INDONESIA

Country M&A Team

Country Leader ~ Melisa Himawan

Ray Headifen

Christian Pellone

Dionsius Damijanto

Name	Designation	Office Tel	Email
Melisa Himawan	Partner	+6221 521 2901 6 ext. 7700	melisa.himawan@id.pwc.com
Ray Headifen	Partner	+6221 521 2901 6 ext. 7707	ray.headifen@id.pwc.com
Christian Pellone	Director	+6221 521 2901 6 ext. 7760	christian.pellone@id.pwc.com
Dionsius Damijanto	Senior Manager	+6221 521 2901 6 ext. 7716	dionsius.damijanto@id.pwc.com

PricewaterhouseCoopers • Gedung PricewaterhouseCoopers 7th Floor • JL Rasuna Said Kav • C-3 Kuningan • Jakarta 12920 • Indonesia

1. Introduction

1.1 General Information on M&A In Indonesia

With a population of over 220 million people and significant natural resources, Indonesia represents both a significant market and potential supplier to the world economy. The Indonesian Government officially welcomes both domestic and foreign private investment. Over the past several years, the Government has progressively sought to liberalise the local rules governing foreign investment.

Indonesia is in the midst of a serious effort to promote foreign investment, capital accumulation and the export of goods other than oil and gas to expedite economic development and to become internationally competitive. A broad range of deregulatory measures has been implemented, and additional measures can be expected to further enhance the investment climate.

The Indonesian Government has passed a number of broad ranging amendments to the tax laws arising from a recent tax reform review.

1.2 Corporate Tax

Indonesian companies are subject to tax on their worldwide income. A non-resident of Indonesia is, however, subject to Indonesia tax on its Indonesia sourced income.

The corporate tax rates are as follows:

Income (Rp)	Tax rate
Up to 50 million	10%
From 50 million to 100 million	15%
Greater than 100 million	30%

1.3 Withholding Tax

Indonesian tax system relies heavily on a withholding tax mechanism for tax collection purposes.

Certain payments made by a resident taxpayer or an Indonesian permanent establishment (PE) of a foreign company to another resident taxpayer or another Indonesian PE are subject to withholding tax at the following rates:

Nature of payment	Withholding tax rate[1]
Dividends	0%/15%
Interest	20%/15%
Royalties	15%
Prizes/Awards	15%
Rentals	3%/6%/10%
Fees for services	2%-7.5%

[1]Of the gross amount payable.

Such withholding tax typically constitutes prepaid tax for the income recipients which may be credited against the corporate income tax ultimately payable at year end. Exceptions are withholding tax on bank interest and listed bond interest, the income tax withheld from which constitutes final income tax (i.e. the only income tax due on the income concerned).

Certain payments made by a resident taxpayer or an Indonesian PE of a foreign company to a non-resident which does not have an Indonesian PE are subject to withholding tax at the following rates:

Description	Non treaty rate[1]	Treaty rate[1]
Dividends	20%	10/12.5/15/20%
Interest	20%	0/5/10/12.5/15%
Royalties	20%	0/10/12.5/15%
Branch-profit tax	20%	10/12.5/15/20%
Insurance/Reinsurance premiums	1/2/10%	–
Fees for services	20%	–[2]

[1]Of the gross amount payable.

[2]Exceptions are fees for technical, management, and consulting services payable to residents of Switzerland, Germany, Luxembourg and Pakistan which are subject to withholding tax at 5%, 7.5%, 10% and 15% respectively.

At present, Indonesia has signed tax treaties with more than 50 countries.

1.4 Taxation of Dividends

Dividends received by an Indonesian corporation or Indonesian PE from other Indonesian corporations are assessable at the normal income tax rate. However, such dividends will not be subject to tax if all the following conditions are met:

- the dividends are paid out of retained earnings;
- the recipient corporation holds at least 25% of the paid-in capital in the dividend-payer corporation; and
- the recipient corporation has an "active business" other than shareholding.

For the taxation of dividends payable to non-resident parties, please refer to section 1.3.

Dividends are non-deductible to a payer for corporate income tax purposes.

1.5 Tax Losses

Losses may be carried forward for a maximum of five years. However, for a limited category of business in certain regions, the period may be extended up to 10 years. Losses are not permitted to be carried backwards. Indonesia does not have continuity of ownership or continuity of same business tests that operate to restrict tax loss utilisation.

