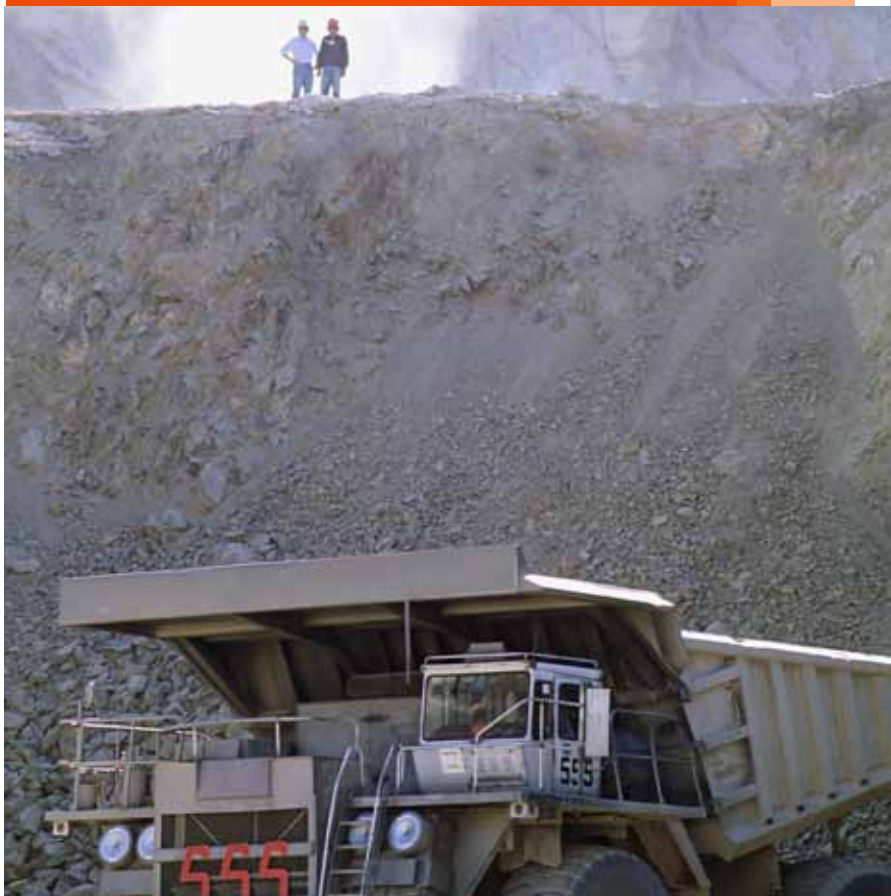


Indonesia
Mining

Mining in Indonesia *Investment and Taxation Guide*

May 2011



pwc

Contents

Preface	1
I. Overview of the Mining Regulatory Framework	3
II. Mineral and Coal Mining Regulatory Framework	7
III. Contracts of Work	27
IV. Tax Regimes for the Indonesian Mining Sector	39
V. Additional Regulatory Considerations for Mining Investment	55
Appendices	
A. About PwC	69
B. Regional Taxes	71
C. Ministry of Energy and Mineral Resources	73
D. Industry Associations	74
E. Summary of CoW generations	76
F. Glossary	87
Acknowledgements	89
Other PwC Mining Publications	90
Map: Indonesian Mining Areas Map (provided in insert pocket)	

Preface

Photo source : PT Newmont Nusa Tenggara



The introduction of the new mining law in 2009 and the subsequent implementing regulations was heralded as the stimulus needed to promote investment in the Indonesian mining sector. While those changes have gone a long way to making the Indonesian mining sector a more attractive and secure investment destination than it was previously, there is still some way to go before the full intentions of the implementation of the mining law are achieved.

During 2010, the Government issued a number of key implementing regulations, in particular in relation to benchmark pricing and clarifications on the domestic market obligation requirement, however a number of areas of detail remain unclear. With the general increase in economic activity in 2010 and associated rise in commodity prices, it is imperative that the Government of Indonesia continue to issue the necessary implementing regulations to provide investors with the certainty they need.

This handbook recognises that reforms are continuing and that some information will require updating as they proceed. This handbook is also not intended to be a comprehensive guide to all aspects of the mining industry in Indonesia, but rather a general guide to certain key considerations related to investment and taxation in the sector.

Companies intending to invest in Indonesia will need to carry out further research and obtain updated information on investment and operational requirements. They should also consider the social, political and economic developments in Indonesia, which can have a significant impact on the success of any investment.

PwC Indonesia recommend investors contact our specialist mining team, should they need further advice. Please see Appendix A for the contact details of the PwC Indonesia mining specialists.

I. Overview of the Mining Regulatory Framework



Photo source : PT. Intrenasional Nickel Indonesia Tbk

Overview

Indonesia continues to be a significant player in the global mining industry with significant levels of production of coal, copper, gold, tin and nickel. In particular, Indonesia remains among the world's largest exporters of thermal coal. Global mining companies consistently rank Indonesia highly in terms of coal and mineral prospects, however assessments of its mining policies and investment climate have not been so positive. As such, in recent years there have been limited levels of investment, particularly in greenfields projects, other than in the coal sector. It was hoped that the new Law on Mineral and Coal Mining No.4 of 2009 ("Mining Law"), and its supporting framework of implementing regulations will provide investors with the necessary regulatory certainty to spur new investment, which will see Indonesia maintain its place as a global mining force. Almost two years on, there has been some movement towards increasing the level of investment, however with a number of critical implementing regulations pending and some aspects of already issued regulations requiring clarification, there is still some way to go before the full impact of the intended changes will be realised.

Indonesia's long standing Contract of Work ("CoW") framework for foreign investment, and licensing system for Indonesian investors, have been replaced under the Mining Law. The Mining Law implemented a new area-based system of licensing, incorporating transparent tendering procedures for granting licences.

Under the Mining Law, national and local governments play a vital role in the mining industry by setting up national mining policies, standards, guidelines and criteria as well as deciding on mining authorisation procedures. Furthermore, the government will be actively involved in development, control, evaluation and conflict resolution in the sector.

The Mining Law is expected to provide greater certainty for investment in the mining industry in Indonesia. However, it is evident from the provisions of the Law that the Government has had a difficult task in balancing the interests of foreign investors wishing to invest in Indonesia's highly lucrative mining industry with those of Indonesian nationals, wishing to ensure that a fair proportion of the wealth derived from the exploitation of Indonesia's minerals is retained by Indonesians for the benefit of Indonesia. The balance formulated by the Government in the Law is intended to achieve the best result for Indonesia. Under the Mining Law, the Central Government will determine areas that can be mined, which is still pending to date. With this mechanism, it is expected that the Central Government will have more control over determination of areas open for mining, and this may reduce the instances of overlapping mining concessions with areas reserved for other purposes, such as forestry.

The implementing regulations which support the Mining Law also set up the framework for determining the annual domestic market obligation for producers, as the Indonesian Government seeks to ensure sufficient supply of natural resources to meet the expected growth in domestic demand as investment in infrastructure expands.

Mining licence holders will also be required to demonstrate a greater level of responsibility for operations, with the regulations requiring mining licence holders to undertake some of their own mining activities rather than wholly subcontracting to third parties. In the circumstances where subcontracting is permitted, priority must be given to Indonesian owned companies.

In a similar move to ensure that more of the benefits of Indonesia's mining activity are retained and reinvested in Indonesia, the implementing regulations provide for a benchmark pricing framework for coal and mineral exports to set a minimum price for transactions in such commodities.

While the Government regulations issued to date provide further detail on the implementation of the Mining Law, there are still a number of key regulations which need to be issued, e.g on the areas open to mining activities. Furthermore, there is still a lack of clarity in relation to some of the recently issued regulations, such as the price benchmark and domestic market obligation rules. At present, there still appears to be some reluctance on the part of investors due to these outstanding regulations.

Contribution to Indonesian economy

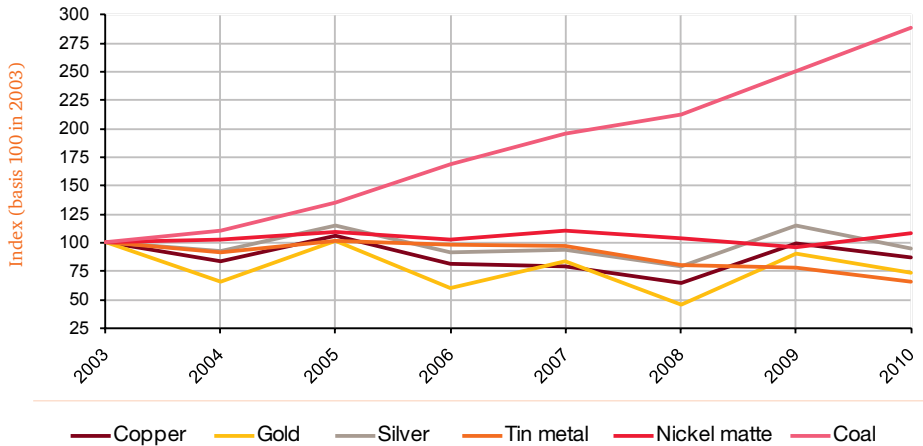
The mining industry benefits Indonesia in many ways. Perhaps of most significance is the development of many remote regions of Indonesia, which otherwise may not have occurred to such an extent, or at such a pace. Mining companies are in many cases the only significant employer in some of these remote areas. In recent years, the mining industry has contributed approximately 4-5% to the total Indonesian GDP, however the industry represents a much larger share of the regional economies of many provinces, including Papua, Bangka-Belitung, West Nusa Tenggara and East Kalimantan. The Government hopes to increase the contribution of the mining industry to national GDP over the coming years through a focus on large scale infrastructure projects and on an improved regulatory climate.

Indonesia's overall mining production levels were slightly lower during 2010, with the exception of coal & nickel. Following the upturn in the global economy in late 2009 and early 2010 and a general increase in prices over this period, the level of investment interest in the Indonesian mining sector is strengthening, however

investors in new projects are still somewhat cautious given the uncertainty about the full impact of the Mining Law.

Coal in particular has seen much interest from the ever increasing demand from China and India. With mining licences now more freely available to foreign investors, and the increased foreign demand for coal, 2011 and beyond should see further increases in coal production.

Indonesian Mining Production 2003 - 2010



Source: http://www.djmbp.esdm.go.id/index_dbm.php

With an increase in both the global economy and the increasing commodity prices, Indonesia is well placed to capitalise on the global demand for commodities. The Indonesian Government, however, needs to act quickly in finalising the outstanding aspects of the Mining Law to give investors the certainty needed to commit investment funds to Indonesia.

II. Mineral and Coal Mining Regulatory Framework

Photo source : PT Adaro Energy Tbk



The Mining Law

Mineral and coal mining activities are governed under the Law on Mineral and Coal Mining No.4/2009 dated 12 January 2009 (“Mining Law”). This Law replaces the predecessor Mining Law No. 11/1967, which provided the framework for all of Indonesia’s pre-2009 mining concessions including all of the existing CoWs and Coal CoWs (“CCoWs”). The Mining Law is dependent on a significant number of implementing regulations to provide detail on how it will be administered. Whilst some of the fundamental implementing regulations have recently been issued, a number of regulations and clarifications in respect of key areas of the new law are still to be issued.

The introduction of the Mining Law in 2009 represented a significant change to the previous Indonesian mining regulatory regime. Contractual-based concessions are no longer available for new mining projects. Both the well-regarded CoW/CCoW framework for foreign investors and Kuasa Pertambangan (“KP”), or mining rights, framework for Indonesian investors, were replaced by a single area-based licensing system based on specified mining areas.

The Mining Law provides for three categories of mining licence, depending upon the location and nature of the resource. The categories are as follows:

1. *Izin Usaha Pertambangan* (“IUP” or Mining Business Licence);
2. *Izin Usaha Pertambangan Khusus* (“IUPK” or Special Mining Business Licence); and
3. *Izin Pertambangan Rakyat* (“IPR” or People’s Mining Licence).

Unlike the restriction on ownership of KP licences to Indonesian nationals, the IUP based licences are open to the both Indonesian nationals and foreign investors who own Indonesian companies.

The Mining Law relies heavily on various implementing regulations. To date, four Government Regulations (“GR”) have been issued in respect of:

- Mining Areas (“GR22”);
- Mining Business Activities (“GR23”);
- Mineral and Coal Mining Direction and Supervision (“GR55”); and
- Reclamation and Mine Closure (“GR78”).

Three Ministerial regulations have also been issued by the Minister of Energy and Mineral Resources (“MoEMR”) in respect of:

- Mining Services (“PerMen 28”);
- Domestic Market Obligation (“DMO”) (“PerMen 34”); and
- Benchmark Price (“PerMen 17”).

The Director General of Minerals and Coal (“DGoMC”) has also issued two key regulations/circular letters in respect of:

- Royalty calculation; and
- Benchmark price.

There are, however, several key Ministerial Regulations which have not yet been issued. The outstanding regulations cover the areas of IUP tender procedures, determination of mining areas, processing and refining obligations, share divestment requirements and community development & empowerment.

The hierarchy of the current regulatory framework is illustrated in the diagram below:

Mining Regulatory Framework



Legal framework

Mining areas

Mining can only be conducted in areas designated by the Central Government as open for mining. As such, the Central Government is required to determine the mining areas (referred to in Bahasa Indonesia as Wilayah Pertambangan – “WP”). WPs will be categorised as:

1. Commercial mining business areas (*Wilayah Usaha Pertambangan – “WUP”*), representing mining areas for larger scale mining;
2. State reserve areas (*Wilayah Pencadangan Negara – “WPN”*), representing areas reserved for the national strategic interest; and
3. People’s mining areas (*Wilayah Pertambangan Rakyat – “WPR”*), representing mining areas for small scale local mining.

In determining the WPs, the Central Government (with the assistance of provincial and regional governments) will carry out a detailed mapping exercise and prepare a map of areas open to mining. The areas identified as mining areas will not necessarily be available exclusively for mining, and therefore may include other uses, such as forestry. Under the regulation, the map may be updated every five years. At the time of writing, this mapping process was still in progress, and since the final Map of designated areas must be approved by Parliament, this process may take some time.

Mining licences

Within those mining areas, mining licences may be issued to one or more parties as follows:

1. Mining Business Licence (“IUP”) is a general licence for conducting mining business activities in a WUP area.
2. Special Mining Business Licence (“IUPK”) is a licence for conducting mining activities in a specific WPN area, in which mining business activities can be carried-out.
3. People’s Mining Licence (“IPR”) is a licence for conducting mining business in a WPR area of limited size and investment. An IPR is not available to foreign investors.

The comments in this guide are directed primarily at IUPs and IUPKs. For further information on the IPR requirements, please contact one of our advisers.

Ownership of mining licences

An IUP may be issued to the following entities:

- a business entity (established under the laws of Indonesia);
- a cooperative; or
- an Indonesian individual (including a partnership).

The business entity must be an Indonesian legal entity, which includes both Indonesian companies wholly-owned by Indonesian nationals and foreign-owned Indonesian companies (i.e. PMA companies). Under the previous Mining Law No.11/1967, a CoW/CCoW could be held by either foreign or domestic investors, whilst a KP could only be issued to domestic investors.

The Mining Law therefore removes most of the distinctions between Indonesian and foreign investors in the mining sector, and is consistent with the current Negative List on Foreign Investment which allows 100 percent foreign investment in the mining sector (subject to the share divestment rules).

One mining licence per company

A key feature of the Mining Law is that a privately held company can only hold one licence (i.e. one IUP/IUPK). Only a company listed on the Indonesian stock exchange is entitled to hold more than one licence.

The transitional provisions in GR23 provide that a privately held company which held multiple KPs may convert these to IUPs and continue to hold them within the one company. Any new licence applications will, however, need to be made through a separate company.

Exploration and Production licences

An IUP or IUPK is granted in two separate phases of mining activities, that is, for Exploration and for Production Operations as follows:

- an Exploration IUP/IUPK is granted for performing general survey, exploration and feasibility studies within a WUP/WPN area.
- a Production Operations IUP/IUPK is granted for performing construction, mining, processing, refining, hauling and selling within the WUP/WPN area.

