Investing in Indonesia

2013

kpmg.com/id
1. Introduction

Indonesia has historically been plagued and associated with weak institutions and a myriad of other problems, being one of the countries hardest hit by the 1997 Asian Economic crisis, which caused a major recession, widespread civil unrest, sectarian violence and resulting socio-economic fallout. At the height of the crisis, foreign investment virtually dried up, the IDR collapsed against the USD and other foreign currencies and interest rates and inflation reached unprecedented levels.

Today, Indonesia is a politically stable democracy, has enjoyed sustained periods of record economic growth and foreign investment, as well as now being the largest economy in South East Asia. However the country is still not without need for significant policy reforms and various challenges remain, with new ones emerging.

This publication is intended as a general guide to investing and doing business in Indonesia for new foreign investors looking to enter the Indonesian market, but also tries to capture practical insights and other intelligence from KPMG’s experience “at the transaction and M&A coalface” based on our experience in providing transaction, M&A and tax advisory services to both foreign and local investors.

The publication is not intended to be a substitute for formal legal and other professional advice. To the best of our knowledge, laws and regulations referred to throughout the document reflect the position as at 1 January 2013.
2. Country Facts and Overview

<table>
<thead>
<tr>
<th>Official Name</th>
<th>Republic of Indonesia</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital city</td>
<td>Jakarta: which is the business and governmental centre</td>
</tr>
<tr>
<td>Other major cities and provinces</td>
<td>Surabaya, Medan, Bandung. Surabaya is the second largest city and a major industrial centre and port. There are 34 provinces comprising 502 regencies, 6,543 districts and 75,244 villages</td>
</tr>
<tr>
<td>Government Type</td>
<td>Independent Republic</td>
</tr>
<tr>
<td>Independence</td>
<td>17 August 1945</td>
</tr>
<tr>
<td>Highest Authority</td>
<td>People’s Consultative Assembly (MPR)</td>
</tr>
<tr>
<td>Geography Location</td>
<td>South Eastern Asia, archipelago between Indian Ocean and Pacific Ocean</td>
</tr>
<tr>
<td>Largest Islands</td>
<td>Sumatra, Java, Kalimantan (Borneo), Sulawesi and Papua account for over 90% of total land area. There are also two large groupings of smaller islands, Maluku and Nusa Tenggara</td>
</tr>
<tr>
<td>Area</td>
<td>1,904,569 sq km (736,600 sq mi)</td>
</tr>
<tr>
<td>Terrain</td>
<td>More than 17,508 islands; 6,000 are inhabited; 1,000 of which are permanently settled</td>
</tr>
<tr>
<td>Coastline</td>
<td>54,716 km</td>
</tr>
<tr>
<td>Climate</td>
<td>Tropical, hot, humid, cooler in the highlands</td>
</tr>
<tr>
<td>People Nationality</td>
<td>Indonesian</td>
</tr>
<tr>
<td>Population</td>
<td>240.8 million: &gt;50% under age of 29 (2010-15E annual average growth: 1.0%)</td>
</tr>
<tr>
<td>Ethnic Groups</td>
<td>40% Javanese, 16% Sundanese and 44% other ethnic groups</td>
</tr>
<tr>
<td>Religions</td>
<td>Islam 86%, Protestant 6%, Catholic 3%, Hindu 2%, Others 3%</td>
</tr>
<tr>
<td>Language</td>
<td>Bahasa Indonesia (akin to Malay)</td>
</tr>
<tr>
<td>English</td>
<td>English is widely spoken by business people in major cities</td>
</tr>
<tr>
<td>Currency</td>
<td>Indonesian Rupiah (IDR)</td>
</tr>
<tr>
<td>Inflation</td>
<td>Average of 5.1% in 2010; 5.4% in 2011 and 4.3% in 2012</td>
</tr>
<tr>
<td>Forecasted between 5.0% - 6.1% over 2011-15</td>
<td></td>
</tr>
<tr>
<td>Natural resources</td>
<td>Oil, tin, natural gas, coal, gold, copper, silver, nickel, bauxite, timber, fertile soils</td>
</tr>
<tr>
<td>Agricultural products</td>
<td>Rice, cassava (tapioca), peanuts, palm oil, rubber, cocoa, coffee, copra, poultry, beef, eggs</td>
</tr>
</tbody>
</table>

The Country

Indonesia is located in South-East Asia between the Indian and Pacific Oceans and is bordered by Malaysia, Singapore, East Timor and PNG. The main islands of Java, Sumatra, Kalimantan, Sulawesi and Papua feature spectacular mountain ranges flanked by rich coastal plains, fertile valleys and large areas of lowlands. The smaller islands, many of which are uninhabited, are often fringed by brilliant beaches and coral reefs and bedecked with tropical palm trees.