In general, one company's tax losses may not be transferred to another company. However, as part of the merger scheme, tax losses of the dissolved companies may be transferred to the surviving company provided all the following conditions prevail:

- the companies have undertaken fixed assets revaluation;
- the companies are still actively running their business before the merger; and
- the surviving company has to continue running its business at least two years after the merger.

1.6 Other Taxes

1.6.1 Value Added Tax (VAT)

VAT is imposed on importers, providers of most goods and services, and users of intangible goods and services originating from outside Indonesia or within Indonesia. The rate of VAT is currently 10%. The export of goods from Indonesia is zero rated.

1.6.2 Luxury Sales Tax (LST)

LST is imposed once only, upon the delivery or sale of specified luxury goods by a manufacturer or upon import. The rates of tax range from 10% to 75% depending on the type of goods.

1.6.3 Stamp Duty

Only nominal stamp duty is payable, at either Rp 6,000 (US$0.60) or Rp 3,000 (US$0.30) on certain documents, such as letters of agreement, proxies, statement letters and notarial deeds.

1.6.4 Land and Building Tax

Land and building tax is payable annually on land and building and on a permanent structure. The effective rate is generally not more than 0.1% to 0.2% per annum of the value of the property.

1.6.5 Land and Building Transfer Tax

The seller and buyer are each required to pay a tax of 5% which is computed on the transfer value or the value forming the basis of the land and building tax (NJOP), whichever is higher. The tax payable by the seller represents a prepayment of its corporate tax liability and is available as a credit to the seller when calculating its final tax liability.

The tax payable by the purchaser may not be claimed as a credit and therefore represents an additional cost of such an acquisition. The duty payable by the purchaser on the acquisitions of title to land and buildings is extended to acquisition via inheritance or as part of a business merger, consolidation, or expansion. The duty may be reduced by 50% where the land and/or building are transferred in connection with a merger. The contractual date of a business merger, consolidation or expansion is considered as the due date for the payment of such duty.

1.7 Tax Issues Relating to Mergers

There are special rules which provide concessions for certain qualifying mergers and consolidations. These concessions include:

- no gain or loss on the transfer of assets;
- the transferor company would not be subject to 5% tax on the transfer of land and/or buildings; and
- subject to certain conditions (including a revaluation of the transferor's fixed assets), a transferor's tax losses may be carried over to the surviving company.

1.8 Thin Capitalisation and Debt/Equity Regime

1.8.1 Thin Capitalisation Regime

There is no thin capitalisation regime. However, interest payable to related parties not at an arm's length basis may result in the tax authority denying a portion of the interest as a deduction.

1.8.2 Debt/Equity Regime

The tax law authorises the Minister of Finance (MoF) to stipulate the acceptable debt/equity ratio under MoF regulations. However, up to now the MoF has not issued any regulation on this matter. In practice, a debt/equity ratio requirement is normally imposed only in the investment registration and approval process by the Foreign Investment Coordinating Board (BKPM).

1.9 Common Forms of Business Entity

The following are the common forms of business carried out in Indonesia:

- Corporation

  The corporation is the most common form of business enterprise in Indonesia. As an investment vehicle, a corporation is regulated by the 1995 Limited Liability Company (PT Company) law. Being a legal entity distinct from its shareholders, a PT Company is taxed as separate entity.

  Where foreign investors hold more than 50% of the company shares, such a company is referred to as a foreign investment (PMA) company. Otherwise, it is a domestic investment (PMDN) company.

- Partnership

  Partnerships are normally used by professionals, such as accountants and lawyers, as a vehicle to conduct their business. A partnership is taxed in respect of its income as a single entity while partnership profit distribution to partners is not taxable to the partners.

- Joint Operation

  As an unincorporated cooperation between two (or more) legal entities, this vehicle is commonly used in the telecommunication business and for running public works or governmental foreign aid funded projects. As far as income tax is concerned, a joint operation is a flow-through entity. However, wherever applicable, it is a taxable entity for VAT.

- Branch

  Foreign corporations are allowed to register branches in Indonesia only in exceptional circumstances. It is, however, the most common vehicle for foreign investors engaged in the oil and gas industry by virtue of Production Sharing Contracts (PSCs).

Except for joint operations, all other entities above are subject to corporate income tax in respect of their income.