Authority to issue an IUP

An IUP may be issued by either a Regional Government (Regent or Governor) or the Central Government (represented by the Minister of Energy and Mineral Resources (“MoEMR”)), depending on the location of the proposed mine and its associated infrastructure.

Similar to the process under the old mining Law for dealing with issuing a KP, an Exploration IUP may be granted by the Regent, the Governor or the Minister depending on the location of the exploration activities.

The issuance of an Exploration IUP is performed as follows:

Exploration IUP

Grantor	Project location
Minister	where the area covers more than one province.
Governor	where the area covers more than one regency, but is within one province.
Mayor/Regent	where the area is within one city or regency.

The authority to issue a Production Operations IUP depends upon the location of the mine infrastructure such as a processing plant, hauling road, stockpile and port facilities and the environmental impact of the project, as shown in the following table:

Production IUP

Grantor	Project location	Environmental impact
Minister	where the mining area, processing and refining and port facilities extend across more than one province.	where the environmental impact extends across more than one province (with the recommendation of the Mayor/Regent and Governor).
Governor	where the mining area, processing and refining and port facilities extend across more than one regency, but within one province.	where the environmental impact extends across more than one regency, but within one province (with the recommendation of the Mayor/Regent).
Mayor / Regent	where the mining area, processing and refining and port facilities are within one city or regency.	where the environmental impact is within one city or regency (with the recommendation of the Minister and Governor).

It is uncertain which test will prevail for the grant of a Production IUP in circumstances where there is inconsistency between the project location and the extent of the environmental impact.

Since many mining projects will have mining, processing, hauling and port facilities within different regencies or even within different provinces, it can be expected that the Governors and Minister will have greater control on the issue and renewal of Production Operations IUPs than was the case under the previous KP licensing system.

Authority to issue an IUPK

An IUPK should be issued by the Central Government, regardless of the geographical coverage of the operations. State-owned companies are to be prioritised for the development of a WPN, but in the event it is not taken up, the IUPK can be offered to private investors via a tender process.

Licence terms and extensions

The Mining Law and regulations provide for mining licences to be issued and extended as follows:

	Exploration IUP	Production IUP	Extensions
Coal	7 years	20 years	10 years x 2
Metallic minerals	8 years	20 years	10 years x 2
Non-metallic minerals	3 years	10 years*	5 years x 2*
Rocks	3 years	5 years	5 years x 2

* certain non-metallic minerals may be granted a Production IUP of 20 years, extendable twice for a maximum of 10 years.

	Exploration IUPK	Production IUPK	Extensions
Coal	7 years	20 years	10 years x 2
Metallic minerals	8 years	20 years	10 years x 2

Licence areas

A key aspect of GR 23 is that the size of the Exploration IUP for coal and metallic minerals must be reduced in size after three years of exploration (less for non-metallic minerals and rocks). The maximum area for the production phase is again reduced when the Production IUP/IUPK is issued.

Exploration IUP		Downsizing after 3 years of exploration (under GR 23)	Production IUP
Coal	5,000ha – 50,000ha	Must be reduced to a maximum of 25,000ha	Max 15,000ha
Metallic minerals	5,000ha – 100,000ha	Must be reduced to a maximum of 50,000ha	Max 25,000ha
Non-metallic minerals	100ha – 25,000ha	12,500ha (applies after 2 years)	Max 5,000ha
Rocks	5ha to 5,000ha	2,500ha (applies after 1 year)	Max 1,000ha

Exploration IUPK		Downsizing after 3 years of exploration (under GR 23)	Production IUPK
Coal	Max 50,000ha	Must be reduced to a maximum of 25,000ha	Max 15,000ha
Metallic minerals	Max 100,000ha	Must be reduced to a maximum of 50,000ha	Max 25,000ha

An IUP or IUPK is issued for one type of mineral or coal. In the event other minerals are discovered, the relevant government authority may issue further IUPs or IUPKs for those different minerals. The Exploration IUP holder will be given priority to acquire a licence to mine the additional mineral(s) before the relevant government authority grants a mining licence to another investor.

Tender requirements for new mining licences

New IUPs and IUPKs must be issued through a competitive tender process rather than direct appointment. Any of the entities discussed above may bid for an IUP, however, for IUPK licences, State-owned companies are to receive preference. The winner of a tender is then issued the exploration IUP or IUPK for the specific coal or mineral applied for. The tender process is intended to create transparency and fairness for all potential investors and represents a significant change from the system adopted under the old mining law, where the relevant government authority could directly grant a KP upon application.

Some of the details of the tender process and selection criteria have been set out in GR 23, although precise details are still to be confirmed by further Ministerial Regulation.

Tender procedures

The tender process must be announced at least three months prior to its commencement. Provision is made for all three levels of government (Central, Provincial and Regency) to participate in the tender committee.

Foreign investors wishing to bid in the tender process must use an Indonesian legal entity (i.e. a PT PMA).

There must be more than one bidder in a tender process. If there is not more than one bidder, there must be a re-tender. If upon re-tender, there remains only one bidder, the licence can only be awarded to the sole bidder where the “tender base price” has been met.

Selection criteria

GR23 provides that the successful bidder will be determined on “Price bid and technical considerations”, however, the precise details of how this broad principle will apply are to be determined by further Ministerial Regulation.

In accordance with these “technical considerations”, detailed technical, administrative and financial requirements are to be submitted during the tender process. These requirements include:

- evidence of at least three years of previous mining experience by the company (for newly established entities of a group, this can be substantiated by recommendation letters by parent or affiliate companies);
- evidence of at least one employee that has mining/geological expertise with at least three years of experience; and
- submission of an annual work plan for the first four years of exploration.

A bidder must also place a cash deposit with a state-owned bank with its application for up to 10% of the value of compensation for data and information for a new mining licence, or 10% of the total cost of the data or investment in the case of a licence which has expired. A successful bidder will be required to pay the tender value within five working days of being announced as the tender winner.

Domestic Market Obligation (“DMO”)

The Mining Law and implementing regulations contain a framework for a DMO, where the Central Government has the authority to control production and export of each mining product. The Regional Government is obliged to comply with the production and export controls imposed by the Central Government. This policy is to guarantee the supply for increasing domestic demand, especially for coal.

Details of the DMO procedures were issued in PerMen 34 on 31 December 2009.

PerMen 34 provides that the DMO applies to all types of coal and minerals. Broadly, mining companies must comply with the DMO requirements by selling to domestic consumers of minerals/coal.

Neither PerMen 34 nor GR23 provide for a specific DMO percentage, rather the decision for a particular year is to be made by the Minister upon the following procedures:

1. Domestic users submit their forecast requirements by no later than March of the preceding year;

2. The Minister reviews and calculates the domestic requirements submitted and the production plans of the mining companies;
3. The Minister must then issue a decree on the minimum DMO percentage by no later than June of the preceding year. The decree must also list the domestic users and their respective needs; and
4. The mining company must then submit its work program and budget for the relevant year to the authority that issued its licence (Minister, Governor or Mayor/Regent) and the Director General of Minerals and Coal stating its commitment to the DMO percentage.

There are provisions for a minimum floor price for DMO sales which will be subject to Ministerial Regulation. However, PerMen 34 does provide that the minimum price will be subject to the same minimum price for exports (see comments on Coal and Mineral Price Benchmarking below).

PerMen 34 provides for a 'cap and trade' system whereby Mining Companies that exceed their DMO obligations may sell/transfer DMO credits to a mining company that is unlikely to meet its DMO commitment. The pricing mechanism for DMO credits is to be determined on commercial terms. The mechanism for trading DMO credits has been clarified in Circular 5055/30/DJB/2010 (dated 29 November 2010) which provides that DMO credits can be transferred between mining companies with the approval of the DGoMC, including credits held by traders on behalf of a mining company.

As at the date of writing, the Government has determined minimum coal DMO sales only for selected coal mining companies. These mining companies are required to sell 24.75% and 24.17% of their annual production in 2010 and 2011, respectively. Noting that the domestic coal demand has been increasing over recent years, it is expected that DMO coal sales will continue to increase in the coming years.

Coal and Mineral Price Benchmarking

GR23 provides the framework which authorises the MoEMR to set the mineral and coal sales reference price. This requirement is further detailed in PerMen 17.

Broadly, the MoEMR, through the DGoMC, will be responsible for setting the Benchmark price for coal and metallic minerals. Whilst the Governor and Regent or Mayor will be responsible for setting the Benchmark for non-metallic minerals and rocks.

The Benchmark price is set at the FOB vessel point of sale. Accordingly, certain costs are accepted to adjust the Benchmark price if the delivery point takes

place at a point other than FOB vessel (i.e. FOB barge or CIF). The allowable adjustments would include the costs of barging, surveyors, insurance, and transhipment (for metallic minerals, the type of costs allowable as adjustments to the Benchmark price extend to treatment costs and refinery costs).

The Benchmark price will serve as the floor price for the Government Royalty calculation. If the actual sales price is higher than the Benchmark price, then the Government Royalty will be based on the actual sales price. If actual sales are below the Benchmark price, the Government Royalty calculation should be performed based on the Benchmark price.

Specific coal types (e.g. fine coal, reject coal, and coal with specific impurities) and coal for specific purposes can be sold below the Benchmark price with the prior approval of the DGoMC.

The Benchmark price is applicable for spot sales and long term sales. For long term sales, PerMen 17 requires mining companies to adjust the sales price every 12 months. Specifically for coal, the long term coal sales price is determined based on the weighted coal Benchmark price for the preceding three months. A coal mining company is required to notify the DGoMC of the proposed sales price before signing long term sales agreements.

The Benchmark price will be updated monthly and determined in accordance with market prices (based on a basket of recognised global and Indonesian coal indices in the case of coal). Currently the available Benchmark price issued by the DGoMC is still limited to thermal coal. However, through Regulation No.515.K/32/DJB/2011, the DGoMC has also issued the formula to calculate the Benchmark price for coking coal.

Divestment

The Mining Law provides that foreign capital controlling shareholders must divest part of their interest in a mining concession company by the fifth year of production. GR23 provides that Indonesian Nationals must own a minimum of 20% of the shares in an IUP holding company. Divestment is to be made to (in order of preference) the Central Government, Provincial Government or Regental/Municipal Government, a state-owned company or a national private business entity.

Further provisions in respect of the specific mechanisms are to be stipulated by Ministerial regulation. Importantly, the current Government regulations do not specify the basis for calculating the price which must be paid to the divesting party.

Mandatory in-country processing

Under the Mining Law, holders of IUPs and IUPKs are required to carry out in-country processing and refining to increase the value of the relevant mineral or coal. The IUP/IUPK holders may also have processing and refining undertaken by entities which have already obtained a Special Production Operation IUP/IUPK for processing and refining.

The holders of a Special Production Operation IUP/IUPK may also process and refine the mining output from another IUP/IUPK holder.

In respect of coal, the elucidation for GR 23 provides that processing covers the following activities:

- Coal crushing
- Coal washing
- Coal blending
- Coal upgrading
- Coal briquetting
- Coal liquefaction
- Coal gasification
- Coal water mixing

No further details on the precise meaning of processing and refining have been provided, with further implementing regulations to be issued to regulate the in-country processing requirements.

Mineral Mining Production Limitation Regulation

Due to the non-renewable nature of coal and mineral resources, which is essential for national development, and to guarantee sufficient supplies to fulfill national needs, the Central Government considers it is important to limit national coal and mineral production where considered necessary. The Minister, governor, or head of regency will determine the policy for production limitation.

Sanctions apply for non-compliance, which include warnings, suspension of activities, or revocation of mining licences in extreme cases.

Mining support services

Mining service businesses are also governed by the Mining Law and PerMen 28. PerMen 28, provides that an IUP or IUPK holder can no longer contract out all activities, but must actually remove the coal/minerals ore from the ground itself. PerMen 28 provides a detailed list of the types of Mining Services Businesses and distinguishes between certain defined Mining Services Businesses and Non-Core Mining Services. Broadly, the requirements are directed at ensuring the use of local businesses and restricting the use of affiliate companies.

Pursuant to PerMen 28, an IUP/IUPK holder must carry out mining, processing and refining and can only engage a Mining Services Company for the purposes of consultation, planning and testing, overburden stripping and transportation. A detailed list of Mining Services as defined are further detailed in Attachment I to PerMen 28.

Classification of Mining Services and Mining Service Companies

Companies wishing to provide services to an IUP/IUPK holder must obtain the following licences:

Mining Service Sub-categories and licensing requirements

Mining Service Business	Non-Core Mining Service
Expansive list in PerMen 28	Any service business other than a “Mining Service Business” that provides services in support of mining business activities.
Licence: Mining Services business Licence/ <i>Izin Usaha Jasa Pertambangan</i> ("IUJP")	Licence: Registration Letter/ <i>Surat Keterangan Terdaftar</i> ("SKT")

Mining Services must be provided by an Indonesian entity with a clear priority for the use of Local and/or National Companies. In this regard, PerMen 28 provides the following classifications for service providers:

Local Company	A wholly Indonesian owned company/entity which operates and is domiciled only in one regency/province.
National Company	An Indonesian legal entity where all shares are owned by Indonesian nationals and operates in Indonesia or offshore.
Other Company	An Indonesian legal entity where some/all of its shares are owned by a foreigner.

Further entrenching the local theme, is the requirement of the mining service company to use local goods, local subcontractors and local labour.

Restriction on the use of affiliates/subsidiaries

Further restrictions are placed on the ability to use subsidiaries and affiliates of the IUP/IUPK holder, namely the requirement to obtain approval from the Directorate General of Minerals and Coal. Subsidiaries and affiliates are further defined (pursuant to the Directorate General of Minerals and Coal Regulation no. 376.k/30/DJB/2010, dated 10 May 2010) as an entity that has a direct ownership in the IUP/IUPK holder, i.e. where:

- the IUP/IUPK holder directly owns at least a 25% shareholding in the affiliated mining service company;
- the IUP/IUPK holder is a direct shareholder and owns a voting rights in the affiliated mining service company for more than 50% based on an agreement for direct financial and operation control; and/or
- the IUP/IUPK holder has the authority to appoint or replace financial and operational directors or others at similar level in the mining contractor company.

Approval will only be granted in circumstances where there are no other mining companies of the same kind in the Regency/Province, the IUP/IUPK holder has put the services to tender and no Local or National service providers have either the technical or financial capability required to carry out the service. The IUP/IUPK holder must provide a guarantee that pricing will be based on arm's length principles.

Prohibition on receiving any fees from mining services company

The IUP/IUPK holder is prohibited from receiving any fees from the mining services company. This appears to have been introduced to eliminate practices where the mining licence owner assigns all mining operations to a third party and receives compensation based on profit or the quantity of coal/mineral produced.

Transitional provisions for existing Mining Services arrangements

Mining companies which have already engaged mining services companies before the enactment of PerMen 28 must comply with the regulation no later than three years from the effective date of PerMen 28 (i.e. 30 September 2012).

All existing IUPs will continue to be valid until their expiration but must comply with the provisions of PerMen 28.

Fiscal regime

There are no specific articles outlining the details of tax or other fiscal provisions, in the Mining Law, however it does provide that tax facilities should be provided in accordance with prevailing law, except as otherwise stated in the IUP/IUPK. This appears to indicate that the *lex specialis* concept embedded in some CoWs/CCoWs may not be completely dead, if certain enduring fiscal terms can be agreed in the IUP/IUPK. There are however, no details on this at the time of writing this publication, so implementation remains unclear. The ability of a term in an IUP/IUPK to override a Tax Law would also seem to be problematic in practice, and likely to result in further uncertainty. It appears that all IUPs issued to date contain no specific tax concessions.

Refer to Section IV for further details in relation to mining specific taxation issues.

Royalties

All IUP/IUPK holders are required to pay production royalties, the rates of which will vary depending on the mining scale, production level, and mining commodity price. Currently, a range of percentages of sale proceeds applies for the different types of coal and mineral mining, and it is expected that such an arrangement will continue under the Mining Law.

Holders of an IUPK will be required to pay an additional royalty of 10 percent of net profit. The Central Government is entitled to receive 40 percent of this additional royalty while the balance is to be shared between the relevant province and regencies. Since this additional royalty is determined based on net profit, it is expected that the government will have a greater monitoring role over capital expenditure and mining operating costs in the case of IUPKs.

