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Omnibus Law

The DPR and the Government of Indonesia agreed to pass the "Job Creation BIll" into law which is generally known as the Omnibus Law. The Job Creation Bill is now waiting for the President's signature for completing the legalisation process. Failing which, the bill will automatically become law within 30 days after the draft bill is jointly approved by the DPR and the President. The Omnibus Law is a comprehensive legislative instrument (approx. 900 pages) which will operate to directly amend an extensive number of underlying laws in a range of areas. These areas span immigration to land procurement to taxation with all changes aiming to provide stimulus to counter the economic impact of COVID 19.

The Omnibus Law will be subject to a series of implementing regulations etc. due to come into effect progressively over the next three months.

This Law represents a significant legislative initiative from the Indonesian Government. Considerable regulatory guidance is obviously still outstanding. However for our readers in the energy and mining sectors some early comments on the key fiscal aspects are set out below.

VAT on Coal Supply

Under Article 4A(2) of the current VAT Law "mining product taken directly from source" is treated as an exempt supply for VAT purposes. This exemption has historically applied to the supply of coal by Indonesian coal miners (except for some coal producers operating under certain Contracts of Work) and unless there was some level of processing such as through briquetting, etc.

As a result coal miners have historically not charged output VAT on their coal sales but also did not receive credits for VAT incurred on input costs. This resulted in an effective 10% increase in many costs.

Pursuant to the Omnibus Law however the supply of coal, even in an unprocessed state, will become a VATable supply.

As a result, once this provision takes effect, coal miners will (presumably) need to register for VAT-purposes. The miner should then be entitled to an input credit for VAT incurred on relevant costs but need to add VAT to coal supplies at the prevailing VAT rate. The rate is currently 10% for domestic supply and 0% for exports.

If implemented in this manner this change is likely to have a significant financial impact on the coal mining and associated industries. This can be shown as follows:

a) for domestic coal supply: most domestic coal supply is made for the generation of electricity. As a result coal miners selling thermal coal to PLN or Independent Power Producers ("IPPs") - as the case may be - will need to add VAT to their supply at the rate of 10% (probably resulting in a price increase below this rate as some input costs should become creditable to the miners).

   Under the relevant power purchase agreement ("PPA") the IPP in question may or may not be able to pass the additional VAT cost on to PLN according to the pricing mechanism of the PPA in question. In other words, the VAT change in the Omnibus Law is likely to increase overall coal supply costs, which will ultimately be borne by either the IPP or PLN, resulting in upward pressure on electricity prices. In addition, PLN is likely to constitute a "VAT Collector" adding a VAT-related cash flow concern at least where coal is supplied directly to PLN. This is unless there is some "counter" mechanism also implemented such as the VAT on coal being treated as "VAT not collected";

b) for exported coal supply: coal miners selling coal for export should also be required to register for VAT purposes and be able to charge VAT at the 0% rate. This should mean that input VAT incurred by the exporters will become creditable and without any need to increase the export price. Consequently this change under the Omnibus Law should be favourable to coal miners and potentially make Indonesian suppliers more internationally competitive.

Treatment of Dividends

The Omnibus Law outlines a number of proposed changes to the tax treatment of dividends. These changes are not specific to the energy and resources sector but may nevertheless be disproportionately relevant to this sector given the scale and complexity often associated with these groups.

These changes include:

a) resident to resident dividends: under the current tax rules dividends paid by resident entities are taxable to Indonesian shareholders unless the shareholder has, amongst other things, at least a 25% equity interest in the dividend payer.

   Under the Omnibus Law these dividends are now to be exempt without this pre-condition.

   As a result Indonesia appears to be moving towards a single level of corporate taxation. This is a model which is common in many other jurisdictions either through similar inter-entity dividend exemptions and/or intra-group profit relief.

   This change should better accommodate more complex corporate structures as the risk of the "double-taxation" of corporate profits should be reduced;

b) non-resident to resident dividends: under the current tax rules foreign-sourced dividends are fully taxable to an Indonesian shareholder at least upon the repatriation of the dividends into Indonesia. In addition no foreign tax credits are allowed for the corporate taxes levied on those profits in the overseas jurisdiction.