A large percentage of world trade transits the strategically important straits of Malacca that link the Indonesian ocean littoral to the South China Sea and the larger Pacific Ocean basin.

Indonesia is rich in natural resources, minerals, oil, and fertile land to support agricultural products. It is these resources, together with the islands’ central location between India and the Orient, that have made Indonesia so attractive to foreign traders, rulers and investors both historically and as of today.

The people

The people of Indonesia are culturally diverse reflecting their differing ethnic origins, religions and histories.

With an estimated population of 240.8 million, Indonesia is the fourth most populous nation in the world after China, India and the USA, as well as the world’s most populous Muslim nation. The population is expected to grow by 2.5 million people per year through 2015. 54% of the population is below 29 years of age, while about 70% is below 39 years of age. The most populated islands are Java, Sumatra, Sulawesi and Kalimantan. Java, Bali and Madura are the most densely populated with Papua, Kalimantan and many of the smaller islands having low population densities. The most populous cities are Jakarta, Surabaya and Bandung in Java, and Medan in Sumatra. About 44% of the population resides in urban areas, with the annual rate of urbanization estimated at 1.7% over 2010-15.

Most Indonesians are of Malay descent and the largest ethnic group, the Javanese, make up 40% of the total population. The Javanese are pre-eminent in the social
3. Economic Environment

The state of the Indonesian economy
Following the 1997 Asian Economic Crisis, Indonesia experienced a period of severe economic and political instability that was compounded by the collapse of the banking system, a function of unrestrained lending and other practices. Ten years later however following a period of political stability as well as sound economic and financial policy which lowered the national deficit from 89% of GDP in 2000 to less than 30% in 2011, Indonesia was less affected by the Global Financial Crisis ("GFC") compared to many neighboring economies, its resilience underpinned by strong domestic spending and relatively low dependence on exports which make up a small 1.7% proportion of the country’s GDP.

The main opportunities
Indonesia has the economic growth and investment potential to be regarded in the same light as the ‘BRIC’ countries. The country has a large domestic consumption base; its middle class has grown substantially, from approximately 38% of the population in 2003 to 57% in 2010 or well over 100 million people, with 7 million being added each year. Wage growth and an improving employment outlook are expected to support the Indonesian consumer story. The country’s abundance of natural resources and strong demand for these from China, India and other rapidly expanding economies should benefit Indonesia over the longer term.

The emergence of Indonesia’s growing middle class has been well documented. There is also however a growing lower and poor socio-economic class of over 100 million whose income and private expenditure is between USD 2 to USD 4 per day and less than USD 2 per day, respectively. The government is becoming increasingly conscious of this socio-economic group and reform strategies are now a focus.

Barriers, risks and challenges
Indonesia’s business environment is still plagued by poor infrastructure and weak institutions. Despite steps being taken to tackle corruption, Indonesia is still ranked 100th out of 183 in Transparency International’s 2011 corruption perception index. Excessive bureaucracy and a lack of coordination at the ministerial level also undermine the country’s business environment. In terms of 2011 World Bank and IFC “Ease of doing business” and “Ease of starting a business” measurements, Indonesia ranked 128th behind Ethiopia and 155th out of 185 countries, well below East Asia & Pacific regional averages. On contract enforcement,
the country ranked 144th, tied with Malawi. A recent positive development is an announcement by the Indonesia Foreign Investment Review Board ("BKPM") which has plans to reduce the time involved in establishing a business by providing for applications for business and investment licenses to be made online.

These and other similar indicators however do not measure all aspects of a business environment that matter to companies and investors. Related discussion is in Chapter 4 on Infrastructure and Chapter 5 on Investment, as well as other chapters throughout this publication.

There are plans for investments in infrastructure of USD 191 billion over 2011-2014, and USD 440 billion from 2011-2025, nearly half of which has been assigned for basic infrastructure.

Further, the 2012 upgrade of the country’s sovereign debt to BBB- Investment Grade by Fitch Ratings should augment Indonesia’s ability to attract foreign capital and also stabilize its debt market. However it is recognized that further upgrades are likely to be contingent upon the GOI’s ability to achieve progress in development of basic infrastructure.

A possible condition of investor uncertainty is likely to exist in the period leading up to the 2014 Presidential and Parliamentary elections.

