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Draft Omnibus Laws – Tax

The government has recently announced that it will seek to introduce two "Omnibus" Laws. The first (related to tax) will seek to promote investment, voluntary tax compliance, and equality between domestic and foreign businesses. The second is targeting the ease of doing business in Indonesia and will include an updated positive investment list.

The Omnibus Tax Law (entitled "Tax Provisions and Concessions for Economic Consolidation") is proposing to amend:

a) the General Tax Provisions and Procedures Law;
b) the Income Tax Law;
c) the Value Added Tax (VAT) Law; and
d) the Regional Tax and Retribution Law.

This NewsFlash offers high level discussion points on the draft Omnibus Tax Law based upon a Ministry of Finance Press Release of 25 November 2019. Our comments are focussed on matters of relevance to investors in the energy and resources sectors.

Reduction in Corporate Income Tax ("CIT") rate

The Omnibus proposals can be summarised as follows:

a) the CIT rate will be gradually reduced from the current rate of 25% to 22% in 2021–2022 and to 20% starting 2023;
b) the CIT rate for companies newly listed on the Indonesia Stock Exchange, that meet certain requirements, would be reduced by a further 3%, for the first five years of listing (i.e. the CIT rate will become 19% in 2021–2022 and 17% starting 2023).

On an in-principle basis any reductions in the CIT rate should be attractive to investors. However, investors holding assets with "grandfathered" tax regimes, including those with "cost-recovery" era PSCs and certain mining-related contracts of work, will need to review the ability to access these CIT reductions.

Tax exemption on dividends received by domestic taxpayers

The Omnibus proposal can be summarised as follows:

a) Indonesian-sourced dividends received by resident taxpayers will be CIT exempt if reinvested in Indonesia for a certain period (detail still to be specified);
b) foreign-sourced dividends, or the aftertax profits of a Permanent Establishment, earned by resident taxpayers (either listed or non-listed) will be CIT exempt if reinvested in Indonesia for a certain period (detail still to be specified).

A reinvestment incentive for profits arising from the Indonesian branches of foreign investors has been in existence for many years but has rarely been used. This expanded reinvestment incentive, focusing on domestic investors, is significantly wider and potentially more practical. This incentive may therefore be attractive although, as always, this is subject to the detail in the implementing regulations.

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WHT reduction on interest income received by foreign taxpayers

The 20% Article 26 Income Tax withholding currently applying to interest payments due to foreign lenders will be reduced where the interest is sourced from Indonesia. There is no guidance as yet on the reduction.

This is potentially one of the more attractive proposals under the Omnibus tax package. This is noting that Indonesia's general 20% WHT rate has existed since the mid 1980s at a time when the CIT rate was 45%. This means that, while Indonesia's headline CIT rate has nearly halved over the past 35 years to 25%, the cross-border WHT rate has remained static. This is even more critical given that the 20% WHT rate has prevailed during an era where treaty use has become more heavily regulated and so arguably less accessible. A legislative change in the WHT rate would mean less need to rely on treaty relief to manage this WHT exposure. This is therefore likely to be very attractive (and arguably long overdue).

Any WHT relief on interest payments is also likely to largely benefit Indonesian borrowers. This is because lenders are often paid "net of tax" meaning that WHT relief is effectively a borrower's risk and so ultimately just a cost of finance.

Territorial basis in calculating taxable income of individual taxpayers

These Omnibus proposals can be summarised as follows:

a) Indonesian citizens that reside abroad for more than 183 days will be treated as nonresident if they fulfil certain requirements (still to be specified). Withholding on their Indonesian-sourced income will be at the 20% Article 26 Income Tax rate. Non-Indonesian sourced income will be non-taxable while the Indonesian citizen is non-resident.

b) expatriates with dual tax residency and who reside in Indonesia beyond the 183 days time test will be deemed as resident. However only Indonesian-sourced income will be subject to Indonesian income tax.

These proposals could be of particular relevance for those employers managing a large pool of "intermittent labour" such as "rotators" (e.g. drilling crews, etc.) and other project specific workers. In many of these cases employee "residency" can be unclear with employer requirements for the management of immigration movements, the interplay with home-country treaties etc. resulting in considerable administrative and similar costs.

These proposals, especially the elimination of the exposure to tax on non-Indonesian sourced income, is therefore likely to make managing these risks more reasonable.
As indicated this article represents only a resources industry focused summary of the Omnibus tax proposals. We expect to provide more detailed comments as the provisions progress through Parliament.

