Investment Law grants the right to transfer abroad various types of funds by guaranteeing foreign investors the right to transfer (in original currency, at the exchange rate from the time of investment) all current after-tax profits, certain costs, depreciation of capital assets and (in the event of nationalization) compensation. In certain circumstances, convertibility is also guaranteed for capital repatriation. Proceeds from an investment's sale are remitted at the exchange rate at the time of transfer, unless the company's investment agreement specifies another rate. Reinvested profits receive the same treatment as initial capital.

### Remittance notification

Carrying more than IDR 100 million out of Indonesia requires prior approval from BI, while any person carrying IDR 100 million or more into the country must verify the funds with the Indonesian Customs Office upon arrival.

## Restrictions on trade-related payments

According to "BI Regulation No.13/20/PBI/2011 regarding Income of Foreign Exchange derived from Export and Withdrawal of Foreign Exchange of Foreign Debt" issued in September 2011, export payments and loan proceeds obtained from overseas have to be received in Indonesia through the Indonesian banking system. The regulation was meant to create a stable source of foreign exchange by forcing exporters to repatriate their earnings and ensuring that loan proceeds are actually remitted into the country.

The regulation requires the export proceeds to be received by a domestic bank no later than 90 days after the date of Declaration of Goods Exported (PEB).

For import payments, amounts exceeding IDR 100 million require completion of a form issued by BI. Indonesia blocks the import of several goods and requires special licenses for the import of others: refer to related discussion in Chapter 8 on Domestic and Foreign Trade.

## New hedging regulations on offshore loans and reporting

Offshore foreign currency loan hedging requirements were introduced in late 2014 under "Regulation No. 16/20/PBI/2014 on the Implementation of Prudential Principles in Managing Offshore Borrowings by Non-bank Corporations" (Reg. No. 16/20). The purpose of the regulation was to require Indonesian debtor companies that have offshore borrowings to meet 3 key criteria: i) hedging ratio; ii) liquidity ratio; and iii) credit rating. The regulation is understood to have been issued in response to significant increases in Indonesian corporate offshore, foreign currency denominated debt in recent years.

Shortly after, BI issued Regulation No. 16/21/PB/2014 (Reg. No. 16/21) which revoked Reg. No.16/20, and also issued a Circular Letter (116/24/DKEM/2014). Reg No. 16/21 provides clarification around the 3 key requirements in Reg. No. 16/20, the underlying principles of which remain in place:

- Minimum hedging ratio: if foreign exchange obligations exceed foreign exchange assets, the hedge must cover 25% of the differential
- Minimum liquidity ratio of 70% calculated based on foreign exchange assets and liabilities with maturities less than 3 months
- Minimum credit rating of BB- (or equivalent). Credit ratings of related parties can be used under certain conditions.

Exemptions exist for government and institutional infrastructure loans, refinancing with thresholds; institutional bilateral or multilateral guaranteed loans and trade credits.

The rules come into force on 1 January 2016, and from 1 January 2017, a company's foreign currency hedging instruments must be acquired from a local Indonesian bank, presumably to allow time for local banks to prepare their financial instrument systems and product offerings internally.

"BI Regulation 16/22/PBI/2014 on Foreign Activities Reporting and the Application of the Prudential Principle in Managing Offshore Loans for Non-bank Companies Reporting" (Reg No. 16/22) has two reporting requirements:

- Foreign Exchange Activities Report
- The Prudential Principle Report.

Non-compliance can attract administrative sanctions including a BI Warning Letter.

### Sources:

- (1) KPMG Research and Intelligence
- (2) Bank Indonesia website: [www.bi.go.id](http://www.bi.go.id)
- (3) OJK website: [www.ojk.go.id](http://www.ojk.go.id)

# 8. Domestic and Foreign Trade - ASEAN



## Trading in Indonesia

The trade sector includes import, export and distribution in the domestic market for imported and locally produced goods. In general, PMA companies engaged in manufacturing are permitted to:

- Import or buy on the domestic market: capital equipment, spare parts and raw materials for their own production process
- Export their own products, and processed goods of other PMA and domestic PMDN companies
- Sell their own products directly to other companies in Indonesia and use these goods as capital equipment, spare parts or for raw material in their production processes
- Import complementary goods from affiliates outside Indonesia, and sell them into the domestic market (production companies only)
- Sell their own products directly to a large-scale retailer.

As indicated in Chapter 5, distribution activities are closed to foreign investors across all industry sectors. Retailing is also closed except for large scale hypermarket business, with scale or size specifically based on sqm of floor and other space.

Overseas based foreign companies which export into Indonesia will need to establish a relationship with a local import and distribution agent. This relationship can be facilitated by seconding foreign experts to assist the local trading company in business, technical and management matters. Another alternative is to establish a Representative Office to conduct market research and promote the parent company's product range.

## Imports: Customs licensing and registration

### Importing into Indonesia

Importation of goods into Indonesia must be declared with the Indonesian Directorate General of Customs and Excise ("Customs Office") using an Import Declaration Form, and the importer is required to be registered with the Customs Office to obtain a Customs Identification Number (NIK).

PMA and PMDN companies can only import if they obtain an import license. This may be a General Importer Identification Number (API-U) issued to importers which import goods for trading or transfer to other parties, or a Producer Importer Identification Number (API-P) issued to importers importing goods for their own use, such as raw and supporting materials and/or to support production in manufacturing activities. An API is valid for five years and can be extended, if required. The license is applicable for the entire Indonesian customs territory. An Electronic Data Interchange (EDI) from PT Electronic Data Indonesia and the Customs Office enables a company to administer its customs affairs on-line (a company using customs agents will not need this if the agent has EDI registration).

Additional registrations and licensing with the MoT depend on the risk profile of goods being imported by a company including product type and description as well as country of origin:

- Special Importer Identification Number (NPIK)
- Particular Product Registered Importer (IT).

There are relatively onerous layers or pre-requisite licensing as part of the overall Import license registration, but the whole process should be routine if carefully managed. There are no direct licensing application costs.

The licensing authority is BKPM for PMA and PMDN companies, and the MoT for PT Biasa companies.

### **Import Goods Clearance Lane**

Registered importers are assigned Red, Yellow or Green lane status depending on the risk profile of the importer as determined by the Customs Office which is a function of the nature of the goods or commodities and country of origin.

The different processes and procedures involved for releasing imported goods are:

- Red lane involves a more onerous process of physical examination of imported goods attaching to a Customs Import Declaration (PIB) and verification of documentation before any goods are cleared
- Yellow lane process is without physical inspection of goods but involves verification of the PIB documentation before goods are released
- The Green lane process is without physical inspection and PIB documentation is verified after goods are released.

A Green lane company can be given an automatically computer generated, random Red lane determination on a single import transaction basis, but revert back to Green for the next PIB import transaction.

In terms of costs, the difference between Red and Green lane comes down to storage costs and fees at port. Companies with Green lane status can have goods cleared in 4 hours. Red status can take 5 to 7 days or more.

Companies are subject to periodic Customs audits administered by the Customs Office which typically resemble tax audits conducted by the ITO.

### **Certain goods subject to import restrictions**

In order to protect local industry and/or to maintain economic and political stability, restrictions on imports are imposed at three levels:

- Prohibited - for example, motorized vehicle tires, electric light bulbs, matches, certain types of textiles, batteries, iron sheets, fully assembled automobiles and motorcycles, radio and television sets, explosives, narcotics and certain traditional Chinese medicines
- Restricted to State owned companies - such as fuel for vehicles, ships and aircraft
- Restricted to Sole Agencies who must be approved by the GOI, including CBU (Completely Built-Up) motor vehicles of a type not assembled in Indonesia.

The classification of goods subject to import restrictions periodically changes. Intending importers should consult with the MoT.

## **Exports**

### **Exporting from Indonesia**

Any organization that possesses a Principle (manufacturing) License or Business (trading or services) License is permitted to export. PMA companies may be formed for the purpose of exporting Indonesian products and manufactured goods.

### **Certain goods subject to export restrictions**

Goods in the following categories are subject to export restrictions:

- Prohibited: goods including some categories of rubber, scrap metal and antiques are prohibited from being exported due to considerations such as preserving nature, guaranteeing supply of raw materials for small industries or craftsmen and preserving goods with historic and cultural value
- Restricted to certain approved exporters: textiles, plywood and coffee
- Restricted to approved exporters only: certain basic commodities can only be exported if domestic demand has been met. Examples are flour, palm oil, sugar and petroleum. Approval is also required for certain metals: silver, gold, copper and aluminum.

### **Taxes on exports**

Commodities such as palm oil, rattan and wood are subject to Export Duty. The Export Duty is calculated based on the export reference price which is set by a decree of the MoT and valid for a certain period of time. Export Duties are aimed at meeting objectives such as guaranteeing fulfillment of domestic demand, protecting natural resources and maintaining stability of local market prices of certain commodities. Export Duty is calculated based on the Export Duty tariff and Harmonized System classification. The MoF is authorized to decide goods that are exempted from Export Duty.

### **Customs procedures that apply to exports**

Exported goods are subject to inspection in Indonesia only in the following circumstances:

- Where application has been made for restitution or exemption from duties and taxes of imported components
- Where suspicion exists that goods are subject to ban or restriction.

## Export incentives

The government has the stated aim of encouraging exports. A number of incentives exist, including:

- The foreign exchange arising from proceeds of sales abroad may be retained or sold to third-parties by the exporter
- VAT on exports is at the rate of 0%, enabling exporters to claim refund of input VAT.

Import Duties may be reimbursable, or not payable on imports, under various special schemes for export manufacturers.

## Imports and exports, customs and Free Trade Zones

Further discussion on imports and exports, customs duties and taxes as well as Free Trade Zones is in Chapter 10 on Taxation.

## ASEAN Economic Community (AEC)

### Background and history

Formed by the ASEAN member nations in 2003, the ASEAN Economic Community (AEC) is a step toward achieving further regional economic integration among themselves: the original "ASEAN-6" countries of Brunei Darussalam, Indonesia, Malaysia, the Philippines, Singapore and Thailand; together with the CLMV countries of Cambodia, Laos, Myanmar and Vietnam. In 2007, at the 12th ASEAN Summit, the leaders of the ASEAN nations, by signing the Cebu Declaration, agreed on establishing an AEC by 2015 instead of the earlier target of 2020. The AEC intends to encourage trade and investment among the 10 member nations and thereby strengthen the importance of ASEAN as a key global region. Further, they aim to create a single, integrated market or economic unit allowing free movement of goods, services, investment, capital and skilled labor across the boundaries of 10 countries. In addition, the member nations aim to jointly develop a completion policy, protect intellectual property, facilitate e-commerce and develop a comprehensive investment protection and dispute resolution system. The four pillars (objectives) of AEC are to build:

- A single market and production base
- A highly competitive economic region
- A region of equitable economic development
- A region fully integrated into the global economy.

