

New Harmonisation Tax Law-Issues for the Resources/Energy Sectors

On 29 October 2021 the Indonesian President signed the “Harmonisation of Tax Regulations” (*Harmonisasi Peraturan Perpajakan/HPP*) Law.

At the time of writing the HPP Law had only just issued and indicated that a range of subordinate regulations will issue to guide implementation. Consequently our comments on the HPP Law as set out in this NewsFlash should be viewed as preliminary.

The comments set out in this NewsFlash also seek to highlight only the changes most relevant to stakeholders in the resources and energy sectors. A detailed analysis of the entire HPP Law is separately set out in our Indonesia Tax Flash No.20/2021 which can be found on our Indonesian website.

Background

This HPP Law amends a number of existing tax laws as follows:

- a) The General Tax Provisions and Procedures (*Ketentuan Umum Perpajakan/KUP*) Law;
- b) The Income Tax Law (“ITL”);
- c) The Value-Added Tax (“VAT”) Law; and
- d) The Excise Law (although there are no comments on this Law in this NewsFlash).

In addition the HPP Law introduces provisions in regard to:

- a) New Voluntary Disclosure Programmes (“VDPs”) (*Program Pengungkapan Sukarela*) which effectively operate as new Tax Amnesty arrangements (although the existing Tax Amnesty Law of 2016 remains in place); and
- b) A new Carbon Tax Law.

Part A-KUP Law changes

Changes in administrative sanctions

These changes are as follows:

Clause	Existing Law	HPP Law
Tax Assessment Letter (<i>Surat Ketetapan Pajak Kurang Bayar/SKPKB</i>) for:		
a) Unpaid/underpaid Income Tax	50% Increment	(MIR*+20%)/12 Max 24 months
b) Income Tax not withheld/collected or under withheld/collected	100% Increment	(MIR*+20%)/12 Max 24 months
c) Income Tax withheld/collected but unremitted/under remitted	100% Increment	75% Increment
d) Unpaid/underpaid VAT	100% Increment	75% Increment
e) Unpaid tax where an Objection is rejected	50%	30%
f) Unpaid tax where Appeal is rejected	100%	60%

*MIR-MoF Interest Rate

PwC Comments: these changes offer some improvement over the previous penalty regime especially where a taxpayer is unsuccessful with a dispute resolution action. Many may say however that the sanctions are still quite punitive for taxpayers particularly for contests on genuinely “contentious” tax issues.

Taxpayer rights and obligations

These changes include:

- Tax ID Number:* the introduction of an “Indonesian resident number” (*Nomor Induk Kependudukan/NIK*) to replace the Tax ID Number (*Nomor Pokok Wajib Pajak/NPWP*) for individual taxpayers;
- Voluntary Disclosure (Pengungkapan Ketidakbenaran):* that taxpayers may voluntarily disclose tax matters after the start of a tax audit providing that this is prior to the relevant Tax Audit Result (*Surat Pemberitahuan Hasil Pemeriksaan*);
- Appointment of tax withholders:* that the DGT may appoint a 3rd party as a “tax withholder” where the 3rd party helps “facilitate” certain transactions. The tax assessment, collection, dispute resolution process, etc. will then apply equivalently to the 3rd party.

PwC Comments: the introduction of the NIK is apparently part of a process to consolidate the formal identification system for Indonesian nationals and so replaces the existing NPWP. The changes to the tax audit disclosure arrangements should assist in restricting penalties during a tax audit by relaxing the ability to self-disclose once a tax audit is underway. The changes to the withholding arrangements allow the DGT to unilaterally appoint a tax withholder but are probably most relevant to activity in the digital space.

Tax dispute resolution process

These changes include:

- a) *Judicial Review process*:
 - i) that the mere filing for a Judicial Review at the Supreme Court will not defer the implementation of a Tax Court Decision;
 - ii) that any tax underpayment resulting from a Judicial Review Decision will be subject to a 60% penalty which will be payable within two years of the Judicial Review Decision being received by the DGT;
- b) *Mutual Agreement Procedure (“MAP”)*: if a MAP is not agreed before a Tax Court or Judicial Review Decision then the DGT:
 - i) can continue negotiations if the Decision is not related to the MAP case; or
 - ii) use the Decision result during the MAP negotiations, or propose a cessation of negotiations, if the content of the decision is related to the MAP case.

PwC Comments: these changes largely codify existing practice but are nevertheless helpful in providing clarity over these processes.

