PwC Indonesia Energy, Utilities & Mining NewsFlash

The "new" GR 79 – major changes to the key PSC cost recovery and tax regulation

New Government regulation makes significant changes to GR 79 and the fiscal arrangements for PSC activities.

On 19 June 2017, and so just before the Idul Fitri break, the President signed GR 27/2017 to amend the industry-critical GR 79/2010. Readers will recall that GR 79 represents the principal regulation governing the cost recovery and Income Tax arrangements relevant to the upstream oil and gas sector. This includes the founding framework for taxing transfers of PSC interests which was later expanded with Minister of Finance ("MoF") Regulation No. 257 of 28 December 2011 ("PMK 257").

pwc

www.pwc.com/id

What’s new?

Whilst we are still analysing the full impact of the amendments the main changes can be summarised as follows:-

a) Article 10 in regard to State Revenue including Government Share and FTP

This Article has been amended to allow for a range of upstream “incentives” including:-

i. a Domestic Market Obligation (“DMO”) holiday (albeit with no time limit specified);
ii. a range of tax incentives where they are in accordance with the prevailing tax laws; and
iii. a range of non-tax State revenue incentives which may include the use of State owned assets for upstream activities.

The elucidation indicates that this amendment primarily targets the historical PSC-embedded incentives such as investment credits and DMO holidays. It is not clear however whether this will extend to general tax concessions such as those under GR 9/2016. Whilst this amendment appears positive in principle, the true value will not be clear until implementation.

These amendments also include a new Article 10(a) to allow for a “sliding scale” equity split to be determined by the Minister of Energy and Mineral Resources (“MoEMR”). It is unclear at this stage how this scale will interface with the splits shown in the PSCs themselves (although see discussion on Article 38 below);

b) Article 11 in regard to recoverable costs

This Article has been amended to positively confirm the recoverability of LNG processing costs;

c) Article 13 in regard to non-recoverable costs

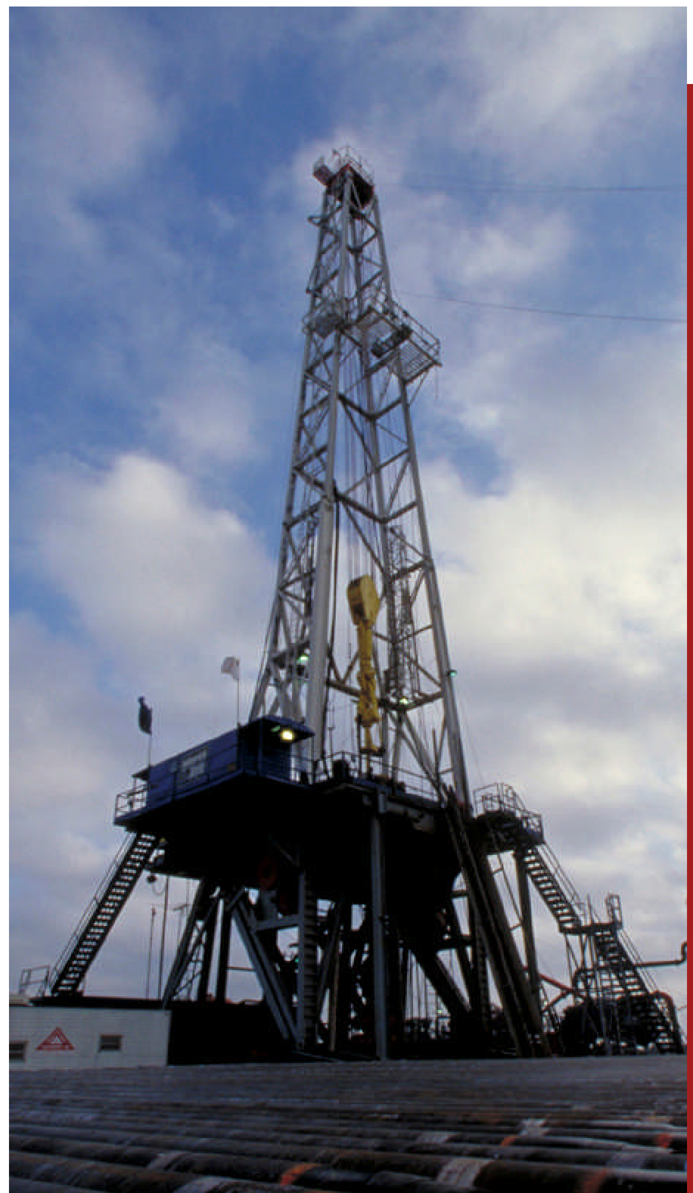
This Article has been amended to remove a number of items from the list of non-cost recoverable spending being:-