   Under the Omnibus Law these dividends will now be non-taxable providing that at least 30% of profits are "reinvested in Indonesia". Further, even in a non-reinvested scenario it appears that 70% of the dividends will be non-taxable.

   This change should provide fiscal support for the growing number of Indonesian-based MNCs (and follow on from recent positive changes to Indonesia's "controlled foreign company" deemed repatriation rules).

Other Matters

Other fiscal initiatives include:

a) the greater recognition of internationally-applied "residency" and "source" principles in relation to the taxation of the remuneration of Indonesian nationals and expatriates;

b) a general reduction in the level of fiscal penalties including a move away from the 2% per month penalty regime to one more reflective of prevailing interest rates;

c) (from a regulatory perspective) the potential reduction in the business fields which are closed to foreign investment. In the energy and resources sector, an example of industries that should benefit from this increased openness are certain oil and gas services sectors.

There will be a lot more to come on the Omnibus Law as regulations issue. We will provide a more comprehensive update as part of our next NewsFlash. In the interim more detailed non-industry specific analysis on the Omnibus Law can be found on our website.

PerMen ESDM 11/2020 – the Government's Support for Domestic Nickel Mining Companies

Background

The Ministry of Energy and Mineral Resources ("MoEMR") through Ministerial Regulation ("PerMen ESDM") 5/2017 concerning "Increasing the Added Value of Minerals through Domestic Minerals Processing and Refining Activities" provided a partial relaxation of the ban on the export of unprocessed nickel ores. This was by allowing mining companies to export low grade nickel ores with a nickel content of < 1.7% (based on a quota system) for a five-year period from 11 January 2017. This was provided that the miner has constructed or is in the process of constructing a nickel refining facility, either individually or jointly with other parties, and pay export duties under the relevant laws and regulations.

However, in August 2019, the Government announced its decision to accelerate the full ban on export of low-grade nickel ore two years ahead of the initial schedule (i.e. the relaxation of the ban on the export of low-grade nickel ore was to terminate at the end of 2019 rather than 2021). This was then followed by the issuance of PerMen ESDM 11/2019 by the MoEMR which effectively prohibited nickel mining companies in Indonesia from exporting unprocessed nickel ore from January 1, 2020. As a result, nickel miners are required to sell nickel ore domestically to domestic smelter companies.

The Government's decision to accelerate the full ban on the export of low-grade nickel ore was met with protests by nickel mining companies in Indonesia. The Indonesian Nickel Miners Association (*Asosiasi Penambang Nikel Indonesia* or "APNI") claims that certain smelter companies in Indonesia control most of the local nickel ore market and therefore could put downward pressure on domestic sales prices of nickel ores. This was despite the fact that a monthly benchmark nickel price has been set and published by the MoEMR since October 2017.

Furthermore, APNI also claim that there are often discrepancies in the verification results of the quality of nickel sold between the verifications performed by the surveyors appointed by the nickel miners and the smelter companies. In such a case, nickel mining companies are forced to accept the verification results performed by the surveyors appointed by the smelter companies, even though these surveyors may not always be registered with the MoEMR.

Therefore, APNI has repeatedly requested the Government to lift the ban on exports of nickel ores, or otherwise help enforce the use of nickel benchmark prices in the domestic trading of nickel ores.

As a response to the concerns voiced by the nickel mining companies and in order to support the domestic nickel miners, the Government issued PerMen ESDM 11/2020 in April 2020 as a third amendment of PerMen ESDM 7/2017 concerning "The Procedures for Setting the Benchmark Prices of Metal Minerals and Coal". Overall, PerMen ESDM 11/2020 addresses most of the concerns raised by APNI.

Key Provisions

Please note that while the coal mining companies in Indonesia are also required to comply with PerMen 11/2020, they are not significantly affected by this regulation (i.e. PerMen 11/2020 does not introduce significant changes from PerMen 7/2017 in terms of the requirements that should be met by coal companies).