The current production royalty rates for a selection of key Indonesian commodities is set out in the following table. For rates applicable under a CoW/CCoW/Coal Cooperation Agreement ("CCA"), please refer to the relevant agreement (see Section III and Appendix F for further detail on CoW/CCoW/CCAs).

Commodity	Production royalty rate
Coal	
- Open Pit	3% - 7%
- Underground	2% - 6%
Nickel	4% - 5%
Zinc	3%
Tin	3%
Copper	4%
Iron	3%
Gold	3.75%
Silver	3.25%
Iron Sand	3.75%
Bauxite	3.75%

Transfer restrictions

Under the Mining Law, the transfer of an IUP/IUPK to another party is prohibited.

The transfer of ownership and/or shares of an IUP/IUPK company on the Indonesia Stock Exchange can only be done after the commencement of a certain phase of the exploration activities (the relevant phase is yet to be further stipulated in a GR). The transfer is subject to a notification to the relevant government authority and it should not contravene the provisions of prevailing legislation.

The Mining Law does not appear to regulate transfer of shares outside the Indonesia Stock Exchange.

Reclamation and mine closure guarantees

On 20 December 2010, the Government released Government Regulation No.78/2010 (“GR No.78”) that deals with reclamation and post-mining activities for both IUP-Exploration and IUP-Production Operation holders. This regulation updates Ministerial Regulation No.18/2008 issued by the Minister of Energy and Mineral Resources on 29 May 2008.

An IUP-Exploration holder, among other requirements, must include a reclamation plan in its exploration work plan and budget and provide a reclamation guarantee in the form of a time deposit placed at a state-owned bank.

An IUP-Production Operation holder, among other requirements, must prepare (1) a five-year reclamation plan; (2) a post-mining plan; (3) provide a reclamation guarantee which may be in the form of a joint account or time deposit placed at a

state-owned bank, a bank guarantee, or an accounting provision (if eligible); and (4) provide a post-mine guarantee in the form of a time deposit at a state-owned bank.

The requirement to provide reclamation and post-mine guarantees does not release the IUP holder from the requirement to perform reclamation and post-mine activities.

The transitional provisions in GR No.78 make it clear that CoW/CCoW holders are also required to comply with this regulation.

The reclamation and mine closure guarantees may only be withdrawn upon approval from the Minister, the Governor, the Regent or the Mayor, as applicable.

Penal provisions

The Mining Law also regulates consequences of infringement of the law by the IUP/ IUPK holder, an illegal miner, as well as the Regional Government.

A breach of the Law can be punished by both administrative and criminal sanctions, including revocation of an IUP/IUPK and prison terms.

Dispute resolution

Disputes regarding IUPs/IUPKs should be settled through court procedures and domestic arbitration in accordance with the prevailing laws and regulations.

Further implementing regulations

Although the Mining Law required all implementing regulations to be enacted by 11 January 2010, to date only seven implementing regulations have been issued. PwC Indonesia will issue further publications on the content of new implementing regulations once they have been finalised by the Government.

Transitional Provisions

KPs

All existing KPs were required to have been converted to IUP licences by 30 April 2010 based on GR23. There are no transitional provisions concerning the conversion of KPs in the Mining Law. Although the conversion itself is relatively straightforward, the impact of the implementing regulations, in particular PerMen 28, mean that a number of the historical mining services structuring arrangements are no longer be permitted under the Mining Law regime.

GR 23 confirms that companies that held multiple KPs can continue to hold these under the Mining Law, upon conversion to IUPs.

CoWs/CCoWs/CCAs

All existing CoWs/CCoWs/CCAs ("Contracts") will continue until their expiry date and may be extended without the need for a tender (where further extensions are still available under the Contract) however the extended licence will be granted under the IUP system, rather than under the CoW framework.

Although the term of existing Contracts will be honoured, the Law specifically provides that holders of existing Contracts must, within five years of enactment of the Law, comply with the obligation under the Law to conduct onshore processing and refining of their ore.

Contract holders which have already commenced some form of activity are required, within one year of enactment of the Mining Law, to submit a mining activity plan for the entire contract area. If this requirement is not fulfilled, the contract area may be reduced to that allowed for IUPs under the Law.

Further, the Mining Law indicates that the provisions of existing Contracts must be amended within one year to conform with the provisions of the new Law, other than terms related to state revenue (which is not defined but presumably includes State Tax Revenue and Non-Tax State Revenue such as royalties). It is not at all clear to which provisions of the new Law these existing contracts must conform. The range of changes could include alignment with the Mining Law's provisions on divestment obligations, re-sizing of the mining areas, reduced production periods, prohibition on using affiliated mining contractors and the like. It is hoped that the further implementing regulations may specify in more detail with which provisions of the new law these existing contracts must be aligned.

The transitional provisions have probably been the most controversial aspects of the Mining Law with debate in Parliament continuing on this point right up to the final passage of the Law. Unfortunately, the outcome appears to be two possibly conflicting provisions meaning that, state income treatment aside, it is not clear how completely existing Contract rights will be honoured. Resolution of this will obviously be of major interest to those investors holding Contracts, and is likely to be a continuing detriment to additional investment by existing contractors, until the Government's interpretation of these transitional clauses is clearly understood. To date, the Government is still negotiating changes to CoWs/CCoWs/CCAs with the contract holders.

Outlook

The above is a brief analysis of some of the key terms of the Mining Law likely to be of interest to investors. Through the enactment of the Mining Law, the Government has sought to create more certainty about Indonesia's mining framework. This certainty will only crystallise, however, when all the regulations implementing the Law are in place. Two years on, the Law still requires some further implementing regulations, which have not been issued yet, so as usual the devil is in the detail. Furthermore, some implementing regulations are not entirely clear in addressing the issues and further guidance is required. This may cause further uncertainty for investors.

The terms of the Mining Law may be adequate to encourage some investors, especially foreign investors, to take direct equity stakes in IUPs for relatively small-scale projects. This should have an immediate positive impact on investment in this sector.

However, there is likely to be greater uncertainty around proposed large-scale projects as the Mining Law does not offer the long-term protection of the CoW system for large, long-life projects which require significant investment.

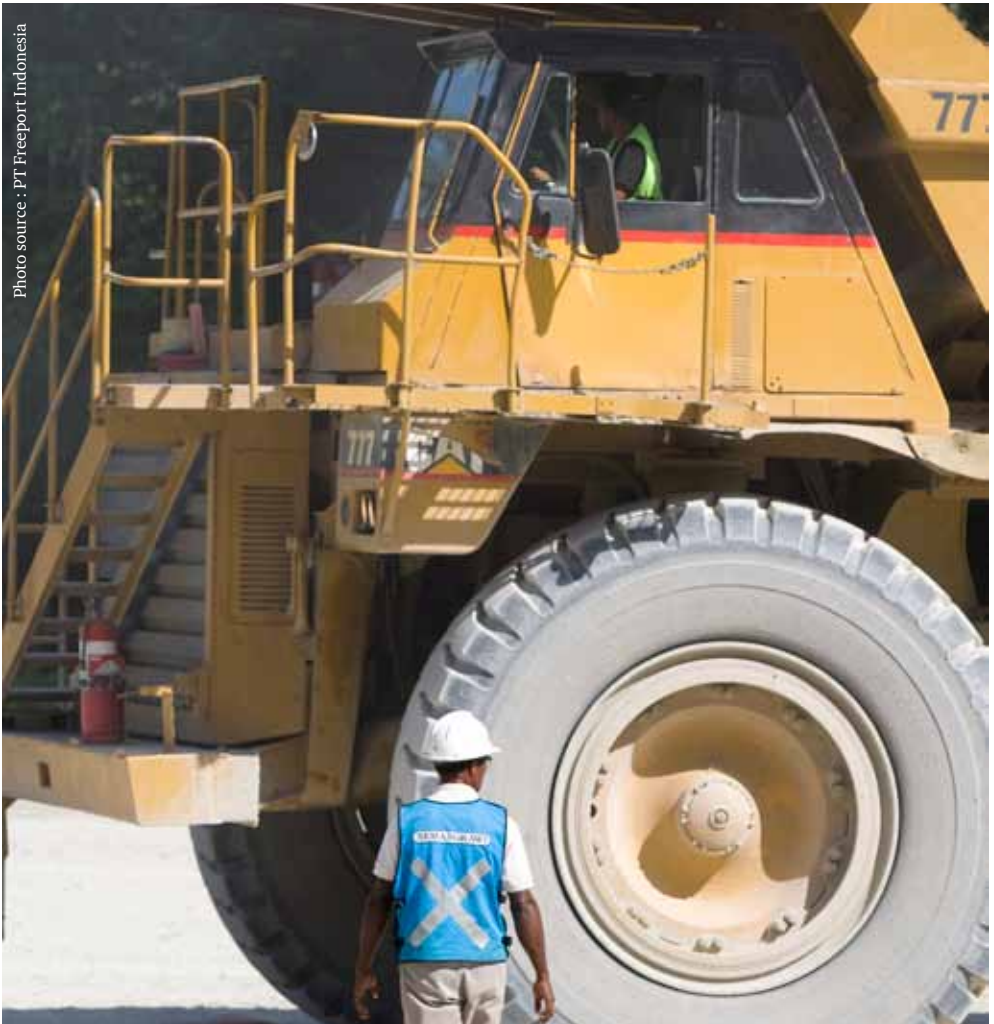
Investors will also be relying on the effective operation of the Indonesian legal system to protect their investments, without the specific terms generally provided in a CoW.

Only time will tell whether the Government will be able to overcome these concerns to attract investment in these large projects, which are the life-blood of a strong mining sector.

PwC Indonesia will provide periodic updates to its clients as the remaining implementing regulations of the Mining Law are issued by the Government.

III. Contracts of Work

Photo source : PT Freeport Indonesia



General Overview and Commercial Terms

Contracts of Work (“CoW”)

The CoW system for regulating mining operations has played a key role in the success of Indonesia’s contemporary mining industry. The CoW system, which was introduced in 1967, has been gradually refined and modernised over the past forty years to reflect changing conditions in Indonesia and abroad. To date, there have been seven generations of CoWs. A comparison of the various generations of CoWs is provided in Appendix F.

As discussed earlier, the Mining Law does not provide for CoWs under the new licensing framework, however the transitional provisions state that existing CoWs will be honoured until the stipulated expiry date, but from that point can only be extended under the new IUP licensing framework. The following discussion, therefore, is only applicable to CoWs which existed prior to the Mining Law. Any new mining activity can only be conducted under the IUP framework of the Mining Law.

CoWs were regulated under Minister of Energy and Mineral Resources Decision Letter No. 1614/2004. In essence, a CoW is a comprehensive contract between the Government of Indonesia and an Indonesian company. The company could be 100 percent foreign-owned. However, if the company was 100 percent foreign-owned, it may have been subject to divestment requirements at a later date. As a practical matter, most CoWs have some level of Indonesian ownership.

The CoW sets out the company’s rights and obligations with respect to all phases of a mining operation, including exploration, pre-production development, production, and mine closure. A CoW applies to a specifically defined geographic area (the “Contract Area”).

The CoW company is the sole contractor for all mining in the CoW area, other than for oil and gas, coal and uranium. The CoW company has control, management and responsibility for all its activities, which include all aspects of mining from exploration, development, production, refining, processing, storage, transport and sale.

The CoW outlines a series of stages with defined terms:

Stage	Term (Years)	Available Extension ¹
General survey ¹	1	6 months – 1 year
General survey ¹	1	6 months – 1 year
Exploration ²	3	1 – 2 years
Feasibility study	1	1
Construction	3	-
Production	30	20 or other period as approved by the Government

¹): Depends on the CoW generation. For the detail, refer to Appendix F.

²): For first generation, the maximum period for general survey until feasibility study was 18 months and can be extended for a maximum of six months

Some of the important considerations that are covered by a CoW include: expenditure obligations; import and export facilities; marketing; fiscal obligations; reporting requirements; records, inspection, and work program; employment and training of Indonesian nationals; preference to Indonesian suppliers; environmental management and protection; regional cooperation in regard to infrastructure; provision for infrastructure for the use of local population and local business development. It is a tribute to the Government and to the industry that these important matters can be appropriately addressed in a concise legal contract.

The CoW covers all tax, royalty, and other fiscal charges, including: dead rent in the Contract Area; production royalties; income tax payable by the company; employees' personal income tax; withholding taxes on dividends, interest, rents, royalties, and similar payments; value added tax (VAT); stamp duty; import duty; and land and buildings tax.

Coal Co-Operation Agreements (“CCA”) and Coal Contracts of Work (“CCoW”)

CCoWs were regulated under MoEMR Decision Letter No. 1614/2004. Since November 1997, coal mining was brought more in line with general mining through the CoW structure. There have been two generations of CCAs (first and second generation contracts) and one generation of CCoW, which is typically referred to as the third generation CCoW.

The first generation of CCA was regulated under the Presidential Decree No. 49/1981 dated 28 October 1981 regarding the Principle Regulation for Coal Co-operation Agreement between PT Tambang Batubara Bukit Asam (now PT Bukit Asam Tbk or “PTBA”), the state-owned mining company and the Contractor. The Presidential Decree No. 49/1981 was replaced by Presidential Decree No. 21/1993 dated 27 February 1993 which regulated the second generation of CCA. The third generation of CCoW was issued pursuant to Presidential Decree No. 75/1996 dated 25 September 2006.

Coal Co-operation Agreements

The key difference between the CCA and the CoW system is that under a CCA, the foreign mining company acted as a contractor to the Indonesian state-owned coal mining company, PTBA. Legislation has since been enacted and CCAs amended to transfer the rights and obligations of PTBA in respect of CCAs to the Indonesian Government represented by the Minister of Energy and Mineral Resources.

Under the CCA, the coal contractor is entitled to an 86.5 percent share of the coal produced from the area, and the contractor bears all costs of mine exploration, development and production. The Indonesian Government (previously PTBA) retains entitlement to the remaining 13.5 percent of production. However, in accordance with Presidential Decree No. 75/1996 dated 25 September 1996, the contractors pay the Government’s share of production in cash, which represents 13.5 percent of sales after deduction of selling expenses.

For the first generation of CCA, equipment purchased by the coal contractor became the property of the Indonesian Government (previously PTBA), although the contractor has exclusive rights to use the assets and is entitled to claim depreciation. For the second and third generation of CCA and CCoW, the equipment purchased by the contractor remains the property of the contractor.

Foreign shareholders that own 100 percent ownership in a first generation CCA are required to offer shares to Indonesian nationals or companies so that, after ten years of operating, foreign ownership in the company is reduced to a maximum of 49 percent.

Coal Contracts of Work

Under the CCoW, the mining company is, in effect, entitled to 100 percent of the coal production, however, a royalty of 13.5 percent of sales revenue is paid to the Indonesian Government.

The CCA and CCoW outline a series of stages with defined terms:

Stage	Term (Years)	Available Extension (years)
General survey	1	1
Exploration	3	2 for third generation but not specifically mentioned in other generations
Feasibility study	1	1 for third generation but not specifically mentioned in other generations
Construction	3	-
Production	30	-

Fiscal regime under CoW, CCoW and CCAs

All generations of CoW, CCoW and CCA (collectively referred to hereafter as the "Contract(s)") except for the second generation CCA are based on the taxation and other laws and regulations in place at the time the agreements were signed. In many circumstances, this means that the regulations affecting mining companies operating under such Contracts differ from current regulations, which often creates difficulties in interpreting the agreements as well as doing business with other companies. Potential investors in mining properties covered by earlier generation Contracts should seek professional assistance to examine such issues.

Many earlier generation Contracts also include divestment requirements for foreign shareholders.

Pre-Contract of Work Expenses

The shareholder of the Contract company would typically incur significant expenditure before the Contract company is incorporated the contract is signed. This pre-incorporation expenditure may be transferred from the shareholder to the Contract company as deferred pre-operating costs and will be amortised starting from the period in which production commences. These expenses are subject to be audited by a public accountant and approved by the MoEMR and the Directorate General of Taxation ("DGT").