In 2015, Asia is once again poised to be the growth engine of global GDP. As China moves away from manufacturing and restructures into a consumption and services based economy, there are growing opportunities for ASEAN to

become Asia's main investment hub, moving towards a single market AEC. ASEAN is now the third biggest economy in the world after China and India, following by United States; Brazil; European Union; Japan and Russia. ASEAN's 625 million population (Indonesia makes up 40% of this) represents nearly 10% of the world's population. For the last 4 years, ASEAN outdid China on FDI.

### Progress on AEC

Clearly, January 2016 will not see the ASEAN transformation having materialized. Overall, the AEC is well behind schedule and individual countries are in various different positions, some heading in opposite directions in terms of achieving an AEC. Progress has been slow, a not unexpected outcome for what is a challenging exercise. There are many difficult hurdles to overcome around trust, sovereignty and nationalistic sentiment or protectionism across the 10 member states. Except for geographical proximity, there is significant diversity in terms of country size and populations, languages, religions, political and economic systems.

Notwithstanding the above, the AEC has come a long way with 279 measures (79.7percent) of the AEC blueprint implemented as of October 2013 and 81 percent by the end of 2014. About 85 percent implementation has been achieved on parameters such as liberalization and facilitation of free movement of goods, services, investment, capital and skilled labor. However, it faces challenges in other areas, such as the services sector not being opened yet for full foreign equity participation in most ASEAN nations. The AEC has set a target of allowing up to 70 percent foreign equity investments in the services sector by 2015; however as indicated, it seems highly unlikely for most ASEAN countries to achieve this goal by 2015.

Visible progress has been achieved in implementing the first and the fourth pillar; modest progress have been made in the second and third pillars:

- Tariffs have been substantially reduced. On an average, ASEAN member states have 95.99 percent Tariff Lines at 0 percent (as of March 2015)
- In terms of supporting and facilitating regional trade, the original ASEAN-6 countries are in the process of implementing the National Single Window (NSW) program. The other four CLMV member countries are also working on the program
- ASEAN Comprehensive Investment Agreement was signed in 2012 to support a positive business environment for the private sector and to liberalize the investment and capital flows in the region
- FTAs have been concluded with ASEAN's six dialogue partners — Australia, the People's Republic of China, India, Japan, the Republic of Korea and New Zealand

- Toward achieving the second and third pillars, the ASEAN Intellectual Property Rights Action Plan 2011–2015 was adopted to strengthen intellectual property institutions in the region
- Further, the Master Plan on ASEAN Connectivity was adopted to enhance the region's transport connectivity and energy security
- The ASEAN Strategic Action Plan for Small- and Medium-Sized Enterprise (SME) Development was also implemented to support the SMEs in the region.

### Key challenges

- While the tariffs on goods traded within the region have been largely reduced, non-tariff barriers to trade (NTBs) still remain in the form of quotas and licenses. From 2009 to 2013, a total of 186 non-tariff protectionist measures were implemented in ASEAN nations. Most of them were implemented by the larger economies: 75 by Indonesia, 39 by Vietnam, 27 by Thailand, 16 by Malaysia and 15 by Singapore
- One of the key challenges for AEC is achieving free trade of services. The middle-income economies in ASEAN — Indonesia, Malaysia, the Philippines and Thailand — are considered to be 'virtually closed' to 'completely closed' in professional services
- Full foreign equity participation in the services sector of most of the ASEAN nations has not opened up yet
- The liberalization of 128 sectors in terms of investment and services, scheduled to be completed by 2014, has been delayed to 2015. Only some sectors, such as retail, wholesaling and transport, were opened for investment and services by January 2015
- Limited progress has been made on objectives such as free movement of skilled labor, capital and investment.

### Impact of AEC

With the larger aim of transforming the ASEAN region into a major global economic bloc, the AEC would help the member nations in achieving economies of scale and efficiency in production network processes. Further, an integrated market and production base would help increase intra-regional trade and investment flows, along with making the overall ASEAN consumer market attractive for investors and create more job opportunities in the region.

The areas of cooperation in the AEC include human resources development and capacity building, recognition of professional qualifications, closer consultation on macroeconomic and financial policies, trade financing measures, enhanced infrastructure and communications connectivity, development of electronic transactions through e-ASEAN, integrating industries across the region to promote regional sourcing and enhancing private sector involvement for the building of the AEC.

### Potential impact of AEC on Indonesia

#### Positive

- Indonesia, being ASEAN's largest economy, poised to take a lead on the trade and investment opportunities
- Indonesia's strong position in cocoa, crude palm oil and rubber industries to potentially help the country lead the regional market
- Increased intra-ASEAN trade, FDI, tourism and regional resilience.

#### Negative

- Free movement of skilled workers a potential threat to domestic employment opportunities in Indonesia
- Challenges in Indonesia around growth and attaining a developed-nation status with slow infrastructure development and lack of skilled labor.

### Readiness of Indonesia for AEC

Being the largest economy in ASEAN, with 40 percent contribution to the region's GDP, Indonesia is one country expected to lead the implementation of AEC. While the country has abundant human and natural resources, and a strategic geographic position, it needs to improve the quality of its products and services, human skills and regulatory environment.

According to its former Economic Minister, Hatta Rajasa, Indonesia's preparation for AEC was 78 percent complete as of February 2014. However, it still has reservations in opening up to the market-integration plan, primarily due to deficiencies in areas such as infrastructure, when compared to the rest of the ASEAN region. Led by economic nationalism, the lack of participation from Indonesia can significantly impact AEC's success.

The following measures taken by the Indonesian Government fail to support the AEC vision and put to question its willingness for and commitment toward regional integration:

- The liberalization and integration of ASEAN members' capital markets is one of the key themes in the AEC to enable free flow of capital within the region. Toward achieving this, The ASEAN Trading Link plays an important role. However, only Singapore, Malaysia and Thailand have joined it, with no participation from Indonesia
- The country also opted out of the Asia Region Funds Passport (ARFP) initiative for broader cross-border offering of ASEAN Collective Investment Scheme (CIS). Six countries, Australia, South Korea, New Zealand, the Philippines, Singapore and Thailand, are part of this initiative
- Indonesia has refrained from ratifying the ASEAN Multilateral Agreement for Full Liberalization of Air Freight Services (MAFLAFS) to protect its domestic aviation industry from regional competitors.



### 2014 Negative List and AEC

As indicated in Chapter 5, the GOI has demonstrated its AEC commitments by granting ASEAN investors comparably higher foreign ownership threshold levels in certain sectors: transportation, healthcare, services and tourism.

### ASEAN Free Trade Area (AFTA)

#### Background and history

The ASEAN Free Trade Area (AFTA) is a free trade area covering the members of Association of South East Asian Nations (ASEAN). Under AFTA, ASEAN will become a free trade area with no tariff or non-tariff barriers on cross border transactions between ASEAN countries by 2015. Unlike the European Union, AFTA does not apply a common external tariff on imported goods. Each ASEAN member may impose tariffs on goods entering from outside ASEAN based on its national prevailing tariffs. Key objectives of AFTA are to:

- Make ASEAN a more competitive production base for global markets
- Attract more FDI; and
- Improve intra-ASEAN trade.

Indonesia is a member of AFTA and one of the first six signatories together with the other ASEAN-6 countries. The primary mechanism for achieving the objectives of AFTA is the Common Effective Preferential Tariff (CEPT) scheme where ASEAN members are to apply a tariff rate of 0% to 5% on a wide variety of imported goods originating within ASEAN. The general rule is that local ASEAN content must be at least 40% of the FOB value of the goods.

In 2009, ASEAN Trade in Goods Agreement (ATIGA) was signed to enhance the CEPT-AFTA Agreement. ATIGA became effective in May 2010. It adds value to CEPT-AFTA agreement with the following initiatives:

- Comprehensive coverage in Trade in Goods
- Consolidated and streamlined rights and obligations
- Full tariff reduction schedules
- Streamlined provisions on modification of concessions and trade remedies
- Non-tariff measures
- Trade facilitation and related chapters; and
- Trade repository.

The AFTA Council has agreed that the target dates to achieve this objective will be in 2015 for the six original ASEAN-6 countries and 2018 for the newer four members.

Effective 1 January 2010, the ASEAN – 6 had eliminated import duties on 99.20% of products in the 'inclusion list' and became a complete free trade area- from a tariff standpoint. For the CLMV countries, 90.85% of the Tariff Lines in the Inclusion List are already at 0% (as of March 2015). Based on the commitments under AFTA, Cambodia, Laos, Myanmar and Vietnam are to eliminate duties on all designated products in 2015 with flexibility of 7% of tariff lines up to 2018.

CEPT has an Inclusion List that lists products which are subject to the CEPT scheme; however ASEAN members have the option of excluding products from the CEPT in three cases:

- Temporary exclusions – products for which tariffs will ultimately be lowered to 0% to 5%, but which are being protected temporarily by a delay in tariff reductions

- Sensitive products – commodities such as rice, sugar and wheat. Senior ASEAN members (Indonesia, Malaysia, Singapore, Thailand, Brunei, Philippines) had until 2010 to reduce the tariff levels to 0% to 5%; while Vietnam had until 2013, Laos and Myanmar until 2015 and Cambodia until 2017
- General exceptions – products which an ASEAN member deems necessary for the protection of national security, public morals, the protection of human, animal or plant life and health as well as protection of articles of artistic, historic or archaeological value. Indonesia categorized groups of products in weapons and ammunition, alcoholic beverages and others on as many as 68 tariff lines as General Exception.
- Lower production costs for Indonesian producers which require raw/auxiliary materials from other ASEAN countries
- Wide range of available products in the domestic market in terms of quality and price levels
- Bigger opportunity to have business cooperation with other ASEAN countries.

#### *Negative and other considerations*

- Other than Free Trade Agreements (“FTAs”) with member countries, ASEAN countries also have FTA agreements with other countries which are: China, Korea, Japan, India, Australia and New Zealand which have been in effect from 2010. The China – ASEAN FTA is considered to have negatively impacted the Indonesian economy with the Indonesian domestic market flooded with the low price products, competing with national products
- Readiness of government institutions at both central and regional level to properly train employees in preparation for liberalized investments and open trade of goods and services, including general awareness and English language skills
- Risk of rising labor costs with free flow of labor entering the country, or entry of cheap labor
- Readiness of infrastructure and national logistics systems.

### **Impact of AFTA**

The reduction of tariffs has positively impacted the trade and investment flow within the region. It has further affected trade structures especially around procurement in ASEAN countries. However, the overall effects, especially export structures, vary from country to country and from industry to industry.