1.10 Foreign Ownership Restrictions

A foreign investor may acquire shares in an existing foreign-owned company (PMA) or convert a locally-owned company (PMDN) to a PMA. Acquisition of such a company is permitted as long as the proposed business activities of the company are open for foreign investment.

There are various restrictions on foreign investment which are dependent on the type and nature of activity undertaken. Four broad categories of business restrictions exist:

- business closed to all investors including local investors, for example, harmful chemical production;
- business closed to foreign investors, for example, natural forest concessions and radio/television broadcasting services;
- business where a foreign investor may be a joint venture party, for example, shipping, electricity production, transmission and distribution; and
- business investment open to all investors but subject to certain restrictions, for example, aquaculture and pulp wood industries.

The types of activities listed in each of the above categories are extensive. These are contained in what is referred to as a negative investment list. Foreign investors should therefore enquire as to the foreign investment rules governing the appropriate sectors of their investments before embarking on any merger or acquisition deal in Indonesia.

A foreign investor may now own 100% of the shares in an Indonesian company. However, it is still required to be owned by two or more shareholders. Although there is no specific indication of the required percentage, a transfer of at least a nominal proportion of equity (divestment) by the foreign investor to an Indonesian party or parties is required within 15 years.

At the time of the establishment of a joint venture company operating in a sector previously closed to foreign investment, an Indonesian shareholding of at least 5% is required. A foreign investment company may set up new companies and purchase shares of a PMDN and non-facility companies as long as the business activities of the company are open for foreign investment. However, while holding companies are common among local conglomerates, foreign-owned holding companies are not commonly used.

2. Structuring a Stock Deal

2.1 Seller's Perspective

2.1.1 Profit on Sale of Stock

There are a number of considerations surrounding a stock (or shares) acquisition by an offshore entity. The sale of shares in an unlisted Indonesian company by a non-resident attracts a withholding tax of 5% of the gross proceeds due to the vendor. However, the vendor may be protected from this tax under a tax treaty. It should be noted that where the seller is a resident of Australia or Singapore, Indonesia's tax treaties with Australia and Singapore do not provide for such an exemption.

Any capital gain on the sale of unlisted shares by resident corporations is treated as ordinary income and subject to corporate tax at normal corporate rates. Shares listed on an Indonesian stock exchange are subject to a tax of 0.1% of gross proceeds (0.6% for founder shares).

The sale of shares is likely to be the preferred approach for the seller, as this tax liability is a once-off income tax on the profit on disposal. In many cases, offshore elements are often introduced into share transactions so as to further limit the Indonesian tax on disposal.

2.1.2 Stamp Duty

Only nominal stamp duty is payable on the issue of shares at Rp 6,000 per document.

2.2. Buyer 's Perspective

2.2.1 Acquisition Structure

Most share acquisitions are structured as direct investments from outside Indonesia. The acquiror generally seeks to hold Indonesia Target Companies through a company located in a country which has entered into a double tax treaty agreement with Indonesia so as to minimise dividend withholding tax and/or capital gains tax. The choice of a suitable jurisdiction will depend on the acquiror's own tax considerations.

2.2.2 Funding Cost

Interest paid on borrowing to finance a share acquisition must satisfy normal tests for deductibility. Where a local corporate taxpayer uses borrowing to finance a share acquisition, interest would generally not be deductible because any dividends received would not be taxable. Dividends are not taxable where:

- the dividends are paid out of retained earnings;
- the relevant shareholders hold at least 25% of the paid-in capital; and
- the relevant shareholders have an "active business" other than shareholding (i.e. a holding company).

Interest on borrowing used to finance equity investment in newly established companies or to participate in rights issues is deductible by way of capitalisation to the share investment.

2.2.3 Equity Structure

The minimum capital requirement is Rp 20 million. The minimum allowable foreign investment may be determined by the investors on the basis of the scale of the business. It may comprise both debt and equity.

2.2.4 Preservation of Tax Losses, Tax Depreciation and Tax Incentives

A change in ownership of the shares of a company does not alter the depreciation allowances claimed by the company or its carry forward tax losses. There is no facility for stepping up or increasing the basis of assets to reflect the purchase price. The acquisition of shares in a tax loss company in theory provides flexibility in loss utilisation because of the lack of provisions for continuity of ownership or business.

2.2.5 Unpaid Taxes of the Acquired Company

Unpaid taxes or unrecorded liabilities of the company being acquired remain with the company. It is generally recommended to obtain warranties and indemnities from the seller to meet unknown and undisclosed tax and other liabilities.