Exploration and Development

The stages coincide with decision points for the relinquishment of part of the Contract Area. This section deals with the general survey, exploration, feasibility and construction stages.

Upon signing the Contract, the company is required to lodge a US Dollar security deposit (see Appendix F for details) into the MoEMR's bank account, which is released on completion of the following:

- Satisfactory completion of the General Survey period (50 percent); and
- On submission of a general geological map to the Ministry within 12 months of completion of the Exploration Stage (50 percent)

For the seventh generation of CoW or third generation of CCoW, the security deposit is released on completion of the following:

- Satisfactory completion of the General Survey period (25 percent);
- On the first year of exploration (25 percent); and
- On submission of a general geological map within 12 months of completion of the Exploration Stage (50 percent)

During the preproduction stage, all of the companies signing the Contract are required to submit detailed quarterly progress reports to the MoEMR. Under the contracts, the companies have responsibility for all financing requirements of the project and details are to be reported to the MoEMR.

For a company holding a Contract, obligations are imposed throughout the life of the contract with respect to environmental restoration, the employment and training of Indonesian nationals, preference to Indonesian suppliers, and the provision of infrastructure for the use of the local community.

The company also has the following obligations under the Contract:

Contracts of Work	Coal Co-operation Agreements/Coal Contracts of Work
<ul style="list-style-type: none"> • General Survey Stage <p>The company is obliged to spend an agreed amount during the General Survey stage. At the end of the period, the company must submit a report detailing the items and amount of expenditure and is required to relinquish at least 25 percent of the original Contract Area.</p>	<ul style="list-style-type: none"> • General Survey Stage <p>The company is obliged to spend an agreed amount during the General Survey stage. At the end of the period, the company must submit a report detailing the items and amount of expenditure and is required to relinquish at least 25 percent of the original Contract Area for second and third generations and 40 percent for first generation.</p>
<ul style="list-style-type: none"> • Exploration Stage <p>In the Exploration stage, the company is obliged to spend an agreed amount per year on exploration activities. At the commencement of this stage, the company must submit an annual program and budget to the MoEMR.</p> <p>At the end of the Exploration stage, the company is required to file with the MoEMR:</p> <ul style="list-style-type: none"> - A summary of its geological and metallurgical investigations and all data obtained; and - A general geological map of the Contract Area. <p>On or before the second anniversary of the Exploration stage the company is required to have reduced the Contract Area to not more than 50 percent of the original Contract Area.</p>	<ul style="list-style-type: none"> • Exploration Stage <p>In the Exploration stage, the company is obliged to spend an agreed amount per year on exploration activities. At the commencement of this stage, the company must submit an annual program and budget to the MoEMR.</p> <p>At the end of the Exploration stage, the company is required to file with the MoEMR:</p> <ul style="list-style-type: none"> - A copy of drill holes, pits and assay of the samples; and - A copy of geophysical or geological map of the Contract Area. <p>On or before the second anniversary of the Exploration stage the third generation company is required to have reduced the Contract Area to not more than 25 percent of the original Contract Area. While first and second generation contractors are required to have reduced the Contract Area to not more than 20 to 40 percent of the original Contract Area.</p>

Contracts of Work	Coal Co-operation Agreements/Coal Contracts of Work
<ul style="list-style-type: none"> • Feasibility Study Stage <p>At the end of the Feasibility Study stage the company is required to submit a feasibility study, including environmental impact studies, to the MoEMR and to design the facilities.</p> <p>At the end of the Feasibility Study, the company is required to have reduced the Contract Area to not more than 25 percent of the original Contract Area.</p>	<ul style="list-style-type: none"> • Feasibility Study Stage <p>At the end of the Feasibility Study stage the company is required to submit a feasibility study, including environmental impact studies, to the MoEMR and to design the facilities.</p> <p>At the end of the Feasibility Study, the third generation CCoW company is required to have reduced the Contract Area to not more than 25,000 hectares.</p>
<ul style="list-style-type: none"> • Construction Stage <p>The company undertakes the construction of the facilities.</p>	<ul style="list-style-type: none"> • Construction Stage <p>The company undertakes the construction of the facilities.</p>
<ul style="list-style-type: none"> • Dead Rent <p>Throughout the life of the CoW, the company is required to pay dead rent. This is an annual amount based on the number of hectares in the CoW area and the stage of the CoW.</p>	<ul style="list-style-type: none"> • Dead Rent <p>Throughout the life of the contract, the company is required to pay dead rent. This is an annual amount based on the number of hectares in the approved area and the stage of the mining.</p>

Production

During the production stage, the company is required to provide the following Exploitation reports to the MoEMR:

- Fortnightly statistical report;
- Monthly statistical report;
- Quarterly report concerning progress of operations;
- An annual report; and
- Other reports to various departments.

The company may export its production, but is encouraged to meet domestic demand first. Sales to associates are required to be at arms' length prices. Sales contracts exceeding three years are subject to Government approval.

The Contract also requires contractors to provide the following reports to the Ministry of Energy and Mineral Resources:

- Monthly statistical report;
- Quarterly report concerning progress of operations; and
- An annual report for the third generation of CCoW.

The Contract company may choose to operate the mine itself or it may sub-contract operation of the mine, but outsourcing mining operations should now be considered in light of the rules contained in the Mining Law and PerMen 28, which may be applicable to Contracts.

Because a company can be party to only one contract (either CoW, CCA or CCoW), it is common for mining groups to have more than one company in Indonesia. Group overheads can be borne by yet another company formed to service the group Contract companies. This can provide operational efficiencies, but its tax implications should be considered further.

Other financial obligations

Royalties

Royalties are payable quarterly to the Government based on the actual volume of production or sales according to details set out in the Contract. The royalty is tax deductible.

Dead rent and land and building tax

The company is required to pay dead rent and land and building tax as set out in the Contract. Dead rent is an annual charge based on the number of hectares in the Mining Area. Both imposts are deductible for income tax.

Termination of the Contract

If at any time during the term of a Contract, the company believes the Contract Area is unworkable, it may terminate the contract. The procedures for terminating the contract may be summarised as follows (this matter is not specifically mentioned in first and second generation CCoWs):

1. Submit written notice to terminate the contract, attaching a closure plan, related documents, maps, plans, worksheets and other technical data and information.
2. Provided that the data and fulfilment of the company's obligations are considered acceptable to the MoEMR, the Minister will issue confirmation within six months from the date that the company submitted the notice. Otherwise, the contract is automatically considered terminated, and the company shall be relieved of its obligations.

A general summary of the implications of termination of the Contract at the various stages of the contract is set out below. All sales, removals or disposals of property will be subject to the tax rules as set out in the Contract.

- a. General Survey and Exploration Periods
 - The company has a period of six months to sell or remove its property, otherwise the property becomes the property of the Government.
 - The company is required to provide any information gained from the work it has performed to the Department of Mines and Energy.
- b. Feasibility Study Period
 - The company is required to offer all property located in the Contract Area to the Government at market value.
 - The offer is valid for 30 days. If the Government accepts the offer, it is required to settle within 90 days.
 - If the Government does not accept the offer, the company then has six months to sell or remove its property, otherwise the property reverts to the Government without any compensation to the company.
- a. Construction Period
 - The conditions are identical to those for the Feasibility period except that, if the Government does not accept the offer, the company has 12 months to remove or sell its property.
- b. Operating Period or Expiration of the Contract
 - The company is required to offer all property located in the Contract Area to the Government at market value.
 - The offer is valid for 30 days. If the Government accepts the offer, it is required to settle within 90 days.
 - If the Government does not accept the offer, the company then has twelve months to sell or remove its property, otherwise the property reverts to the Government without any compensation to the company.

At the termination of the Contract, any property that is used for public purposes such as roads, schools and hospitals with associated equipment immediately becomes the property of the Government without any compensation to the company.

Transfer of Contracts

Purchase and sale of direct interests in the Contract

The Contract does not allow the CoW/CCA/CCoW companies to transfer or assign all or part of its interest in the contract without prior written consent of the Government. On such a transfer, the company is not relieved of any of its obligations under the contract, except to the extent that the transferee or assignee assumes and performs such obligations.

Purchase and sale of shares in a Contract Company

Due to the difficulties involved in transferring a direct interest in a Contract, it is common for such interests to be transferred indirectly through the transfer of shares in the company holding the Contract, or through transferring shares of holding companies above the company holding the Contract.

However, the shareholders of the Contract company can not transfer shares prior to the commencement of the operating period, without written consent of the Government.

The shareholders in the Contract company also require the prior written consent of the Minister of Energy and Mineral Resources for a transfer of shares of the Contract company after the commencement of the operating period. Under the terms of the Contract, such consent shall not be unreasonably withheld or delayed.

Consent is not required in the case of a transfer of shares to:

- Indonesian Participants (as defined); or
- An affiliate or subsidiary of the shareholder.

Unincorporated joint ventures

As alluded to above, transfers of partial interests in Contracts are rare events, and require some degree of negotiation with the MoEMR. For this reason, joint venture ownership and operation is equally unusual. The Contract and the income tax legislation of general application are silent as to the tax treatment of joint ventures. The tax treatment of a joint venture is one of a number of matters to be negotiated with the Minister in conjunction with the transfer of an interest in the Contract that creates the joint venture.

Farm-ins

The Contract and the income tax legislation of general application do not address farm-ins per se. As a commercial matter, a typical farm-in to a mineral property involves an eventual transfer of an interest in the property. Accordingly, the farm-in arrangement, and the tax treatment thereof, will be considered by the Minister in conjunction with his consideration of approval of the transfer. A farm-in can usually be effected more easily by a transfer of shares in the offshore investing company.

IV. Tax Regimes for the Indonesian Mining Sector

Photo source : PT Newmont Nusa Tenggara



General Overview of Indonesian Tax Systems

On an annual basis, PwC Indonesia publishes the Indonesian Pocket Tax Book. This publication provides a general guide of the prevailing Indonesian tax laws and regulations, and is available on PwC Indonesia's website (www.pwc.com/id).

Tax Regime for an IUP/IUPK Company

General

The Mining Law stipulates that any tax facilities for a mining project should be provided in accordance with the prevailing laws, except as otherwise stated in the IUP/IUPK. This indicates that tax concessions outside of the prevailing tax law/regulations may still be available.

However, it appears that there is a strong intention of the Government to apply the prevailing tax laws/regulations on the IUP/IUPK holders. Therefore in practice, special tax provisions with overriding status (*lex specialis*) status may not be available for an IUP/IUPK, which is the case for already issued IUPs.

A company holding an IUP/IUPK is required to register for tax and obtain a tax registration number. The tax registration number is called Nomor Pokok Wajib Pajak ("NPWP"). The IUP/IUPK company is also required to register for tax at the local tax office where the mine operates, which includes the obligations for VAT (if applicable and not centralised in the head office) and Withholding Tax ("WHT").

Corporate Income Tax

Under the prevailing Income Tax Law No.36/2008 ("Tax Law"), the Government may issue a Government Regulation (Peraturan Pemerintah) governing taxation of mining business. As at the date of this publication, a Government Regulation on mining taxation has not been issued.

Below are some of the main tax considerations which will be relevant to a mining investor.

Corporate Income Tax Rate

Under the prevailing Tax Law/regulations a company is subject to corporate income tax on its net taxable profit. Net taxable profit is calculated based on gross income minus allowable expenditure.

The prevailing corporate tax rate for 2010 and onward is a flat rate of 25% of net taxable profit. A 5% income tax reduction is applicable for a company listed on the Indonesia Stock Exchange, subject to meeting certain requirements.

Income

Gross income usually represents sales of mining products and any other income earned by the mining company.

General expenses

Broadly, deductible expenses are those incurred to generate, maintain and collect taxable income and generally include an amount paid or accrued for all expenditure attributable to the company's operations in a year which typically have a useful life of less than one year.

Certain expenditure may not be tax deductible under the prevailing Income Tax law, e.g. donations and benefits-in-kind provided to employees. Some types of benefits-in-kind provided at the mining site may be deductible if the mine is located in a remote area (which is usually the case) and an approval from the DGT is obtained.

Specific operating expenses of a mining operation may include supplies, contracted services, insurance, royalties on intellectual property, processing expenses, repairs and maintenance, etc. They should deductible in the year incurred.

Selling, general and administrative expenses are generally tax deductible and should be deductible in the year incurred.

Exploration and development expenses

Exploration and development expenses may include camp construction, drilling, access road, project communication facilities, etc.

On-site exploration expenses are generally deductible in the year the expenses are incurred provided the expenses meet the general deductibility criteria.

Exploration and mine development expenses should generally be capitalised and amortised upon spending rather than production.

Depreciation of fixed assets

Fixed assets are categorised into four categories, depending on the nature of the asset and its expected useful life. The rate at which the asset can be depreciated will depend upon the category of the asset. Assets are generally depreciated over four, eight, 16 or 20 years and taxpayers may apply a diminishing balance or straight line approach to depreciation.

Amortisation of intangible assets

Intangible assets may include pre-operating costs, patents, rights, licences, etc.

Costs incurred in the acquisition of mining rights with a beneficial life of more than one year should be amortised based on a production unit method, not exceeding 20% per annum.

Carried forward tax losses

Tax losses can be carried forward for up to five years under the Tax Law and are normally recouped on a first-in-first-out basis. Tax losses cannot be carried back.

Reclamation reserve

For accounting purposes, a mining company is usually required to maintain a reclamation reserve in its accounts for environmental management and reclamation work during the contract period and at the end of the life of the mine. During the exploration stage the reclamation reserve should be in the form of a time deposit with a local bank.

The reclamation reserve amount should be tax deductible provided that it is calculated in accordance with the prevailing energy/mineral resources sector laws/regulations. If the actual cost exceeds the reserve, the balance is generally tax deductible.

Mine closure

The prevailing tax laws/regulations are not clear on whether a provision for mine closure (e.g. mine infrastructure demobilisation costs) is deductible. Since mine closure costs are usually spent in the later stages of a mine's life when the company is earning little or no income, proper tax planning is crucial to ensure utilisation of deductions from these costs. The current regulation on reclamation reserves is silent on the matter of mine closure reserves, therefore mine closure reserves are unlikely to be deductible.

Interest expense

There is currently no thin capitalisation limit (i.e. limitation of interest cost based on a pre-determined maximum debt to equity ratio) in the Tax Law. However the DGT is considering introducing such a rule in the near future.

It is generally prudent to ensure that any interest on intercompany loans does not exceed commercially available rates, as excessive rates can be challenged by the DGT based on transfer pricing principles.

It is a general practice for a shareholder not to charge interest on its loans to a subsidiary during the exploration and development stage. However, care should be taken to structure the loan terms and conditions to ensure that the transfer pricing rules are observed. Non-interest bearing loans from Shareholders are only allowed if certain requirements are met.

Transactions with related parties

Payments to parent companies or affiliates may be deductible if they are reasonable and directly attributable to the mining operations. The amount of the deduction is limited to the amount that would have been paid to a non-related party for the same service (i.e. transfer pricing rules must be observed).

The Indonesian Tax Office ("ITO") has increased its audit focus on related party transactions. Taxpayers must disclose a significant amount of detail in their Corporate Income Tax Return ("CITR") regarding the level of transfer pricing documentation that exists and must also be able to justify the use of a particular transfer pricing methodology. The ITO has recently commenced performing transfer pricing specific audits, which it has not done in the past. As a result, taxpayers that incur related party expenses in Indonesia must carefully consider their transfer pricing position and have adequate documentation available for the ITO to review (within 30 days if requested during a tax audit).

The application of the recently introduced mineral/coal benchmark price to related party transactions for tax purposes is unclear. The benchmark pricing regulation currently only applies for the basis of performing the Government Royalty calculation, it does not technically apply to the corporate income tax calculation, nor does it necessarily compel the mining company to contract at the benchmark price. However, given the major coal indices are used as the basis for setting the benchmark price, it is highly likely that this price would be used as the reference point for the ITO in determining the arm's length price. Accordingly, for tax purposes, in practice the benchmark price could be the minimum acceptable price from a transfer pricing perspective.

