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PwC Indonesia Energy, Utilities & Mining NewsFlash

New Tax Holiday Regulation

Raemon Utama and Suyanti Halim

On 18 August 2015 the Minister of Finance (MoF) issued a new Tax Holiday Regulation No.159/ PMK.010/2015 (MoF-159) which had effect from 16 August 2015. MoF-159 revokes MoF regulation No. 130/PMK.011/2011 (MoF-130).

Key considerations for investors in the energy, utilities and mining sectors are set out below. These comments should be read in conjunction with our Tax Flash No. 23/2015 and covers the eligibility criteria, other requirements, changes in the application process and additional conditions leading to Tax Holiday revocation.

Eligible pioneer industries

MoF-159 stipulates the following "pioneer" industries as eligible for Tax Holiday facilities:

a) upstream metal industries (*industri logam hulu*) - *previously metal based industries (industri logam dasar)*;
b) oil refineries;
c) base organic chemicals sourced from oil and gas;
d) machinery;
e) telecommunications and information;
f) sea transportation - *new*;
g) processing industries for agriculture, forestry and fishery products - *new*;
h) processing industries which represent a primary industry in a Special Economic Zone (*industri pengolahan yang merupakan industri utama di Kawasan Ekonomi Khusus/KEK*) - *new*; and/or
i) Economic infrastructure other than those under a Public Private Partnership (*Kerjasama Pemerintah dengan Badan Usaha/KPBU*) - *new*.

Note that MoF-159 no longer includes renewable energy as a pioneer industry.

Upstream metal industry

In the absence of any specific guidance/definition, we understand that this term is to have the same meaning as used in MoF-130 (i.e. metal based industries).

Based on the above interpretation, the fact that the MoF continues to include base metal industries as eligible for this tax concession raises a question as to whether the Government intends that:

- Option 1: smelting and activities are both eligible - if so this would be in line with the existing Indonesian Business Classification Code (*Klasifikasi Baku Lapangan Usaha Indonesia/ KBLI*) which specifies "base metal industry" (code 24) as covering metal smelting and refining activities with various metallurgical techniques; or
- Option 2: only refining activities are eligible.

Since the Government has expressed its view that new investment in activities should apply for the Tax Allowance facilities under Government Regulation No. 18/2015 (i.e. instead of the Tax Holiday facility) Option 1 appears the leastikely.

Processing industries which represent a primary industry in a Special Economic Zone (Kawasan Ekonomi Khusus/KEK)

Under KEK Law No. 39/2009 (Law-39), a KEK may consist of one or more of the following zones:

a) export oriented processing (*pengolahan ekspor*);
b) logistics;
c) industrial;
d) technology development (*pengembangan teknologi*);
e) tourism;
f) energy; and/or
g) other economies (*ekonomi lain e.g. creative industries and sports industries*)

Whilst export oriented processing and industrial zones can accommodate a broad range of processing activities there is doubt over whether smelting/refining activities established in a KEK would be eligible for the Tax Holiday facility.

In general, this tax concession is intended for investment in processing activities undertaken in a new area that can otherwise attract or stimulate the development of business activities.

Investors who consider investing in processing activities which could provide a multiplier effect to the nearby economy are arguably best placed to explore whether the investment would be eligible for this tax concession.

Tax holiday period for taxpayers in a KEK

The ad-interim Head of the Fiscal Policy Board (*Badan Kebijakan Fiskal/BKF*) in a recent news article indicated that the Government is considering a Regulation to extend the Tax Holiday period to 25 years (the current maximum is 20 years) as well other tax incentives. There are no further details at this point.

Economic infrastructure other than those under Public Private Partnerships (Kerjasama Pemerintah dengan Badan Usaha/KPBU)

Under Presidential Regulation No. 38/2015 dated 22 March 2015 (PR-38) regarding "Public Private Partnerships" (PPP), a PPP represents a cooperation arrangement between the Government and a business entity for the provision of infrastructure in the public interest and with funding either partly or entirely supplied by the business entity. PR-38 specifies that economic and social infrastructure covers an array of assets relevant to transportation, roads, water resources and irrigation, drinking water, waste water, electric power, oil and gas and renewable energy and energy conservation.

MoF-159 excludes economic infrastructure developed within a PPP scheme from this tax concession. The intention of this may to avoid any duplication/overlapping with the tax incentives made available to PPP projects by virtue of PR-38.

