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PwC Indonesia Energy, Utilities & Mining NewsFlash

New Value Added Tax reimbursement procedures for PSCs

Production Sharing Contracts (PSCs) signed prior to Government Regulation No.79/2010 (GR-79) generally entitle the holder to a "reimbursement" of input Value Added Tax (VAT) costs (out of Government share) rather than to cost recovery of the VAT. Reimbursement represents an absolute financial advantage vis a vis cost recovery as it is on a dollar for dollar basis. The principle arguably harks back to the original PSC premise of contractor protection from all Government taxes (other than Income Tax).

On 5 December 2014, the MoF issued Regulation No.218/PMK.02/2014 (PMK-218) setting out new procedures for VAT reimbursement by PSCs. PMK-218 is effective from 2 February 2015 and replaces MoF Regulation No.64/PMK.02/2005 (PMK-64).

Some of the key reimbursement-specific changes are as follows:

a) that Government Share is to exclude the Government's entitlement to FTP (this had been an unclear area in the past but this interpretation does reduce the pool of funding available for reimbursement);

b) that reimbursement is to be subject to confirmation from the Directorate General of Taxes via a "Tax Clearance Document" (previously the tax authorities played no verification role in this process);

c) that SKK Migas may offset a reimbursement entitlement against any contractor "overlifting" (previously overliftings were settled in cash); and

d) that there is no time frame for obtaining the full verification from SKK Migas (this was previously set at 45 working days).

These arrangements are to be further outlined under an implementing SKK Migas regulation.

In an additional change PMK-218 indicates that the reimbursement entitlement excludes input VAT arising from LNG processing (as well as VAT arising on other VAT "exempt" or non-recoverable supplies). Whilst the exact scope of this alteration is still being determined this has the potential to fundamentally impact the economics of at least some of the LNG production in Indonesia (and might even be challengeable in a contractual sense). It is also not clear if this principle could be extended into other "downstream" VAT input costs. This issue in particular needs to be monitored closely.

2015 Bid Round

The Ministry of Energy and Mineral Resources recently announced the intention to offer eight new PSCs in 2015 with four to be via negotiation and four to be via regular tender. It will interesting to see the level of interest in these blocks not just as an indication of investor confidence in the new administration but also for the impact of a low oil price environment.

Land and Building Tax reduction for PSCs in exploration stage

Aiming to support domestic oil and gas production, especially for the mining of oil and gas in exploration stage, the MoF issued Regulation No.267/PMK.011/2014 (PMK-267) on 31 December 2014 that provides tax incentive for this sector in the form of Land and Building Tax (*Pajak Bumi dan Bangunan/PBB*) reduction.

The reduction is granted on the sub-surface component and can amount to up to 100% of the PBB due on that component. This incentive is applicable for the year 2015 onwards. The oil and gas contractor should fulfil the following requirements to enjoy this incentive:

a) its PSC must be signed after 20 December 2010 (i.e. the effective date of Government Regulation No.79/2010 regarding Reimbursable Operational Costs and the Tax Treatment on Upstream Oil and Gas Operations);

b) have submitted a Tax Object Notification Form (*Surat Pemberitahuan Objek Pajak/SPOP*) to the Tax Service Office; and

c) provided a recommendation letter from the Minister of Energy and Mineral Resources (MoEMR) that stipulates that the PBB object is still at exploration stage.

The reduction is granted yearly for a maximum of six years from the PSC signing date and can be extended by up to four years (subject to a recommendation letter from the MoEMR).

Corporate Income Tax rate for 3rd Gen CCoWs and 6th/7th Gen CoWs Companies

On 24 November 2014, the Director General of Tax (DGT) issued Circular No.44/PJ/2014 (SE-44) providing its views on the Corporate Income Tax (CIT) rate applicable to taxpayers holding 3rd generation Coal Contract of Works (CoWs) and 6th/7th generation Mineral CoWs (which were generally signed between 1996 to 2000). The DGT is now indicating that these taxpayers are subject to CIT at the rate of 30%.

The CIT rate applicable to these taxpayers has been a longstanding issue not least because these CCoWs/CoWs typically provide a lex specialis tax framework linked to the 1994 Income Tax Law (i.e. with a 30% maximum CIT rate) but with a specific entitlement to any CIT rate reduction to be made via "Government Regulation" (noting that the expectation of a CIT reduction existed at the time of the 1994 CIT Law).

The rate reduction was ultimately introduced via legislation rather than via a Government Regulation. The issue has therefore been whether the legal instrument which provided the rate reduction should be relevant to a taxpayer's ability to enjoy the reduction.

SE-44 states that, in the DGT's view, the CCoW/CoW reference to "Government Regulation" should be read narrowly so as to be restricted to the regulatory instrument which implements the reduction. Consequently, the 30% rate is considered to continue to apply. The DGT has also instructed for the socialization of this matter and a focus on taxpayers previously applying the 25% rate (including presumably on monthly CIT instalments).