Bookkeeping in US Dollars

For tax purposes, a PT PMA company (i.e. an Indonesian incorporated company with foreign shareholders) may request to maintain bookkeeping in US dollars and in English. The company must request approval from the DGT for the US dollar bookkeeping, no later than three months after the establishment of the PT PMA company or three months before the commencement of the US dollar accounting year for an established company.

In general wholly-Indonesian owned entities (i.e not PMAs) must use Indonesian Rupiah as their bookkeeping currency for tax purposes, even where the majority of their transactions are conducted in another currency, such as US Dollars. This may result in a conflict with the requirements of accounting standards which may require companies to report in their functional currency. This would result in an additional administrative burden, which should be considered by investors.

Value Added Tax (“VAT”)

Delivery of goods and services in Indonesia is generally subject to VAT, except for delivery of certain pre-determined types of goods and services. The current VAT rate is 10%.

The prevailing VAT Law stipulates that supplies of gold bars, coal and natural resources taken directly from source are not subject to VAT. This VAT position may change according to the level of processing of the mining product in question. In respect of coal, there are a number of private rulings from the ITO indicating that washing or crushing activities do not constitute “processing” (although “briquetting” activities do). Further issues may arise in this respect once the detailed requirements of the Mining Law in respect of in-country processing are stipulated.

In the event that a company delivers a non-VAT-able mining product, e.g. gold bars and coal, any Input VAT incurred on the import and/or domestic purchase of goods/services will not be creditable/refundable, effectively becoming an additional cost, which should be deductible for corporate income tax purposes.

During the pre-production stage, the company will not have any Output VAT due to there being no delivery of mining product at that point. Therefore, VAT overpayment is likely as the company should pay its Input VAT to vendors for purchase of taxable goods/services.

For most companies, a VAT refund is only available at the end of the year. However, companies that incur VAT during the pre-production stage may still apply for refunds in respect of capital goods only on a monthly basis (note:

Input VAT on services during the pre-production stage is neither creditable nor refundable). If they fail to reach production (which is defined as the delivery of VATable goods/services) within three years from the date they have credited the Input VAT, they must repay the refund by the end of the month following the failure to enter production. This timing requirement obviously presents a problem for long-term mining projects which may take several years to enter into production.

Withholding Tax (“WHT”)

Taxpayers, including mining companies, are obliged to withhold tax on payments for dividends, interest, royalties and most types of services.

WHT is payable on dividends, interest and royalties paid to Indonesian companies at the rate of 15%. However, in the case of dividends, provided that the dividend is sourced from retained earnings and the Indonesian corporate shareholder owns at least 25% of the mining company’s shares, the dividend will not be subject to income tax, including WHT.

A 2% WHT is applicable on payments for most types of services made to Indonesian resident entities.

If the payments are made to a non-resident, the current WHT rate is 20%. A tax treaty may provide relief from the WHT on payment of services and reduce the WHT rate on payments of dividends, interest, and royalties (generally to 10% or 15%). The DGT has introduced procedures to be followed to access the benefits of a tax treaty, including a pre-determined disclosure form, and measures to prevent tax treaty abuse. These requirements should be considered when structuring an investment in Indonesian entities by foreign investors.

Tax Regime for a CoW/CCoW/CCA Company

One of the key features of a CoW/CCoW/CCA (“Contract”) is its *lex specialis* status – that is, the terms in the contract override the general laws. For example, when certain specific tax rules are set out in a Contract, these tax rules generally take precedence over the prevailing tax laws.

Generally, the tax rules in a Contract reflect those that are in force at the time the contract is signed, although there may be some exceptions. Typically, a Contract fixes the tax rules for the duration of the contract (with the exception of second generation Contracts where they generally follow the prevailing tax regulations).

Taxation matters that are not governed in the Contract should follow the prevailing tax laws and regulations (as discussed above).

The advantage of having *lex specialis* tax rules in a Contract includes tax stability throughout the life of the project or at least up to the end of the Contract term.

The disadvantage of the *lex specialis* status of a Contract is that the mining company may not always be able to access favourable changes in the tax law, such as reduction of income tax rates or introduction of tax incentives. Despite this, the *lex specialis* tax rules have historically been favoured by investors, in particular for big long-life mining projects because it provides stability in various aspects of mining operations, including tax.

The mining tax regime included in a Contract is relatively straight forward. However, in some cases, the language in the Contract may be interpreted widely which can result in disputes between the mining company and the ITO.

The transitional provisions of the Mining Law (Article 169) provide that the existing contracts will remain effective until the expiration date. However, the contracts should be adjusted within one year to conform with the Mining Law, except provisions on state revenue (note that the exception is not applicable if there is an effort to increase the state revenue). Currently the circumstances that fall within the parameters of an effort to increase the state revenue where the government can seek to amend the tax/non-tax state revenue provisions in a Contract remain unclear. It is understood the Government has been involved in negotiations with individual Contract companies regarding revision of the Contract terms, but as yet there has not been any wholesale changes to Contracts. Rather, any changes have been made on a case by case basis, if at all. At present, there is still no guidance on how Article 169 of the Mining Law will be implemented.

Note that the tax treatments described in this booklet are generic and so deviation may exist between the various generations of Contracts. Appendix E summarises the typical tax treatments in the particular generations of Contract respectively. Not all generations of Contract have specific tax rules, as such those contacts may simply require the tax treatments to follow the prevailing tax laws. In assessing the applicable tax regime, detailed review of the Contract is necessary because different rules may exist between two Contracts of the same generation.

Tax administration of a CoW/CCoW/CCA company

Tax registration

A company holding a Contract is also required to register for tax and obtain a NPWP.

The Contract company should also register for tax at the local tax office where the mine operates. These include the obligations for VAT (if applicable and not centralised at head office) and WHT.

Bookkeeping in US Dollars

For tax purposes, a Contract company may opt to apply bookkeeping in US dollars and in English. The company only needs to notify the DGT for the US dollar bookkeeping, no later than a month before the commencement of the US dollar accounting year.

Irrespective of the currency and the language used, the company may settle their corporate income tax liabilities in Rupiah or US dollars, and file tax returns in Indonesian language. With respect to Corporate Income Tax, relevant tax returns should be presented in US dollars side by side with Rupiah in the annual Corporate Income Tax return.

Income Tax

Similar to an IUP/IUPK company, a Contract company is subject to income tax on its net taxable profit. In the Contract, the expenditure described below is normally allowed to be deducted from the gross income.

The mineral CoWs typically have *lex specialis* corporate income tax rules. In respect of a CCA/CCoW, the first and most of the third generation contracts include *lex specialis* corporate income tax provisions whilst the second and remaining third generation CCoWs do not. Where *lex specialis* tax rules do not apply the company must follow the prevailing income tax rules for the Income Tax calculation.

Income tax rate

Where a Contract includes a specific income tax rate, these Contract companies may not be entitled to the reduced 25% corporate tax rate, which is applicable from the 2010 income year onwards (the rate was reduced from 30% in 2008). Some generations of Contracts have unclear language as to whether the reduced rate is accessible. In this case, tax advice should be sought before applying the reduced tax rate.

Operating expenses

Generally the same as under the prevailing law.

Exploration and development expenses

On-site exploration expenses are generally deductible in the year the expenses are incurred provided the expenses relate to the Contracts Area.

Mine development expenses should generally be capitalised and amortised in accordance with the amortisation rules in the Contract.

Reclamation reserve

As per the prevailing tax rules, however, some generations of Contracts may require reference to the previous Income Tax Law and/or a deposit in a state-owned bank in order for the reclamation provision to be deductible.

Selling, general and administration expenses

Generally as per the prevailing law.

Asset revaluation

A Contract company that maintains its books in US dollars is not allowed to revalue its assets for fiscal purposes.

Employee benefits/facilities

The Contracts normally provide concessional tax treatment on benefits provided to employees who reside in the Contract Area. The cost of most benefits provided to employees located in the Contract Area is deductible to the company, but is not taxed in the hands of the employees.

Pre-Contract expenses

The shareholder(s) of the Contract company may incur relatively significant expenditure before the Contract company is incorporated and the respective mining contract is signed.

A Contract normally allows these pre-incorporation expenses to be transferred from the shareholder(s) to the Contract company. The pre-incorporation expenses are recognised as deferred pre-operating costs and may be claimed

as tax deductions in the calculation of the Contract company's Corporate Income Tax by way of amortisation starting from the period when production commences.

Most Contracts require these pre-incorporation expenses to be audited by a public accountant and approved by the DGT. The implementation of this rule is not entirely clear.

There are also a number of transactional tax issues to be addressed in relation to the transfer of pre-incorporation expenses from the shareholder(s) to the company, in particular the VAT and WHT obligations (although VAT may be exempt under the Contract).

Depreciation of fixed assets

Fixed assets are generally deductible through depreciation. Different generations of Contracts regulate different depreciation rules (but most of them are at an accelerated rate).

Mining infrastructure assets such as buildings, roads, bridges and ports are depreciable. Public infrastructure such as roads, schools, and hospitals are usually deductible through depreciation under the Contract's rules.

Fixed assets should be classified into several different categories based on their useful life. Accelerated depreciation rates may be available for fixed assets located in the Contract Area. Earlier generations of CCoW/CCA usually provide an investment allowance deduction (i.e. hypothetical depreciation) and have a fixed depreciation rate under a straight line method, irrespective of the type of assets.

For certain Contracts, if the mine life is shorter than the asset's fiscal useful life, the remaining book value may be fully depreciated at the end of mine life.

Amortisation of intangible assets

Intangible assets may include pre-operating costs, patents, rights, licences, etc.

Expenses incurred prior to production (with a useful life greater than one year – some Contracts do not require this) may be capitalised and amortised once production commences. These expenses may also include expenses incurred by the Contract company's shareholder(s) prior to the formation of the company (i.e. pre-incorporation expenses).

Interest expense

Most Contracts provide that interest expense paid on loans is deductible as long as the arm's length principle is observed and the debt to equity ratio does not exceed that specified in the Contract.

As per the prevailing tax laws, interest on intercompany loans should not exceed commercially available rates.

Some Contracts also require the authorised capital to be fully paid in order to claim an interest deduction.

Carried forward tax losses

Under a Contract, tax losses can be carried forward for the period stipulated in the Contract. This may be more or less than the five years carry forward allowed under the prevailing tax law. Tax losses cannot be carried back.

VAT

Some Contracts may adopt a VAT regime different than the prevailing VAT regulations. For example, there may be provision that Input VAT may be creditable/refundable despite the fact that coal or gold bars are being produced.

During the pre-production stage of the Contract, the company will not have any Output VAT due to there being no delivery of mining product at that point. Therefore, VAT overpayment is likely as the company should pay its Input VAT to vendors for purchases of taxable goods/services.

Until 2004, mining companies were designated as VAT Collectors under the tax regulations prevailing at that time. This means that the mining company should collect and pay VAT charged by its vendors (i.e. Input VAT) directly to the State Treasury, rather than to the respective vendors. Some Contract companies continue to act as a VAT collector as required by the relevant Contract.

Subject to the tax rules in the Contract, the company may claim a refund on the Input VAT paid. In order to receive a refund the company must undergo a tax audit.

Currently there are several outstanding disputes in respect of VAT refunds due to different interpretations of the provisions in the Contract. Therefore, care should be taken before proceeding with the VAT refund claim to ensure that the risk of dispute is managed.

All VAT payments are denominated in Rupiah. As the company may keep its books in US dollars, outstanding VAT receivable balances would give rise to a foreign exchange gain/loss risk.

WHT

The Contract company is obliged to withhold tax from payments of dividends, interest, royalties and most types of services. The WHT rate will depend on the tax rules stipulated in the Contract, type of service and whether the service provider is a resident or non-resident.

There may be WHT concessions on dividends paid to non-resident founder shareholder(s) (the WHT rate under the prevailing tax law is 20%, before tax treaty relief). Some Contracts may provide a reduced WHT rate of nil or 7.5%. This rate is less than most tax treaty rates.

Import of Capital Equipment

Most Contracts provide exemptions from duties, VAT and income tax on the importation of capital equipment up to a certain year after commencement of commercial production (known as the “masterlist” facility). Some generations of Contracts however do not provide any import facility.

If no import facility is available under a Contract or IUP/IUPK, relief or exemptions may be available under the general law (e.g. exemption from import duties and import VAT, subject to meeting certain criteria).

Non-Tax State Revenue

Royalties

Royalties are payable quarterly to the Government based on the actual volume of production or sales price, according to details set out in the Contract and or prevailing regulations for IUP/IUPK holders. The royalty is deductible for corporate income tax purposes.

The prevailing royalty rates applicable to IUP/IUPK holders is set out on Page 22.

Dead Rent

Throughout the life of the Contract or IUP/IUPK, the company is required to pay dead rent. This is due annually and the amount is normally calculated based on the number of hectares in the contract/licence area and the stage of the mining operations (e.g. different rates for general survey, exploration, and exploitation stage).

Regional Tax

A mining company may be liable to a number of Regional Taxes and Retributions. The rates range from 1.5% to 35% of a wide number of reference values determined by the relevant regional Government. Contracts may limit additional types and rates of the Regional Tax introduced after the signing date of the contract. A summary of the types of regional taxes that may apply is included at Appendix B.

There are currently several disputes between mining companies and the Regional Government in respect of regional taxes, including those related to street lighting tax and heavy equipment tax.

Transfer of Mineral Interests

Purchase and sale of mining interests

The direct transfer of a Contract is subject to a number of restrictions, which make such transfers uncommon. The direct transfer of an IUP/IUPK is prohibited under the Mining Law. As set out below, an assignment of a Contract would create a number of difficult tax issues. The transfer of ownership (in whole or in part) is therefore generally achieved through the disposal of an interest in the company holding the Contract or IUP/IUPK.

The 2008 Income Tax Law stipulates that gains arising from transfer of a mining interest, financing participation or capital investment in a mining company is subject to Income Tax.

The 2008 Income Tax Law also stipulates that the Government will issue a separate Government Regulation on the calculation of Income Tax for mining sectors. The Government Regulation may cover the Income Tax on the transfer of a mining interest, however to date, no mining sector specific Government Regulation has been issued in respect of the calculation of Income Tax.

Technically, the transferor might include the proceeds of sale of the mining interest as income for Income Tax purposes. Whilst, the transferee is entitled to deduct the purchase price in accordance with the rules for deducting the cost of intangible assets.

There are several tax issues which need to be resolved in respect of assignment of a Contract. This includes the tax implications of transfer of the tangible assets (such as mine infrastructure equipment, etc.) and intangible assets (such as Deferred Exploration Expenditure) to the buyer without creating any additional tax costs. Therefore, specific advice should be sought on the tax impacts arising from the sale of mining rights.

Purchase and sale of shares in an IUP/IUPK or Contract company

This approach is common in the acquisition of mine properties in Indonesia.

The sale of shares is a taxable event. For a domestic seller, the Income Tax is imposed on the profits earned from the sale. For a non-tax resident seller, a 5% income tax on gross proceeds is due unless relief is available under a tax treaty or the company being sold is a listed company in Indonesia (in this case, a 0.1% final tax is due on the sale proceeds).

The 2008 Income Tax Law provides for a “long-arm” capital gains tax provision. The ITO can now treat the sale of a conduit or special purpose company established in a tax haven country which has an Indonesian PE or subsidiary as the sale of an interest in an Indonesian (PT) company. In this case, the ITO can impose a 5% final income tax on the gross sale proceeds.

The implementation and further development of this new rule should continue to be closely monitored, since to date, there is still no clear definition of what will constitute a tax haven, or what the implications will be if the indirect ultimate shareholder of the tax haven company is resident in a jurisdiction with which Indonesia has a tax treaty.

