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MEMR Regulation No 03/2010: Further clarification on the Domestic Market Obligation for Gas

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The Minister of Energy and Mineral Resources ("MEMR") issued Minister of Energy and Mineral Resources Regulation No 03/2010 on 27 January 2010 concerning Natural Gas allocation and usage for domestic needs ("MEMRR 03/10").

Previous Regulations

The Production Sharing Contract ("PSC") has long required contractors to sell a percentage of crude oil production into the local market at a below market price (i.e. as the Domestic Market Obligation or "DMO"). Historically, this DMO did not extend to gas. However several regulations over the past six years have changed this as shown in the table below.

Regulations	Description of Gas DMO
Government Regulation No. 35/2004 dated 14 October 2004 ("GR 35/04")	The Minister will determine the amount of each Contractor's DMO with a maximum of 25% share of the production for Natural Gas. The mechanism for implementation will be specified in the PSC.
Minister of Energy and Mineral Resources Regulation No 02/2008 dated 5 February 2008 ("MEMRR 02/08")	This obliged all PSC contractors to provide 25% of gas production as DMO, at a price similar to any gas contract for each work area.

Regulations	Description of Gas DMO
New generation PSCs (i.e. since 2008.)	These typically oblige Contractors to provide 25% of the Contractor's share of proven Natural Gas reserves in any newly discovered reservoir as DMO. Upon discovery the Government shall give the opportunity for domestic buyers to purchase this Natural Gas and negotiate with the Contractor. If the negotiation fails, the Contractor can request approval to sell the DMO portion in the international market (note that all new PSCs are still in exploration and, as such, there has been no implementation of Gas DMO).

The reason behind these regulations is to help secure domestic gas needs. Various news sources have reported that some domestic industries have experienced gas supply defeciencies despite Indonesia continuing to export gas.

Although the above regulations have already come into force there has been no DMO implementation over existing gas production meaning that uncertainties remain including around pricing and the impact on existing gas contracts.

Features of MEMRR 03/10

In response to this uncertainty, MEMRR 03/10 provides some clarification on the Gas DMO requirements as follows:

- The Contractor is obliged to provide 25% of production as Gas DMO.
- Each year, the MEMR will issue a policy on the "Indonesia Gas Balance Sheet".
- Based on the Gas Balance Sheet and the Gas Development Plan prepared by BP Migas, the MEMR will determine an allocation of gas.
- The Gas DMO will be considered as part of the economics of any project.
- The MEMR can determine the need for imports.
- The priority of the Gas DMO usage is: 1. Oil/Gas production increment, 2. The fertiliser industry 3. Electricity supplies 4. Others.
- If the domestic gas needs have been fulfilled, the MEMR can determine other policies.
- Gas DMO is applicable to a PSC that has signed a gas contract, Heads of Agreement, Memorandum of Understanding or is in the final stages of negotiation.

However, clarification is still needed on the aspects mentioned below.

Economics of the project

To ensure the economics of a project, gas sales are commonly sold under long term contracts. The regulation is not clear however on whether the Gas DMO portion can be sold under long term contracts especially given that the DMO allocation will be updated on an annual basis and that the MEMR will separately determine the policy for any excess gas.

Furthermore, MEMRR 02/08 indicates that the domestic pricing should be the same as any existing gas contract and that domestic pricing must be considered in the economics of any project. The regulation does not however determine whether the PSC contractor is automatically eligible to sell gas into the international market if price negotiations with a domestic buyer fails.

Government share

Gas DMO under MEMRR 02/08 is only for 25% of the Contractor's share of the production. The regulation is silent on whether the Government's share also needs to be utilized for domestic needs (although we understand from a policy position this would be the case).

Commitments in existing contracts

Gas contracts typically commit sellers to deliver agreed quantities of gas or pay a penalty for not fulfilling this commitment. Some Indonesian PSC Contractors have experienced a decline in gas production as a result of the maturity of the gas fields and have been required to separately source gas to fulfill delivery commitments. The Gas DMO does not seem to accomodate this and does not provide for a contractor to "escape" from any agreed commitment to international buyers.