Renegotiated Indonesia – Singapore Tax Treaty

On 4 February 2020, Indonesia and Singapore signed a renegotiated tax treaty (as an amendment to the 1990 Indonesia - Singapore Tax Treaty).

This new treaty will enter into force upon the exchange of ratification documents and will then be applicable to amounts paid or credited on or after the 1 January following the year of ratification. Assuming that the new treaty is ratified in 2020 then the date of operation will therefore be 1 January 2021.

Many "headline" features of the new treaty remain the same as the current 1990 treaty. These include the general dividend withholding tax ("WHT") rates of 10%/15% (according to shareholding level) as well as the interest WHT rate of 10%. However, the new treaty does make important changes in a number of areas.

We have not attempted to analyse all of the changes in this NewsFlash. However, same of the key changes, from the perspective of energy and resource investors, are discussed below.

Decrease in royalty WHT rate

The current royalty WHT rate is 15% in all cases. Under the new treaty the royalty WHT rate will reduce to:

a) 10% on payments for the use of, or the right to use, any copyright of literary, artistic or scientific work including cinematograph films, or films or tapes used for radio or television broadcasting, any patent, trademark, design or model, plan, secret formula or process;

b) 8% on payments for the use of, or the right to use, industrial, commercial or scientific equipment, or for information concerning industrial, commercial or scientific experience.

Separately, proceeds arising from the alienation of any of the above royalty-generating assets will no longer be treated as a royalty (and so will presumably be treated as a capital receipt-see below).

The reduction in the royalty rate may be interest for those involved in the leasing of industrial or commercial equipment (e.g. drilling vessels, etc.) and perhaps the provision of associated technology.

Capital Gains

The new treaty introduces an article to deal with the allocation of taxing rights in respect of capital gains. Essentially, the article provides that the right to tax capital gains will default exclusively to jurisdiction of residency of the asset seller (a position adopted in most of Indonesia's tax treaties).

This default is however subject to the following qualifications:

a) for gains from the disposal of immovable property:- these may be taxed in the country where the property is located;

b) for gains from the disposal of movable property which forms part of a Permanent Establishment:- these may be taxed in the country where the PE is located;

c) for gains from the disposal of ships or aircraft operating in international traffic:- these shall be taxable only in the country where the seller is a resident;

d) for gains from the disposal of non-listed shares where:

    i) the value of the shares is more than 50% directly or indirectly derived from immovable property; and

    ii) the seller owns at least 50% of the issued shares of the company:

    In these cases the gain may be taxed in the jurisdiction where the immovable property is located. This is unless the gain from the disposal of these shares arises from immovable property used to carry on the alienator's business or arises out of a corporate reorganisation, merger, or a similar restructuring activity;

e) for gains from the disposal of shares listed on an Indonesian Stock Exchange:- these may be taxed in Indonesia.

These provisions should mean that the holding of shares in Indonesian entities by Singapore residents will be afforded the same treaty protection as the holding would have enjoyed if held via countries with comparable treaties. Note however that Indonesia continues to reserve taxing rights for transfers of immovable property (e.g. interests in PSCs) or for a controlling interest in an entity holding such an asset (e.g. an interest in a mining concession). The limitation on the "immovable property" look-through to a controlling shareholding interest in the relevant entity is however unusual.

Branch Profit Tax (BPT)

The new treaty will move the entitlement to levy a BPT into the treaty itself (currently the BPT entitlement is set out in the protocol to the 1990 treaty). The BPT tax rate is also reduced from 15% to 10%.

The BPT rate reduction is however no longer applicable for branch profits earned pursuant to production sharing contracts. The "Most Favoured Nation" BPT rate provisions, also currently set in the Protocol, will also be discontinued.

Other Income

Article 21 of the 1990 tax treaty dealing with "Income Not Expressly Mentioned" will be replaced with Article 22 in the new treaty dealing with "Other Income".

Article 22 provides that income not dealt with in the new treaty shall be taxable only in the jurisdiction of residence unless the income arises in the other jurisdiction. In this later case the income may also be taxed in the other jurisdiction.