### Indonesia economy maintains positive momentum

#### Economic growth and Gross Domestic Product ("GDP")

The economic growth forecast for Indonesia remains at 6.1% in 2012. Growth is still being driven to a large degree by domestic consumer demand and spending from a growing middle class of over 100 million people with increasing levels of disposable income and a relaxed savings mindset. Indonesia’s GDP rose to 6.4% in 2Q2012 and is projected to be maintained at 6.3% in 2013.

FDI is also now at record levels higher than what was achieved prior to the 1997 Asian Economic Crisis. Recent BKPM data suggests that in 1Q2012, foreign investment realization in manufacturing reached USD 5.7 billion, a 30% increase YoY. The increase in FDI inflows has been driven by relatively low labor costs, the availability of abundant, key natural resources and a large and growing domestic market, reflecting favorable demographics, high GDP per capita growth and the rapidly growing middle class. Indonesia has enjoyed recognized political stability since around 2004.

#### Inflation and Exchange rates

As at 3Q2012, the national inflation rate remained under control at 4.58% YTD despite a rise in some consumer goods prices which occurs annually due to and depending on the timing of Ramadan and Idul Fitri religious festive celebrations.

In terms of currency, the IDR depreciated by 0.6% over 3Q2012 to IDR 9,840/USD, due to a strengthening of the USD. The IDR is projected to reach IDR 9,670/USD at 4Q2012 and slightly strengthen to IDR 9,461 in 2013. Currency fluctuations and volatility as a country risk have now largely disappeared, for the time being at least, with the IDR being relatively stable for some time. However deteriorations in the external trade balance and other factors can creates risks of the IDR coming under depreciation pressures.

Fuel price increases and government policy on lifting of subsidies can impact inflation and thus interest rates. Following public demonstrations and a "last minute" cancellation of a planned fuel price increase on 1 April 2012 in an effort to reduce the level of fuel subsidies, a stipulation in a Revised Budget Law on 31 March 2012 provides for fuel price to be reviewed semi-annually based on movements in worldwide oil price. Historical increases in fuel prices in Indonesia have had adverse impacts on inflation and interest rates.

#### Economic outlook

Indonesia is not totally immune from spillovers from international developments through both financial and trade channels. Downside risk remains due to ongoing external uncertainties, including the extent and impact of the slowdown in China’s economy, the ongoing recession in the Euro Area and US fiscal issues. Should these risks transpire, Indonesia’s growth rate could be considerably slower. Much of the current growth has been built on rising commodity prices and strong domestic consumption. Whilst the manufacturing sector is growing, it lags behind Thailand, Malaysia, Brazil and Turkey in terms of size and sophistication. Labor laws complicate doing business and discourages value added, solutions based, labor intensive sophistication.

The baseline outlook is for growth of 6% in 2012 and 6.4% in 2013. However, in the event of a major freezing of international financial markets which contributes to a decline in trading partner growth, a fall in global commodity prices and reduced domestic investor confidence, similar to the Global Financial Crisis (GFC) in 2009, it is projected that growth could slow to 4.7% in 2013 ahead of the 2014 Parliamentary and Presidential elections.

### Investment Rating

<table>
<thead>
<tr>
<th>Investment Rating</th>
<th>Fitch</th>
<th>Moody’s</th>
<th>S&amp;P</th>
</tr>
</thead>
<tbody>
<tr>
<td>AAA</td>
<td>AAA</td>
<td>AAA</td>
<td>AAA</td>
</tr>
<tr>
<td>AA+</td>
<td>Aa1</td>
<td>AA+</td>
<td>AA+</td>
</tr>
<tr>
<td>AA</td>
<td>Aa2</td>
<td>AA</td>
<td>AA</td>
</tr>
<tr>
<td>AA-</td>
<td>Aa3</td>
<td>AA-</td>
<td>AA-</td>
</tr>
<tr>
<td>A+</td>
<td>A1</td>
<td>A+</td>
<td>A+</td>
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<tr>
<td>A</td>
<td>A2</td>
<td>A</td>
<td>A</td>
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<tr>
<td>A-</td>
<td>A3</td>
<td>A-</td>
<td>A-</td>
</tr>
<tr>
<td>BBB+</td>
<td>Baa1</td>
<td>BBB+</td>
<td>BBB+</td>
</tr>
<tr>
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<td>Baa2</td>
<td>BBB</td>
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</tr>
<tr>
<td>BBB-</td>
<td>Baa3</td>
<td>BBB-</td>
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<td>BB+</td>
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<td>BB+</td>
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<tr>
<td>BB</td>
<td>Baa2</td>
<td>BB</td>
<td>BB</td>
</tr>
<tr>
<td>BB-</td>
<td>B1</td>
<td>BB-</td>
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<td>B</td>
</tr>
<tr>
<td>B-</td>
<td>B3</td>
<td>B-</td>
<td>B-</td>
</tr>
</tbody>
</table>