Implementation?

MEMRR 03/10 comes into force as of the date of its enactment. We have however not seen any update on the Gas Balance Sheet as the first step to implementation of the Gas DMO. Stay tuned for updates in later Newsflashes.

Tax Treatment of Oil and Gas Drilling Services – Heads up for a new approach

Triadi Mukti

The provision of offshore drilling services in the oil and gas industry in Indonesia has historically been conducted pursuant to cooperation arrangements between National Drilling Companies (NDCs) and Foreign Drilling Companies (FDCs) in order to satisfy the procurement requirements of BP Migas. On this point, the drilling contract is typically signed by the NDC, while the FDC provides the drilling service including the provision of the drilling rig.

The contract with the Production Sharing Contract (PSC) entity is normally arranged as a package of drilling services, i.e., the provision of a drilling rig together with the expertise to operate the rig (e.g. drilling crews, supply of technical equipment and materials etc). The contract may be structured in different ways, such as a sub-contract arrangement, or joint services/consortium arrangement. Historically, the Indonesian Tax Office (ITO) has accepted such arrangements and taxed the overall income as a package of drilling services. As a result the payment from the PSC contractor to the FDC for its involvement has generally not been subject to withholding tax.

There is an indication that the ITO would however now like to push for a new approach. This would be to segregate the contract into the provision of the rig by the FDC and the other components, and impose a 20% withholding on drilling rental based on Article 26 of the income Tax law. This is on the basis that, in the drilling contract, there is a separate stream of income solely from the rig charter which is (implicitly) separate to the overall drilling service. In a recent case the ITO in fact asked a PSC Contractor to withhold the 20% income tax based on such an approach. There are indications also that this approach will be followed in tax audits.

We understand that ITO policy on this is still evolving. However, if the ITO adopts this new approach on an industry wide basis it could significantly impact the cost of drilling services.

Cooperation between National Drilling Companies (NDC) and Foreign Drilling Companies (FDC)

- BP Migas requires a NDC to “cooperate” or “partner” with a FDC to carry out drilling contracts with Production Sharing Contractors and requires the NDC to sign the drilling contracts.
- The partnership/cooperation agreements can be in different forms. (***Acknowledged in Circular No. SE-21/PJ.31/1991***)
- Commercially, the FDC provides the majority of the drilling work (“Drilling Services”) and the NDC play a smaller role.
- The provision of drilling technology and the drilling rig is the responsibility of the FDC.

Contract arrangement

- ***Sub-contract Arrangement***
- ***Joint Operation/Agent Arrangement***
- ***Consortium***

Components of Drilling Services

- Labor provider
- Drilling Rig
- Other services

- **S-1746/PJ.22/1985:**

  So long as the business activities of the FDC, and all the expatriates are fully involved in drilling activities, the FDC should be considered to be conducting drilling activities as mentioned in Decree No. 714/KMK.04/1984 and be subject to tax based on the special calculation norm.

- **S-467/PJ.22/1987:**

  To the extent that the activities of the FDC are drilling activities, payments made by the NDC for charter, foreign experts and technical services should not be subject to witholding under Income Tax Art. 21, 23 or 26.

Mining in forest areas

Ali Mardi/Tjen She Siung

On 1 February 2010 the Government of Indonesia issued Government Regulation No. 24/2010 (“GR 24”) regarding the use of forest areas. GR 24 is the implementing regulation of Law No. 41/1999 as amended by Law No. 19/2004 regarding Forestry.

GR 24 stipulates that the use of forest areas involves the use of part of a forest for development purposes outside of forestry activities, without changing the function or purpose of the forest.

The use of forest areas for development purposes can only be carried out for activities with unavoidable strategic objectives. These include mining activities, which covers oil and gas, mineral, coal and geothermal mining.

Mining activities inside of production forests can be carried out using open pit and underground mining methods. However for protected forest areas, only underground mining is allowed, and provided that the activities do not result in:

a) land surface subsidence; or

b) a permanent change in the main function of the forest area; or

c) damage to the ground water.