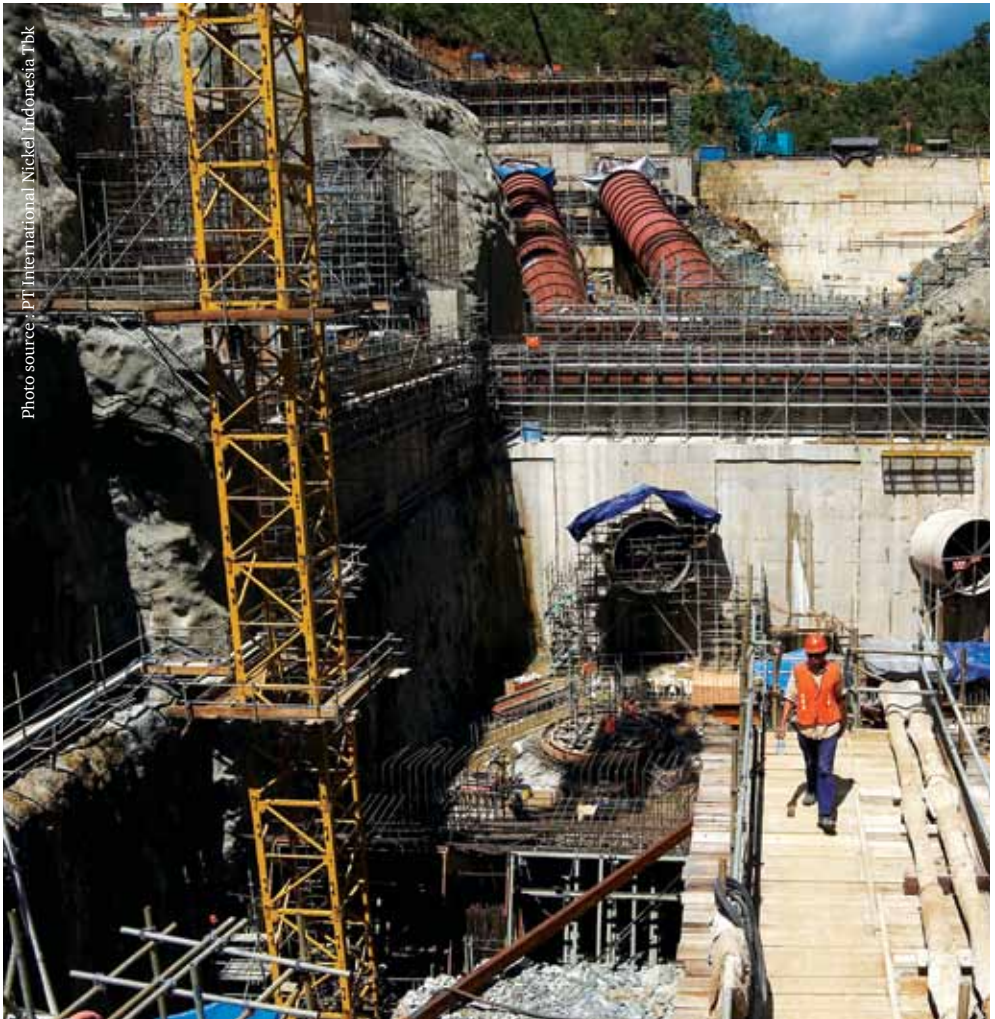
Investment Structuring

As a general rule of thumb, a tax efficient investment structure would create significant tax saving for the life of mine, which will in turn increase the economic value of the mine. A favourable structure would also be effective for project financing purposes. Care must therefore be taken in structuring the initial investment in the mining industry. Some relevant Contract and IUP/IUPK issues to be aware of include:

- A company can only hold one Contract or one IUP/IUPK. This “ring fencing” rule, together with the fact that there is no group relief for Income Tax purposes, requires careful planning, particularly for the use of service companies within one group, inter-company charges, inter-company borrowings, etc;
- The use of a tax efficient shareholding structure to maximise profit repatriation/dividends would enhance the project feasibility (note that under some tax treaties the WHT on dividends may be reduced from 20% to 15% or 10%);
- Sale of shares in Contract or IUP/IUPK companies that are not listed on the Indonesia Stock Exchange by foreign Investor is taxed at 5% income tax on gross proceeds, unless protected by a tax treaty. The investment may be structured to reduce the tax on exit;
- A typical concession in some of the Contracts of a reduced WHT rate for dividend tax payments to “founder” foreign shareholder(s); and
- The use of tax efficient project financing strategies or intra-group financing considering the thin capitalisation rules and the fact that debt forgiveness is subject to tax in Indonesia (this issue is common in unsuccessful exploration projects).

Professional advice should be obtained at an early stage of the investment process. This includes the investment structuring considerations and financial/tax due diligence on the target mining company.

V. Additional Regulatory Considerations for Mining Investment



Investment Law

Law No. 25 of 2007 (“Investment Law”) is the most recent investment law which introduces an integrated one-stop service to simplify business licensing. Under the Investment Law, the Investment Coordinating Board (*Badan Koordinasi Penanaman Modal* or “BKPM”) is given the power of coordinating the implementation of the investment policy.

Obligations for Limited Liability (“PT”) companies are set out in the Investment Law No. 25 and include such things as:

- prioritising the use of Indonesian citizen manpower;
- creating a safe and healthy working environment;
- implementing corporate social responsibility; and
- preserving environmental conservation.

Investors exploiting non-renewable natural resources must also allocate funds for site restoration that fulfill the standards of an environmental feasibility. Sanctions for non-compliance with certain aspects of the Investment Law, (which includes corporate social responsibility) include restriction, freezing or revocation of business activities/licences.

The Central Government provides protection from nationalisation unless such nationalisation is required by law. In this case, the Central Government will provide compensation based on the market value. In addition, investors are also given the right to freely transfer and repatriate foreign currency in the form of, amongst others, royalties, dividends, loan repayment, sale of investment and management and technical service fee.

Forestry Law

Geographically, Indonesia is located in a resource-rich soil, which includes forest resources. The use of forest resources is therefore strictly governed by the Central Government, especially protected forests. It is common that mining concession areas overlap with forestry areas (either a protected or productive forest), which means that mining activities will be impacted by the rules applicable to such forests.

Law No. 41 of 1999 (“Forestry Law”) as amended by Law No. 19 of 2004 allows 13 open-pit mines in protected forests, as long as the mining companies had contracts prior to the introduction of the Forestry Law (as governed under Presidential Decree No.41/2004).

Under Government Regulation No. 24 of 2010 and the recently issued Minister of Forestry Regulation No.P18/Menhut-II/2011 dated 30 March 2011, the utilisation of Forest Areas for non-forestry activities is permitted in both Production forest areas and Protected forest areas, on obtaining a 'borrow-and-use' permit from the Minister of Forestry.

'Protected forest' areas are open for mining activities provided that mining is performed through underground mining (not an open pit), subject to a number of conditions. For areas designated as 'Production forest' areas, underground and open pit mining may be permitted. Mining is prohibited in areas designated as 'Conservation forests'.

Use of a forest area for mining will require compensation to be made, by way of either land compensation or compensation payments. No compensation is payable for certain limited survey and exploration activities (unless for a trial purpose to determine a mine's economic feasibility). The borrow-and-use permit holder will also be required to pay certain non-tax State Revenues and undertake reforestation activities upon ceasing its use of the land.

Approval for use of forestry areas is generally granted by the Minister of Forestry. However, approval for use of forestry areas for mining operations in a WPN that have a significant impact, cover a significant area, and have strategic value, can only be granted by the Minister of Forestry after initial approval is obtained from the Parliament.

Environmental Laws and Regulations

There is a difficult balance between protecting the environment and preserving natural resources, and maintaining a viable mining industry. Environmental protection in Indonesia is governed by various laws, regulations and decrees, and non-compliance may result in fines and penalties and revocation of licences and/or permits in extreme cases.

The environmental law was recently updated in Law No. 32 of 2009 ("Environmental Law"). It requires the Central Government and Regional Governments to prepare a strategic environmental analysis and ensure that the principles of sustainable development have been integrated into the development of a particular region.

Both the Mining Law and the Environmental Law in conjunction require mining companies conducting exploitation of natural resources that have an environmental or social impact to obtain and maintain an environmental impact

planning document (*Analisa Mengenai Dampak Lingkungan* or AMDAL), which consists of an environmental impact assessment, an environmental management plan and an environmental monitoring plan. An environmental management effort document, *Upaya Pengelolaan Lingkungan* (UPL) and *Upaya Pengawasan Lingkungan* (UKL) generally need to be prepared in any situation where the AMDAL document is not required.

Sanctions applied in respect of breaches of the Environmental Law range from three to 15 years of imprisonment and/or a fine of Rp 100 million to Rp 750 million. The new Environmental Law now also stipulates minimum penalties which apply, depending on the nature of the breach.

The environmental quality requirements (which concern emissions and waste water temperature levels) have been the subject of recent industry concerns due to the time lag required in implementing new process technologies and increased production costs. MoEMR officials have proposed that the Government postpone implementation of the Environmental Law for two years so that any impact on current production levels is minimised. As this publication went to print, there has been no decision announced on a postponement of the Environmental Law.

Energy Law

Given the importance of energy resources, the Central Government's involvement in composing an energy management plan to fulfill the national energy needs in the long run is necessary. According to Law No. 30 of 2007, a National Energy Council is a government body that is established to design and formulate the national energy policy, to determine the national energy general plan, to determine the steps to be taken in an energy crisis and in emergency conditions, and to monitor the implementation of policy in energy fields with cross-sectoral characteristics.

Other Regulations Related to Mining Operations

Other relevant regulations applicable to Indonesian mining operations include regulations regarding the use of groundwater, technical guidelines to control air pollution from immovable sources, water quality and pollution, used oil regulations and storage of production chemicals. Failure to comply may lead to fines, penalties and in extreme cases, revocation of the licence/permit.

Service Providers to the Mining Industry

Mining companies typically have four phases of operations - exploration and evaluation, development, production, and closure and rehabilitation. In most cases, the activities carried out in each of the phases are performed by external parties which may include:

- exploratory drilling and sampling
- infrastructure construction
- contract mining and overburden removal
- hauling and barging

Under the Mining Law and PerMen 28, only Indonesian incorporated entities may provide services to mining licence holders in Indonesia.

We outline below some of the guidance associated with the most significant mining services described above:

	Exploratory drilling and sampling company	Construction company	Contract mining and overburden removal company	Hauling and barging company
Regulation	Law 25/2007 PR 36/2010 Law 4/2009 PerMen 28	Law 25/2007 PR 36/2010 Law 4/2009 PerMen 28	Law 25/2007 PR 36/2010 Law 4/2009 PerMen 28	Law 25/2007 PR 36/2010 Law 4/2009 PerMen 28
Investment licence issuer	Investment Coordinating Board	Investment Coordinating Board	Investment Coordinating Board	Investment Coordinating Board
Business licence issuer	Minister of Energy and	Construction Services Development Agency	Minister of Energy and Mineral Resources	<ul style="list-style-type: none"> • Minister of Transport • Minister of Energy and Mineral Resources or governor or city mayor (depending on service area)

	Exploratory drilling and sampling company	Construction company	Contract mining and overburden removal company	Hauling and barging company
Period of Business licence	3 years and extendable	Minister of Energy and	3 years and extendable	<ul style="list-style-type: none"> • Unlimited from Minister of Transportation • 3 years and extendable from Minister of Energy and Mineral Resources
Maximum foreign ownership	Up to 100%	<ul style="list-style-type: none"> - Engineering procurement construction services (95 percent) - Non small scale construction contracting and consulting (55 percent) - Small and medium scale construction contracting and consulting (only for local small scale company) - A construction company can be in the form of a representative office. In this case, joint operation with local construction company is required. 	<ul style="list-style-type: none"> - Up to 100 percent - Small and medium scale excavating and earthmoving work and site preparation for mining (only for local small scale company). 	<ul style="list-style-type: none"> - Ferry, river and lake transport and transport facilities (49 percent) - Special goods, cargo and heavy equipment transport (49 percent) - Support business in terminals (49 percent) - Domestic and international sea transport (49 percent) - Land transport rental (local investor only) - Up to 100 percent, if it is formed as a general mining service company.

	Exploratory drilling and sampling company	Construction company	Contract mining and overburden removal company	Hauling and barging company
Tax	Prevailing tax laws	Prevailing tax laws (with a final deemed profit tax regime)	Prevailing tax laws	Prevailing tax laws

Corporate Social Responsibilities

Contractors are required to comply with relevant laws and regulations on Corporate Social Responsibility (CSR) and Community Development (CD).

Under Corporations Law (UU PT) no 40/2007 article 74, PT companies that have a resource business must implement CSR which must be budgeted for in the companies' expenditure plans. The details of such responsibilities will be further regulated under government regulations. As of the date of writing, no government regulation had been issued.

Processing

Under the Mining Law, mining companies will be required to process their minerals within Indonesia (refer to Section II – New Mineral and Coal Mining Law for further discussion). Currently, other than PT Smelting (copper smelter and refinery in East Java), there is no other significant downstream processing conducted in Indonesia.

The Ministry of Energy and Mineral Resources is planning to issue guidance for downstream processing companies, however until such time the permit should refer to the general laws and regulations as follows:

	Downstream processing
Regulation	Law 25/2007, PR 36/2010, Law No. 4/2009
Investment licence issuer	Investment Coordinating Board
Business licence issuer	MoEMR/Governor/Mayor depending on the location
Period of business licence	3 years and extendable
Maximum foreign ownership	Up to 100 percent
Tax	Prevailing tax laws

Under Government Regulation No. 62/2008, the government provides incentives for certain downstream processing companies (only for new and expansion projects) which include iron ore processing, certain iron and steel making industry, aluminum smelter, copper plate and wire industry, copper and rod extraction industry and copper tube, pipe and rod industry, hydrometallurgical nickel purification, lead processing and purification and zinc processing and purification. The incentives are as follows:

- A 30 percent *investment allowance* on qualifying capital spending over six years (i.e. 5 percent each year)
- Accelerated depreciation/amortisation entitlements (twice the normal rate)
- Reduced WHT rate to 10 percent on dividend payments to non-resident shareholders
- An extended tax loss carry forward (maximum of ten years).

Mining Infrastructure

The establishment of a greenfields mining project is capital intensive and in the case of Indonesia often involves substantial investment in mine infrastructure (access/haulage roads, potentially railways, conveyors, captive power plants, camp and recreation facilities, washing and crushing facilities and ship loaders) given the often remote locations and distance from water/transshipment facilities.