Note: Indonesia Current Rating Nov 2012

Source: Fitch Ratings, Moody’s, Standard & Poors

Source: Mandiri Sekuritas, Macroscope Economic Research, 2 October 2012

Source: Central Statistic Bureau, Economic Growth in Indonesia 1Q2012
4. Infrastructure

Introduction
Infrastructure spending in Indonesia (both government and private) has remained subdued since the 1997 Asian Economic crisis. As a result Indonesia continues to have poor basic infrastructure and remains under invested. Population pressures and strong interest of foreign investors in Indonesian commodities gives rise to a significant need for infrastructure development in the country, which has a congested road network, over utilized airports, weak rail network and inadequate supply of infrastructure is consistently identified across many industries, as well as adversely impact foreign investment. Inadequate infrastructure and poor basic infrastructure and remains under invested. Despite being given a high priority in government spending programs, road building in Indonesia has progressed at a slow pace. Only 85kms of the 1,095km target for new toll roads has been developed over the past 5 years. Land acquisition challenges are commented on overleaf.

Indonesia's infrastructure condition
Overview
The World Economic Forum ranks Indonesia’s road infrastructure as 83rd out of 142 countries, rail infrastructure as 52nd out of 123 countries and port infrastructure as 103rd out of 142 countries.

Poor levels of infrastructure development are not only holding back Indonesia’s growth potential but also poverty reduction progress. The symptoms of more than a decade of slow pace. Despite being given a high priority in government spending programs, road building in Indonesia has progressed at a slow pace. Only 85kms of the 1,095km target for new toll roads has been developed over the past 5 years. Land acquisition challenges are commented on overleaf. Poor levels of infrastructure development are not only holding back Indonesia’s growth potential but also poverty reduction progress. The symptoms of more than a decade of slow pace. Only 85kms of the 1,095km target for new toll roads has been developed over the past 5 years. Land acquisition challenges are commented on overleaf. Poor levels of infrastructure development are not only holding back Indonesia’s growth potential but also poverty reduction progress. The symptoms of more than a decade of slow pace. Only 85kms of the 1,095km target for new toll roads has been developed over the past 5 years. Land acquisition challenges are commented on overleaf.

Rail
The railway system covers 5,042km, all of which is narrow gauge, 565km is electrified. The public railway which comprises most of the Indonesian rail network is operated by the state-owned PT Kereta Api (Persero), while some freight railways are privately owned and operated.

As of February 2011, there are 684 airports, of which 171 have paved runways, and 64 heliports operated by Angkasa Pura II and the Directorate General for Aviation. Ports are among the least efficient in South-East Asia in terms of turnaround times and unit costs. According to a World Bank survey of international buyers at the Jakarta Trade Expo 2009, most firms are satisfied with factory gate prices and the quality of Indonesian products but find high transport costs and lack of reliability of delivery schedules as the main constraints for business transactions. For example, logistics costs from Cikarang – Bekasi factories to Tanjung Priok ports for a 40ft container is USD 775, far higher than logistics costs from factories in Malaysia to port, which are only USD 450. Thailand is in the same range. Corresponding costs in Vietnam are lower again at USD 250.

Maritime
There are 21,579km of navigable waterways in the larger islands such as Sumatra, Java, Madura, Kalimantan, Sulawesi and Irian Jaya.

Natural gas pipelines extend 8,183km, with oil pipelines totaling 7429km and refined product pipelines 1,229km. The main ports are at Jakarta and Palembang supported by others in Cilacap, Gresik, Kupang, Makassar, Semarang and Surabaya. Belawan and Medan are big commodity ports. Indonesia is recognized to have a lack of deep water ports. In 2011, marine fleets operating in Indonesia totaled 16,331 vessels consisting of 10,902 national fleets, 562 foreign charted fleets and 4,867 foreign agency fleets.

Transport is expected to account for 71% of the total infrastructure investment – from USD 26.1 billion in 2010 to USD 93.0 billion in 2014.

• Water & sanitation: water access is low; 76% of the population do not have access to ‘improved’ water and only 24% are connected to local water utility companies. Sanitation services are severely lacking – only 1.3% of the population are reached (not necessarily connected) to a sewage network.

The Government has stated its commitment to achieving the Millennium Development Goals. In order to do so, an estimated 10 million household connections is required to be implemented.

• Energy: access is low; 43% of the population is without power (approx. 90 million people); investment needs are high – an estimated USD 15-17 billion is required before 2012 for an additional 9,700 MW of capacity, expanded transmission and distribution.