Part B-Income Tax Law (ITL) changes

These changes include:

- a) *Individual income tax rates*: with effect from the 2022 Fiscal Year these are to be as follows:

Taxable Income-per annum	Tax Rate*
≤ 60 million	5%
> 60 million - ≤ 250 million	15%
> 250 million - ≤ 500 million	25%
> 500 million - ≤ 5 billion	30%
> 5 billion	35%

* can be amended through Government Regulation (“GR”)

- b) *Corporate Income Tax (“CIT”) rate*: the previously proposed CIT rate reduction from the current 22% to 20% from 2022 is abolished;

PwC Comments: the scrapping of the 20% CIT rate reduction is surprising especially given that the reduction was legislated only a few months back. This reversal also signals the care needed with after-tax project modeling in a COVID-19 environment where all Governments are grappling with revenue settings. Nevertheless, the complementary increase in the highest personal tax rate band to 35% could still incentivise the greater use of corporate structures for high income earners.

- c) *Benefits in Kind (“BIKs”)-taxability*: the provision of all BIKs are to now be taxable to the employee. This is except for:
 - i) food and beverages provided for all employees;
 - ii) BIKs provided in certain areas (generally remote);
 - iii) BIKs necessary to carry out work;
 - iv) BIKs financed by a regional/state revenue budget; or
 - v) certain other BIKs to be specified;

- d) *BIKs-deductibility*: to complement c) above the cost of all BIKs is to now be deductible to the provider. In addition a number of non-taxable BIKs will remain deductible where outlined in a GR (yet to issue);

PwC Comments: this represents a significant change to the long standing policy in relation to the tax treatment of BIKs (i.e. by essentially reversing the historical tax treatment of BIKs). Noting the emerging “spread” in the CIT and personal tax rates the changes are also likely to be fiscally disadvantageous for employers. This is assuming that the cash cost of the tax on BIKs might simply be passed on to the employer;

- e) *Specific tax deductions*: these extend to:
- i) *permanent buildings and intangible assets*: the tax depreciation or amortisation is to follow a 20-year straight-line method or (where the useful life is more than 20 years) the actual useful life, based on the taxpayer’s bookkeeping;
 - ii) *further limitation on interest deductions*: this expands the methods which can be used to limit the deductibility of interest including by reference to a percentage of EBITDA (Earnings Before Interest, Taxes, Depreciation, and Amortisation).

PwC Comments: the detail of these changes are yet to be provided but both could substantially impact project economics (either positively or negatively). Developments around interest deductibility in particular need to be monitored although the move away from the current “one-size-fits-all” 4:1 ratio would generally be welcomed. Also interesting will be how the interest deductibility rules apply to “infrastructure”.

Part C-VAT changes

These changes extend to a number of fundamental features of the VAT system and which will generally commence from 1 April 2022. These changes include:

- a) *VAT rate*: the VAT rate is to increase from 10% to:
- i) 11% – from 1 April 2022;
 - ii) 12% – by 1 January 2025 (i.e. at the latest);

PwC Comments: this represents the first general VAT rate increase since the introduction of VAT into Indonesia in 1984. This arguably also reflects a Government effort to shift revenue collection more towards indirect taxes;

- b) *Non-VATable goods/services which become VATable*: these include:
- i) mining or drilling products taken directly from the source;
 - ii) gold bars, other than for the Government’s forex reserves;
- c) *Non-VATable goods/services which become VATable but with “strategic” exemption facilities*: these are:
- i) basic necessity products that are highly needed by the public;
 - ii) financial services;
 - iii) insurance services;
 - iv) labour services;
 - v) industrial downstream activities; and
 - vi) goods/services needed for non-natural disasters;

PwC Comments: this package of VAT changes has the potential to significantly impact all resource-related investment in Indonesia (both positively and negatively).

For hard rock mining the alteration of the VATable supply status for all mining products should result in credits for all input related VAT and therefore be of benefit particularly for exporters (i.e. due to the 0% VAT rate). The impact on mineral processing activities should also be positive at least where all VAT charges are treated as creditable throughout the value chain. The VAT changes should therefore better

allow for separate investment modelling between (say) the mining and processing components (e.g. with regard to smelters, etc.).

For gold mining most production (excluding gold bars) has already been VAT-able at least where refined into granules or dore. These supplies are however then concessionally treated as “strategic goods” via a Government Regulation and thereby allowed credits for input VAT charges but without the need to add VAT to supplies. However the HHP Law appears to now provide a finite list of “strategic goods” and gold products are not included. This is unless the earlier Government Regulation can still be relied upon. At the time of writing this was unclear in the technical sense.

Conversely gold bars have historically been treated as non-VATable under a different VAT exemption and have also not been treated as strategic goods. These supplies however will now simply become VAT-able (except for supplies for Government reserves) meaning a VAT outcome similar to that for hard rock mining (see above).