Therefore, the key provisions of PerMen ESDM 11/2020 discussed below are more relevant for nickel mining and smelter companies than coal mining companies:

- The nickel benchmark prices issued by the MoEMR must be used as a reference in the sales of nickel ores and refined nickel product, which includes sales made to affiliated companies. Specifically, for nickel ores, smelter companies must also purchase nickel ores based on the benchmark prices issued by the MoEMR.
- The benchmark prices for nickel are determined by the MoEMR based on the benchmark price formula, which takes certain factors into account such as the nickel content, the Mineral Reference Prices (*Harga Mineral Acuan* or “HMA”), corrective factors, treatment costs, and refining charges. The HMA is determined by the MoEMR on a monthly basis based on market price indices such as the LME, Asian Metal, etc. The benchmark price formula is reviewed every six months, or earlier when considered necessary.
- The benchmark price serves as the floor price for the Government Royalty calculation (which applies for both metal minerals and coal). However, PerMen ESDM 11/2020 specifically stipulates that the benchmark prices should also be used as a reference price for the sale transaction itself not just for royalty payment. Such a requirement does not apply to the sale of coal.
- Sales of nickel ores may be made at prices lower than the nickel benchmark price, but the difference between the actual selling price and the nickel benchmark price must not be more than 3%. If the actual selling price of the nickel ores as agreed by the seller and the buyer is higher than the nickel benchmark price, then the actual selling price should be used.
- Verification of the quality and quantity of nickel sold should be performed by surveyors registered with the MoEMR. For the domestic sales of nickel, a third-party surveyor must be appointed as an umpire. In the case where there is a discrepancy in the results of verifications performed by the surveyors appointed by the seller and the buyer, the verification results performed by the umpire surveyor should be used. The umpire surveyor must also be a registered surveyor with the MoEMR.
- Sanctions for any parties who do not comply with PerMen ESDM 11/2020 include written warnings, temporary suspension of business activities, and the revocation of the business license. Article 2A (3) of PerMen ESDM 11/2020 specifically stipulates that these sanctions are also applicable for nickel smelter companies.

Conclusion

While PerMen ESDM 11/2020 has been well accepted by nickel mining companies, smelter companies have been reluctant to purchase nickel ores at the nickel benchmark prices issued by the MoEMR. Despite this, the Government requested all mining business players and smelters to comply with PerMen ESDM 11/2020.

The Government claims that the benchmark prices have been determined fairly by considering the interests of nickel miners and smelter business players (i.e. the benchmark prices have been determined at prices below the international price but still above the production cost of nickel mining companies). The Government therefore expects that the regulation will support both nickel miners and smelter companies by ensuring there is continued exploration and production of nickel ore to satisfy the growing smelter demand into the future.

Despite PerMen ESDM 11/2020 being issued and effective since April 2020, nickel mining companies claim that nothing has significantly changed to date (i.e. nickel ores are still traded domestically at prices below the benchmark prices).

To address this the Government has formed a Task Force to supervise the transaction process for the sale and purchase of nickel ores from miners to smelters and to ensure the implementation of PerMen ESDM 11/2020. The Task Force will routinely evaluate and have authority to give sanctions to parties that are proven to have committed violations in accordance with PerMen ESDM 11/2020.

Time will tell whether PerMen ESDM 11/2020 can achieve its intended objectives and whether the Task Force formed by the Government can perform its supervisory role effectively.

Update on Regulation for Gross Split PSCs

In early 2017, the Ministry of Energy and Mineral Resources ("MoEMR"), via Regulation No. 08/2017 ("MoEMR-08"), mandated that all new PSCs, including extensions to existing PSCs, were to follow a new "gross split" ("GS") format from 1 January 2017. Existing PSC holders were also "encouraged" to convert their "traditional" cost recovery PSCs into the GS PSC format – an approach that was followed in a number of cases. Please refer to our EU&R NewsFlash No. 60/2017 or our Oil and Gas in Indonesia: Investment and Taxation Guide for more details on the introduction of the GS PSC format.

On 15 July 2020, the MoEMR issued Regulation No. 12/2020 ("MoEMR-12"). This represents the third amendment to MoEMR-08 noting that MoEMR-08 has previously been amended via Regulations No. 52/2017 and No. 20/2019. The amendments reflect a gradual winding back of the emphasis on GS PSCs arguably in response to the apparent lukewarm response to the GS PSC format by a number of industry players.