CIT reduction (instead of CIT exemption)

As outlined in our Tax Flash No. 23/2015, MoF-159 provides a CIT rate reduction (the CIT exemption under MoF-130) for taxpayers who satisfy the relevant criteria.

Whilst MoF-159 allows for a CIT reduction ranging from 10% - 100%, the absence of a specific requirements creates ambiguity around how the MoF will determine the specific CIT rate reduction for each applicant. Since the Head of the Investment Coordinating Board Regulation No. 13/2015, which was recently amended by Regulation No. 19/2015 (as the implementing regulations of MoF-159), does not cover this point either a further implementing regulation is expected. Developments should be monitored by taxpayers.

And finally

As regulated in MoF-130, taxpayers who access the Tax Allowance facility are not eligible for the Tax Holiday facility and vice versa.

Power Investment Certainty: Investment Coordinating Board to oversee investors

Tim Boothman

- BKPM (*Badan Koordinasi Penanaman Modal*, The Investment Coordinating Board) will now provide post-PPA support to power plant developers on licensing and land acquisition issues.
- In particular, BKPM will support efforts to accelerate the licensing process at the sub-national level, which is not currently covered by BKPM’s “One Stop Shop” (centralised licensing service).
- Getting local government permits and licenses has remained a key barrier to investment in the sector since the implementation of the One Stop Shop, and these efforts to coordinate between national and sub-national may have a positive impact on investor confidence.

Thin Capitalisation in Resources Sector

Antonius Sanyojaya

Recently the Minister of Finance (MoF) issued the long awaited rules on “thin capitalisation” with Regulation No.169/PMK.010/2015 (PMK-169). PMK-169 will become effective from fiscal year 2016 onwards. The thin capitalisation rules seem to be applicable only for Indonesian incorporated entities (i.e.PT companies) and provide a general maximum ratio between debt and equity (DER) of 4:1, except for certain industries (see below). No deduction is allowed for interest expenses arising on loans exceeding the allowed ratio.

The industries exempted from the thin capitalisation rules include:

a) financial services (i.e. banking, financial institutions and re-insurance);
b) certain resources industries (e.g. those operated under Profit Sharing Contracts (PSC), Contracts of Work (CoW) or Mining Cooperation Agreements (ie PKP2B) where the respective contract specifies the DER);
c) infrastructure; and
d) final income tax industries (e.g. construction and shipping).

Infrastructure is not defined in PMK-169 but it may cover electricity (e.g. power generation, transmission and distribution), downstream oil & gas (e.g. refineries, storage, transportation and distribution) and drinking water (e.g. raw water sourcing, production and distribution). An implementing Director General of Tax (DGT) regulation to elaborate on infrastructure is expected.

The PMK-169 specifically defines debt, equity and interest as follows:

a) **debt** includes long-term debt, short-term debt and interest bearing trade payables. Debt amount for the DER calculation is an average of month end balances. Unlike equity (see below) debt is not referenced to accounting standards. It is therefore unclear as to whether PSAK 50/55 (on financial instruments) will influence the DER calculation (i.e. whether debt should be the nominal amount stated in the agreement or the fair value according to PSAK 50/55);
b) **equity** includes all items recorded as the equity (so presumably including retained earnings) based on the accounting standards. Interest-free loans from a related party are also treated as equity for DER purposes. Similar to debt, equity for the DER calculation is an average of month end balances; and
c) **interest expense** includes loan interest, discounts and premiums, arrangement fees, lease interest, guarantee fees and foreign exchange losses arising from the interest expense.

PMK-169 disallows interest expenses in the following circumstances:

a) entirely if equity is zero or negative;
b) partly, according to the portion of loan exceeding the 4:1 ratio;
c) partly, according to the portion of loan associated with final tax income (e.g. land and/or buildings rental); and
d) entirely for non-reporting offshore private loans (to be further clarified in a DGT regulation).

It is also worth noting that, even when the DER is within the permitted level, the general income tax rules should be complied with. A challenge on interest deduction would remains if, for example, the interest rate on a related party loan was not arm’s length, the loan was used to generate Indonesian bank interest income, the loan was used to finance benefits in kind spending (e.g. employee’s housing), or the related party loan leverage was beyond the common industry practice.