i. tax allowances related to employee Income Tax (which appears to be employee Income Tax where remitted on a grossed up basis);
ii. interest formally approved for cost recovery; and
iii. community development during an exploitation phase.

As a result spending on these items should now be cost recoverable at least to the extent that this is in accordance with the requirements of the relevant PSC;

d) Article 16 in regard to depreciation

This Article has been amended to allow for the residual value of assets that are “no longer able to be used” to be cost recovered outright. Under the previous arrangements, and Exhibit C of most PSCs, this spending was to continue to be depreciable based upon the original useful life of the asset;



e) Article 25 dealing with the Income Tax calculation

This Article has been amended to include:-

i. a new Article 25(7a) which requires that Assessments arising out of a tax audit are to be issued within 12 months from the receipt of a "complete" tax return (previously there was no formal timeline except in a tax refund case).

   The intent/impact is not clear particularly noting the current joint-audit framework with the BPKP and SKK Migas. It is possible however that this amendment will mean less of a role for the Directorate General of Tax ("DGT") in Income Tax related audits;

ii. new Articles 25(12) and (13) which provide that Income Tax on First Tranche Petroleum ("FTP") is to be due when "accumulated" FTP exceeds the relevant cost recovery balance.

   This amendment is not entirely clear but could mean that FTP is to be accumulated as non-taxable income until reaching exhaustion of unrecovered costs (and so an equity oil position) at which point the entire accumulated FTP becomes taxable.

   If so this treatment would be consistent with the treatment for FTP as outlined under DGT Regulation No. 5/2014 which required Income Tax on FTP to be remitted once an equity split is reached;

f) Article 26 dealing with Tax Facilities

This Article has been amended to include new Articles 26(A) to (E) to provide specific tax facilities as follows:-

i. a "duty/import tax exemption" in relation to physical imports by PSCs during both the exploration and exploitation phases;

ii. reductions in Land and Building Tax ("PBB") of 100% (during exploration phase) and up to 100% (during exploitation phase).

   Note that MoF approval is required for these import related and PBB incentives during exploitation (the incentives during exploration phase appear to be automatic);

iii. that income arising out of charges from the shared use of assets by PSCs is to be exempt from withholding tax ("WHT") and Value-added Tax ("VAT").

   Interestingly the amendment does not formally provide that the income itself is otherwise exempt;

iv. that "indirect head office allocations" do not constitute Income Tax "objects" or VATable "supplies". This appears to be a formalisation of the long established principle set out under MoF letter S-604 issued in 1998 which has been challenged by the DGT in recent years.

   The consequence of this amendment is presumably to render cost allocations exempt from WHT and VAT. There is however no elaboration on the meaning of a "head office" and so it is unclear how widely this incentive can be extended to affiliate charges from overseas;

g) Article 27 dealing with Uplifts and PI transfers

This Article has been amended to include:-

i. a new Article 27(1a) which provides that taxable income arising from uplifts, after being reduced by Final Income Tax, is to be non-taxable; and

ii. a new Article 27(2a) which provides that taxable income arising from PSC transfers, after being reduced by Final Income Tax, is to be non-taxable.

In these cases the consequence of the after tax income becoming non-taxable is presumably that no further tax should apply to the after tax income. This should therefore now formally exclude the levying of a branch profits tax ("BPT") on the after tax income from PSC transfers presumably in either a direct or indirect transfer scenario. Readers should note however that this outcome is not actually stated.