### **Impacts of AFTA on Indonesia**

#### *Positive*

- Bigger market opportunities for Indonesian products given a combined ASEAN market population of around 600 million people and a variety of income levels in ASEAN countries

#### Sources:

- (1) KPMG Research and Intelligence
- (2) KPMG Asia Pacific Tax Summit, Singapore 26-29 January 2015: “Thriving in Diversity and Change”
- (3) Re-drawing the ASEAN map: how companies are crafting new strategies in South-east Asia (The Economist Intelligence Unit)
- (4) [www.asean.org/communities/asean-economic-community](http://www.asean.org/communities/asean-economic-community)
- (5) [www.legalbusinessonline.com/features/aec-approaches-indonesia-ready/68315](http://www.legalbusinessonline.com/features/aec-approaches-indonesia-ready/68315)
- (6) [www.kpmg.com/SG/en/IssuesAndInsights/ArticlesPublications/Documents/Tax-Itax-The-ASEAN-Economic-Community-2015.pdf](http://www.kpmg.com/SG/en/IssuesAndInsights/ArticlesPublications/Documents/Tax-Itax-The-ASEAN-Economic-Community-2015.pdf)
- (7) [www.bangkokpost.com/learning/work/454697/asean-economic-community-2015-ready-or-not-here-it-comes](http://www.bangkokpost.com/learning/work/454697/asean-economic-community-2015-ready-or-not-here-it-comes)
- (8) [www.worldbank.org/en/region/eap/publication/asean-integration-monitoring-report](http://www.worldbank.org/en/region/eap/publication/asean-integration-monitoring-report)
- (9) [www.adb.org/features/asean-economic-community-12-things-know](http://www.adb.org/features/asean-economic-community-12-things-know)
- (10) [www.antaranews.com/en/news/89033/indonesia-must-speed-up-preparations-for-asean-market-integration](http://www.antaranews.com/en/news/89033/indonesia-must-speed-up-preparations-for-asean-market-integration)
- (11) [www.eastasiaforum.org/2014/03/03/why-indonesia-needs-to-lead-in-economic-integration](http://www.eastasiaforum.org/2014/03/03/why-indonesia-needs-to-lead-in-economic-integration)
- (12) [www.rappler.com/world/regions/asia-pacific/indonesia/90492-wef-indonesia-asean-economic-community](http://www.rappler.com/world/regions/asia-pacific/indonesia/90492-wef-indonesia-asean-economic-community)
- (13) [www.sr-indonesia.com/in\\_the\\_journal/view/indonesia-must-get-ready-now-for-the-asean-economic-community?pg=all](http://www.sr-indonesia.com/in_the_journal/view/indonesia-must-get-ready-now-for-the-asean-economic-community?pg=all)
- (14) [www.thejakartaglobe.beritasatu.com/business/indonesia-may-struggle-early-years-asean-economic-integration](http://www.thejakartaglobe.beritasatu.com/business/indonesia-may-struggle-early-years-asean-economic-integration)
- (15) [www.bangkokpost.com/learning/work/454697/asean-economic-community-2015-ready-or-not-here-it-comes](http://www.bangkokpost.com/learning/work/454697/asean-economic-community-2015-ready-or-not-here-it-comes)
- (16) [www.thestar.com.my/Business/Business-News/2014/11/14/Indonesia-the-key-Key-official-feel-there-is-a-need-for-the-largest-economy-in-Asean-to-step-up/?style=biz](http://www.thestar.com.my/Business/Business-News/2014/11/14/Indonesia-the-key-Key-official-feel-there-is-a-need-for-the-largest-economy-in-Asean-to-step-up/?style=biz)
- (17) [www.asiapathways-adbi.org/2014/12/asean-economic-community-2015-what-is-next](http://www.asiapathways-adbi.org/2014/12/asean-economic-community-2015-what-is-next)
- (18) [www.therakyatpost.com/news/2014/08/21/dont-fear-aec-2015](http://www.therakyatpost.com/news/2014/08/21/dont-fear-aec-2015)
- (19) [www.asiapathways-adbi.org/2015/02/aec-is-due-but-what-about-institutions](http://www.asiapathways-adbi.org/2015/02/aec-is-due-but-what-about-institutions)
- (20) [www.conventuslaw.com/asia-pacific-asean-free-trade-area-afta-asean-economic-community-aec-an-overview-hopes-for-the-future](http://www.conventuslaw.com/asia-pacific-asean-free-trade-area-afta-asean-economic-community-aec-an-overview-hopes-for-the-future)
- (21) [www.manadopostonline.com/read/2014/09/02/AFTA-2015-Perdagangan-Bebas-dan-Kesiapan-SDM-Indonesia/5408](http://www.manadopostonline.com/read/2014/09/02/AFTA-2015-Perdagangan-Bebas-dan-Kesiapan-SDM-Indonesia/5408)
- (22) [www.miti.gov.my/cms/content.jsp?id=com.tms.cms.section.Section\\_8de83760-7f000010-72f772f7-f5047602](http://www.miti.gov.my/cms/content.jsp?id=com.tms.cms.section.Section_8de83760-7f000010-72f772f7-f5047602)
- (23) [www.miti.gov.my/cms/content.jsp?id=com.tms.cms.section.Section\\_8de83760-7f000010-72f772f7-f5047602](http://www.miti.gov.my/cms/content.jsp?id=com.tms.cms.section.Section_8de83760-7f000010-72f772f7-f5047602)

# 9. Labor and Employment



## Indonesian labor laws, regulations and landscape

The main employment law in Indonesia is contained in Law No.13/2003 on Labor (“Labor Law”). There is also Law No.2/ 2004 on Industrial Relations Dispute Settlement; Law No.21/2009 on Labor Unions and Law No.3/1992 on Workers Social Security. These laws are designed to safeguard interests of employees. The main regulatory authority is the Ministry of Manpower or “Manpower Affairs”.

Employers generally consider the Labor Law places onerous obligations on employers, particularly in respect of ability to terminate and the level of severance and termination benefits payable. For companies operating factories in highly labor intensive industries, this can make wage and benefit levels uncompetitive compared to other neighboring countries. A lack of training, cultural background and difficulty in terminating non-performing workers often means that staff numbers can reach higher levels than an investor may initially anticipate. Attempts by governments in the past to make aspects of the law more friendly to employers has led to street demonstrations and is politically sensitive.

Notwithstanding recent increases in statutory minimum wages, Indonesia still has one of the lowest average wage rates in Asia, and the cost of labor has been lower than China in recent years. However lower average wages available in Vietnam and the Philippines present emerging threats.

## Resource pool of skilled Indonesian workers

Indonesia has a large pool of workers, with a reported labor force of 118.2 million people in 2014, and a labor force participation rate of 66.9%. These statistics exclude the self-employed, informal sector. With the high birthrate in recent decades and the drift away from traditional village

life, the potential workforce has been growing at almost 1.5 million per year over the last decade. 64% of the Indonesian workforce is concentrated in Java and Bali, and workers continuously migrate from rural to urban areas in search of jobs.

Despite the large population, the country’s resource pool is being “stretched thin” with corporate demand for skilled and experienced Indonesian professionals and technicians across various disciplines outstripping supply. This is considered to be a function not only of rapid economic growth post GFC but deficiencies in the education system. Remedying deficiencies is a long term, challenging exercise.

A report released in January 2015 by the Institute of Indonesian Chartered Accountants (IAI) and Chartered Institute of Management Accountants confirms commonly communicated concerns expressed by industry leaders on the preparedness of Indonesian university graduates to enter the labor market. Whilst there is a plentiful supply of graduates, many fail to meet employer expectations in terms of talent and future employability. The report findings include a lack of practical day to day business skills (communication, problem solving, critical thinking and people management) and a lack of ability to work in teams. English language skills were also found to be deficient.

## Levels of wages and benefits: overview

Basic salary and wage levels can vary considerably with geographic region and across industries.

Under Article 89 of the Labor Law, each province/city is given the power to frame its own Provincial Minimum Wage or “UMP” which is reviewed and set annually on the are under

basis of agreement between corporates, organizations and labor unions as finally determined by the Governor of each province: refer corresponding data in Chapter 3. Regulation of the minimum wage is stipulated in Articles 88, 89, and 90:

- a. Provincial or district/city-based minimum wage
- b. Provincial or district/city-based sectoral minimum wage.

Once a year each provincial government adjusts the UMP based on a Governor Decree on Minimum Wage. A Remuneration Council, a non-structural tripartite organization which consists of government, entrepreneur associations and labor organization representatives (as stipulated under Presidential Decree No.107/2004) makes recommendations on the UMP based on a "decent living needs survey". With regional autonomy fully implemented at provincial level, there is a Regency Minimum Wage ("UMK") for each city in every province based on recommendations from the Regent Mayor and the Remuneration Council.

In November 2012, the Government of Jakarta raised the UMP for Jakarta by 44% to IDR 2.2 million (USD 228) based on Governor of Jakarta Regulation No.189/2012 concerning the 2013 Provincial Minimum Wage, recording its highest ever increment. Increases in 2014 and 2015 were 13% and 19%, respectively. The Confederation of Indonesian Labor Unions (KSPI) is monitoring compliance with UMP.

Under the Labor Law, an employer is prohibited from paying below the minimum wage which covers basic salary and a fixed allowance, the salary component comprising at least 75%. Working hours under the Labor Law are 7 or 8 hour days depending on whether 5 or 6 days are worked per week, with additional hours considered overtime which is calculated based on formulae in the law.

An employee with at least 12 months service is entitled to a Religious Festivity Allowance or "THR" of an additional one month salary. Other aspects of the law deal with workers social security, employee facilities, annual leave as well as various other paid leave including illness, marriage, maternity and death which may be higher or better under Company Rules ("PP") or HR policy than what is stipulated in the law. There are special benefits for female employees working between 11pm and 7am under a Ministerial Decree.

The Labor Law is structured around two main types of employment: Indefinite and Definite Period Employment.

### **Permanent employees (Indefinite Period Employment)**

Permanent employment status is the more commonly used type of employment in most industries. Under the Labor Law: Article 156, a company has an obligation to pay severance, gratuity and other compensation to permanent employees:

- in the general occurrence of employees resigning voluntarily or terminating working relations with the employer in the normal course, but only if company policy provides for this. Following a Ministerial Letter issued in 2005, employers are no longer legally obligated to provide this benefit
- to employees being involuntary terminated or retrenched when a company is demonstrably committed to either termination before the normal retirement age; or providing termination benefits as a result of an offer made in order to encourage voluntary redundancy.

The termination and severance payment needs to be the higher of that provided under the Labor Law, the Company Regulations or CLA. In general terms, minimum severance pay is based on one month's salary or wages for each year of service, up to a maximum of 9 months pay.

The termination of employees needs to be handled carefully. Most employment contracts or agreements provide for an initial 3-month probation period, after which staff may be terminated only on strong grounds and usually only after several written Warning Letters. Termination by notice or salary in lieu of notice is not permitted in Indonesia; however, terminations should involve negotiations in bipartite meetings, mediation or conciliation, and labor court approval as a last measure. An employee also has a right of appeal to the Ministry of Manpower. In practice, negotiations normally occur with the objective of an employee agreeing to termination terms and benefits in writing.

The Ministry of Manpower must also be advised of imminent staff retrenchments, due to downturn or discontinuation of business activity.

## Contract employees and Daily workers (Definite Period Employment), Outsourcing

### Introduction

Contract employees and Daily workers are not eligible to receive termination/severance benefits under the Labor Law, although early termination can lead to contractual compensation obligations.