We outline below some of the investment guidance associated with the most significant infrastructure described above:

As a separate business

	Port	Road	Power Plant	Railways
Regulation	Law 17/2008 Law No. 25/2007 Presidential Regulation No. 77/2007 Presidential Regulation No. 36/2010 Presidential Regulation No. 61/2009	Law 38/2004 GR 34/2006 GR 8/1990 GR 40/2001 GR 15/2005 Law No. 25/2007 Presidential Regulation No. 77/2007 Presidential Regulation No. 36/2010	Law No. 30 year 2009 GR 3/2005 GR10/1989 Law No. 25/2007 Presidential Regulation No. 77/2007 Presidential Regulation No. 36/2010	Law No. 23 year 2007 Government Regulation No. 56/2009 Law No. 25/2007 Presidential Regulation No. 77/2007 Presidential Regulation No. 36/2010
Investment licence issuer	Investment Coordinating Board Port business will be performed by the company by entering into concession right or agreement with Port Authority	Investment Coordinating Board	Investment Coordinating Board	Investment Coordinating Board

	Port	Road	Power Plant	Railways
Business licence issuer	<p>Port Operating Licence is granted to Port Authority which is formed by the Ministry of Transportation not to the company itself.</p> <p>Sea Port Operating Licence is issued by :</p> <ul style="list-style-type: none"> - Minister for Main Port and Hub Port - Governor or Mayor/Regent for Feeder Port <p>Lake/River Port Operating Licence is issued by Mayor/ Regent</p>	<p>Minister of Public Works</p> <p>Based on concession right agreement with the government</p>	<p>Ministry of Energy and Mineral Resources, Governor or Mayor depending on the business/ transmission area and electricity facility location</p>	<p>Ministry of Transportation, Governor or Mayor depending on the railways coverage</p>
Period of business licence	<p>Based on concession right or agreement with Port Authority</p>	<p>Based on concession right agreement with the Ministry</p>	<p>No specific regulation limiting period of operating licence.</p>	<ul style="list-style-type: none"> - Railways Infrastructure operational license: based on concessioon on the agreement with Ministry, Governor or Mayor - Railways Facility operational license : 5 years and extendable
Transferable licence?	No	Yes, based on agreement with the Ministry	Not regulated	Not regulated

	Port	Road	Power Plant	Railways
Maximum foreign ownership	<ul style="list-style-type: none"> - Supply of harbor facilities (49 percent) - Loading / unloading (49 percent) - Supply of reception facilities (49 percent) - Supply & business of sea harbor (no max foreign ownership, but it may be max 49 percent in a proposed Government Regulation) 	95 percent	<ul style="list-style-type: none"> - Development & installation of electricity equipment (95 percent) - Maintenance and operation of electricity equipment (95 percent) - Development of electricity equipment technology (95 percent) - Electricity consulting (95 percent) - Power plant, nuclear power plant, electricity transmission and electricity distribution (95 percent) - Power plant up to 10MW (closed for investment) 	Not specified
Land rights	Land right is given to Port Authority. The company performs business based on concession right or agreement with Port Authority	Based on concession right given by the government	Legal title transferred to company in form of Hak Guna Bangunan (Right to Use Land for Erecting Building) for a total period of 80 years.	Depend on concession right given by the government
Fee to government	Stipulated in the concession right agreement	Not stipulated in the regulation	Non tax state revenue collected from electricity transmission and distribution facility	Not stipulated in the regulat

	Port	Road	Power Plant	Railways
Tax	Prevailing tax laws	Prevailing tax laws	Prevailing tax laws	Prevailing tax laws
Other issues	Law 17/2008 stipulates that implementing regulation will be more defined in GR. No specific regulation on port operation in place to date.	Only able to engage in toll road business	Further GR is yet to be issued	Implementation is waiting for further Ministry Regulation

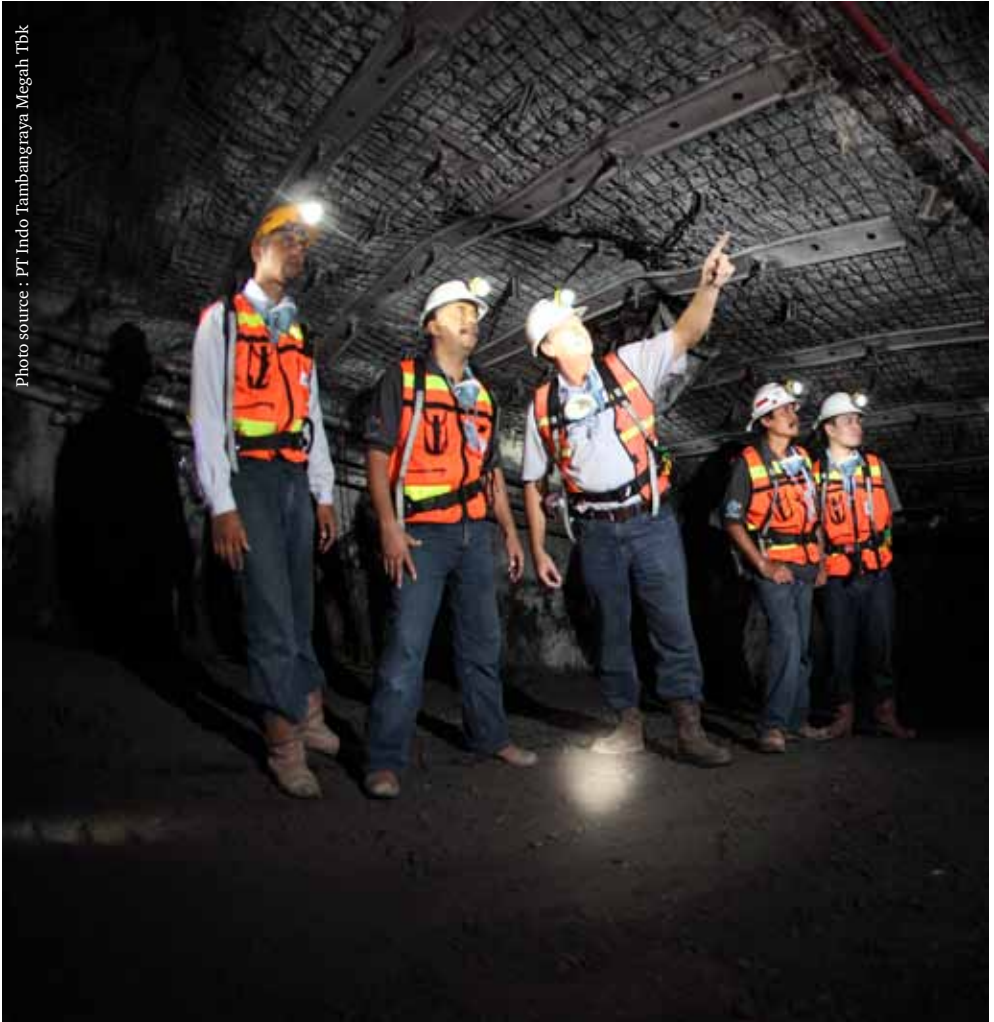
As part of mining business

	Special Port/ Terminal	Road	Power Plant	Railways
Regulation	Law 17/2008 Law 4/2009 Presidential Regulation No. 61/2009	Law 38/2004 GR 34/2006 GR 8/1990 GR 40/2001 GR 15/2005 Law 4/2009	Law 30 /2009 GR 3/2005 GR10/1989 Law 4/2009	Law 23/2007 Government Regulation No. 56/2009 Law 4/2009
Business licence issuer	Minister of Transport	<ul style="list-style-type: none"> - Mayor/ Regent if within a regency - Governor if cross regency within a province - Minister of Energy and Mineral Resources if cross province 	<ul style="list-style-type: none"> - Mayor/ Regent for transmission within a regency - Governor for transmission inter regency within a province - Ministry for national transmission 	Ministry, Governor or Mayor depending on the railways coverage
Period of business licence	Five years and extendable	No specific regulation limiting period of operating licence.	No specific regulation limiting period of operating licence.	Will be stipulated further in Ministry Regulation
Land rights	Right to Use	Right to Use	Right to Use	Right to Use

	Special Port/ Terminal	Road	Power Plant	Railways
Other issues	Allowed only if the nearest available port can not assume the special port activities	None	None	Implementation is waiting for further Ministry Regulation

V. Appendices

Photo source : PT Indo Tambangraya Megah Tbk



About PwC

The firms of the PwC global network (www.pwc.com) provide Industry-focused assurance, tax and advisory services for public and private companies. More than 161,000 people in 154 countries connect their thinking, experience and solutions to build trust and enhance value for clients and their stakeholders.

Our offerings are organised into three Lines of Service, each staffed by highly qualified experienced professionals and leaders in our profession.

- Assurance Services provides innovative, high quality, and cost-effective services related to an organisation's financial control, regulatory reporting, shareholder value and technology needs;
- Tax Services provides a range of specialist tax services in three main areas: tax consulting, tax dispute resolution, and compliance. Some of our value-driven tax services for the mining sector include:
 - International tax structuring
 - Indirect taxes
 - Mergers and acquisitions
 - Transfer pricing; and
 - Compliance services
 - Tax process reviews.
 - Dispute resolution

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Appendix A

- Advisory Services provides comprehensive advice and assistance relating to transaction, performance improvement and crisis management, based on long-term relationships with clients and our financial analysis and business process skills.

For companies operating in the Indonesian mining sector, there are some compelling reasons to choose PwC Indonesia as your professional services firm:

- The PwC network is the leading adviser to the mining industry, both globally and in Indonesia, working with more explorers, producers and related service providers than any other professional services firm.
- We have operated in Indonesia since 1971 and have over 1,000 professional staff, including 38 Indonesian national partners and expatriate technical advisors, trained in providing assurance, advisory and tax services to Indonesian and international companies.
- Our Energy, Utilities and Mining (“EUM”) practice in Indonesia comprises over 250 dedicated professionals across our three Lines of Service. This body of professionals brings deep local industry knowledge and experience with international mining expertise and provides us with the largest group of industry specialists in the Indonesian professional market. We can also draw on the PwC global EUM network which includes some 3,400 qualified industry experts.
- Our commitment to the mining industry is unmatched and demonstrated by our active participation in industry associations around the world and our thought leadership on the issues affecting the industry. Through our involvement with the Indonesian Mining Association, Indonesian Coal Mining Association and Indonesian mining companies, we help shape the future of the industry.
- Our client service approach involves learning about the company’s issues and seeking ways to add value to every task we perform. Detailed mining knowledge and experience ensures that we have the background and understanding of industry issues and can provide sharper, more sophisticated solutions that help clients accomplish their strategic objectives.

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Regional Taxes

This table represents a selection of the various regional taxes relevant to the mining industry.

Type of Regional Tax	Maximum Tariff	Current Tariff	Imposition Base	
A. Provincial Taxes				
1	Taxes on motor vehicle and heavy equipment	10%	Non-public vehicles	
			1%-2% for the first vehicle owned	Calculated by reference to sales value and a weight factor (size, fuel, type, etc.) Government table will be published annually to enable calculation.
			2% - 10% for the second and more vehicle owned	
			0.5% - 1% - public vehicles	
0.1% - 0.2% heavy equipment vehicle				
2	Title transfer fees on motor vehicle, above-water vessels and heavy equipment	20%	Motor vehicle	
			20% - on first title transfer	
			1% on second or more title transfer	
			Heavy equipment	
			0.75% - on first title transfer	
0.075% on second or more title transfer				
3	Tax on motor vehicle fuel	10%	Public vehicles: at least 50% lower than tax on non-public vehicle fuel (depending each region)	Sales price of fuel (gasoline, diesel fuel and gas fuel)

Appendix B

Type of Regional Tax		Maximum Tariff	Current Tariff	Imposition Base
4	Tax on the collection and utilisation of underground water and surface water	10%	Tariff on surface water only	Purchase value of water (determined by applying a number of factors).
B. Regency and Municipal Taxes				
5	Tax on street lighting	10%	3% utilisation by industry	Sales on electricity
			1.5% personal use	
6	Tax on non-metal mineral and rock (formerly C-Category mined substance collection)	25%	Set by region	
7	Tax on groundwater	20%	Set by region	Purchase Value
8	Land and building tax	0.3%	Set by region	Only on certain types of land and buildings
9	Duty on the acquisition of land and building rights	5%	Set by region	Land and building sale value

Ministry of Energy and Mineral Resources



Industry Associations



Indonesian Mining Association

IMA is a non-governmental, non-political, and not-for-profit national mining organisation, established in Jakarta on 29 May 1975.

Membership is open to both organisations and individuals actively participating in the Indonesian mining industry.

The association serves as a link between Government and the mining industry; organising lectures, seminars and training activities for the members; organising periodic conferences on mining in Indonesia; publishes proceedings and mining information; and represents the Indonesian mining industry at national and international meetings.

IMA is a founding member of the Asean Federation of Mining Associations (AFMA) and currently provides the secretariat for the Federation. The aims and objectives of IMA are to support the Government in its policies to encourage the mining industry development, and to disseminate non-confidential and non-proprietary information to promote the exploration, mining, beneficiation and metallurgical aspects in Indonesia through:

- a) fostering mining development;
- b) facilitating professional and business exchange of know-how and experience of experts active in the industry; and
- c) cooperation with similar organisations all over the world in promoting mining business and technology.

The association has over 120 company members.



ASOSIASI PERTAMBANGAN
BATUBARA INDONESIA
INDONESIAN **COAL**
MINING ASSOCIATION

Indonesian Coal Mining Association

APBI-ICMA is a non-political and non-profit oriented organization for companies in the coal business sector. APBI-ICMA was established on 20 September 1989 and was registered as a member of the Indonesian Chamber of Commerce on 16 October 2004.

The objectives of APBI-ICMA are to participate in developing the business climate in the coal mining sector which enables the broad involvement of all members and to share a significant role for the national economic development.

The association facilitates a communication and a consultation forum among its members and also serves as a link between the Government and the coal industry. APBI-ICMA also cooperates with other associations, companies or any related parties nationally and internationally for the development of the coal sector in Indonesia. Currently APBI-ICMA has over 50 companies registered as members.

Summary of CCoW generations

No	Item	First Generation	Second Generation	Third Generation	Remarks
1	Deadrent – in US\$ per hectare per annum except stated otherwise				
	a. General Survey	0.01 – 0.03	0.05 – 0.10	0.025 – 0.05	Second Generation's deadrent follows the prevailing deadrent tariff
	b. Exploration	0.08 – 0.20	0.20 – 0.70	0.10 – 0.35	
	c. Feasibility	0.20	1.00	0.50	
	d. Construction	0.20	1.00	0.50	
e. Operation	1.00	2.00 - 4.00	1.50 – 3.00		
2	Production royalty rate (%)	13.5%	13.5%	13.5%	Calculated from coal sales price minus certain marketing/selling expenses
3	CIT				
	a. Tax Rates	35% for the first ten years of Operating Period; 45% thereafter	Follows the prevailing tax rates. The rate is reduced to 28% in 2009 and to 25% from 2010 onwards.	Maximum rate of 30% (tax rate reduction subject to a Government Regulation)	
	b. Depreciation rates				
	<u>Non-building assets:</u>				For Third Generation, the tax depreciation rates only apply to tangible assets located in the Contract Area. Otherwise, provision under the Income Tax Law Year 1994 should prevail.
	i. Straight line	12.5%	Follows the prevailing tax depreciation rates	10% -50%	
ii. Double declining	Not Applicable		20% - 100%		
<u>Building assets:</u>					
i. Straight line	12.5%	Follows the prevailing tax depreciation rates	10% -20%		
ii. Double declining	Not Applicable		Not Applicable		

No	Item	First Generation	Second Generation	Third Generation	Remarks
	c. Amortization rates (%)				
	a. Straight line	12.5%	Follows the prevailing tax amortisation rates	10% -50%	Under most CCoWs costs incurred prior to commercial operation may be deferred and amortised
	b. Double declining	Not applicable		20% - 100%	
	d. Accelerated Depreciation				
	<i>Non-building assets:</i>	25%	Not Applicable	Not Applicable	Accelerated depreciation can be claimed only within any one of the first four years of the life of the assets
	<i>Building assets:</i>	10%	Not Applicable	Not Applicable	
	e. Investment allowance	20% of total investment	Not Applicable	Not Applicable	At the rate of 5% a year
	f. Deductible expenses:				
	<i>Operating Expenses:</i>				
	i. Cost of materials, supplies, equipment and utilities	✓	✓	✓	
	ii. Expenses for contracted services	✓	✓	✓	
	iii. Premiums for insurance	✓	✓	✓	
	iv. Damage/losses not compensate for insurance	✓	✓	✓	
	v. Payments of royalties or other payments in respect of patent, design, technical information and services	✓	✓	✓	

Appendix E

No	Item	First Generation	Second Generation	Third Generation	Remarks
	vi. Losses from obsolescence or destruction of inventory	✓	✓	✓	Provision is not deductible
	vii. Rentals	✓	✓	✓	
	viii. Deadrent, surface rent, production royalties, stamp duty, and other levies	✓	✓	✓	
	ix. Sales tax	✓	✓	Silent	
	x. Uncredited VAT	Silent	✓	✓	
	xi. Expenses for treating, processing, repairs and maintenance, handling, storing, transporting and shipping	✓	✓	✓	
	xii. Expenses for commissions and discounts	✓	✓	✓	
	xiii. Expenses for environment/reclamation	Silent	✓	✓	
	xiv. Expenses incurred prior to the establishment of the company and expended by a shareholder	Silent	x	✓	For the third generation, it is deductible provided the expenditures have been audited by independent auditor and approval from the DGT has been obtained
	<u>Sales, General & Administration</u>				
	i. Salaries and wages	✓	✓	✓	

No	Item	First Generation	Second Generation	Third Generation	Remarks
	ii. Costs of specified benefits-in-kind in the contract area	✓	x	✓	For the second generation, not deductible unless it obtains remote area approval from the DGT
	iii. Research expenses	✓	✓	✓	For the second generation, should be performed in Indonesia
	iv. Travel expenses	✓	✓	✓	Only for business purposes
	v. Technical fees	✓	✓	✓	
	vi. Management fees and other fees for services performed abroad	✓	✓	✓	
	vii. Communication and office expenses	✓	✓	✓	
	viii. Dues and subscriptions	✓	✓	✓	
	ix. Advertising and other selling expenses, public relations, marketing expenses	✓	✓	✓	
	x. Legal and auditing expenses	✓	✓	✓	
	xi. General overhead expenses	✓	✓	✓	
	xii. Exploration expense	✓	✓	✓	
	xiii. Other relevant expenses	✓	✓	✓	