On this point, readers should also note that the BPT on PSC transfers was introduced via PMK 257 and so was arguably never part of the original GR 79 architecture. It is not clear whether a complementary amendment of PMK 257 will now be issued to ensure complete clarity on this matter;

h) Article 31(2) dealing with PSC Transfer Reporting

This Article has been amended to require that the value of a PSC transfer be reported to both the Directorate General of Oil and Gas ("DGOG") of the MoEMR and the DGT.

Previously the GR 79 reporting was only to the DGT;

i) Article 37 dealing with pre-GR 79 PSCs

This Article has been amended to include a new Article 37(A).

The amendment reinforces the requirement for pre-GR 79 PSCs to follow the GR 79 interpretation of 8 "unclear" matters set out at Article 38 of GR 79 (i.e. the matters on which GR 79 has, controversially, sought to apply itself to the exclusion of the underlying PSC). This amendment therefore appears designed to allow these unclear matters to continue to be governed by regulation rather than traditional PSC interpretations;

j) Article 38 dealing with Transitional Provisions

This Article has been amended to include new Articles 38(A)-(C) which set out transitional provisions as follows:-

i. for PSCs signed before Law No. 22/2001:- the relevant PSC holders should elect to either:-

   A-(exclusively) follow the provisions of the relevant PSC (and so disregard GR 27); or

   B-"adjust" their PSCs so as to comply with GR 27 (in its entirety).

   The election, which appears to be mandatory, therefore requires the PSC holder to take an "all or nothing" approach to the adoption of GR 27 (including therefore the residual components of GR 79).

   This election is to be made within 6 months of the issuance of GR 27 (i.e. by mid December 2017);

ii. for PSCs signed before GR 79 (but post Law No. 22/2001):- the outcome here appears to be identical to category i. above (i.e. for PSCs signed pre-Law No. 22/2001);

iii. for PSCs signed after GR 79 (but prior to 19 June 2017):- the outcome here appears to be similar to category i. PSCs above although presumably with any election to "opt-out" of GR 27 still leaving the PSC holder subject to GR 79;

iv. for PSCs signed post 19 June 2017:- the outcome here appears to simply require the PSC holder to follow GR 27.

   The impact of these transitional rules, including on the underlying PSC itself, will require some consideration (noting that an election of this nature was not a feature of the introduction to GR 79). In the most benign scenario "opting-in" would appear to mean that a pre-GR 79 PSC holder would follow the underlying PSC arrangements (other than in respect of the 8 unclear matters) while accessing the new concessions specific to GR 27. A question does however arise as to how vulnerable that scenario would leave the PSC holder to future amendments to GR 27.

   Alternatively if a pre-GR 79 PSC holder were to "opt-out" the framework might still be the underlying PSC position as modified by GR 79.

Food for thought

In conclusion, the package of amendments may, on balance, be viewed positively by the industry and particularly for newer PSCs. However, all PSC holders will need to carefully weigh-up the economic implications of the different options before making an election to opt-in to GR 27.

One key concern for older generation PSCs is whether the long-held concept of an “assume and discharge by the Government” for all taxes not stated in the PSC continues to be available under the new GR 27. It could be that, under GR 27, only the specific exemptions or tax facilities provided for in the GR are available which would then be subject to ongoing uncertainty from changes in regulations in the future. Conversely, if PSC holders choose not to opt-in they may not be able to access the new positive elements of GR 79 or GR 27, and may nevertheless continue to be subject to the interpretational vagaries of their PSC by the tax and other authorities.

From a purely fiscal perspective the apparent clarity around the non-imposition of BPT on PSC transfers will no doubt be welcome and potentially add significant “book” value to producing PSCs in particular. Other fiscal interventions, including those in relation to head office costs, should also be helpful. However, to avoid uncertainty, several MoF regulations/DGT decrees will need to be amended to be in line with these new terms.