Remittance requirement-LoB

The new treaty will discontinue Article 22 of the 1990 treaty regarding the "Limitation of Relief" ("LoB") requirements. The LoB provision currently provides that income which is taxable in a particular jurisdiction on a remittance basis only (typically the case for foreign income earned by a Singapore resident) must be remitted into that State in order for the treaty relief to operate in the jurisdiction of source.

Anti tax avoidance/MLI

The new treaty has adopted Article 6 of the Multilateral Instrument ("MLI") by including the preamble dealing with the purpose of a covered tax agreement as prescribed in the MLI.

The new treaty has also adopted a new Article 28 regarding the Entitlement of Benefits concept. This means that the Principal Purpose Test, as prescribed in Article 7 of the MLI regarding the prevention of treaty abuse, is also formally included.

As a result, the new treaty appears to represent Indonesia's first MLI-compliant treaty.

Conclusion

The amendments to the Singapore treaty are still being considered and further analysis will be required as the new treaty proceeds through the ratification process. However, the new treaty represents an important development for the Indonesian fiscal/investment landscape for a number of reasons. These include:

a) that Singapore continues to be a major source of investment into Indonesia;
b) that, whilst the "headline" dividend and interest WHT rates are not scheduled to fall the introduction of more traditional "capital gains tax" and "other income" taxing rights puts Singapore investors on an equal footing with those resident in "comparable" jurisdictions (e.g. Hong Kong);
c) this is the first post-MLI treaty and so arguably provides a template for how future Indonesian treaties will operate.

Land and Building Tax Objects-New Minister of Finance Regulation

On 10 December 2019 the Minister of Finance issued regulation No.186/PMK.03/2019 ("MoF-186") regarding the following changes in relation to the application of Land and Building Tax ("L&B Tax" or PBB). These changes are:

a) an updated classification of "Tax Objects"; and

b) new procedures to determine the Sales Value of these Tax Objects.

The regulation was effective from 1 January 2020.

Application

The MoF-186 applies to L&B Tax Objects in the following sectors:

a) the plantation sector;

b) the forestry sector;

c) the oil and gas mining sector;

d) the geothermal mining sector;

e) the mining sector (mineral and coal); and

f) other sectors meeting the following criteria:

  i) located within the Indonesian waters; and

  ii) not being L&B Tax Objects of a Village or Town.

New Categories of Objects

For "Other Sectors" the definition of "land" now includes "territorial waters" used for storage and processing facilities and thereby extends to the various categories of vessels used on these waters (see below).

The definition of "buildings" extends to technical constructions planted or attached permanently on "land" within Indonesia's territorial waters. This includes pipelines, cable networks, toll roads and, most importantly, industry-relevant storage and processing facilities (i.e. FSO, FPS, FPU, FSU, FPSO and FSRU).[1]

The inclusion of these vessels is noteworthy and represents the first time that floating facilities have been officially included as L&B Tax Objects. However this classification is consistent with recent DGT activity (i.e. prior to the issuance of MoF-186) where the DGT had been arguing that PBB should extend to these assets.

NJOP Calculation

MoF-186 provides procedures to calculate the Sales Value ("NJOP") of Tax Objects falling into the above sectors.

For land, the NJOP will vary according to the characteristics of use (e.g. productive, not yet productive, non-productive, onshore/offshore etc.). This is obviously relevant for oil & gas and mineral/coal mining, etc.

For buildings, the NJOP for all sectors is based on the "New Acquisition Price". This is defined as all costs incurred to acquire the Tax Object at the time of assessment less depreciation based on the physical condition of Tax Object. The L&B Tax calculation under Contracts of Work ("CoWs"), Coal CoWs or Special Mining Business Licenses should follow the provisions under the relevant contracts and licenses.

1 FSO – Floating Storage and Offloading; FPS – Floating Production System; FPU – Floating Processing Unit; FSU – Floating Storage Unit; FPSO – Floating Production Storage and Offloading; FSRU – Floating Storage Regassification Unit.