Whilst SE-44 provides the DGT's views it is still possible that taxpayers will move to contest the interpretation. Nevertheless holders of these CCoWs/CoWs should review their position in light of this development.

New Regulation on Advanced Pricing Agreements

On 7 January 2015, the Ministry of Finance issued Regulation No.7/PMK.03/2015 (PMK-7) regarding procedures for the establishment and execution of Advanced Pricing Agreements (or APAs - used to support related party transaction pricing) as mandated under Article 58 of Government Regulation No.74 year 2011.

PMK-7 provides guidelines and a framework for APA procedures both for the DGT and taxpayers. Some of the key areas covered include:

a) the applicability of APA arrangements;

b) the duration of APAs – unilateral or bilateral (being a maximum three or four years respectively);

c) the application procedures including for preliminary discussion, APA application and DGT discussion;

d) the timelines for the various stages of the APA process;

e) the expected content of APAs;

f) the implementation, evaluation and renewal of APAs.

PMK-7 comes into effect 90 days from the date of the enactment and also covers APA applications filed before the enactment where an APA has not been issued.

Whilst PMK-7 is a welcome development many process-related uncertainties continue to exist. Readers interested in exploring an APA should contact their PwC advisor to help determine a strategy.

New electricity tariff and procurement procedures

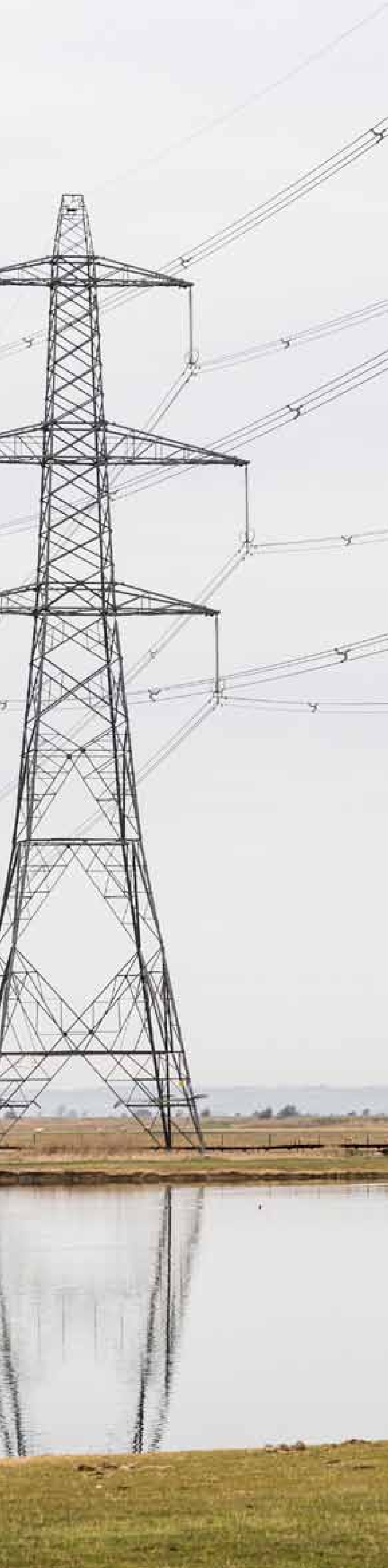
On 12 January 2015, the Minister of Energy and Mineral Resources issued Regulation No. 3/2015 (MoEMR 3/2015) regarding updated procedures for power purchases and the benchmark price for power from mine mouth power plants, coal-fired power plants, gas-fired and gas turbine power plants and hydro power plants by PT Perusahaan Listrik Negara (Persero) (PLN) through direct selection and direct appointment.

MoEMR 3/2015 was issued to simplify and accelerate the power procurement process and tariff negotiation, and to help attract private investment especially for non-diesel power projects.

Direct selection and direct appointment

Direct selection of power suppliers is carried out by comparing at least two offers and direct appointment is done by directly appointing one power supplier.

In line with Government Regulation No.14/2012 as amended by No.23/2014 and MoEMR Regulation No.1/2006 and No.4/2007, MoEMR 3/2015 states that PLN may purchase power using the direct selection method when changing the feedstock of the



power plant from diesel to non-diesel and that PLN may use the direct appointment method:

a) for mine mouth, marginal gas or hydro power projects; or

b) for purchase of excess power from mine mouth, marginal gas or hydro power plants; or

c) for critical or emergency power supply; or

d) for expansion projects.

Further procurement procedures for direct selection and direct appointment will be determined by PLN.

MoEMR 3/2015 stipulates that the maximum time frame for the execution of the power purchase agreement (PPA) is 30 days for direct selection and 45 days for direct appointment.