Road infrastructure is the platform for all other major infrastructure: land acquisition is the challenge underpinning progress
The lack of clear regulations on land acquisition for public use and the provision of land compensation to owners have caused delays to toll road and other infrastructure projects. There has been a long history of informal land ownership in Indonesia that gives rise to any number of individuals claiming the rights to the land during the land acquisition process. The implication of this is the need for the administrative process involving a number of government institutions to resolve land ownership issues, which is problematic.

Another frequent issue encountered is land owners holding on to their land as long as possible to benefit from appreciation in value while a project progresses, which has led to unexpected land cost escalation. Property prices in Indonesia and especially Java and Jakarta are increasing at a rapid rate.

Land acquisition issues have been one of the main obstacles for infrastructure projects in Indonesia. Enactment of President Regulation No.36/2005 concerning Land Acquisition for Infrastructure Development was intended to outline the rules and procedures for infrastructure projects serving public purposes, however the regulation was not effective due to vagueness in the rules.

Sources:
(1) Logistic Performance Index 2010: Indonesia, World Bank
(2) World Bank, Indonesia’s Logistics Costs Inefficient, November 11, 2011
(3) www.viglaceraland.vn/tiensoniz/Investment/PriceCharges/tabid/1119/Default.aspx
5. Investment

The Government has further enacted “Law No.2/2012 concerning Land Procurement for Development Purposes in Public Interest” to improve and put clarity around the land acquisition framework. However for the Law to be practical, a Presidential Regulation elaborating on the law was required. “Presidential Regulation No.71/2012 concerning Administration of Land Procurement for Development Purposes in Public Interest” was issued on 7 August 2012, and subsequently in the first week of November 2012 Regulation of BPN No.5/2012 which sets out technical implementation guidelines and rules. There is anticipation now that these regulatory developments have occurred, the prospects of progress being made and additional private funding flows being achieved will be improved.

“Indonesia to ramp up infrastructure”

Expenditure plans
Recognizing the pressing need for infrastructure development, the Indonesian government has increased its focus on improving the regulatory environment and stimulating infrastructure spending. Whether this can be achieved or not is open to discussion, but what is certain is that long lead times are involved. Indonesia’s 2011-2025 Development plan comprises IDR 4,012 trillion (USD 440 billion) of investment, with IDR 1,786 trillion or USD 196 billion assigned for basic infrastructure with substantial investments planned for roads, railways, ports and power plants.

Under Indonesia’s economic plan for 2011-2014, infrastructure investment has been targeted as requiring up to USD 191 billion for the economy to grow at its full potential. One third is expected to be funded by the Government with USD 140 billion being sought from the private sector. To encourage local and international investment, Indonesia plans to abolish more than 800 regional restrictions on businesses that clash with national regulations as well as continuously revising its regulations and providing various facilities to investors like tax holidays. Indonesia also plans to increase spending on the country’s overburdened roads, airports and power plants to IDR 194 trillion (USD 20 billion) in 2013 from a target of IDR 169 trillion in 2012. The fund will be used to improve 4,431km of roads, add 380km of new railway and finance construction of 15 new airports and the expansion of another 120.

In September 2012, the World Bank approved a new project to support the newly established Indonesian Infrastructure Guarantee Fund (“IIGF”), an institution under the Ministry of Finance (“MOF”) responsible for providing guarantees for infrastructure projects, or more specifically Public-Private-Partnership (“PPP”) projects. With the World Bank’s support, the IIGF will be able to provide guarantees to leverage private investments in infrastructure projects such as toll roads, bridges, railroads, irrigation canals, wastewater infrastructure, telecommunication towers and power generators among other undertakings.

Government institutions
PT Sarana Multi Infrastruktur (SMI) was established on 26 February 2009 to accelerate infrastructure development in Indonesia. The establishment was based on Government Regulation No.66/2007 and Government Regulation No.75/2008 on State Equity Participation in the Establishment of Perusahaan Perseroan (Persero) in the Sector of Infrastructure Financing. The role of SMI is to become a catalyst in the acceleration of the infrastructure development in Indonesia, to provide alternative sources of project financing by working with stakeholders to obtain an appropriate financing solutions, to promote PPPs in financing infrastructure projects in Indonesia and to increase the size and capacity of SMI through partnerships with third parties.