The impact on the upstream oil and gas sector is potentially even more transformative. From the outset this VAT change will (presumably) require all PSC entities to register, for the first time, as a VAT entrepreneur (PKP) from 1 April 2022.

An immediate issue would then be whether input VAT will now be creditable to PSC entities or whether input VAT will continue to be reimbursable or cost recoverable pursuant to the relevant PSC mechanism.

If so further complications could arise for input credits incurred during pre-production. This is because pre-production credits are refundable for “ordinary” taxpayers but with repayment obligations if production is not achieved within a fixed time period (i.e. 3-5 years). PSC exploration periods frequently extend beyond this.

From an output perspective, once registered as a PKP, PSC entities would also then be required to issue VAT invoices on hydrocarbon supplies. Complications could arise however in regard to whether a mere lifting (say of crude) even constitutes a “supply”. This is because, under a PSC, the contractual outcome is actually an entitlement by the PSC entities to take possession of the crude.

Even if liftings do constitute a “supply” there will still be VAT collection issues where PSC entities are selling hydrocarbons (especially gas) on behalf of parties outside of the PSC consortium (e.g. for Government share). Individual PSC entity invoicing (i.e. not just by the operator on behalf of the consortium) may also be required especially for Contractors to a gross split PSC.

Also of interest will be the impact on supplies of gas derivatives such as LNG. The VAT status of LNG was contentious for many decades until a recent Government Regulation confirmed LNG supplies as VAT-able but (again) treated as exempt due to “strategic good” status.

The HPP Law now returns LNG to VAT-able supply status but with a similar lack of clarity over whether LNG nevertheless remains exempt as a “strategic good”. This is again because LNG is also not listed as a strategic good in the HPP Law. If VAT is due, this could obviously have a significant impact on energy costs especially for domestic LNG and natural gas being utilized for power generation.

With regard to electricity, which is also currently treated as the supply of a strategic good by Government Regulation, the HPP Law has also not included electricity in the statutory list of strategic goods. A similar question therefore arises on whether the supply of commercial electricity is to now become “fully” VATable.

Finally the impact of any change in VAT status also needs to take into account the proposed increases in the VAT rate (i.e. to 11% in 2022 and 12% by 2025);

- d) *Scope of strategic goods/services:* changes to remove certain strategic goods/services:
- i) affordable housing for low-income households;
 - ii) clean water; and
 - iii) electricity (for low capacity consumption);

PwC Comments: these changes could be significant in certain areas but are likely to be less relevant to resources/energy investment.

Part D-Voluntary Disclosure Programme (“VDP”)

VDP 1

The VDP 1 applies to taxpayers who participated in the 2016-2017 Tax Amnesty (“TA”) programme (essentially as a refresh of that program). Details include:

- a) *Scope/assets:* VDP 1 covers net assets acquired from 1 January 1985 – 31 December 2015 and which were not disclosed under the original TA program;
- b) *Disclosure:* the disclosure period is 1 January – 30 June 2022;
- c) *Tax rates:* being the “Final Income Tax” applying to asset values as follows:

Circumstance	Final Tax	Assessed through SKPKB	Voluntarily paid
A) Assets located in Indonesia and invested in eligible investments	6%	4.5%	3%
B) Assets located in Indonesia and not invested in eligible investments	8%	N/A	N/A
C) Assets located outside of Indonesia, repatriated and invested in eligible investments	6%	4.5% (where fail to reinvest) 7.5% (where fail to repatriate)	3% (where fail to reinvest) 6% (where fail to repatriate)
D) Assets located outside of Indonesia, repatriated and not invested in eligible investments	8%	5.5% (where fail to repatriate)	4% (where fail to repatriate)
E) Assets located outside of Indonesia and not repatriated	11%	N/A	N/A

- c) *Repatriation and re-investment:* (as indicated above) lower rates of tax apply for investment in “eligible investments” and/or offshore assets which are repatriated into Indonesia;
- d) *Eligible re-investments:* these are:
 - i) in the processing of natural resources (e.g. gold ore to pure gold) or renewable energy (e.g. solar energy) in Indonesia; or
 - ii) Government Debt Securities (*Surat Berharga Negara/SBN*), for a minimum of five years;