GR 24 also stipulates that the provisions regarding underground mining activities inside of protected forest areas will be regulated by a Presidential Decree.

Borrow-use permit

The use of forest areas shall be based on a borrow-use permit issued by the Forestry Minister. Prior to issuing the permit, if the application fulfills all of the requirements, the Minister will issue in-principle approval for the use of the forest. The borrow-use permit will then be issued after the in-principle approval holder fulfills all of the obligations set out in the approval. For survey or exploration activities, the Minister will not issue an in-principle approval but will directly issue a borrow-use permit.

The borrow-use permit for forest areas used for mining activities that have a “significant impact and wide coverage with strategic value” can only be issued with the approval from the House of Representatives. The criteria for “significant impact and wide coverage with strategic value” will be determined by Minister of Forestry regulation after taking into consideration the views from the Minister of the Environment and the Minister of Energy and Mineral Resources.

Depending upon the size of the forest areas, the borrow-use permit for mining activities may require land compensation or the payment of Non-Tax State Revenue (“PNBP”) plus an obligation for re-vegetation/rehabilitation of any river area.

The land compensation and re-vegetation ratios will be further stipulated by Minister regulation. With regard to the PNBP, the amount is to be taken from Government Regulation No. 2/2008 regarding the type of tariffs for PNBP derived from the utilisation of forest areas for developments outside of forestry activities approved by the Department of Forestry.

The borrow-use permit is valid for the period of the mining license.

International Tax Treaty update

Tim Watson/Simon McKenna

In recent times there have been extensive developments in the International tax arena that have or will affect foreign investors into Indonesia. Developments have included amendments to the ability to utilise tax treaties through the introduction of new certificate of domicile and beneficial ownership requirements (see TaxFlash 05/2010) and increased documentary requirements for cross-border transactions with related parties (see TaxFlash 09/2009). The Directorate General of Taxation has clearly increased its focus on international tax matters.

There have also been significant tax treaty developments with Indonesia and its trading partners including:

- The signing of a tax treaty with Hong Kong;
- The signing of a new protocol amending the Malaysian tax treaty; and
- An announcement by the Dutch tax authorities that there may be amendments to the Indonesia – Netherlands tax treaty in the future.

Each of these developments is elaborated on below.

New Hong-Kong / Indonesia Tax Treaty

On 23 March 2010 Indonesia signed a tax treaty with Hong Kong. The tax treaty will come into force after the completion of ratification procedures on both sides. The earliest possible dates are 1 January 2011 for Indonesia and 1 April 2011 for Hong Kong.

Key features of the treaty include a 5% dividend withholding tax rate (**WHT**) and (subject to certain conditions), the protection from capital gains tax (i.e. the 5% Transfer Tax) on the sale of shares in a non-listed Indonesian entity where, broadly, the relevant entity's "assets" consist less than 50% of real property. Furthermore, the WHT on royalties is capped at 5% and interest WHT is capped at 10%. For further details on the provisions of the treaty, please refer to Tax Flash 04/2010.

These comparably generous features have generated a lot of interest in using Hong Kong as an entry point for inbound investment into Indonesia. As with any tax structuring involving Indonesia, due regard must be had to the enhanced certificate of domicile and beneficial ownership criteria (see above).

New Protocol amending the Indonesia / Malaysia Tax Treaty

Recently the Governments of Indonesia and Malaysia negotiated a new protocol amending the Indonesia / Malaysia tax treaty. On 15 July 2010, the exchange of ratification letters took place. According to Article 7 of the Protocol, the amendments shall have effect for amounts paid or credited on or after the second month next following the date on which the Protocol enters into force. This means that the Protocol shall have effect from 1 September, 2010.

Important features of the Protocol include:

- The reduction in the dividend, interest and royalty WHT rate to a maximum of 10%; and
- The exclusion to the application of the Indonesia / Malaysia Treaty to "offshore business activities" conducted under the Labuan Offshore Business Activity Act 1990.