The key message arising from MoEMR-12 is that the MoEMR now has the discretion to determine the type of contract applicable to a PSC Working Area including whether this be the GS or traditional cost recovery formats. This discretion is applicable to all new PSCs and to all extensions to existing PSCs.

At this stage, there is no further detail on the extent to which investors will have the opportunity to negotiate the type of contract with the MoEMR. However we would suggest prospective investors model the economic outcomes under both the GS and traditional cost recovery schemes.

It will be interesting to see how MoEMR-12 now impacts enthusiasm in the industry and whether this "reversion" to the cost recovery format acts as a spur for new investments in the upstream oil and gas business. PwC will continue to monitor developments on this matter.

Gross Split PSCs - Facilities re. VAT and Land & Building Tax

As readers would be aware the initial fiscal framework for Gross Split ("GS") Production Sharing Contracts ("PSCs") was set out under Government Regulation No. 53 Year 2017 ("GR-53"). Pursuant to Article 25 of GR-53 Value Added Tax ("VAT") and Land & Building Tax ("L&B Tax") are generally payable by a PSC Contractor and then treated as a deduction (i.e. there is no "assume and discharge" mechanism as there was under some of the early cost recovery PSCs).

During the pre-production stage GR-53 also provides that:

a) VAT is to be "not collected"; and

b) L&B Tax is to be entitled to a "reduction".

On 15 June 2020 the Minister of Finance issued regulation No.67/PMK.03/2020 ("MoF-67") providing guidelines on the VAT and L&B Tax facilities for GS PSCs. MoF-67 serves as the implementing regulation of GR-53 and was effective from 15 July 2020.

Application

In order to obtain the VAT/L&B tax facilities the PSC Operator needs to apply to the Regional Tax Office ("RTO") via the Tax Office where the PSC Operator is registered. The application should include:

a) a confirmation letter from the Minister of Energy and Mineral Resources stating that the Contractor is in pre-production;

b) provide the following information:

   i) the name of the Working Area;

   ii) a list of Contractors;

   iii) the name of the Operator; and

   iv) the effective date of the GS PSC or the approval of conversion (from a Cost Recovery PSC);

c) a copy of the GS PSC.

Approval Process

The RTO will issue the "Gross Split Tax Facilities Letter" ("SKFP Gross Split") within 7 (seven) working days of the application being submitted.

The effective date of the SKFP Gross Split shall be as follows:

a) for GS PSCs signed after GR-53: from the effective date of the GS PSC;

b) for Conversions from a Cost Recovery PSC into a GS PSC: from when the conversion is approved;

c) for GS PSCs signed prior to GR-53: from the effective date of GR-53

The "SKFP Gross Split" will be invalid if the contract is expires is terminated or the Contractor commences commercial production.

VAT Not Collected Mechanism

Prior to the delivery of VATable goods/ services the PSC Operator needs to show local vendors the SKFP Gross Split and provide them wih a copy.

Local vendors can then issue VAT invoices with the statement "VAT NOT COLLECTED IN ACCORDANCE WITH GR-53".

The PSC Operator (as a VAT Collector) is thereafter:

a) not obliged to collect VAT on the local procurement of goods and/or services;

b) not required to self-assess VAT ("SA-VAT") on overseas procurements.

L&B Tax Reduction Mechanism

The PSC Contractor should submit the following to the Tax Office where the L&B Tax object is administered:

a) the Tax Object Notification Letter (*Surat Pemberitahuan Objek Pajak* – "SPOP"); and

b) a copy of SKFP Gross Split.

The Director General of Tax ("DGT") should then issue a Tax Payable Notification Letter (*Surat Pemberitahuan Pajak Terutang* – "SPPT") based on the relevant SPOP (which encloses the L&B Tax reduction amount based on SKFP Gross Split).

VAT and L&B Tax Clawback

A VAT and L&B Tax clawback may apply, along with the associated late payment penalties, in the event that the facility is not used in the context of oil operations and/or utilizes an invalid SKFP Gross Split.

Contacts

Please feel free to contact our Energy, Utilities & Resources (EU&R) specialists or any of your regular PwC advisors.

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