Benchmark price

MoEMR 3/2015 also regulates the benchmark price for each feedstock as at the commercial operation date. The power purchase price may however be adjusted as set forth in the PPA. The tariff varies according to the unit capacity (and heat rate in the case of coal and gas plants) as follows:

a) Mine mouth coal: 6.9 - 8.2 US cents/KwH;
b) Non mine mouth coal: 6.3 - 11.8 US cents/KwH;
c) Gas: 7.3 - 8.6 US cents/KwH;
d) Hydro: 8 - 9 US cents/KwH.

The tariff is determined on assumptions of coal and gas prices, however the coal or gas price is treated principally as a "pass through". PLN may purchase power at a price above the benchmark price where it obtains approval from the Minister to do so.

MoEMR 3/2015 comes into force from enactment for new and upcoming power plants (including expansion projects).

Power Plan – 35 GW in five years

New President Joko Widodo has outlaid an ambitious plan for infrastructure development including a goal to add 35 GW of electrical generating capacity over the next five years. Realizing this would involve massive investment in power generating capacity. On this point the Government estimates that US$50 billion will be required mostly for coal-fired power plants. Up to 25 GW will be earmarked for the private sector.

To help stimulate private investment in power generating capacity the Government has increased the feed-in-tariffs (FiTs) that PLN must accept from IPPs for electricity sourced from a variety of feedstocks (see separate article). The Government has also sought to mitigate land acquisition and other issues which have so far been additional investment impediments. While the focus is on large scale coal-fired projects, including mine-mouth, there are still opportunities for private investment in gas and renewable energy projects.

Fuel subsidy savings to benefit infrastructure

As most readers would be aware, on 1 January 2015 President Joko Widodo's administration removed the subsidy on gasoline and capped the subsidy for diesel. This followed a 30% reduction in subsidies in October last year. The fall in oil prices has meant that fuel subsidies, which have long been a drain on the Goverment budget, have been cut without significant public backlash. The administration has indicated that the savings will be applied to spending on infrastructure mainly in the power and transportation sectors, as well as for public works and for agriculture.

BEPS and the resources sector

Most readers, even those not directly focused on fiscal concerns, would be aware of the "Base Erosion and Profit Shifting" (BEPS) initiative being pursued by the OECD along with the Governments of the G20 countries (of which Indonesia is a member).

The BEPS' mission (broadly) is to respond to perceived deficiencies in international tax arrangements including treaty misuse, tax arbitrage opportunities and failures in regard to the existing transfer pricing enforcement mechanisms.

The OECD's overall initiative will involve issuing 15 "Action Plans" by December 2015. These will be issued in consultation with the various participating comments (including Indonesia's) and provide a framework for tightening fiscal arrangements in the areas so covered. The latest release of these Action Plans was made in September 2014.

Whilst it is probably fair to say that some of the world's major technology companies have attracted most of the recent headlines in this area the BEPS-inspired changes will certainly spill over into the resources sector. Some of the areas that taxpayers operating in Indonesia should monitor include:

a) *tighter/clearer rules around beneficial ownership*: this initiative is largely targeting treaty "misuse" and looking for the better alignment of entity "substance" and treaty entitlement. U.S-style "limitation of benefits" rules could become more common. This is likely to impact many areas of international corporate structuring including in relation to financing (noting of course the capital-intensive nature of many resource projects);

b) *creation of a permanent establishment*: this initiative targets the avoidance of PEs through "artificial" means such as the "fragmentation" of in-country activities including via contract structuring. This could raise new areas of exposure for those with internationally mobile work forces (such as "rotators") or those involved in EPC or similar construction activities with a significant ex-Indonesian value component;

c) *transfer pricing*: there are a number of Action Plans focusing on transfer pricing. Perhaps the most significant is the promotion of a Country by Country (CbC) Reporting protocol which would require the documenting of income, economic activity and taxes paid on a CbC basis.

We will keep readers updated as matters progress.

Update for taxpayers' maintaining English language and USD bookkeeping

On 7 January 2015, the Minister of Finance (MoF) issued Regulation No.1/PMK.03/2015 (PMK-1) as an amendment to MoF Regulation No.196/PMK.03/2007 regarding Procedures for Foreign Language Bookkeeping and Currency other than Rupiah as well as the Obligation to Submit Annual Income Tax Returns for Corporate Taxpayers.

PMK-1 introduces new requirements in this area under the following circumstances:

a) where the taxpayer has already obtained a Decision from the Director General of Tax or the Head of Regional Tax Office, etc. but the Decision notice is damaged, not readable or has been lost; or

b) where the taxpayer has a "contract" with Government (e.g. a Contract of Work or Cooperation Contract/ PSC) which provides for English and USD bookkeeping but the contract itself has expired.