The Indonesia Infrastructure Finance Fund (IIF) was established as part of the governor’s 100-day Priority Program. The commitment to accelerate infrastructure development is further reflected in the MOF through PT Sarana Multi Infrastruktur (Persero) (“PT SMI”) and the establishment on 15 January 2010 of PT Indonesia Infrastructure Finance (“PT IIF”), an infrastructure financing company. PT IIF is majority privately owned, with initial shareholders being the Asian Development Bank (“ADB”), International Finance Corporation (“IFC”), Deutsche Investitions- und Entwicklungsgesellschaft mbH (“DIEG”) and PT SMI. A Project Development Facility (PDF) has been established and being administered by BAPENAS with funding from ADB. The objectives of PDF is to assist in project preparation, selection of appropriate private partners in infrastructure services and monitoring of project preparation and transactions being conducted in accordance with PPP principles.

BKPX serves as the “front office” for PPP projects. BKPX’s role is to be the primary interface between private investors and the government.

The foreign investment landscape
Indonesia welcomes foreign investment on its own terms. Government policies aim at ensuring that foreigners work with Indonesians to assist in development of the country’s economy and skill-base. There is a general recognition that Indonesia needs the development capital, and the technical and management skills of foreigners.

Government regulation of foreign investment in Indonesia is manifested in a variety of ways, for example:

- approved and monitored through governmental bodies
- companies can employ only a limited number of expatriates, and are required to demonstrate plans for replacement of those expatriates by Indonesians (with the exception of expatriate directors and commissioners)
- certain fields of business are closed to investment by foreigners
- foreign individuals are permitted to acquire land or land rights with a number of restrictions.

A “foreign investor” is usually a foreign company incorporated under the laws of its host nation; however foreign individuals are also acceptable.

Direct and Non-direct investment
Law No.25/2007 concerning Investment ("the Foreign Investment Law") defines investment as Direct investment and Indirect investment. Indirect investments, also known as portfolio investments, are the transactions made through the domestic capital market/stock exchanges of a country. The Indonesian equity market is highly institutionalized, whereby over a period from 2002 to 2007 foreign institutions held almost 70% of the free-float value of the Indonesian equity market, while less than 5% of the free float value was held by individuals.

The Indonesian government encourages Direct foreign investment or “FDI” in most areas of the Indonesian economy. Foreign investment approvals can be issued either by BKPM in Jakarta or an Investment Board (BPM) in every Province, Investment Institution in Regency Municipality or through Representative Offices of the Republic of Indonesia in several countries.

Foreign Investment Law, Investment Negative List and FDI
The Foreign Investment Law regulates FDI by granting a right of entry to foreign businesses through a government licensing procedure principally controlled by BKPM. It specifies that foreign investment shall be in the form of a limited liability Foreign Investment Company or “PMA” incorporated in Indonesia, in which the investor goes into partnership with an Indonesian person or entity as shareholders. Foreign investors can hold up to 100% ownership, or between 45% to 95% of ownership in certain industries, but this will vary within sectors and business fields.

Foreigners are permitted to invest with no restriction on the maximum size of the investment, the source of funds or whether the products are destined for export or for the domestic market. This is except in an industry sector which is listed as closed to foreign investment on the Negative List ("Negative List") which attaches to the Foreign Investment Law under Presidential Regulation.

The latest 2010 Negative List set out in Presidential Regulation No.36/2010 contains 20 nominated industries or fields of business that are closed to foreign investment. The rest are open if certain conditions are fulfilled.
The underlying principle is that if a business within a certain industry can be capably conducted by Indonesians, then that sector will be closed to foreign investment. Navigating the Foreign Investment Law and Negative List together with other regulations, decrees or specific industry laws that can interplay with, override or supercede each other and the Foreign Investment Law/Negative List is fraught with danger, and professional advice is recommended together with consultation with government officials at BKPM and/or relevant Ministries that regulate specific industries on how the business field of a particular target or business is categorized.

<table>
<thead>
<tr>
<th>Sector</th>
<th>Business Field</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture</td>
<td>Marijuana Cultivation</td>
</tr>
<tr>
<td>Forestry</td>
<td>1. Capturing of Fish Species as Stated in Appendix I Convention on International Trade in Endangered Species of Wild Fauna and Flora (CITES) 2. The use (removal) of coral/atoll from nature for construction material/timber/calium and souvenirs/jewelry, also live or dead coral (recent dead coral) from nature 3. Chemical Material Industry that can damage the environment, such as: - Penta Chlorophenol, Dichloro Diphenyl Trichloro Ethane (DDT), Dieldrin, Chlorodane, Carbon Tetra Chloride, Methyl Chlorofom, methyl Bromite, Chloro Fluoro Carbon (CFC) 4. Chemical Material industry Schedule 1 Chemical Weapon Convention (Gasin, Soman, Tabun, Mustard, Levisite, Ricine, Saxtoxin, VX, etc)</td>
</tr>
<tr>
<td>Industry</td>
<td>1. Alcohol Beverage Industry (Liquor, Wine, and Mall Containing Beverages) 2. Mercury processed Chlorine Alkali Maker Industry 3. Chemical Material Industry that can damage the environment, such as: - Penta Chlorophenol, Dichloro Diphenyl Trichloro Ethane (DDT), Dieldrin, Chlorodane, Carbon Tetra Chloride, Methyl Chlorofom, methyl Bromite, Chloro Fluoro Carbon (CFC) 4. Chemical Material industry Schedule 1 Chemical Weapon Convention (Gasin, Soman, Tabun, Mustard, Levisite, Ricine, Saxtoxin, VX, etc)</td>
</tr>
</tbody>
</table>