There is more flexibility around ease of termination or non-renewal of "Working Agreements" compared to permanent employees which makes employment of such staff attractive to employers in certain industries in terms of managing employee profiles and labor cost structures.

### Contract employees

A contract employee is employed under a "Working Agreement for a Specified Period" ("Work Contract").

The Labor Law states the following:

- "Definite period employment agreements" or "Work Contracts" can only be made for certain jobs which according to kind and characteristics of activities will be completed in a specified period (jobs expected to be completed in a short time frame, seasonal jobs or jobs related to new products or activities which are still in trial run or exploration stage)
- Work Contracts cannot be applied to regular jobs which need to be held by permanent employees
- Work Contracts for a specified period can be extendable and renewable
- Work Contracts can be applied for a period of 2 years at the maximum and only extendable once for another period of 1 year; but can be renewed once after a 30 day grace period for up to another 2 years.

The above translates to a maximum contract employment periods of 3 or 5 years, after which permanent employment is the only option if employment of an individual is to continue.

If the Ministry of Manpower identifies any non-compliance with the Labor Law on the appropriate employment of contract employees, it could result in the employees being classified as permanent and thus be entitled to all the rights and benefits afforded to permanent employees.

### Daily Workers

Under the Decree of the Minister of Manpower No. Kep.100/MEN/VI/2004 regarding the Implementing Regulation on the Definite Period Employment Agreement, the employment of a Daily worker is appropriate where the volume of work and the period within which a certain job is to be performed

is irregular in nature and changes from time to time. Wages are paid based on daily presence at work, which must be completed in a relatively short period of time (three months) with a maximum of 20 working days per month. A Daily Worker is not bound by general working hours applicable in a company.

Daily workers are commonly seen in the plantation and other agriculture industry sectors.

### Outsourced Personnel

Article 65 of the Labor Law stipulates that sub-contracted work must meet the following requirements:

- the work can be done separately from the main activity
- the work is to be undertaken under either a direct or an indirect order from the party commissioning the work
- the work is an entirely auxiliary activity of the enterprise
- the work does not directly inhibit the production process.

Regulation No.19/2012 on Conditions for Outsourcing the Implementation of Work to Other Companies was enacted on 19 November 2012. Regulation 19 replaced two previous Ministry of Manpower "Decrees 101 and 220". Regulation 19 reflects the provisions of the Labor Law, maintaining the 2 types of outsourcing already regulated:

- Outsourcing of Work: the work contracted out to a service provider must be "supplemental"
- Outsourcing of Workers (or "labor supply"): the outsourcing of labor is limited to 5 "supporting activities" - cleaning services; catering services for employees; security services; support services in the mining and oil & gas sectors as well as transportation services.

In addition, work contracted out must be conducted separately from the main activities of a company.

All companies involved in the outsourcing of work must have complied with the regulation by 19 November 2013.

Outsourcing Agreements for Labor Supply also need to have a minimum prescribed content and be registered with the local Ministry of Manpower office. Employment between the labor supply company and its workers assigned to user companies were able to be based on Definite Period Employment Agreements or Indefinite Period Employment Agreements, but the labor supply company must have had written agreements with its workers that are also registered at the local Ministry of Manpower office.

On 17 January 2012 the Constitutional Court issued a Decision No. 27/PUU-IX/2011 (Decision 27") relating to outsourcing. Decision 27 has invalidated the phrase "Definite period employment agreement" in Article 65.7 and Article 66.2(b) of the Labor Law. However, the invalidation is limited. It only applies where the definite period employment agreement of the outsourced worker does not include a clause protecting the worker's rights if the company that engages the labor supplier/outsourcing company changes service provider.

Following Decision 27, on 20 January 2012 the Director General of the Development of Industrial Relations and Workers' Social Security, Ministry of Manpower issued Circular Letter No. B.31/PHIJSK/I/2012 on the implementation of Decision 27 ("Circular Letter 31"). The position under Circular Letter 31 is:

- if an employment agreement between a labor supplier (outsourcing company) and an outsourced worker does not include a clause protecting the outsourced worker's rights if the company engaging the labor supplier (outsourcing company) changes service provider, the employment of the relevant outsourced worker will be on an indefinite period basis
- if the employment agreement between the labor supplier (outsourcing company) and the outsourced worker does include such clause, the outsourced worker can be employed on definite period basis.

Companies that outsource work or engage labor suppliers are encouraged to contact the service provider and seek clarifications as to whether:

- the outsourced workers provided are definite period workers; and
- if so, whether the employment agreements of the definite period workers include a clause in relation to the protection of the rights of the workers in the event of a change of service provider during the term of the contract.

If some of the requirements for outsourcing arrangements set out in the decrees are not complied with, there is a risk that the outsourced workers will be deemed as employees of the company that uses the services of the labor supplier (outsourcing company). Contingent liabilities and exposures would then be triggered because the outsourced worker may become entitled to all of the rights and benefits of permanent employees under the Labor Law, including severance upon termination.

### **Worker's Social Security scheme**

Under Law No.3/1992 on Workers Social Security, companies with a payroll exceeding IDR 1 million per month, or employing 10 or more staff, needed to enroll their employees in the JAMSOSTEK program.

JAMSOSTEK was a government social security scheme, mandatory by law, to which an employee and employer must make monthly contributions based on a percentage of basic salary for: (i) employee work accident insurance, (ii) retirement benefit fund, (iii) life insurance, and iv) health care benefit coverage. The first three were mandatory. Health care benefit contributions were payable only if the employer did not provide equivalent or better health benefits.

Contribution fees needed to comply with the standard provisions in Government Decree No.14/1993. Fees varied across job classifications and industries, but generally fell in a range of 4.24% to 5.74% of basic salary. Employee contributions were made by the employer except for retirement benefit insurance to which the employee also contributed.

Permanent, Contract employees and Daily workers needed to be covered by JAMSOSTEK. Expatriates were required to be enrolled unless covered by an equivalent scheme in his or her home country.

*Effective 1 January 2014 – BPJS Ketenagakerjaan and BPJS Kesehatan*

The GOI commenced implementing a new social security system effective 1 January 2014 based on Law No. 24/2011 regarding Social Security Agencies which builds on Law No. 40/2004 regarding the National Social Security System ("SJSN"). BPJS Ketenagakerjaan is the new Social Security Administration Body.

The compulsory requirements to join the new social security scheme (both worker's social security and health care) cover all employees, including expatriates who have been working in Indonesia for more than six months. Starting 1 January 2014 BPJS Ketenagakerjaan administers worker's social security comprising workplace accident, old age, death and pension benefits and BPJS Kesehatan administers health care benefits.

All participants of the worker's social security program comprising workplace accident, old age and death benefits under JAMSOSTEK automatically became participants of BPJS Ketenagakerjaan with the same benefits effective 1 January 2014. The existing worker's social security scheme is expanding to include pension benefits starting 1 July 2015. To date, the implementing regulations of BPJS Ketenagakerjaan, including pension, have not been issued. Subject to the content of these regulations, the overall elements of the new BPJS or "JKN" are similar to JAMSOSTEK.

According to Presidential Regulation No. 12/2013, as amended by Presidential Regulation No. 111/2013 regarding Health care benefits, effective 1 January 2014:

- All employees covered by health care benefits under JAMSOSTEK transitioned to a national health care benefits program (Jaminan Kesehatan Nasional or "JKN") under BPJS Kesehatan
- There is no "opt-out" clause for companies who already provide health care benefits for employees and their dependents via self-administered plans or health insurance programs or a combination of the two. Small, medium, large and state-owned enterprises were obligated to register their employees with JKN by 1 January 2015. Companies can continue providing private health care coverage but must now also make the corresponding contributions to BPJS Kesehatan.

Employers and employees of private companies are required to make monthly contributions calculated based on the following:

Monthly contributions of JKN			
	1 Jan 2013 - 31 Dec 2013 (JAMSOSTEK)	1 Jan 2014 - 30 Jun 2015 (BPJS Kesehatan)	1 Jul 2015 onwards (BPJS Kesehatan)
<b>Employer</b>	3% (single) up to max. IDR 141,750; OR 6% (married) up to max. IDR 283,500	4% up to max. IDR 189,000	4% up to max. IDR 189,000
<b>Employee</b>	None	0.5% up to max. IDR 23,625	1% up to max. IDR 47,250

Starting 1 July 2015, BPJS will monitor companies operating in Indonesia to ensure mandatory registration of employees into the scheme is complied with, and will have authority to enforce the law and proceed with litigation. Penalties and other sanctions now also apply.

### Employee entitlements and benefits relating to change in ownership

Under Article 163.1 of the Labor Law, employers are liable to pay severance, gratuity and other compensation to those employees who elect not to continue their employment in the event of a change in ownership of the employer. This will normally occur as part of a transaction involving an acquisition of shares. The "change of ownership" provisions and compensation obligations are generally considered to be triggered on a 51% or majority change in share capital.

Law 13/2003 requires the amount of severance, gratuity and compensation to be calculated based on formulae prescribed in the law and under two scenarios:

- scenario (a): an employee elects to resign – voluntary resignation
- scenario (b): employer decides to terminate employment – involuntary resignation.

The multiplier of the severance, gratuity and compensation is based on period of service which is set out in Law No.13/2003.

Historically changes in ownership usually did not trigger mass resignations. However post-GFC when the Indonesian economic growth story started to take flight and the extent of the problem of scarcity of employable resources began to emerge, the need for risks to be carefully assessed and managed increased. Resignations are more likely to be limited to long serving employees who consider a relatively large compensation payment attractive. Risks can be greater in industries with less sophisticated employee profiles; as well as high growth, specialized sectors where there is strong demand for scarce, quality resources. If labor unions are involved then negotiations can become very involved.

### Industrial relations and labor unions

The reformation in labor politics in Indonesia was initiated by the issuance of Ministerial Regulation No.5/1998 concerning Labor Union Registration, which ended the monopoly of All-Indonesian Workers Union Confederation ("KSPSI"). Following enactment of Law No.21/2000 concerning Trade/Labor Union, many local labor unions representing many different industries have emerged and registered their establishment with the Ministry of Manpower.

Membership is not compulsory. The majority of Indonesian workers are not unionized (this may be partly a function of Indonesian labor laws providing for generous severance and termination benefits as well as labor court approval for involuntary resignations, except where accepted by written agreement or resignation).

The Indonesian Labor Movement Council ("MPBI") was set up in May 2012 to launch a strong resistance movement against Indonesian labor/worker issues and exploitation. It comprises of three main labor confederations: KSPSI, the Confederation of Indonesian Workers Unions ("KSPI") and the Confederation of Indonesian Prosperous Labor Unions ("KSBSI"), as well many small unions.