To continue with the English language/USD entitlement the taxpayer should:

- in the event of scenario a), request for the Decision to be re-issued; or
- in the event of scenario b), submit an application to the Head of Regional Tax Office where the taxpayer is registered within one year of the enactment of PMK-1 (i.e. by 6 January 2016) or one year after the expiry of the relevant contract

2015 budgetary outlook

As most readers would be aware Indonesia's 2015 financial budget, the first under the Jokowi administration, is working its way through the various Government processes. Approval could be as early as mid-February.

One of the headlines is an increase in projected tax revenue from IDR1,200 trillion to IDR1,300 trillion indicating a potentially more aggressive Revenue Authority.

Whilst still at speculative stage the local media is reporting areas where taxes may be increased. Some of these which are potentially relevant to the resources sector include:

a) the introduction of an Article 22 (i.e. an Income Tax prepayment) on mineral and coal exports. There is no indication of a rate as yet;

b) an expansion of the services subject to Article 23 WHT;

c) an increase in the WHT rate on Land & Building rent (currently a 10% final WHT applies);

d) an increase in the WHT rate on payments for shipping activities (currently a 1.2% or 2.64% final WHT applies);

e) the imposition of VAT on electricity supplies to households from a level of 2,200 watts (the current minimum is 6,600 watts);

f) an increase in the WHT rate applying to "founder shareholders" presumably for transactions on the ISX (currently this tax is due at 0.5%).

Obviously these changes are not certain and so they may or may not represent formal Government policy. Nevertheless readers should monitor developments in cases where any changes could be relevant.

New Minister of Trade Regulations on Export/ Import

Early this year, the Minister of Trade (MoT) issued regulations No. 03/M-DAG/PER/1/2015 (MoTR-03) and No. 04/M-DAG/PER/1/2015 (MoTR-04) which could impact the export and/or import activities of certain resource based commodities. The MoT regulations become effective early April 2015.

MoTR-03 provides that, amongst other things, exporters of certain oil and gas related products are required to obtain registration, recommendation and approval from the relevant ministries.

MoTR-04 requires the export proceeds of a number of selected commodities, including mineral products, coal and oil and gas, to be transacted through a Letter of Credit (L/C) mechanism.

MoTR-03

With the objective of securing the domestic supply of oil and gas and fuel, the following requirements are covered under the MoTR-03 on the export and import of oil, natural gas, and other type of fuel (hereinafter OG&OF):

- exporters and importers of OG&OF should first obtain an Export Registration and Import Registration from the Director General of Foreign Trade (under the MoT);
- the exporters and importers should obtain recommendations from either the Director General of O&G or Director General Renewable Energy, as relevant (under the Minister of Energy and Mineral Resources) and specific approval from MoT before undertaking the export and import;
- the verification of the import/export should be conducted by a surveyor appointed by the MoT;
- the Customs Office remains entitled to conduct a customs audit;
- the export and import activities (both realised and unrealised) should be reported to the MoT by the 15th of the following month; and
- failure to comply results in sanctions under the customs and other applicable laws and regulations.

MoTR-04

With the objective of obtaining more accurate information on foreign exchange revenue from exports, the MoT now requires the use of an L/C for the export of mineral products (e.g. nickel oxide, gold concentrate, gold bars, pure tin solder, copper bars, etc), coal, oil and gas (i.e crude oil, condensates, LNG, CNG and vacuum residues). The L/C requirements can be summarised as follows:

- the price stated in the L/C should not be lower than the global market price;
- the payment should be made to a domestic foreign exchange bank;
- the L/C mechanism should be declared in export declaration (PEB);
- the L/C documentation is subject to audit by a surveyor appointed by MoT; and
- no exports will be allowed if they fail to satisfy the L/C requirements.

Further implementing regulations will be issued by the Director General of Foreign Trade. We would recommend players impacted by the new MoT regulations to have a closer look at new procedures and requirements to avoid unnecessary sanctions including suspension of export/import activities. Regarding MoTR-04 in particular, it remains to be seen how the rules can be effectively applied for inter-company sales, non-sales export, export through pipelines, and export under trustee arrangements, among others.

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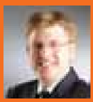
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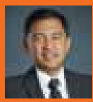
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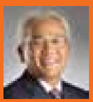
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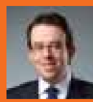
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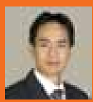
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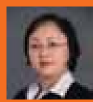
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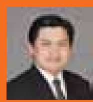
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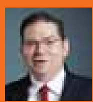
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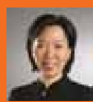
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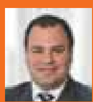
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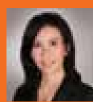
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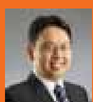
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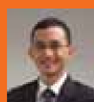
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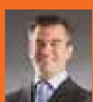
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