Sources: President Regulation No.36/2010, Investment Negative List

To invest in Indonesia, an investor should first look at the Negative List which is updated regularly with policy changes. Accordingly, if a business field is not mentioned in the Negative List, conceptually it is regarded as ‘open’ to foreign investment. The GOI had plans to revise the Negative List in 2012 in a bid to boost higher foreign investments, however this is yet to occur as at December 2012. The revision is understood to be prioritized to ease investments in telecommunication towers, pharmaceuticals and health care as well as education sectors.

In general conceptual terms, the following lines of business are not open to FDI in Indonesia:  
- those that are reserved for micro, small, medium enterprises and cooperatives  
- those for which a partnership is required  
- those for which certain sharing arrangements are required  
- those that may be conducted only in certain locations  
- those for which a special license is required.

FDI in specific sectors – Negative Investment List

<table>
<thead>
<tr>
<th>Sector Heading</th>
<th>Sub-sector Heading</th>
<th>Regulation of PDI</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture</td>
<td>Seeding plantation and crop cultivation (area less than or equal to 25 Ha), Pig (basis less than or equal to 125 pigs and free-range poultry breeding and farming; Plantation product processing</td>
<td>Reserved for micro, small, medium enterprises and cooperatives (“UMMK”) Pig breeding must comply with local regulations</td>
</tr>
<tr>
<td>Agriculture</td>
<td>Pig breeding and farming for quantity of more than 125 pigs</td>
<td>Allowed in certain locations and must comply with local regulations</td>
</tr>
<tr>
<td>Agriculture</td>
<td>Use of genetics in agriculture products</td>
<td>Maximum 49% foreign shareholding Requires a recommendation from the Minister of Agriculture</td>
</tr>
<tr>
<td>Agriculture</td>
<td>Plantation business (with and without processing unit or mill) including seeding, cultivation, and product processing business (area equal to or more than 25 Ha)</td>
<td>Maximum 96% foreign shareholding Requires a recommendation from the Minister of Agriculture</td>
</tr>
<tr>
<td>Agriculture</td>
<td>Non-reptile wild life capturing and propagating; swalow’s nest business in nature; forest plantation; sugar palm, pegan, etc.; Pine sap, bamboo, and rattan processing primary industry, mangrove semi finished goods and saw mill – under 2,000 m³/year</td>
<td>Reserved for UMKMK</td>
</tr>
<tr>
<td>Agriculture</td>
<td>Rattan, pine sap, bamboo, resin, agarwood, shellac, bee, latex, natural silk and alternative crops</td>
<td>Requires partnership with small enterprise</td>
</tr>
<tr>
<td>Agriculture</td>
<td>Hunting business; raising wildlife plants; coral raising/collecting</td>
<td>Maximum 49% foreign shareholding</td>
</tr>
<tr>
<td>Agriculture</td>
<td>Nature tourism and ecotourism business</td>
<td>Maximum 51% foreign shareholding</td>
</tr>
<tr>
<td>Agriculture</td>
<td>Capturing/making and distributing reptiles and coral/ decorative coral</td>
<td>Requires a recommendation from the Minister of Forestry</td>
</tr>
<tr>
<td>Agriculture</td>
<td>Development of technology on use of plant and wildlife genetics</td>
<td>Requires a statement on partnership with an accredited institutional/national research and development institution appointed by the Minister of Forestry</td>
</tr>
<tr>
<td>Agriculture</td>
<td>Wood processing industry</td>
<td>Requires a recommendation on sustainable raw material supply from the Minister of Forestry</td>
</tr>
<tr>
<td>Agriculture</td>
<td>Timber utilization and forest plant seed and seedling export and import</td>
<td>Requires 100% domestic capital</td>
</tr>
<tr>
<td>Agriculture</td>
<td>Water environment use service in forest area</td>
<td>Requires a special license</td>
</tr>
<tr>
<td>Maritime and Fishery</td>
<td>Small scale fishery business</td>
<td>Reserved for UMKMK</td>
</tr>
<tr>
<td>Maritime and Fishery</td>
<td>Marine, brackish water, and fresh water fish rearing and hatchery; Fishery processing, marketing, and distribution business</td>
<td>Requires a partnership with small enterprise</td>
</tr>
<tr>
<td>Maritime and Fishery</td>
<td>Indonesian Exclusive Economic Zone (“ZEEI”) fishing using 100 GT ship or above</td>
<td>Requires a special license Requires compliance with the Ministerial Regulation No.PER 12/MEN/2009 concerning Capture Fishery Business</td>
</tr>
<tr>
<td>Maritime and Fishery</td>
<td>Usage (taking) and distribution of decorative coral/ atoll from nature for aquarums</td>
<td>Requires a recommendation from the Minister of Maritime and Fishery</td>
</tr>
<tr>
<td>Maritime and Fishery</td>
<td>Lifting of valuable items from a shipwreck’s cargo or artefact from nature for aquarums</td>
<td>Requires a recommendation from the Minister of Maritime and Fishery</td>
</tr>
<tr>
<td>Maritime and Fishery</td>
<td>Big scale fishing business and sea sand extraction</td>
<td>Requires 100% domestic capital</td>
</tr>
</tbody>
</table>