The government enacted Ministerial Regulation No.PER.16/MEN/XI/2011 concerning Procedures for the Making and Ratification of Company Rules ("PP") and the Making and Registration of Collective Labor Agreement ("CLA"). A company that employs at least 10 workers must register a PP which documents its working policies and requirements. A CLA is a bipartite agreement which covers working, wage payments, health-and-safety benefits and systems as well as regulations on violations and sanctions for workers, the employer and union. In case there is only one labor union in a company, the union may have the right to negotiate a CLA if it is supported by more than 50% of all workers. If there is more than one labor union, a maximum of 3 labor unions which have a minimum of 10% of all workers may have right to negotiate a CLA. Both parties must submit a renewal of the PP and CLA at the latest 30 working days before expiration.

In accordance with the Labor Law, a labor strike is legal and recognized as a fundamental right of workers and their unions, which must be staged legally, in an orderly and peacefully manner and as a result of failed negotiations. Article 140 No. 1 of the Labor Law stipulates that within a period of no less than 7 days prior to an intended strike being staged, workers/laborers and trade/labor unions are under an obligation to give written notification of the intention to the employer and the local Ministry of Manpower office. The Ministry of Manpower has enacted Ministerial Decree No.232/MEN/2003 concerning the Legal Consequences of Illegal Strike designed to prevent occurrences of sudden and illegal strikes in Indonesia.

Labor unrest has been an increasingly common feature in Indonesia. While strikes have historically tended to be brief and factory-specific, in recent years country-wide demonstrations have occurred in relation to perceived improper use of contract employees, outsourcing of workers and "cheap" labor policy. Employers are also reporting increasing occurrences of "labor problems" relating to minimum wage increases and comparisons to the "cost of living".

## Employment of expatriates

The government classifies jobs into those closed to foreigners, those open only while nationals are being trained and those open for other reasons. The Ministry of Manpower regulates the employment of foreign citizens for certain positions and for certain time periods only as determined and specified in Ministerial Decree No.40/2012 concerning Restricted Positions for Foreign Employees. Accordingly, expatriate employment requires government approval, and foreigners must obtain a Limited Stay Visa (VITAS), Limited Stay Permit Card (KITAS) and Work Permit through their sponsoring employer. Work Permits have historically been valid for a 12-month period extendible subject to approval from the Ministry of Manpower upon expiration (in 2015 instances of shorter 6 month work permits being issued are emerging). Certain other documentary formalities are also normally required. Once an expatriate has a KITAS, he or she can bring a spouse and children to Indonesia.

An employer must obtain Expatriate Manpower Utilization Plan (RPTKA) approval from the Ministry of Manpower, the master document for processing individual Work Permits for expatriate employees. It contains information on the position that will be held by the expatriate, the number of expatriates required by the employer, the duration for employing the expatriate, the proposed commencement date for employing the expatriate and details on the Indonesian worker appointed as the counterpart (position, education and work experience).

In general, the government will expect the number of expatriates in any organization to reduce over time, and may require the employers who employ foreign workers to:

- appoint workers of Indonesian citizenship as accompanying working partners for expatriates to facilitate transfer of knowledge, technology and expertise
- educate and train workers of Indonesian citizenship until they have the qualifications required to hold the positions currently occupied by expatriates.

### *Local language test for Foreign Workers*

A draft government regulation that was to require foreign workers to obtain a degree of proficiency in the Indonesian language in order to obtain new and preserve existing Work Permits (KITAS) was withdrawn in April 2015 following widespread criticism from foreign companies and the local expatriate community.

---

#### Sources:

- (1) KPMG Research and Intelligence
- (2) Central Statistic Agency (BPS) website: [www.bps.go.id](http://www.bps.go.id), April 2015
- (3) KPMG IES Bulletin, February 2014: BPJS Kesehatan: a new medicare system?
- (4) BKPM "Monitoring Investment Climate in Indonesia" Seminar 20 May 2015

# 10. Taxation



## Summary data

### Corporate Tax Rates

Rate (%)	Applicable Year
25 (flat rate)	from 2010

Article 17 Law No. 36/2008

Listed companies which meet certain conditions are eligible for a 5% reduction in the corporate tax rate.

A company with gross turnover less than IDR 50 billion is eligible for up to a 50% reduction of the corporate tax rate based on the percentage of its taxable income which results when IDR 4.8 billion is divided by its gross annual turnover. If gross turnover is below IDR 4.8 billion, the 50% reduction applies on all taxable income. Article 31E Law Number 36/2008.

### Personal Tax Rates

Rate (%)	Taxable income
5	< IDR 50 million
15	IDR 50 million – IDR 250 million
25	IDR 250 million – IDR 500million
30	> IDR 500 million

Article 17 Law No.36/2008

## General

In Indonesia, taxes are levied under three laws that were introduced in December 1983. These cover:

- General Tax Provisions and Procedures
- Income Tax
- VAT on goods and services, and Sales Tax on Luxury goods (STLG).

With certain exceptions, Withholding Tax (WHT) is imposed on payments to onshore and offshore parties, including payments such as dividends, interest, royalties and fees paid for services. The GOI also collects taxes on land and buildings, stamp duty and import duties. Local governments collect various other taxes.

The official tax year runs from January 1 to December 31. Companies may adopt different year ends in their AoA and may change their financial years with prior approval from the Indonesian Tax Authorities. A financial year cannot exceed 12 months for tax purposes.

Indonesia has a self-assessment system under which returns are considered final if not queried by the Indonesian Tax Office ("ITO") within five years.

### Residence

All organizations incorporated in Indonesia are subject to taxation. Corporate organizations include limited liability companies, other companies, partnerships, cooperatives, foundations, pension funds and associations.

Non-resident Indonesian individuals present in Indonesia for more than 183 days per year and corporate organizations incorporated overseas receiving or accruing income from Indonesia are subject to taxation. These corporate organizations are obliged to register for tax purposes if they have a Permanent Establishment ("PE") in Indonesia. Certain types of income payable to non-residents by resident taxpayers are subject to WHT.

Representative Offices of foreign companies are also required to register as taxpayers, even though they may not be a PE. This is necessary as the Representative Office will have to withhold tax on payments to employees and third parties and lodge relevant tax returns.

VAT registration is available only to registered taxpayers.

### **Permanent establishment**

A PE generally covers representative offices, management base offices, branch offices, office buildings, plants, warehouses, dependent agencies and may also include construction projects, mines or other places of extraction of natural resources, as well as consultants providing services in Indonesia.

This is very broadly defined so that the presence of an employee in Indonesia performing work for a foreign company is sufficient to establish the existence of a PE. Foreign companies should be beware of inadvertently creating a PE, and should take positive steps to enter into one of the formal arrangements permitted in Indonesia.

### **Capital Gains**

Capital gains, regardless of the reason for the disposal of the asset, are taxable. A taxable gain, except for land and buildings, is defined as the net proceeds less the adjusted tax basis at the time of disposal. The tax rate is 25%. Losses from a sale or transfer of property or rights used in a business to earn income are deductible.

Disposals of land and buildings are subject to a 5% final income tax based on the selling price or the deemed tax market value of the property, whichever is higher. The acquirer is also required to pay a 5% levy/transfer title tax on the purchase price.

Capital gains on the sale of shares listed on the Indonesia Stock Exchange (IDX) are subject to a final tax rate of 0.1% of gross proceeds (plus an additional 0.5% for founder shares). However, certain types of venture capital companies are not required to pay tax on capital gains under particular circumstances. There is also a final tax, being 5% of gross proceeds, on the sale of unlisted shares held by a foreign shareholder in an Indonesian company, unless protected by a Double Tax Agreement (DTA).

### **Dividends**

Dividends and other shares of profit derived by resident limited liability companies, cooperatives, state-owned enterprises or regional government-owned enterprises from participation in the capital of an enterprise established in Indonesia, may not be included in taxable income in certain situations. Companies, which do not meet these conditions, will be subject to tax on such income. Dividends and shares of profits from other sources must be included in taxable income. A foreign tax credit is allowed for any tax withheld on foreign-source dividends. A credit is however not available for foreign tax on underlying profits.

### **Losses**

The carry forward of tax losses is limited to five years, commencing the first year after the loss was incurred. This period may be extended for up to 10 years under special

facilities available for certain regions and/or industries. There is no provision for the carry-back of losses. Changes in shareholders do not affect the validity of the carried forward losses.

Capital losses are treated the same as operating losses provided that the losses are reasonable based on sound market practice. No foreign sourced losses can be included in the tax computation.

### **Grouping/Consolidation**

No provision exists for group or consolidated income tax returns under Indonesian law.

### **Tax Depreciation/Capital Allowances**

Depreciable property is defined as tangible property owned and used in the business or owned for the production, recovery and securing of income, which has a useful life of more than one year. Land is not depreciable, except for certain industries.

Buildings and other immovable property are depreciated only using the straight-line method. For all assets other than buildings and other immovable property, depreciation is calculated using either the declining balance or the straight-line method at a company's option. These assets must be grouped into categories defined by the tax regulations, as are the useful lives to be applied in calculating tax depreciation for each category.

Once applied, taxpayers are not allowed to change the method of depreciation without ITO approval. Special rules apply in the oil & gas and mining sectors.

### **Amortization of Expenditure**

The acquisition price of intangible property with a useful life of more than one year must be amortized consistently using either the straight-line or declining balance method over the useful life of the asset, following the rates of depreciation for tangible assets. For mining industries, forestry and other natural resources businesses, the taxpayer must use the unit of production method with a maximum of 20% per year.

### **Interest**

Interest on funds borrowed by a company for the purposes of obtaining, collecting and maintaining income is deductible from gross income. However, where funds are used to derive income subject to final tax (such as interest on domestic bank deposits) no deduction is available.

Interest may also be disallowed as a deductible item if such charges might be considered excessive, such as interest rates in excess of commercial rates. Interest-free loans from shareholders may in certain cases create the risk of the imposition of deemed interest and WHT obligations for the borrower.

## Tax Administration

### Registration

All taxpayers are required to register for income tax purposes. A non-resident foreign company is only obliged to register if it has a PE as defined in the domestic tax law or applicable DTA. Upon registration, a taxpayer identification number (NPWP) is obtained. The ITO may register any entity or person which, in its opinion, should be registered as a taxpayer. Subsequently, that entity or person must meet all obligations stated in the law.

A taxpayer must deregister with the ITO when it ceases to be a taxpayer in Indonesia. The ITO will generally perform a tax audit in order to ensure that the taxpayer has met all obligations. Until the ITO deregisters a company, all obligations stated in the tax law continue to apply.

### Tax Installments

Corporate and individual taxpayers must pay monthly income tax installments. For most taxpayers, installments are based on the income tax payable reflected in the annual corporate income tax return of the prior year. Banks and other taxpayers which are required to submit periodical financial reports should base their installments on such reports, as adjusted for tax purposes.

### Returns

Companies are required to self-assess and lodge annual corporate income tax returns. Consolidated returns for commonly owned entities are not permitted. The returns must be lodged with the relevant ITO within four months after the end of the calendar year or tax year, this deadline may be extended for two months by notifying the ITO.