- e) *Asset value*: to be as per the “Asset Declaration Letter” (*Surat Pemberitahuan Pengungkapan Harta/SPPH*) as follows:
 - i) *for cash or equivalents*: nominal value;
 - ii) *for land and buildings and motor vehicles*: the sales value for tax purposes;
 - iii) *for gold and silver*: the Antam rate;
 - iv) *for listed shares/warrants*: as per the Indonesian Stock Exchange index;
 - v) *for SBN, debt securities and corporate Sukuk*: as per the PT Penilai Harga Efek Indonesia index at the end of the previous fiscal year;
- f) *Procedures*: an SPPH submission is to include:
 - i) a tax payment slip;
 - ii) a list of assets and liabilities; and
 - iii) a statement letter regarding asset repatriation or reinvestment in eligible investments;
- g) *DGT approval*: the DGT to issue an approval (*Surat Keterangan/SK*) upon the submission of an SPPH. The SK may be amended or revoked if the DGT subsequently discovers any inaccuracies in the submission;
- h) *Incentives*: for taxpayers who have received an SK:
 - i) the taxpayer will not be subject to an administrative sanction under Article 18(3) of the TA Law (i.e. a 200% penalty); and
 - ii) the data declared in SPPH cannot be used as a basis for a tax investigation and/or criminal prosecution.

PwC Comments: the “refreshment” of the original TA programme offers an opportunity for affected taxpayers to now declare these assets including with additional incentives for investment in renewable energy, etc. The introduction of a 2nd amnesty program, barely 5 years after the last, could however call into question the effectiveness of the initial TA.

VDP 2

The VDP 2 is a new TA programme and applicable only for individuals taxpayers. We refer readers to TaxFlash No.20/2021 for further detail.

Carbon Tax

The Carbon Tax is a significant new tax to be implemented from 1 April 2022. The Carbon Tax, which follows on from a “voluntary” programme which has been place for the last 12 months, is complemented with a Presidential Regulation also dated 29 October 2021.

A large number of areas of clarification remain outstanding in regard to the Carbon Tax. However the HPP Law indicates that the key framework will be as follows:

- a) *Tax objects*: being those carbon emissions which have a “negative environmental” impact. This criteria will be progressively refined according to Indonesia’s Carbon Tax “roadmap” which will ultimately cover:
 - i) carbon emission reduction strategies;
 - ii) priority sector targets;
 - iii) alignment with new and renewable energy development;
 - iv) alignment between various other policies;

- b) *Tax subjects:* being individuals or corporations who:
 - i) buy goods containing carbon; or
 - ii) carry out activities which generate carbon emissions within a specified period. The elucidation to the HPP Law states that the Carbon Tax will be prioritised towards corporate taxpayers and, at least initially, apply only to coal-fired power producers (as was the case during the voluntary trial period). This is understood to cover both IPP and PLN power generation.

PwC Comments: these criteria are obviously still very broad and will need to be streamlined as Indonesia's climate policy is developed. The initial application to coal-fired power producers means only limited application from April 2022. However, in a cost sense, this could still be significant given the flow-on effect on power prices, as power generation in Indonesia is still circa 70% coal-fired;

- c) *Milestones:* the Carbon Tax programme is to be gradually implemented as follows:
 - i) *for 2021:* development of a carbon trading mechanism;
 - ii) *for 2022 – 2024:* introduction of a tax mechanism based on emission limits (i.e. following a “cap and tax” formula) to be applied for coal-fired power plants from 1 April 2022 at IDR 30/kg CO_{2e} (circa US\$2.10/CO₂ tonne p.a.);
 - iii) *for 2025 onwards:* full implementation of:
 - A) a carbon trading mechanism; and
 - B) the expansion of carbon taxation according to the readiness of the relevant sectors by considering economic conditions, the readiness of the players, etc.;
- d) *Tax rate:* being the higher of:
 - i) the price set by the domestic carbon market (on a kg CO_{2e} basis); or
 - ii) IDR 30/kg CO_{2e};
- e) *Facility:* taxpayers who participate in carbon trading and the offsetting of emissions (as well as other mechanisms) can be given:
 - i) a Carbon Tax reduction; and/or
 - ii) other incentives for the fulfilment of Carbon Tax obligations;
- f) *Implementing rules:* these will be in accordance with the roadmap and the allocation of Carbon Tax revenue for greater climate change control. Implementing regulations will stipulate key features including the tax rate, the tax base, the administrative mechanism, and the procedures aimed at reducing Carbon Tax or other fulfilments of Carbon Tax obligations.

PwC Comments: the introduction of a Carbon Tax represents a major development with regard to Indonesia's commitment to climate related policy. While the framework at this stage is limited to a single impost on only one category of emitters there is clearly a more sophisticated plan to be rolled out over time. This will ultimately extend to a credit trading scheme. Given Indonesia's current reliance on fossil fuels, and the economic benefits which flow from this, Indonesia's progress in this area is likely to be challenging. Considerable investor focus should therefore be given to the actual policy settings as we go forward.

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