Impacts on the resources sector

Mining

Only *lex specialis* mining entities (generations 1 and 3 of Coal CoWs and all generations of mineral CoWs) are likely to be exempt from the 4:1 DER. This would mean that those taxpayers should continue to follow the DER specified in the respective mining contract (whereby the DER ranges from 1.5 to 8 times). It could be argued that the definition of debt, equity and the calculation method (which are not typically specified in mining contracts) should follow PMK-169 although this is not clear. Taxpayers should also be aware that interest deductibility may be subject on the level of paid up capital (if required to be fully paid up).

Non-*lex specialis* mining taxpayers (including IUP holders) should follow PMK-169.

Oil and gas

The upstream sector appears to be less impacted by PMK-169. The thin capitalisation rules should only apply to PSCs:

a) signed prior to 2011 (before the issuance of Government Regulation No. 79/2010);
b) where the interest has been approved for cost recovery; and
c) is held by a PT.

Other than these circumstances, PMK-160 should not be applicable to PSCs as these are typically held by branches (Permanent Establishment/BUT) and/or interest expenditure is contractually non recoverable.

The downstream sector may also be exempt from the 4:1 DER if the *investment constitutes* "infrastructure" (subject to further confirmation in a DGT regulation).

Electricity/power

Similar to the downstream sector it is possible that the electricity/power sector will be exempt from the 4:1 DER as infrastructure (again subject to further confirmation).

Mining/oil and gas support

Except for those industries subject to final income tax (such as construction, shipping or barging) taxpayers in the mining/oil & gas support sectors should follow PMK-169.

DER application

The application of thin capitalisation in the resources sector will therefore vary with clarification still required in a number of critical cencus. PMK-169 should at this stage serve as early guidance on DER levels until further regulations are issued (hopefully before year end 2016). Close monitoring of this development is necessary.

It is also advisable to initiate a DER assessment before the rules are implemented. The assessment may include a dividend pay-out strategy. Strategies to increase capital (including debt conversion), inter-company loan rearrangements (whether or not interest bearing), assets revaluation, etc. These could have a direct impact on the equity balance and hence the acceptable leverage.

Please contact your usual PwC consultant if further clarification is required.

Mandatory use of Rupiah and its impact on financial reporting

Irwan Lau

On 31 March 2015 Bank Indonesia issued Regulation No. 17 as implementing guidance for Law No. 7/2011 regarding the mandatory use of rupiah for cash and non-cash transactions in Indonesia. A circular letter No.17/11/DKSP (SE 17) was issued on 1 June 2015 with the objective of further regulating the requirements on the mandatory use of rupiah for domestic transactions.

Starting 1 July 2015 any cash or non-cash transaction made within the Republic of Indonesia must use and be settled in Rupiah. All price quotations of goods and services must also be in Rupiah and dual currency quotation is prohibited.

Through circular letter SE 17 Bank Indonesia clarified that the following types of strategic infrastructure projects can be exempted from the mandatory use of Rupiah rules (although the list is not exhaustive):

a) transportation (e.g. the construction of an airport);
b) road construction and irrigation system;
c) infrastructure for water supplies;
d) power utilities, including power plants and transmission system;
e) oil and gas projects.

To obtain the exemption, the project owner should obtain a confirmation from the related Ministry declaring that the work is for a strategic infrastructure project and obtain a waiver letter from Bank Indonesia for not using Rupiah.

On 1 July 2015, the Minister of Energy and Mineral Resources issued a press release (No. 40/SJI/2015) outlining a framework to classify transactions into three main categories (for the energy sector), as a transition towards mandatory use of Rupiah. The categories are:

Category 1 – transactions which can be directly converted to Rupiah, for example, leases and salary payments to local employees (6 months transition);

Category 2 – transactions which require time to be converted to Rupiah, for example, long-term service contracts (continue to use foreign currency subject to future amendment of the contract);

Category 3 – transactions that are fundamentally difficult to use Rupiah, for example, salaries to expatriates, drilling services and lease of ships.

Impact on financial accounting and reporting

Companies will need to assess whether their functional currency needs to change.

The primary indicators of a functional currency is the currency that:

a) mainly influences the sales price of goods and/or services. This means the currency whose competitive forces and regulations mainly determine the sales price of goods and services, and
b) mainly influences the labour, material and other costs of providing the goods/services.

Secondary considerations are the currency that:

a) funds from financing activities are generated in, and
b) receipts from operating activities are usually retained in.