Status of the Indonesia / Netherlands Tax Treaty

According to a press release by the Dutch Ministry of Finance on 1 July 2010, negotiations for a revision to the Netherlands / Indonesia Treaty and protocol of 29 January 2002, are scheduled to start in the second half of 2010.

PwC has recently contacted the Indonesian and Dutch Tax Authorities to seek clarity on the status of this intention to amend. It is understood from these discussions that no formal procedures or timeline have been established although preliminary email correspondence has begun.

It would appear that the concern with this treaty is the exemption for interest WHT. Speculation is that any renegotiation could target the continuation of this exemption. Developments on these matters should however be carefully monitored.

Draft Government Regulation on Upstream Oil and Gas Taxation – Industry Seminar

Anthony J. Anderson/Antonius Sanyojaya/Rita Susanto

PwC Indonesia representatives recently attended a seminar organized by the Indonesian Fiscal Association on the draft Government Regulation ("GR") concerning "Cost Recovery and Provisions on Income Tax in the Upstream Oil and Gas Business".

A number of senior Directorate General of Tax ("DGT") officials participated as speakers.

Some of the issues discussed in the seminar and our understanding from a reading of the draft GR are summarised below.

Effective Application Date

The draft GR indicates that the new rules on Cost Recovery and Income Tax could be applicable to all PSCs (existing and future) and will apply prospectively from 1 January 2010.

Existing PSCs should be adjusted to follow the provisions stipulated under the GR within a three year transition period.

Preservation of Uniformity Principle

The GR will constitute a special regulation to cover both Cost Recovery and Income Tax for PSC operations. This is on the basis that the GR will be a joint implementing regulation of Article 4(2) of Law No.41/2008 regarding the 2009 State Budget (in respect of Cost Recovery) and Article 31D of Income Tax Law No.36/2008 ("Law No.36") (in respect of Income Tax).

The elucidation of Article 10 of the draft GR indicates that all cost recoverable expenses should also be tax deductible (i.e. ostensibly following the uniformity principle).

Income Tax

Cost Recovery

The Cost Recovery and rules governing tax deductions under the GR will become more rigid or defined. It seems that, for an expense to be allowed for cost recovery, or tax deductible, that it should:

a) be consistent with the expenses listed in the accounting procedure as stipulated in Exhibit C of the PSC contracts;

b) be tax deductible as stipulated in Article 6 of Law No.36;

c) satisfy the arms' length principles for related party transactions as stipulated in Article 18(4) of Law No.36;

d) be consistent with good business and engineering practices; and

e) be approved by BPMigas and included in the Work Program and Budget.

The current 17 categories of non-cost recoverable items in the so called "negative list" under Minister of Energy and Mineral Resources Regulation No. 22/2008 will be expanded to 24 items.

Indirect taxes

Indirect taxes (such as Value Added Tax ("VAT") and regional taxes/retributions) will be treated as operating costs (i.e. cost recoverable/tax deductible). This presumably means that VAT will no longer be processed through the existing reimbursement mechanism.

Transfer of PSC interests

Farm ins-farm outs (or PSC transfers) will give rise to the following tax implications:

a) during the exploration stage:

i) if the transfer is for non-risk sharing purposes, a 5% final tax of the gross proceeds will be imposed; or

ii) if the transfer is for risk sharing purposes, the transfer will be exempted from Income Tax subject to satisfying all of the following conditions:

- the entire interest is not transferred out;
- the interest has been held for more than three years;
- exploration activities have been conducted in the working area (i.e. there was expenditure on investment); and
- the transfer is not intended to generate gains;

b) during the exploitation stage, a 7% final tax on the gross proceeds will be imposed (irrespective of the motive of the transfer i.e. whether or not for risk sharing purposes).

Sale of by-products

Any income derived from the sale of any by-product will be treated as a reduction to the Cost Recovery pool (i.e. effectively becoming taxable income).

Other income

Income other than from normal PSC operations (i.e. liftings) will also be subject to Income Tax.

An uplift will be subject to final Income Tax at 20%.

Tax Compliance

Tax ID registration

A PSC will be required to register for its own tax ID number. The registration will be done by the operator of the particular PSC.