Import Tax Facilities for PSC and Geothermal Sectors – An Update

In late 2019 the Minister of Finance (“MoF”) issued 3 (three) new regulations aimed at synchronising/aligning a number of existing import facility regulations applicable in the PSC and geothermal sectors. This is summarised as follows:

No.	New Regulation	Applicable Sector	Effective Date	Replaces
1.	MoF No. 217/ PMK.04/2019 (“MoF-217”) – Import Duty and taxes facilities	Oil and Gas (PSCs) (all PSC generations)	1 March 2020	• MoF-20/2005 (import facility for pre-2001 PSCs) • MoF-177/2007 (Import Duty exemption for post 2001 PSCs (and geothermal IUPs))
2.	MoF No. 218/ PMK.04/2019 (“MoF-218) – Import Duty and taxes facilities	Geothermal (all geothermal generations)	1 March 2020	• MoF-78/2005 (import facility for JOCs) • MoF-177/2007 (Import Duty exemption for geothermal IUPs (and post 2001 PSCs))
3.	MoF No. 198/ PMK.010/2019 (“MoF-198) – (renewed) import VAT facility	Oil and Gas (PSCs) and Geothermal	23 December 2019	• MoF-231/2001 as lastly amended by MoF-196/2016 – import VAT facility

The detailed mechanics of the import facilities are set out in each Regulation. However some of the key features are as follows:-

1. MoF-217 (import tax facilities for PSCs)

a) Historically the import facilities applicable to PSCs have been scattered over various regulations. With the enactment of MoF-217 the MoF has attempted to “pool” the arrangements under one regulation which applies to all generations of PSCs (including gross split).

b) A summary of the import facilities (which are ultimately unchanged) applied to each PSC generation can now be summarised as follows:

Incentives	Cost Recovery PSCs-Generations					Gross Split PSCs
	Fully adjusted to GR-27				Not adjusted with GR-27	
	Pre-2001 PSCs	Pre GR-79 PSCs (2001-2010)	Pre GR-27 PSCs (2010-2017)	Post GR-27 PSCs (post 2017)	Predominantly Pre-2001 PSCs	
Import Duty (exempt)	(a)	(a)	(a)	(a)	(b	(c)
VAT (not collected)	(a)	(a)	(a)	(a)	(b)	(c)
Art.22 (not collected)	(a)	(a)	(a)	(a)	(b)	(c)

(a) : facilities apply during exploration only (i.e. up to PoD). Incentives during exploitation apply according to project economics
(b) : facilities apply during the entire contract period
(c) : facilities apply during exploration and up to commencement of commercial production

c) Other important features of MoF-217 include:

   i) *type of goods*: applies to imported goods which:

      A. have not been produced locally; or

      B. are produced locally but do not meet required specifications; or

      C. are produced locally but in insufficient quantity.

   ii) *validity period*: the validity of the facility is 12 months from approval.

   iii) *"extended" facility to vendors/suppliers*: MoF-217 seems to have extended the import facility beyond the "project owner" (as the importer of record) to the relevant suppliers/vendors. This is provided that the vendor is stated in the application and the relevant procurement contract is attached to the application.

   iv) *no claw back*: goods covered under this facility can be re-exported, transferred to other PSC contractors or moved to other PSC work areas without triggering any claw back. This is subject to SKK Migas approval and a notification being sent to the Tax Office.

2. MoF-218 (import tax facilities for Geothermal)

a) Similar to MoF-217, MoF-218 was issued to "pool" the import facilities for the geothermal sector under one regulation. MoF-218 therefore applies to both (old) JOC Contractors and to IUP holders.

b) The facilities include an Import Duty exemption, an import VAT (not collected) concession and an Article 22 Income Tax (not collected) concession on imports undertaken during the following phases (i.e. the full life-cycle):

   ii) preliminary survey;

   iii) exploration;

   iv) exploitation; and/or

   v) utilisation (i.e. to transform steam into electricity)

c) MoF-218 provide similar guidance on the type of goods that can be imported and the 12-month facility validity. MoF-218 also "extends" the applicability of the facility beyond the "project owner" to suppliers/vendors.

d) However, under MoF-218, an import taxes "claw back" may apply if the goods are transferred within 5 years (for Import Duty) and 4 years (for VAT/Article 22 tax) from the time of import.

3. MoF-198 (renewed import VAT facility)

a) MoF-198 is an updated regulation which confirms the "non-collection" of import-related VAT for goods upon which Import Duty is exempted. Whilst this is a more general regulation MoF-198 nevertheless includes goods imported in both the PSCs and geothermal sectors.

   Further, and whilst confusing, PSC imports during exploitation would still not appear to be granted a VAT-facility via MoF-198 as the underlying Import Duty exemption should not exist.

Photo source: Sarulla Operations Ltd.

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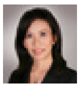
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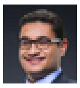
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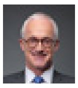
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