Appendix E

No	Item	First Generation	Second Generation	Third Generation	Remarks
	xiv. Reserve for reclamation	Silent	✓	✓	For the third generation, subject to a deposit placed in a State Owned bank, audited by a public accountant and approved by the DGT
	g. Interest deductibility				
	Maximum debt to equity ratio	1.5 to 1	Silent	Not Applicable	At the time of writing, the DGT is drafting a Government Regulation on Mining Taxation, which may include thin capitalisation rule
	Maximum debt to equity ratio for Investment <US\$200m	Not Applicable	Silent	5 to 1	
	Maximum debt to equity ratio for Investment >US\$200m	Not Applicable	Silent	8 to 1	
	h. Tax loss carried forward	Four years (loss before the fifth anniversary of the Operating Period can be utilised in any years)	Five years	Eight years	Second generation follows the prevailing tax loss carried forward period
4	Withholding Tax				
	i. Dividends, interest and royalties	10%	20%	20%	- Third generation WHT obligations are grandfathered to 1994 Income Tax Law
	ii. Dividends (founder shareholder)	10%	Silent	7.5%	- Reduced tax rate is available under a tax treaty
	iii. Rentals, technical, management fees and other service fees	10%	2% to 20%	1.5% to 20%	

No	Item	First Generation	Second Generation	Third Generation	Remarks
	iv. Employee income tax	Applicable	Applicable	Applicable	- Second generation follows the prevailing employee income tax regulations
5	Value Added Tax rate				
	i. VAT on coal sales	Not Applicable	Exempted	10% on domestic sales; 0% on export sales	- Third generation CCoW VAT obligations are grandfathered to the 1994 VAT Law. VAT paid should be creditable/refundable
	ii. VAT on domestic purchases	Not Applicable	10% paid to vendor	10% collected by the mining company	- Input VAT cannot be credited/refunded by second generation CCoW, but this is deductible for corporate income tax purposes.
	iii. VAT on import	Not Applicable	10% paid to Custom Office	Exempted up to the tenth anniversary of Operating Period	- Second Generation follows the prevailing VAT Law
	iv. VAT on offshore services	Not Applicable	10% on self assessment basis	10% on self assessment basis	
		note: remittance is required but will get reimbursement			
6	Sales Tax rates	5% on domestic services	Not Applicable	Not Applicable	Sales tax was repealed in 1984, when VAT was introduced.

Appendix E

No	Item	First Generation	Second Generation	Third Generation	Remarks
7	Import Duty on capital goods	Exempted	Exempted/ reduced rates up to the tenth anniversary of Operating Period, in accordance with prevailing regulations	Exempted/ reduced rates up to the tenth anniversary of Operating Period, in accordance with prevailing regulations	Exemption of import duty is subject to BKPM Master List approval
8	Other taxes & levies				
	a. Regional taxes (e.g. motor vehicles and street lighting levy)	Regional Development Tax (“IPEDA”): maximum of US\$100,000 a year	Applicable	Follows the prevailing Regional Tax Law at the rate not exceeding the prevailing rate at the signing date	Second Generation follows the prevailing laws and regulations
	b. Land and building tax	Silent	Applicable	Applicable	Second Generation follows the prevailing law and regulations

Summary of Mineral CoW generations

No	Item	Third Generation	Fourth Generation	Fifth Generation	Sixth Generation	Seventh Generation	Remarks
1	Deadrent – in US\$ per hectare per annum except stated otherwise						
	a. General Survey	0.01 - 0.03	0.025 - 0.05	0.025 - 0.05	0.025 - 0.05	0.025 - 0.05	
	b. Exploration	0.08 - 0.2	0.1 - 0.35	0.1 - 0.35	0.1 - 0.35	0.1 - 0.35	
	c. Feasibility	0.2	0.5	0.5	0.5	0.5	
	d. Construction	0.2	0.5	0.5	0.5	0.5	
	e. Operation	1.00 - 2.00	1.50 - 3.00	1.50 - 3.00	1.50 - 3.00	1.50 - 3.00	
2	Production royalty rate (%)	Annex E	Annex F	Annex F	Annex F	Annex F	Annex F of the CoW usually provides details of the royalty rates.
3	Corporate Income Tax						
	a. Tax Rates	Follows the prevailing laws, but not higher than: - 35% for the first five years of Operating Period; - 40% for the second five years of Operating Period; - 45% thereafter.	Maximum 35%	Maximum 35%	Maximum 30% (potential tax rate reduction is available subject to a Government Regulation)	Maximum 30% (potential tax rate reduction is available subject to a Government Regulation)	
	b. Depreciation rates						
	<u>Non-building assets:</u>						
	i. Straight line	12.5%	Not Applicable	Group 1 & 2 follows ITL 1984 Group 3: 12.5%	10% -50%	10% -50%	For the fifth generation, the tax depreciation rates only apply to tangible assets located in the Contract Area. Otherwise, provision under the 1984 Income Tax Law should prevail.
	ii. Double declining	Not Applicable	25%	Group 1 & 2 follows ITL 1984	20% - 100%	20% - 100%	For the sixth and seventh generations, the tax depreciation rates only apply to tangible assets located in the Contract Area. Otherwise, provision under the 1994 Income Tax Law should prevail.
	<u>Building assets:</u>						
	i. Straight line	12.50%	25%	12.50%	10% -20%	10% -20%	
	ii. Double declining	Not Applicable	Not Applicable	Not Applicable	Not Applicable	Not Applicable	
	c. Amortisation rates (%)						
	a. Straight line	12.5%	Not Applicable	25.0%	10% -50%	10% -50%	Under most CoWs, costs incurred prior to commercial operation may be deferred and amortised
	b. Double declining	Not Applicable	25%	Not Applicable	20% - 100%	20% - 100%	

Appendix E

No	Item	Third Generation	Fourth Generation	Fifth Generation	Sixth Generation	Seventh Generation	Remarks
	d. Accelerated Depreciation						
	<i>Non-building assets:</i>	25%	Not Applicable	Not Applicable	Not Applicable	Not Applicable	For the third generation, accelerated depreciation can only be claimed within any one of the first four years of the life of the assets
	<i>Building assets:</i>	10%	Not Applicable	Not Applicable	Not Applicable	Not Applicable	
	e. Investment credits	20% of total investment	Not Applicable	Not Applicable	Not Applicable	Not Applicable	At the rate of 5% a year
	f. Deductible expenses:						
	<i>Operating Expenses:</i>						
i.	Cost of materials, supplies, equipment and utilities	✓	✓	✓	✓	✓	Third Generation - payment to affiliates is subject to approval from the DGT
ii.	Expenses for contracted services	✓	✓	✓	✓	✓	
iii.	Premiums for insurance	✓	✓	✓	✓	✓	
iv.	Damage/losses not compensate for insurance	✓	✓	✓	✓	✓	
v.	Payments of royalties or other payments in respect of patent, design, technical information and services	✓	✓	✓	✓	✓	
vi.	Losses from obsolescence or destruction of inventory	✓	✓	✓	✓	✓	
vii.	Rentals	✓	✓	✓	✓	✓	
viii.	Deadrent, surface rent, production royalties, stamp duty, and other levies	✓	✓	✓	✓	✓	
ix.	Sales tax	✓	Silent	Silent	Silent	Silent	
x.	Uncredited VAT	Silent	✓	✓	✓	✓	
xi.	Expenses for treating, processing, repairs and maintenance, handling, storing, transporting and shipping	✓	✓	✓	✓	✓	
xii.	Expenses for commissions and discounts	✓	✓	✓	✓	✓	
xiii.	Expenses for environment	Silent	Silent	Silent	✓	✓	
xiv.	Expenses incurred prior to the establishment of the company and expended by a shareholder	✓	✓	✓	✓	✓	

No	Item	Third Generation	Fourth Generation	Fifth Generation	Sixth Generation	Seventh Generation	Remarks
	<i>Sales, General & Administration</i>						
	i. Salaries and wages	✓	✓	✓	✓	✓	Only for business purposes
	ii. Costs of specified BIKs in the contract area	✓	✓	✓	✓	✓	
	iii. Research expenses	✓	✓	✓	✓	✓	
	iv. Travel expenses	✓	✓	✓	✓	✓	
	v. Technical fees	✓	✓	✓	✓	✓	
	vi. Management fees and other fees for services performed abroad	✓	✓	✓	✓	✓	
	vii. Communication and office expenses	✓	✓	✓	✓	✓	
	viii. Dues and subscriptions	✓	✓	✓	✓	✓	
	ix. Advertising and other selling expenses, public relations, marketing expenses	✓	✓	✓	✓	✓	
	x. Legal and auditing expenses	✓	✓	✓	✓	✓	
	xi. General overhead expenses	✓	✓	✓	✓	✓	
	xii. Exploration costs	✓	✓	✓	✓	✓	
	xiii. Other relevant expenses	✓	✓	✓	✓	✓	
	xiv. Reserve for reclamation	Silent	Silent	Silent	✓	✓	
	g. Interest deductibility						
	Maximum debt to equity ratio	1.5 to 1	3 to 1	Not Applicable	Not Applicable	Not Applicable	
	Maximum debt to equity ratio for Investment <US\$200m	Not Applicable	Not Applicable	5 to 1	5 to 1	5 to 1	
	Maximum debt to equity ratio for Investment >US\$200m	Not Applicable	Not Applicable	8 to 1	8 to 1	8 to 1	
	h. Tax loss carried forward	Four years (loss before the fifth anniversary of the Operating period can be utilised in any years)	Eight years	Five to eight years	Eight years	Eight years	
4	Withholding Tax						
	i. Dividends, interest and royalties	10%	15% for domestic tax payer 20% for foreign tax payer	15% for domestic tax payer 20% for foreign tax payer	0% to 20%	0% to 20%	
	ii. Dividends (founder shareholder)	See above	See above	See above	0% to 7.5%	0% to 7.5%	

Appendix E

No	Item	Third Generation	Fourth Generation	Fifth Generation	Sixth Generation	Seventh Generation	Remarks
	iii. Technical, management fees and others	Prevailing law	2% to 20%	9% for domestic tax payer 20% for foreign tax payer	15% to 20%	15% to 20%	
	iv. Rentals	Prevailing law	15% for domestic tax payer 20% for foreign tax payer	15% for domestic tax payer 20% for foreign tax payer	15% to 20%	15% to 20%	
	v. Employee income tax	Applicable	Applicable	Applicable	Applicable	Applicable	
5	Value Added Tax rate						
	i. VAT on sales	Silent	10% on domestic sales; 0% on export sales	10% on domestic sales; 0% on export sales	10% on domestic sales; 0% on export sales	10% on domestic sales; 0% on export sales	The fifth generation VAT obligations are grandfathered to the 1984 VAT Law
	ii. VAT on domestic purchases	Silent	10% paid to vendor	10% collected by the mining company	10% paid to vendor	10% paid to vendor	The sixth and seventh generations VAT obligations are grandfathered to the 1994 VAT Law
	iii. VAT on import	Silent	Deferred up to the 10th anniversary of Operating Period	Deferred up to the 10th anniversary of Operating Period	Exempted up to the 10th anniversary of Operating Period	Exempted up to the 10th anniversary of Operating Period	
	iv. VAT on offshore services	Silent	10% on self assessment basis	10% on self assessment basis	10% on self assessment basis	10% on self assessment basis	VAT paid should be creditable/refundable
6	Sales Taxes rate	Applicable	Not Applicable	Not Applicable	Not Applicable	Not Applicable	Sales tax was repealed in 1984, when VAT was introduced
7	Import Duty on capital goods	Exempted up to the 10th anniversary of commercial production	Exempted/reduced rates up to the 10th anniversary of Operating Period	Exempted/reduced rates up to the 10th anniversary of Operating Period	Exempted/reduced rates up to the 10th anniversary of Operating Period	Exempted/reduced rates up to the 10th anniversary of Operating Period	Exemption of import duty is subject to BKPM Master List approval
8	Other taxes & levies						
	a. Regional taxes (e.g. motor vehicle and street lighting levy)	- Regional charges - Regional Development Tax ("IPEDA"); amount equal to deadrent and an amount based on non-public area	Applicable	Applicable	Applicable	Applicable	Generally capped at the rate not exceeding the rate prevailing at the CoW signing date
	b. Land and building tax	Silent	Applicable	Applicable	Applicable	Applicable	

Glossary

Term	Definition
AMDAL	<i>Analisis Mengenai Dampak Lingkungan</i> (Environmental Impact Assessment)
BI	Bank of Indonesia
BKPM	<i>Badan Koordinasi Penanaman Modal</i> (Indonesia's Investment Coordinating Board)
CCA	Coal Co-operation Agreement
CoW	Contract of Work
CCoW	Coal Contract of Work
CD	Community Development
Contracts	CoW/CCoW/CCA
CSR	Corporate Social Responsibilities
DGoMC	Director General of Minerals and Coal
DGT	Directorate General of Taxation
DMO	Domestic Market Obligation
Forestry Law	Law No. 41 of 1999 as amended by Law No. 19 of 2004
GDP	Gross Domestic Product
GoI/Government	Government of Indonesia
GR	Government Regulation
GR22	Government Regulation No.22 of 2010, dated 1 February 2010
GR23	Government Regulation No.23 of 2010, dated 1 February 2010
GR55	Government Regulation No. 55 of 2010, dated 5 July 2010
GR78	Government Regulation No. 78 of 2010, dated 20 December 2010
ha	Hectare
IPR	<i>Izin Pertambangan Rakyat</i> (People's Mining Licence)
ITO	Indonesian Tax Office
IUJP	<i>Izin Usaha Jasa Pertambangan</i> (Mining Services Business Licences)

Appendix F

Term	Definition
IUP	<i>Izin Usaha Pertambangan</i> (Mining Business Licence)
IUPK	<i>Izin Usaha Pertambangan Khusus</i> (Special Mining Business Licence)
KP	<i>Kuasa Pertambangan</i> (Mining Right)
Minister	Minister of the MoEMR
Mining Law	Law on Mineral and Coal Mining No.4 of 2009
MoEMR	Ministry of Energy and Mineral Resources
MoF	Ministry of Finance
NEP	National Energy Policy
NPWP	<i>Nomor Pokok Wajib Pajak</i> (tax payer identification number)
PE	Permanent Establishment
PerMen 17	Regulation of the MoEMR No. 17/2010, dated 23 September 2010
PerMen 28	Regulation of the MoEMR No. 28/2009, dated 30 September 2009
PerMen 34	Regulation of the MoEMR No. 34/2009, dated 31 December 2009
PMA	<i>Penanam Modal Asing</i> (Foreign Investment Company)
PT	Limited Liability Company
PTBA	PT Tambang Batubara Bukit Asam (Persero) Tbk
PwC	PwC refers to a network of member firms of PwC International Limited, each of which is a separate and independent legal entity
SKT	<i>Surat Keterangan Terdaftar</i> (Registration Letter for non-core mining services business)
VAT	Value Added Tax
WHT	Withholding Tax
WP	<i>Wilayah Pertambangan</i> (Mining Area)
WPN	<i>Wilayah Pencadangan Negara</i> (State Reserve Area)
WPR	<i>Wilayah Pertambangan Rakyat</i> (People's Mining Area)
WUP	<i>Wilayah Usaha Pertambangan</i> (Commercial Mining Business Area)

Acknowledgements

We would like to convey our sincere thanks to all the contributors for their efforts in supporting the preparation of this publication.

Photographic contributions

We gratefully acknowledge and thank the following companies that provided photographs for inclusion in this publication (in alphabetical order):

- PT Adaro Energy Tbk
- PT Freeport Indonesia
- PT Indo Tambangraya Megah Tbk
- PT International Nickel Indonesia Tbk
- PT Newmont Nusa Tenggara

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