### Withholding taxes - Transactions between Residents

WHT is imposed at various rates on various amounts payable either by a resident corporation, a PE of a foreign company or certain individuals appointed as WHT collectors, to other residents. In most cases, the withholding liability arises when the expense is incurred, not when the payment is made.

The regulations are numerous and the following is a summary of the main types of transactions subject to WHT and the related WHT rate:

#### *Amounts payable to resident individuals:*

- Compensation for work or services (including pensions)
- Dividends : 10% (final)
- Royalties - 15%
- Interest -
  - bank interest: 20% (WHT is final on interest from local banks)
  - bonds and certain other securities:15% (final)
  - other interest: 15%
- Rental and other income relating to the use of real property - 10% (final)
- Prizes and awards - lotteries: 25%.

#### *Amounts payable to resident companies and PEs:*

- Royalties - 15%
- Interest -
  - bank interest: 20% (WHT is final on interest from local banks)
  - bonds and certain other securities:15% (final)
  - other interest: 15%
- Rental and other income relating to the use of real property – 10% (final)
- Rental of equipment and vehicles: 2%
- Services: 2% (includes technical services, management services, other services)
- Amounts payable to local banks are exempt from WHT
- Dividends – 15%, unless the following two conditions are satisfied for which the dividend would be exempt from WHT:
  - the dividend is sourced from retained earnings
  - the shareholder company owns at least 25% of paid up capital.

The purchase of goods is generally not subject to WHT, except for certain goods as stipulated by the ITO.

### Disposal of Property

Tax is also imposed at source on proceeds of disposal of property:

- Shares listed on the Indonesian stock exchange - 0.1% (final)
- Founders shares are subject to an additional 0.5% (final) on listing
- Transfer of title of land and buildings - 5% income tax (final) and 5% title transfer tax (duty)
- Sale of unlisted shares held by a foreign shareholder in an Indonesian company - 5% of proceeds (final), unless protected by DTA.

### Exemption

Where the WHT is a prepayment of the recipient's income tax liability, the recipient may be able to apply for an exemption from withholding in certain circumstances.

## Tax Incentives

### Takeovers, Mergers and Acquisitions

Assets may be transferred at book value as part of a merger or in the context of certain other reorganizations, subject to prior approval from the ITO. In addition, there may be partial relief from the 5% transfer of title tax on land and buildings and full relief from the 5% income tax on the transfer of land and buildings.

### **Tax Holidays**

Tax holidays may be available for significant investments in the following “pioneer” industries:

- Basic metals industry
- Petroleum refining industry and/or organic basic chemicals derived from petroleum and natural gas
- Industrial machinery
- Renewable resources industry
- Telecommunications equipment.

The facility is only available to companies established after August 2010. To qualify, applicants must invest a minimum of IDR 1 trillion and provide a statement of agreement to deposit 10% of this amount in a bank in Indonesia before submitting the application. Successful applicants will be entitled to an exemption from corporate income tax for an initial five to ten years and a reduction of 50% to the corporate tax liability for the following two years after expiry. Submission of proposal to the Ministry of Industry or Chairman of BKPM (Indonesian Investment Coordinating Board) are due 15 August 2015 at the latest.

The regulation introducing these facilities provides for possible expansion on scope and period in the future.

### **Direct Tax Incentives for New Enterprises**

New entities established under the Foreign Investment Law may apply for an exemption from tax payable on the importation of capital goods and raw materials. New enterprises must secure an exemption certificate from the ITO where the new entity is registered. The exemption is granted for capital goods indicated in the BKPM Master list and must be applied for each year.

### **Investment in certain businesses and or certain regions**

Income tax relief is available for investments in 25 selected sectors (52 sub-sectors) and/or 15 selected locations (77 sub-locations), effective 22 December 2011. Investors should consult with the ITO or their tax advisors as qualifying sectors and geographical regions change from time to time.

The tax relief for the selected sectors/regions comprise of four incentives:

- Additional tax deduction of 5% of the realized capital investment (depreciable and non-depreciable assets) each year up to six years (revoked if the assets are transferred during facility period)
- Option to use accelerated tax depreciation at double normal rates
- The period for tax loss carry forward may be extended to 10 years (instead of five years)
- WHT on dividends to non-resident shareholders is reduced to 10% (or a lower DTA rate).

The selected business sectors are economic sectors that have high priority on a national scale, particularly in respect of boosting exports. The selected regions are remote regions, which are economically potentially worthy of development but whose economic infrastructure is generally inadequate and where access by public transport is difficult, including maritime waters with a depth of over 50 meters where the seabed has mineral reserves, including natural gas.

### **Free Trade Zones (FTZ) and Free Port Areas (FEA)**

FTZ and FEA are treated as if they were outside of the Indonesian customs territory. There are no import duties and other taxes on the importation of goods. Goods delivered to other locations within Indonesia are treated as imports and are subject to normal customs and other impositions.

The regulations provide specific area coordinates and boundaries, including maps of the area coverage of the Free Trade Zones and Free Port Areas.

Business activities conducted in the Free Trade Zones and Free Port Areas include trading, maritime, industry, transportation, banking, tourism and other activities. Other activities are subject to further stipulation by separate Government Regulations. The regulations stipulate that the economic development of the Free Trade Zones and Free Port Areas must be conducted in accordance with the regional master plan. These Government Regulations do not revoke any agreements, arrangements or cooperation, as well as any licenses or facilities granted prior to the stipulation of the 2007 Government Regulations. These will still apply until expiration.

### **Aid-funded Projects**

Goods, materials and construction equipment imported by a main contractor in connection with an approved government project funded by foreign loans or grants are entitled to the following relief:

- Exemption from import duty
- No collection of VAT and STLG
- Income tax is borne by the government for primary contractors, consultants and suppliers working on such projects.

### Imported Goods

The duty and tax relief available for the importation of goods are summarized in "Indirect and Other Taxes":

### International Tax

#### Double Tax Relief

Indonesia grants a credit for WHTs directly paid on income received or accrued in a foreign country. There is no credit for taxes on underlying profits. The credit is only granted if the income is taxable in Indonesia as being part of worldwide earned income. The credit is limited to the lesser of the tax payable in Indonesia on the foreign income or the amount of the foreign tax paid.

If the foreign tax is reduced or refunded, the credit will be reduced and the tax payable in Indonesia will have to be increased by the amount of the reduction or refund in the year that such refund or reduction is made.

### Withholding Taxes

#### Transactions with Non-residents

WHT is imposed at 20% on various amounts payable to non-residents, unless the non-resident has a PE in Indonesia, whereby the rates applicable to payments to residents apply. The WHT may be reduced if the foreign resident is exempt or eligible for a reduced WHT rate by virtue of a DTA.

In order to qualify for any relief under a relevant tax treaty, non-residents must provide a certificate from the tax authority in their country of residence (Form DGT1 for most taxpayers).

Banks, pension funds and certain others using custodian banks may use an alternative form (Form DGT2) which requires only certification of the tax residency status, without the above additional declarations regarding the business or transaction.

WHT applies to the following:

- Dividends
- Interest, including premiums, discounts and compensation for loan guarantees
- Royalties
- Rent and other income connected with use of property
- Cross border leases
- Gifts and awards
- Compensation for work by individuals or services or activities by overseas entities (applies whether services are performed outside or inside Indonesia)

- Insurance premiums (the rate of tax is reduced depending on the nature of the transaction)
  - Insured - 10%
  - Insurance company - 2%
  - Reinsurance company - 1%
- Disposals of shares in unlisted Indonesian companies. The effective rate of tax is 5%. If a foreigner is buying the shares in a company, the company must pay the WHT before the transfer of ownership can be recorded.

#### Branch Profits Tax

PE's of foreign enterprises are subject to 20% WHT on their after-tax income unless eligible for a reduced rate by virtue of a DTA.

#### Double Tax Agreements

At April 2015, Indonesia had signed DTAs with 63 countries (excluding treaty with Saudi Arabia which only governs air transport).

### Anti-avoidance Rules

#### Introduction

The income tax law contains specific anti-avoidance provisions. Where the ITO considers that transactions have not been conducted at arm's length due to the existence of a "special relationship" between the parties, the consideration paid may be adjusted. The ITO's power extends to all domestic and cross border transactions.

In addition to the power of the ITO to adjust transfer prices, there are "thin capitalization" considerations and controlled foreign company rules. These are summarized below.



## Transfer Pricing

The regulations/guidelines which have been issued with regard to Transfer Pricing are now largely in line with the 2010 OECD Transfer Pricing Guidelines although guidance to ITO tax auditors and the rules prior to November 2011 suggest that a hierarchical approach should be taken to the selection of methodology and the limited nature of the guidelines allows for broad interpretations.

A special relationship includes:

- A relationship between two or more taxpayers that are under common ownership or control, whether directly or indirectly
- A relationship between a taxpayer that owns 25% or more of the capital of another party, or a relationship between a taxpayer that owns 25% or more of two or more parties, and the relationship between the two or more parties last mentioned
- A family relationship, either of the same blood or by marriage in one straight descent line and or one degree sideways.

It is important to note that the above transfer pricing rules apply to domestic as well as international transactions. However, amended guidance issued in November 2011 applies in the case of domestic transactions only when the related parties are subject to the application of different tax rates or luxury goods sales tax is involved in the transaction.

In 2013 the DGT released a standard transfer pricing questionnaire. This extensive questionnaire is not only sent to taxpayers that are under tax audit but also to other taxpayers.

A taxpayer may request for a Mutual Agreement Procedure (MAP), should a transfer pricing adjustment lead to double taxation. Amended regulations were issued in the autumn of 2014.

The ITO may also enter into Advance Pricing Agreements (APA) on prices with companies and other tax jurisdictions. The ITO issued an updated regulation covering the policies and procedures that will be adopted in establishing such APAs in early 2015.

Indonesia is currently negotiating a number of APAs/MAPs with a number of tax treaty partners.

### Application of "Thin Capitalization" concepts

Where a special relationship exists, interest may be disallowed as a deduction where such charges are considered excessive, such as interest rates in excess of commercial rates. Interest-free loans from shareholders may in certain cases create a risk of deemed interest being imposed, giving rise to withholding tax obligations for the borrower.

The law allows the MOF to issue a decree defining the maximum ratio of debt to equity in determining deductible interest. Such a decree, proposing a maximum 3:1 ratio for all industries, was issued in 1984. However, a subsequent decree postponed its implementation indefinitely. The DGT later issued a draft proposal for a 5:1 ratio, however it has never been finalized. Special rules on tax deductibility of interest apply in the mining and oil & gas sectors.

## Controlled Foreign Company (CFC) Provisions

Effective January 2009, the CFC rules whereby Indonesian resident shareholders may be subject to tax on deemed dividends have changed. A CFC is now defined as a foreign unlisted corporation in which an Indonesian resident individual or corporate shareholders, either individually or as a group, hold 50% or more of the total paid in capital. Listed corporations are not CFCs. The Indonesian shareholders shall be deemed to receive dividends within 4 months after filing the tax return, or 7 months after the end of the fiscal year where there is no obligation to file an annual tax return or there is no specific deadline of filing in the country of residence of the CFC.