Implementation will therefore be key with the major area of consideration being the impact of the “all or nothing” nature of the GR 27 adoption election. With this in mind one immediate recommendation would be for all PSC holders to review the package of amendments in their entirety with a view to coming to an early view on how to approach a December 2017 election.

Contacts

Please feel free to contact our Energy, Utilities & Mining (EU&M) Specialists or any of your regular PwC advisors.

Assurance

Sacha Winzenried
sacha.winzenried@id.pwc.com
T: +62 21 528 90968

Yusron Fauzan
yusron.fauzan@id.pwc.com
T: +62 21 528 91072

Gopinath Menon
gopinath.menon@id.pwc.com
T: +62 21 528 75772

Yanto Kamarudin
yanto.kamarudin@id.pwc.com
T: +62 21 528 91053

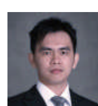
Daniel Kohar
daniel.kohar@id.pwc.com
T: +62 21 528 90962

Toto Harsono
toto.harsono@id.pwc.com
T: +62 21 528 91205

Dodi Putra
putra.dodi@id.pwc.com
T: +62 21 528 90347

Firman Sababalat
firman.sababalat@id.pwc.com
T: +62 21 528 90785

Heryanto Wong
heryanto.wong@id.pwc.com
T: +62 21 528 91030


Dedy Lesmana
dedy.lesmana@id.pwc.com
T: +62 21 528 91337

Tody Sasongko
tody.sasongko@id.pwc.com
T: +62 21 528 90588

Tax

Tim Watson
tim.robert.watson@id.pwc.com
T: +62 21 528 90370

Suyanti Halim
suyanti.halim@id.pwc.com
T: +62 21 528 76004

Antonius Sanyojaya
antonius.sanyojaya@id.pwc.com
T: +62 21 528 9097

Turino Suyatman
turino.suyatman@id.pwc.com
T: +62 21 528 75375

Gadis Nurhidayah
gadis.nurhidayah@id.pwc.com
T: +62 21 528 90765

Tjen She Siung
tjen.she.siung@id.pwc.com
T: +62 21 528 90520

Alexander Lukito
alexander.lukito@id.pwc.com
T: +62 21 528 75618

Otto Sumaryoto
otto.sumaryoto@id.pwc.com
T: +62 21 528 75328

Hyang Augustiana
hyang.augustiana@id.pwc.com
T: +62 21 528 75329

Raemon Utama
raemon.utama@id.pwc.com
T: +62 21 528 75560

Advisory

Mirza Diran
mirza.diran@id.pwc.com
T: +62 21 521 2901

Joshua Wahyudi
joshua.r.wahyudi@id.pwc.com
T: +62 21 528 90833

Michael Goenawan
michael.goenawan@id.pwc.com
T: +62 21 528 90340

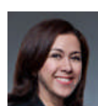
Hafidsyah Mochtar
hafidsyah.mochtar@id.pwc.com
T: +62 21 528 90774

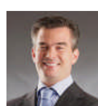
Agung Wiryawan
agung.wiryawan@id.pwc.com
T: +62 21 528 90666

Tim Boothman
t.boothman@id.pwc.com
T: +62 81 288 128766

Ripa Yustisiadi
ripa.yustisiadi@id.pwc.com
T: +62 21 528 90947

Consulting


Lenita Tobing
lenita.tobing@id.pwc.com
T: +62 21 528 75608


Paul van der Aa
paul.vanderaa@id.pwc.com
T: +62 21 528 91091

This content is for general information purposes only, and should not be used as a substitute for consultation with professional advisors.

PwC Indonesia is comprised of KAP Tanudiredja, Wibisana, Rintis & Rekan, PT PricewaterhouseCoopers Indonesia Advisory, PT Prima Wahana Caraka and PT PricewaterhouseCoopers Consulting Indonesia each of which is a separate legal entity and all of which together constitute the Indonesian member firm of the PwC global network, which is collectively referred to as PwC Indonesia.

© 2017 PwC. All rights reserved. PwC refers to the PwC network and/or one or more of its member firms, each of which is a separate legal entity. Please see http://www.pwc.com/structure for further details.