3. Structuring an Asset Deal

3.1 Seller's Perspective

3.1.1 Profit on Sale of Assets and Goodwill

Capital gains derived by a company on the transfer of goodwill and assets are taxed as ordinary income and (after utilising any carry forward tax losses) are subject to income tax at the maximum corporate rate of 30%. The transfer of land and/or building will attract a transfer tax of 5% of the proceeds. This tax is creditable against the transferor company's annual income tax liability.

3.1.2 Value Added Tax

The transfer of assets is subject to 10% VAT. Specific concessions may be available, for example, where the transferor company is a company not required to be registered for VAT purposes.

3.1.3 Stamp Duty

Stamp duty is not payable on the transfer of assets.

3.2 Buyer's Perspective

3.2.1 Selection of Acquisition Vehicle

An asset acquisition or transfer is subject to the approvals of various government departments including that of the foreign investment regulatory body (BKPM). The acquisition of assets may be effected either by an existing subsidiary company or through a newly established Indonesian entity.

Generally, an asset acquisition is preferred in Indonesia because of the difficulties in determining the undisclosed liabilities (such as tax) of the targets. For years after 1994, the Indonesia Tax Office has 10 years to initiate a tax audit and therefore potential tax exposures can arise long after an acquisition has been completed. In addition, the legal uncertainties in trying to enforce warranties and indemnities against vendors generally mean that assets acquisitions are preferred.

3.2.2 Unpaid Taxes of the Transferor Company

Unpaid taxes or unrecorded liabilities remain with the seller.

3.2.3 Funding Cost

The buyer in an asset acquisition would be entitled to deductions for interest expenses on loans used to acquire such assets, provided the assets are used in generating income and the transaction has been effected at arm's length. Interest paid to non-residents will be subject to 20% withholding tax (which may be reduced under most tax treaties).

3.2.4 Cost Base Step Up

On an acquisition of assets, the assets should be recorded at transfer value for tax purposes. An asset appraisal may be required for related party transaction to determine the market value at the time of acquisition.

Purchased goodwill and cost of intangible property may be amortised under Indonesian accounting principles using the declining-balance method or the straight-line method. The method adopted must be applied consistently. The amortisation will generally be deductible for tax purposes.

Assets other than buildings are divided into four classes. Depreciation is calculated on an asset-by-asset basis. Buildings are divided into two classes: permanent (useful life of 20 years) and non-permanent (useful life of 10 years). The current rates of depreciation are as below:

Asset category	Declining-balance (%)	Straight-line (%)
Class I	50	25
Class II	25	12.5
Class III	12.5	6.25
Class IV	10	5
Permanent building		5
Non-permanent building		10

Costs incurred to extend certain rights over land (such as right to build, right to commercial use, and right to use), may be amortised over the useful life of the rights. Land acquisition costs are not amortisable.

3.2.5 Value Added Tax

VAT paid by the buyer should be available as input VAT which may be recovered against output VAT, or by claiming a refund. A request for a refund will automatically trigger a tax audit. Special concessions may be available, for example, where the transferor company is a company not required to be registered for VAT purposes.

3.2.6 Land and Building Transfer Tax

On acquiring land and/or building, the purchaser must pay 5% transfer tax which is computed on the transfer value or the value forming the basis of the land and building tax (NJOP), whichever is higher. The tax paid is considered as cost of the acquiring company, that is, it is not creditable against income tax.

3.2.7 Withholding Tax

No Indonesian withholding tax should apply on the transfer of assets.

4. Exit Route

The sale of the shares in an Indonesian company can provide a tax-free exit mechanism for foreign investors provided the seller is resident in a treaty country and the “capital gains” article in the treaty gives protection from the 5% withholding tax discussed previously. Other profit extraction techniques such as interest, technical service fees and dividends can be used to provide an exit route for Indonesian profits but care must be taken to limit withholding taxes and ensure that Indonesia’s transfer pricing rules are not infringed.

5. Ending Remarks: Preparation for a Deal

Indonesia represents significant opportunities for foreign investors. However, while warmly welcoming foreign investment, doing business in Indonesian often poses a unique set of challenges. Careful planning is recommended at the earliest stage of consideration of a merger or acquisition in Indonesia. The legal, tax, government, regulatory and human resources teams will need to work together to ensure that unnecessary hurdles are not overlooked at the outset.