We note that this is similar to the existing arrangements for JOBs.

Transactional taxes

Any transactional taxes (Withholding Tax ("WHT") and VAT) in respect of PSC operations shall be reported under the respective PSC's tax ID number (instead of the operator's tax ID number as per current practice).

Tax Treaty benefits

PSC contractors appear to be allowed to use tax treaties to reduce the branch profit tax rate provided that the PSC contractors are able to meet the criteria regulated under the DGT Regulations No.61/PJ/2009 and No.62/PJ/2009 as amended by DGT Regulations No.24/PJ/2010 and No.25/PJ/2010.

Corporate Income Tax return filing

The DGT will produce a specific corporate income tax return form for PSC operations.

Tax Audit on C&D Tax

The draft GR seems to indicate that the DGT will acquire further tax audit roles particularly in regard to the C&D tax. A tax assessment will be issued upon a completion of a tax audit. It seems that only tax paying taxpayers will be subject to a C&D tax audit.

Matters Requiring Clarification

Whilst the draft GR does provide some guidance on the proposed Income Tax arrangements for the upstream sector, further issues need clarification. These include:

a) whether the three year transition period is determined from the effective date of the GR or from the date of signing;

b) whether a transfer of a PSC interest which takes place as part of an internal group/corporate restructuring (i.e. which does not alter the economic ownership of the PSC interest) can be exempted from Income Tax even where that PSC transfer is not done for risk sharing purposes;

c) what evidence would be required to justify that a transfer of a PSC interest is not intended to generate a gain. This is particularly so if the tax paying entity is the buyer (i.e. via WHT mechanism). Also how can a buyer be held responsible for the motive of the other party (i.e. seller);

d) what is the tax payment mechanism for PSC transfers and other non-liftings income (i.e. whether through WHT or self remittance of tax);

e) how to settle the Income Tax on a PSC transfer if the payment is made in the form of deferred consideration (e.g. a "carry" arrangement) and where the carry is contingent on future cash calls or other milestones;

f) whether the 20% final Income Tax on uplifts is based on the assumption that the uplift is interest and so whether tax treaty benefits can be accessed to reduce the 20% tax rate; and

g) whether the DGT's audit power over C&D tax will change the administration of C&D tax (e.g. whether the tax will then be paid to the DGT's account or continue to the Director General of Budget's account).

VAT Collection – More Difficult To Implement?

(Ministry of Finance ("MoF") Decree No.73/PMK.03/2010)

Anthony J. Anderson/Triadi Mukti/Alexander Lukito

Following the issuance of the new VAT Law, the MoF has issued Decree No.73 regarding the appointment of PSC and Geothermal contractors as VAT Collectors. This regulation was effective on 1 April 2010.

Whilst PSC contractors were reappointed as VAT collectors in 2005, MoF No.73 has now reinstated Geothermal contractor's as VAT collectors (which previously ended in 2003).

Timing of VAT Collection

VAT Collectors should "collect" and pay the input VAT charged by suppliers directly to the State Treasury. This is different from other taxpayers where their input VAT is paid through the relevant suppliers.

Readers may recall that, back in 2005, PSC contractors were reappointed as VAT collectors with new requirements around the timing of VAT Collection. The current VAT collection rule imposes an even higher compliance burden. The following is a summary of comparison between the two VAT collection regimes:

Previous Regime (MoF Decree No.11/2005)	Current Regime (MoF No.73)
• The VAT is due and should be collected by VAT collectors at the latest:	• The VAT is due and should be collected by VAT collectors at the earliest of:
a) by the end of the month following the delivery month of the goods/services – (if payment has not been made)	a) the time of the delivery of the services/goods;
b) the payment date - if the payment is made before/at the time of the delivery, or before the end of the month following the delivery month	b) the payment date – if payment is made before the delivery of services/goods;
	c) the payment date of any installment – if it relates to work in progress
• VAT collected should be paid to the State Treasury by the 15th of the month following the month of collection	• VAT collected should be paid to the State Treasury by the 15th of the month following the month of collection
• VAT Collector returns should be lodged on the 20th of the month following the month of collection	• VAT Collector returns should be lodged at the end of the month following the month of collection

In summary, VAT collectors now have approximately one month less time to collect and pay the VAT compared to the previous regime. The shorter period is particularly problematic since VAT collectors are relying on suppliers to issue the VAT invoice properly in order to meet payment deadlines, while any late payment penalties are imposed on the VAT collectors.