## Taxation of Individuals

### Introduction

An employer is obligated to withhold, remit and report tax on income received by an employee in connection with employment. Individuals who are resident in Indonesia for tax purposes are required to obtain a personal tax registration number (NPWP) and file an individual tax return, unless he or she receives net income below the non-taxable income threshold (discussed below).

### Residence

The tax law distinguishes between resident tax and non-resident taxpayers. A resident taxpayer is defined as any individual present in Indonesia for more than 183 days in any consecutive 12-month period, or any individual present in Indonesia and intending to reside in Indonesia. Resident individuals are taxed at the normal rates on taxable income, i.e. worldwide gross income less allowable deductions and non-taxable income.

### Taxable income

Gross income is broadly defined as any economic benefit received or accrued by a taxpayer, whether originating from within or outside Indonesia. Gross income includes wages, salaries, bonuses and other compensation for work performed, honoraria, lottery prizes and awards, gross profits from a business, gains from the sale or transfer of property, dividends, interest, royalties, rent and income from the cancellation of indebtedness.

Interest income earned by individuals from time deposits held in Indonesia is subject to a 20% final WHT, accounted for by the paying bank. This income is not subject to further taxation in the hands of the recipient.

Income from the rental of land and buildings is subject to 10% final WHT. Corporate tenants must deduct the 10% tax from amounts payable to the lessor.

### Capital Gains Tax

Similar to companies, capital gains derived by individuals are taxable as normal income.

### Dividends

Dividends are taxable to individuals. Dividends received from domestic taxpayers are subject to a final WHT of 10%. A foreign tax credit may be available for any foreign taxes paid on dividends received from overseas.

### Employment Income/Employee Benefits

Companies paying amounts to resident individuals in excess of a small daily sum are required to withhold tax at standard rates, except for rental and certain professional services where lower rates of withholding may apply.

It is common practice for salaries and certain other amounts payable to individuals to be expressed on a "net of tax" basis.

By special concession, Indonesian nationals are allowed the full benefit of non-taxable income allowances and the lower bands of tax rates against part-year employment income. In all cases, the occupational support deduction is limited to the lower of 5% of gross income, or IDR 500,000 per month.

#### Employee Benefits

Generally, the full cost of benefits-in-kind is excluded from the taxable income of an employee and is not an allowable deduction from gross income in determining the taxable income of the employer.

Benefits-in-kind are considered to be any benefits received by the employee or his or her family from an employer not in the form of cash. For example, the medical expenses of an employee paid directly by the employer to a hospital are excluded from taxable income because the benefit was not received as cash and was paid directly to a third party. Such benefits can also include housing (except in isolated areas), home leave, motor vehicles, children's education expenses and tax borne by an employer on behalf of an employee.

For oil & gas and mining contractors, the cost of benefits-in-kind may be deducted from taxable income.



### Personal Allowances

Resident individual taxpayers can also deduct the following in determining taxable income:

- For the individual taxpayer – IDR 24,300,000/year
- For a married taxpayer who is the principal earner – an additional IDR 2,025,000/year
- For each lineal family member by blood or marriage who is a full dependant (up to a maximum of three dependants) – an additional IDR 2,025,000/year per dependant.

Resident individual taxpayers are also allowed the following tax deductions:

- For occupational support, an additional allowance of 5% of gross income up to a maximum of IDR 6,000,000/year
- Contributions to registered pension funds and the BPJS scheme.

### Tax Rates

The following are the rates of tax applied to the annual taxable income of resident individuals:

Rate (%)	Taxable income
5	< IDR 50 million
15	IDR 50 million – IDR 250 million
25	IDR 250 million – IDR 500 million
30	> IDR 500 million

[Article 17 Law No.36/2008](#)

An employee who does not have a tax identification number (NPWP) is subject to a surcharge of 20% on the tax rate, such that the maximum rate will be 36%.

Subject to relevant DTAs, income received or earned by a non-resident for any work or services performed in Indonesia and paid by, or charged to an Indonesian entity, is subject to a final withholding tax of 20% applied to the gross amount of the income. The payer of the income is responsible for the WHT due on the income paid to the non-resident.

Payments to non-residents in the form of dividends, interest, royalties, rent for property, compensation for services, prizes and awards, pensions and other periodic payments, rentals, insurance premiums or the deemed gain from the disposal of shares in unlisted Indonesian companies in Indonesia are also subject to a 20% WHT, unless reduced or exempted by an applicable DTA. This 20% WHT can be treated as a prepayment of tax if a non-resident becomes a resident taxpayer.

The tax year is the calendar year.

### Tax Administration

#### Payment of Taxes

Income tax withheld by employers from payments of wages, salaries, honoraria and other payments to individuals subject to tax, must be remitted on a monthly basis by the 10th day of the following month.

Employers must file a monthly tax return by the 20th day of the following month outlining total compensation and taxes withheld. There is no obligation to file an annual employee tax return. However, the December tax return to be lodged on the 20th of January, must detail, by individual, all taxes paid and income earned during the year by employees and other individuals subject to withholding. Any income tax payable as shown in such December tax return must be remitted before the filing date of the January 20th. Individuals must pay monthly installments based on regular non-employment income declared in the previous year's tax return.

Individual tax returns may be subject to tax audit. Payment of tax audit assessments is due within one month following issuance by the ITO. There is a five-year statute of limitations.

### Other Issues

#### Expatriates

Under the tax law, resident individuals including expatriates are taxed on worldwide income. The ITO has issued a schedule of salary guidelines, the most recent version of which was issued in April 2002. The guidelines address the industry of employment, nationality and job title. They are used by the ITO in circumstances that indicate that salaries are not being properly declared for employee income tax purposes.

For expatriates commencing or terminating employment during the year, annualization of income is required for

calculating the tax payable on the part-year income. This effectively pro-rates the non-taxable income allowances and the lower bands of tax rates. As such, the timing of arrival in or departure from Indonesia of expatriates is of no significance for tax purposes.

Expatriate employees of drilling companies are taxed on a deemed salary basis, for which separate regulations exist.

## Indirect and Other Taxes

### Value-Added Tax

#### Overview

A person or body, in whatever form, which in the course of its operation; produces, imports or exports taxable goods, conducts trading activities or renders taxable services, is required to register as a "Taxable Entrepreneur" with the ITO. However, only a resident or a PE can obtain a VAT registration. Registration by non-residents is not allowed

The rate of VAT is 10% but under the law the government may amend this rate to a minimum of 5% and a maximum of 15%. VAT is levied on exports at 0%.

#### Goods and Services Subject to VAT

VAT is imposed on:

- The delivery of taxable goods (tangible or intangible) in Indonesia by "Taxable Entrepreneur"
- The importation of taxable goods
- The rendering of taxable services in Indonesia
- Utilization of intangible taxable goods from outside the Indonesia
- Utilization of offshore taxable services in Indonesia
- Export of taxable goods by a "Taxable Entrepreneur"
- The activities of self construction
- The disposal of fixed assets by a Taxable Entrepreneur including the transfer in the course of a merger (except where VAT on the original acquisition could not be credited).

Special schemes for VAT apply to sales of cigarettes, pre-recorded cassette tapes and compact discs.



### *Collection, Filing and Payment of Tax*

VAT is determined by applying the tax rate of 10% to the sale, replacement or import price. The sales price is the money value including all costs of delivery, installation, insurance, technical and maintenance, commission, guarantees, interest and others, as long as they relate to the delivery of goods. Compensation for services is the money value, including all costs, which relate to the delivery of the services.

Excluded from the sales price, are sales tax and discounts and rebates, as long as these are included on the tax invoice.

For imported goods, the import value is the value used as the basis for calculating the import duty together with other levies imposed on the basis of the provisions in the customs law, but excluding VAT and STLG.

In cases where a special relationship exists between two parties involved in a transaction, the ITO may substitute a market price that becomes the basis on which the VAT is charged.

Monthly remittances to the government are required for the excess of output VAT over input VAT. Output VAT is VAT charged by a taxable entity on its sales of goods and services. Conversely, input VAT is the VAT incurred on purchases of goods and services used in the business. If input VAT exceeds output VAT for any month, it can be carried forward to the next month or a refund can be claimed (except Input VAT for certain transactions). A refund claim triggers a tax audit. Input VAT, supported by a valid tax invoice, is only creditable if it is reported within three months after the end of the period stated in the tax invoice.

There is a self-collection obligation in relation to input VAT on offshore services purchased from non-residents for the benefit of residents.

Monthly VAT returns must be filed by the end of the following month and any VAT payable must be paid before the submission of the return.

Certain government bodies, production sharing contractors and mining companies are subject to special rules as they are designated VAT collectors. These bodies are obliged to remit VAT related to their purchases directly to the ITO.

### *Exemptions and Reliefs*

The principal activities not subject to VAT are as follows:

- Goods produced by mining or drilling that are taken directly from their source: crude oil, natural gas, geothermal energy, sand and gravel, coal (before processed into briquettes), and ores (iron, tin, gold, copper, nickel, silver and bauxite)
- Basic necessities needed by the population as a whole: rice, corn, sago, soybeans and salt

- Money, gold ingots and negotiable instruments
- Banking, insurance, leasing services and securities
- Manpower services
- Social, health, religious and education services
- Public transportation, postal services, non-commercial broadcasting
- Entertainment services
- Hotel and catering services
- Government services.

There are also goods and services that are granted an exemption from VAT.

### *Relief for Export Manufacturers*

There are a number of relief schemes to allow exporter manufacturers to operate on a virtually VAT and duty-free basis. Such schemes include bonded zones, economic development zones (KAPET) and free trade areas. The Government has approved a number of Bonded Areas located throughout Indonesia.

Free trade areas and free ports are located in Indonesia but are considered outside the customs area and, therefore, goods brought into these areas are exempt from import duties, VAT and STLG. Business activities that can be carried out in a free trade area include, among others, trade, services, mining, transportation, banking and manufacturing. Sabang, Batam, Bintan and Karimun are currently the free trade areas in operation.

An import incentive is granted to a manufacturer who imports raw materials to be used for processing, assembling, or installing goods, provided those goods will be 100% exported. A manufacturer must be registered in order to be entitled to this incentive. A bank guarantee or customs bond is required for the full amount of the import duty, excise, VAT and STLG that would otherwise have been payable. When goods are exported, the guaranty or bond is released. A refund can be granted on any import duty, excise and tax paid on imported goods that are later used in producing items for export.

### *Sales Tax on Luxury Goods*

The VAT law also imposes a STLG on deliveries of luxury goods by manufacturers in Indonesia and on the importation of luxury goods. The rates vary depending on the category of the goods. The current rates range from 10% up to 75%, although the Law allows for a maximum of 200%. Conceptually, this tax is charged only once. Like VAT, STLG is charged at 0% on the export of luxury goods and any STLG suffered may be reclaimed. STLG is calculated by multiplying the applicable rate against the sales price or import price, excluding VAT. The STLG payable on the purchase of luxury goods cannot be credited against the VAT collectable when the goods are subsequently sold.