A change in functional currency should be accounted for prospectively from the date of change. Please call your PwC contact to discuss further as necessary.

1.5% tax on mining purchases of coal

Rita Susanto

On 9 June 2015, the Minister of Finance (MoF) issued Regulation No.107/PMK.010/2015 (PMK 107), the fourth amendment of MoF Regulation No.154/PMK.03/2010, which included several new transactions into the subject of Article 22 Income Tax. PMK 107 became effective on 8 August 2015.

From a purely mining perspective PMK 107 requires an entity which purchases coal from an entity (or individual) holding an IUP to collect and remit Article 22 Income Tax at 1.5% of the purchase price at the time of purchase (please refer to our Tax Flash No. 17/2015 for a list of additional transactions subject to Article 22 Income Tax).

Under Directorate General of Taxation (DGT) Regulation No. PER-31/PJ/2015 (PER 31) as the implementing guidance for PMK 107, an IUP (defined in Government Regulation No. 23/2010) constitutes a license for the mining of minerals or coal and is divided into Exploration and Production Operation IUPs.

However, given the broad definition provided under Government Regulation No. 23/2010 companies involved in other mining related activities are also required to hold an IUP (e.g. a Production Operation IUP for transportation and sales). As a result these IUP holders may also be caught under the rules for the 1.5% tax.

Overall it is now clear that the 1.5% tax applies to purchases of coal from an IUP holders, but less clear on whether the tax should be collected on purchases of coal from a coal trader holding a Production Operation IUP.

Developments should be monitored.

GR-79 Update – Where are things at?

Alexander Lukito

After almost five years since its issuance, the pros and cons around GR-79/2010 remain an interesting topic of discussion.

A recommendation from the National Exploration Committee (*Komite Eksplorasi Nasional (KEN)*) to ESDM, which essentially proposes the cancellation of GR-79, seems to be a hot issue in the industry, notwithstanding that the Government (at least ESDM), to our knowledge, has not made any decision on this.

Irrespective of the pros and cons around the cancellation of GR-79, it may be worth revisiting where things are at, especially on certain areas as follows:

- **Cost recovery audits and the Tax Office's position:** in regard to joint audits conducted by SKK Migas, BPKP and the Tax Office, the industry players have raised concerns around the work coordination amongst these three institutions. Recent developments indicate that the Tax Office has unilaterally issued tax assessments despite long standing cost recovery audit findings which are still subject to discussions/negotiations with SKK Migas and/or BPKP. Such a precedent creates a major concern in the industry;
- **Taxing indirect PSC transfers:** the Tax Office taxing policy in this area continues to evolve. The "substance over form" concept is being upheld with a strong desire to levy GR-79/PMK-257 tax in a wide range of indirect PSC transfer scenarios. In many cases the Tax Office issued written scrutiny to PSC taxpayers particularly when debt assignment and treaty protection scenarios were involved. Some tax assessments have been issued. Furthermore, the Tax Office also performed reconciliations to any taxpayer declarations on individual PSC value, public announcement, etc;
- **Land & Building Tax ("PBB"):** post the 2012 and 2013 PBB "assessments" (which had previously become the industry's major concern) some positive trends appear to exist, at least for the (post GR-79) exploration PSCs.

  The 2014 and 2015 PBB "assessments" seem to be no longer a significant concern for exploration PSCs, particularly after the issuance of Minister of Finance ("MoF") Regulation No.267/2014 which provides a PBB reduction (up to 100%) for the sub-surface component of exploration PSCs.

  Notwithstanding that PBB continues to be an issue for (post GR-79) producing PSCs;
- **New C&D tax Reporting:** with the issuance of MoF Regulation No.70/2015 the Government in principle has put the payment of C&D tax on an equal footing with general taxes. This means that the fund is to be remitted into the (general) State Treasury account rather than into the (previous) Oil & Gas account. Remittance in US$ should be made via a *Bank Persepsi Mata Uang Asing* – which seems to be limited to Bank BNI and Mandiri at this stage. We are aware that in practice this new process has been quite cumbersome.

Whilst the above is not an exhaustive list of GR-79 issues, readers who are interested in exploring other GR-79 issues may wish to contact their regular PwC advisor, or any of the contacts listed in this newsletter.

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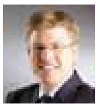
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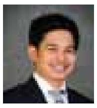
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