What do VAT Collectors need to do?

To avoid any late VAT collection and payment to the Tax Office, VAT collectors will need to pay more attention to administrative matters and potentially find a way to more closely monitor the delivery date of goods/services and the issuance of VAT invoices. This may involve new upfront agreements with suppliers to issue VAT invoice on a timelier basis, or even establishing standard wording in contracts requiring suppliers to comply with the new VAT invoices rules.

Geothermal Business Activities

Shaun McCaffrey/Anthony J. Anderson

Indonesia's vast but untapped resource

It is estimated that Indonesia's geothermal reserves make up approximately 40% of the world's total, with the potential to produce approximately 27,000MW of electricity. Despite this potential the sector remains largely underdeveloped with only approximately 1,200MW of geothermal power capacity currently installed. This equates to just 3% of Indonesia's current energy production.

To promote electricity development, the Government's second 10,000 MW "crash program" is targeted at developing power from various forms of renewable energy, including geothermal. In the longer term, the Government has set geothermal capacity targets of 3,442 MW by 2012, 4,600MW by 2016, 6000 MW by 2020 and 9,500 MW by 2025.

The need for oversight and coordination of renewable energy has also now been recognised with the establishment of the Directorate General of Renewable Energy and Energy Conservation.

Regulatory framework for geothermal activities

The push for enhanced private sector involvement in the geothermal industry actually predates the "crash program" with Geothermal Law 27/2003 ("Law No. 27"). However, it wasn't until mid-2009, when the Minister of Energy and Mineral Resources ("MoEMR") issued Regulation 11/2009 ("Regulation 11/2009") as the implementing regulation for Government Regulation 59/2007 ("Regulation 59/2007") that renewed regulatory progress began.

With the framework for geothermal activities now quite advanced, this article is intended to provide a brief overview of the key elements of the geothermal regime.

Geothermal mining licences and tender process

Under the geothermal regime, the Government offers a Mining License ("IUP") over a designated geothermal area to an Indonesian business entity. This includes an Indonesian incorporated company. However it does not extend to a branch (i.e a permanent establishment) of a foreign company. For foreign investors, it will therefore be necessary to establish an Indonesian incorporated company in which they will be permitted to hold a maximum 95% equity share. Each business entity is also only entitled to hold only one IUP.

Geothermal work areas are offered to prospective investors by way of tender undertaken by either the MoEMR, Governors or Regents (Regencies/Cities) depending upon the areas to be covered by the IUP. A Tender Committee is appointed with MoEMR, Provincial and Regional representation which will evaluate the bidders' qualifications.

Evaluations are carried out in two phases with the first covering administrative formalities such as technical and financial capabilities, and the second phase concerning an evaluation of the steam and electricity prices to be offered by the bidders. Regulation 11/2009 specifically provides that the lowest offered price under Phase 2 carries a preference to win the bid.

Terms of an IUP

The winning bidder will be granted an IUP in respect of the relevant work area which will be issued for a maximum of 35 years. The phases of geothermal activities permitted by an IUP are separated into the following categories:

- Exploration – for an initial 3 year term, extendable twice for 1 year on each extension;
- Feasibility study – for a maximum term of 2 years; and
- Exploitation – for a maximum term of 30 years (extendable upon application).

Work areas

The largest work area to be granted in an IUP is initially 200,000 hectares which should be gradually relinquished during the exploration and feasibility study phases. Upon entering the exploitation phase, the largest permitted work area is 10,000 hectares (although approval can be sought for more than 10,000 hectares).

Planning and budgeting requirements

For each phase of geothermal activity, the IUP holder is required to submit written reports to the MoEMR and to the relevant Government Authorities. These reports include a long term plan of activities, and an annual work program and budget (submitted at least two months prior to the commencement of the relevant month).