It is necessary to determine the applicability of the STLG on a case-by-case basis as the rules are complex and subject to change. There is an exemption from STLG on certain items for public use.

### **Customs Duties**

Customs duties are imposed on items imported into Indonesia. Customs duties are generally imposed on an ad valorem basis.

Duties are payable based on the Harmonized System (HS) classification. Duties are based on the cost, insurance and freight (CIF) value of the imported item and, in general, are imposed at rates of 0% to 20% for most goods, 25% to 80% for cars, and 170% for alcoholic beverages.

The Indonesian customs procedures are based upon General Agreement on Tariffs and Trade (GATT) principles.

Some key features of the current system are:

- Ports have a “red and green channel” system for imported goods. Red channel goods are all inspected. Green channel goods are not normally inspected unless there is some justification
- Duties and taxes shown on the import declaration must be paid through a designated bank in order for the goods to be released
- Valuation of goods is based on GATT conventions
- The accuracy of the declaration and value is subject to subsequent audit of the importer’s records.

Simplified procedures apply for goods entering bonded areas. Special rules apply for imports in the oil & gas sector, and goods for government projects funded by loans or grants from other governments.

Import duties are not payable in certain circumstances, including:

- Imports used in the production of exports where the manufacturer is located in a bonded zone or free trade area
- Certain imports by the petroleum, geothermal and mining industries.

Other relief includes:

- For certain goods which are imported on a temporary basis, the importer must pay 2% of the import duty and VAT each month for the period of usage. The remaining amount can be guaranteed. If the goods are not re-exported, the full amount of import duty and taxes plus a 100% penalty on the import duty must be paid
- Import duty tariffs are reduced to 5% on importation of goods by approved foreign and domestic investment companies using Master list facilities.

### **Excise Duties**

Excise duties are levied on specific products whose consumption is restricted or controlled, namely alcoholic beverages and tobacco products.

### **Stamp Duty**

A stamp duty tax of either IDR 3,000 or IDR 6,000 is charged on certain documents such as receipts, agreements, powers of attorney and other legal documents.

### **Tax on Land and Buildings**

This is a tax levied on the holding of land or buildings within Indonesia. The ITO, or in practice delegated regional authorities, will initially determine who the taxpayer is and issue a Report On The Tax Object to that property. Normally, the owner is responsible for paying the tax due.

#### *Tax Rate and Method of Calculation*

Tax is currently imposed at 20% or 40% of the full statutory rate, which is 0.5% of the sales value. Thus, the actual tax rate is 0.1% or 0.2%. The sales value is the actual transaction price or, in the absence of a transaction, the price of a similar holding can be used. The law provides that the sales value is to be fixed every three years, except for certain areas where it is fixed annually.

The tax is to be determined for the tax year, being the calendar year, based on the condition of the land and buildings as at 1 January. Specific calculation formulae are stipulated for plantations, mining and forestry businesses.

### **Property Title Transfer Tax**

A transfer tax is payable on every transfer of title of land, or land and buildings. The taxpayer is the recipient of the rights.

The definition of “transfer” is broadly defined, and includes:

- A sale and purchase transaction
- An exchange of assets
- A grant or a gift
- A testamentary grant
- The enforcement of a judicial ruling with permanent legal force
- A business merger, liquidation or expansion.

#### *Exemptions*

Tax is not imposed on certain transfers, such as:

- Transfers of title to the state for the public interest
- Transfers to diplomatic representatives and certain international organizations
- Donations for certain religious and community purposes.

#### *Tax Rate and Method of Calculation*

The tax is 5% of the transfer price. There is a non-taxable amount of IDR 60 million. The amount to be taxed is the acquisition cost. If the deemed sale value determined for land and buildings tax purposes is higher, that amount will be used as the basis for the transfer tax.

The property title transfer tax can be reduced in certain cases, including:

- Grant of property to certain close family members - 50% reduction
- Transfer of property in an approved merger or consolidation - 50% reduction.

#### *Collection of Tax*

This tax becomes payable before the transfer is legalized. A lawyer or notary cannot legalize any legal documents in relation to a transfer if the tax has not been paid. The ITO is granted the power to review the property title transfer tax. If any underpayment is found, the ITO can issue a tax assessment.

#### **Payroll Taxes**

There are no additional payroll taxes in Indonesia other than the employee income tax withholding system. However, BPJS (social security contributions) are based on payroll, most of which are borne by the employer.

#### **Regional and Local Taxes**

Local governments collect regional and local taxes. These taxes include:

- Entertainment tax
- Advertisement tax
- Motor vehicle taxes
- Hotel and restaurant tax
- Street lighting tax
- Tax on the use of underground and surface water.

---

#### Sources:

- (1) KPMG Research and Intelligence
- (2) Law on General Provisions and Procedures of Taxation: Law No. 6/1983 (amended by Law No. 16/2000) concerning General Provisions and Procedures of Taxation
- (3) Income Tax Law: Law No. 7/1983 (amended by Law No. 17/2000; amended by Law No. 36/2008) concerning Income Tax
- (4) Value Added Tax Law: Law No. 8/1983 (amended by Law No.18/2000) concerning Goods and Services and Sales Tax on Luxury Goods
- (5) Customs Law: Law No. 10/1995 (amended by Law No. 17/2006) concerning Customs
- (6) Tax Court Law: Law No. 14/2002 concerning Tax Court
- (7) [www.pajak.go.id](http://www.pajak.go.id)

# Glossary

ABC	Anti-Bribery and Corruption
AEC	ASEAN Economic Community
AFTA	ASEAN Free Trade Area
AML	Anti-Money Laundering
AoA	Article of Association
APA	Advance Pricing Agreement
ASEAN	Association of Southeast Asian Nations
BAPPENAS	Indonesia's National Development Planning Agency
BAPEPAM-LK	Capital Market and Financial Institution Supervisory Board
BI	Bank Indonesia/Indonesian Central Bank
BPM	Investment Board
BKPM	Investment Coordinating Board
BOC	Board of Commissioners
BOD	Board of Directors
BPJS	Badan Penyelenggara Jaminan Sosial / Workers Social Security Agency
BPR	Rural Bank/Bank Perkreditasi Rakyat
BUMN	State-Owned Corporation
CAR	Capital Adequacy Ratios
CAGR	Compound Annual Growth Rate
CBU	Completely Built Up
CCOW	Coal Contract of Work
CEMA	Capital Equivalency Maintained Assets
CEPT	Common Effective Preferential Tariff
CFC	Controlled Foreign Company
CLA	Collective Labor Agreement
COW	Contract of Work
CV	Limited Partnership
DGT	Director General of Taxation
DMO	Domestic Market Obligations
DNI	Negative List of Investment/Daftar Negative Investasi
DPD	Council of Regional Representatives
DPR	House of Representatives
DTA	Double Tax Agreement
EIU	Economist Intelligence Unit
ENR	Energy and Natural Resources
FA or Firma	General Partnership
FCPA	Foreign Corrupt Practices Act
FDI	Foreign Direct Investment
FIFO	First-In-First-Out
FTAs	Free Trade Agreements
GATT	General Agreement on Tariffs and Trade
GCG	Good Corporate Governance
GDP	Gross Domestic Product
GFC	Global Financial Crisis
GMS	General Meeting of Shareholders
GOI	Government of Indonesia
HS	Harmonized System
ICAAP	International Capital Adequacy Assessment Process
IDR	Indonesia Rupiah
IDX	Indonesia Stock Exchange
IIA	Initial investment approval

IIGF	Infrastructure Guarantee Fund
IMTA	Working permit
ITAP	Permanent Stay Permit
ITO	Indonesia Tax Office
IUP	Mining Business License
IUT	Permanent business license
JAMSOSTEK	Jaminan Sosial Tenaga Kerja/Employee social security scheme
JV	Joint Venture
KAPET	Economic Development Zone
KITAS	Temporary resident visa
KP	Kuasa Pertambangan / Mining Rights
LIFO	Last-In-First-Out
M&A	Merger & Acquisition
MEMR	Ministry of Energy and Mineral Resources
MOF	Ministry of Finance
MOMT	Minister of Manpower & Transmigration or “Manpower Affairs”
MOT	Ministry of Trade
MOU	Memorandum of Understanding
MOLHR	Ministry of Law and Human Rights
MPR	People’s Consultative Assembly
Negative List	Investment Negative List
NPWP	Tax-payer registration number
NV	Dutch form of limited liability company
OJK	Otoritas Jasa Keuangan / Indonesia Financial Services Authority
PE	Permanent Establishment
PEB	Declaration of Goods Exported
PMA	Foreign investment
PMDN	Domestic investmnt
PNG	Papua & New Guinea
POA	Power of Attorney
PPP	Public-Private-Partnerships
PSC	Production-Sharing Contract
PT	Limited Liability Companies
RBC	Risk-Based Capital
RPTKA	Expatriate manpower plan
SBI	Bank Indonesia Certificates
SIUP	Operating license
SPSI	All-Indonesian Labor Federation
sq mi	square meter
SREP	Supervisory Review and Evaluation Process
STLG	Sales Tax on Luxury Goods
UKBA	UK Bribery Act
UMK	Regency Minimum Wage
UMP	Provincial Minimum Wage
USD	US Dollar
VAT	Value Added Tax
VITAS	Limited stay visa
VoA	Visa on Arrival
WHT	Withholding Tax
WUP	Granting of a Mining Business Area
YoY	Year on Year
YTD	Year To Date



## **KPMG Indonesia**

### **Contact us**

#### **KPMG Siddharta Advisory**

Advisory Services

**T:** + 62 (0) 21 574 0877

**F:** + 62 (0) 21 574 0313

#### **KPMG Advisory Indonesia**

Tax Services

**T:** + 62 (0) 21 570 4888

**F:** + 62 (0) 21 570 5888

#### **Siddharta Widjaja & Rekan**

Audit Services

**T:** + 62 (0) 21 574 2333 / 574 2888

**F:** + 62 (0) 21 574 1777 / 574 2777

#### **Address:**

**35<sup>th</sup> Floor Wisma GKBI**

**28, Jl. Jend. Sudirman**

**Jakarta 10210**

**Indonesia**

#### **Tohana Widjaja**

**Managing Partner, KPMG Indonesia**

Tohana.Widjaja@kpmg.co.id

#### **Ho Wah Lee**

**Head of Advisory Services**

Wahlee.ho@kpmg.co.id

#### **David East**

**Head of Transaction Services**

David.East@kpmg.co.id

#### **Abraham Pierre**

**Partner, Head of Tax**

Abraham.Pierre@kpmg.co.id

**[kpmg.com/id](http://kpmg.com/id)**

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

© 2015 Siddharta Widjaja & Rekan – Registered Public Accountants, an Indonesian partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative (“KPMG International”), a Swiss entity. All rights reserved. Printed in Indonesia.

The KPMG name, logo and “cutting through complexity” are registered trademarks or trademarks of KPMG International.