During each relevant phase, the IUP holder must also submit monthly, quarterly and annual reports detailing the activity undertaken in the period.

Mine closure obligations

IUP holders are required to fund deposits from the commencement of the exploitation phase as a reserve for mine closure rehabilitation work. Detailed procedures on this requirement are still to issue.

Recent developments for the geothermal industry

The establishment of the new Directorate General of Renewable Energy and Energy Conservation in August 2010 was significant. One of the first tasks of the new Director General will be to issue a law which specifically promotes and regulates the development of renewable energy. At the time of writing, details of the proposed new law had not been released, however it is expected to provide a broader range of incentives to promote the development of renewable energy.

On 8 January 2010, Presidential Regulation ("PR") No 4/2010 was issued to expedite the second phase of the 10,000 MW power development project. Article 8 of PR No. 4/2010 indicates that the Government will provide incentives such as import duty exemptions on the importation of materials and other facilities. Since that time, the Ministry of Finance has issued two regulations which assist in this regard.

On 28 January 2010 MoF Regulation 21/PMK.011/2010 was issued, granting a wide range of tax facilities in relation to the utilisation renewable energy, including for Income Tax, import VAT, Import Duty and Article 22 import tax. Geothermal energy is specifically included within the scope of that regulation. (Further preliminary discussion on that regulation can be found in our Energy Utilities and Mining Newsflash No. 36/2010). Since the preparation of that Newsflash we have been able to obtain verbal clarification from the Directorate General of Tax. These clarifications indicate that Regulation 21 is intended to be used by producers of electricity using renewable energy as their primary energy source.

More specifically for geothermal energy, on 29 January 2010 the Minister of Finance issued Regulation No.24/PML.011/2010 (Reg No.24). Reg No.24 provides that, for geothermal exploration, the import of goods used in that activity will be free of VAT (i.e. borne by the Government).

Risk and Anti-Corruption Laws

Insight into the impact of the Foreign Corrupt Practice Act (FCPA) on the Indonesian Oil & Gas Industry

Lili Wijata

With the increasing reach of anti-bribery laws worldwide, companies operating in the energy sector face challenges in steering their business through the complex Foreign Corrupt Practice Act (FCPA) rules.

FCPA?

Two key elements:

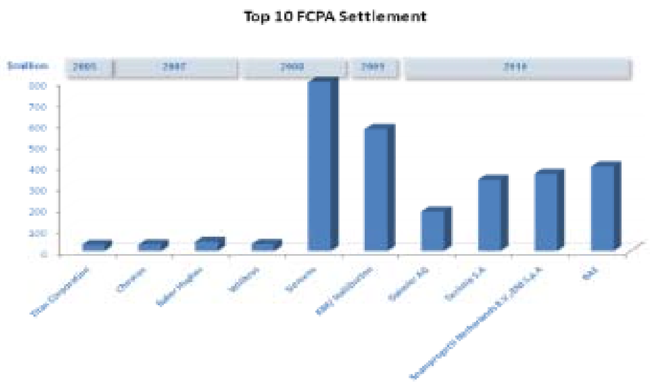
1. Anti-bribery – prohibition on making an offer, payment or authorizing anything of value to be given to any foreign official for the purpose of influencing any act or decision in order to obtain or retain business (with an exemption for payments to facilitate routine official activities).
2. Books and records – requirements to make and keep accurate books and records and devise/ implement a system of internal accounting controls.

FCPA is relevant to US companies as well as any companies with securities registered in the U.S. or required to file reports with the SEC.

Clear and Present Danger

Trends: Implications for Companies and Foreign Operations

One of the most important trends with the FCPA is the increasing enforcement activity. Over 100 investigations are currently being undertaken and the number of prosecutions for FCPA violations has increased over the last five years. This increased regulatory activity has included larger financial penalties being imposed on settling companies. In addition, the burden of responsibility continues to be borne not only by the companies but also by individual company executives, as evident in the most recent 2007 – 2009 prosecutions.



Nowadays, FCPA prosecutions are often followed by a parallel investigation in foreign jurisdictions under "home nation" anticorruption laws. In early 2010 BAE Systems for instance entered into separate settlements with Britain's Serious Fraud Office (SFO) to settle a long-standing investigation over its FCPA violation. The company agreed to pay US$400 million to the US and US$47 million to British authorities. These cases may increase with the passing of the UK Bribery Act in April 2010. This act is broader than the FCPA in several areas especially in its removal of the defense against certain facilitation payments.

Managing Risk

The most common areas of risk in the resouce sector include requests for "facilitation" in order to obtain regulatory approvals, export and import passage, tender awards etc.

By adopting a comprehensive strategy over the selection of controls, business partners etc companies can be better prepared to make decisions in this area.

Knowing your business partners

Joint ventures must consider the implications of their partners. It is prudent to undertake corporate intelligence on a partner's compliance history, both prior and subsequent to any deal. This analysis should involve legal, regulatory, operational and integrity checks. Partnering with companies with potential corruption issues would mean "buying" the liabilities that extend to those risks.

Fundamentals of FCPA Program

The identification of FCPA related risks is not intended to discourage business activity. It is intended to widen business awareness, minimize risks and maximize opportunities within emerging markets. Anticorruption programs can become a tool to strengthen a company's competitive advantage among competitors, governments and consumers who want to be associated with businesses of integrity, through brand value and reputation.

The most effective approach to FCPA risk can start with defining clear company policies and procedures for global anticorruption compliance with a view to establishing an overall compliance framework. These policies and procedures should address expectations on how employees, business partners, and third parties are to conduct themselves in relation to payment processing, expense reporting, and training requirements. To have an effective code of conduct and/or anti-bribery and corruption policy it is necessary for a company to look at their business processes and determine who they interact with (including governments) and where they may be most at risk. Some of the more likely areas to focus on are as follows: state owned / controlled entities, excessive commissions and/or compensations, cash payments required to entities or individuals, and required gifts and donations.

Lifesaver Questions

- How well equipped are you to combat corruption and seize the market opportunities?

- Are you aware of your exposure to corruption risk in your country of operation?
- Do you have an FCPA compliance program? Does it meet with the relevant regulations?
- Do your employees have the necessary knowledge on anti-bribery and corruption policy or law?
- Have you done the right due diligence to embark on new business opportunities? To what extent do you regularly check the background and integrity of your third party providers and business partners?
- What reporting and assessment controls do you have in place to monitor and address corruption related issues before they become significant?
- Have you considered using outside counsel in your company's FCPA compliance programme, especially where privilege may be an issue?

Third party payments (particularly to agents) are a high risk area. Payments that may potentially be in violation of local laws and tax regulations are often overlooked because at first glance they do not appear to be material. One way to achieve better transparency is to streamline and integrate disparate systems and processes, in order to make them as uniform as possible.

Quality and regular training is also important in managing FCPA risk. Employees need to be equipped with skills for dealing with certain situations, knowing where to turn for help, and being able to produce applicable responses.

When all possible controls and policies have been established and socialised, there is still no absolute guarantee that employees will comply. Testing to determine whether employees truly understand and are following the policies will enable companies to verify whether their programmes and controls are working effectively. It also provides insight into continually refining strategies, particularly in high-risk regions or countries.

Conclusion

Investing in developing markets bring opportunities and unforeseeable risks and balancing the two with the right anticorruption strategy is more than just putting up the best defense. It enables organisations to reduce the potential risks at the outset, to more effectively handle any risks as they arise, and to maintain an uninterrupted focus on innovation and competitive positioning.

Whilst still not a widely embraced concept, a well thought out and developed anti corruption strategy can make for a real competitive advantage. More and more, governments, business partners and consumers are seeking to do business only with companies of the highest integrity. Companies that consider all of these factors in formulating their approaches to anticorruption will find themselves better prepared to take advantage of new opportunities both at home and overseas.

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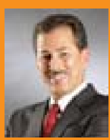
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Leadership demands **courage, vision and integrity.**

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