To the list of business fields that are closed to investments:

<table>
<thead>
<tr>
<th>Sector</th>
<th>Business Field</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture</td>
<td>Seedling plantation and crop cultivation (area less than or equal to 25 Ha), Pig (basis less than or equal to 125 pigs and free-range poultry breeding and farming; Plantation product processing</td>
</tr>
<tr>
<td>Agriculture</td>
<td>Pig breeding and farming for quantity of more than 125 pigs</td>
</tr>
<tr>
<td>Agriculture</td>
<td>Use of genetics in agriculture products</td>
</tr>
<tr>
<td>Agriculture</td>
<td>Plantation business (with and without processing unit or mill) including seeding, cultivation, and product processing business (area equal to or more than 25 Ha)</td>
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</tbody>
</table>
## FDI in specific sectors – Negative Investment List (continued)

<table>
<thead>
<tr>
<th>Sector Heading</th>
<th>Sub-sector Heading</th>
<th>Regulation of PDI</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Energy and Mineral Resources</strong></td>
<td>• Less than 1 MW power plant</td>
<td>• Reserved for UMKMK</td>
</tr>
<tr>
<td></td>
<td>• Small scale power plant (1-10 MW)</td>
<td>• Requires a partnership with small enterprise</td>
</tr>
<tr>
<td></td>
<td>• Drilling services of geothermal and oil &amp; gas off/onshore; Geothermal, nuclear, and more than 10MW of power plants; Power plant transmission and electricity distribution; Operation and maintenance services of oil &amp; gas facility and power plant installation; Technology development of electricity supplied equipment; EPC and electricity consultancy</td>
<td>• Maximum 95% foreign shareholding</td>
</tr>
<tr>
<td></td>
<td>• Radioactive mineral mining</td>
<td>• Requires a recommendation from National Nuclear Energy Agency (“BATAN”)</td>
</tr>
<tr>
<td><strong>Defence</strong></td>
<td>• Explosive material industry (raw materials and all components); Production of weapons, ammunition, explosive devices, and war equipment</td>
<td>• Maximum 49% foreign shareholding</td>
</tr>
<tr>
<td></td>
<td>• Construction services under IDR 1 billion contract value</td>
<td>• Requires a recommendation of the Minister of Defense</td>
</tr>
<tr>
<td><strong>Public Works</strong></td>
<td>• Drinking water and toll road businesses</td>
<td>• Maximum 67% foreign shareholding</td>
</tr>
<tr>
<td></td>
<td>• Construction services above IDR 1 billion contract value</td>
<td>• Maximum 67% foreign shareholding</td>
</tr>
<tr>
<td></td>
<td>• Construction consultancy services</td>
<td>• Maximum 55% foreign shareholding</td>
</tr>
<tr>
<td><strong>Trade</strong></td>
<td>• Private and building cleaning services; Retail business, large trade and property/real estate broker based on fee or contract; Machinery and equipment rental for land transportation, agriculture, construction, office, and others; Survey and other activities services; Large trade of liquor</td>
<td>• Maximum 95% foreign shareholding</td>
</tr>
<tr>
<td></td>
<td>• Direct selling through marketing network developed by business partner</td>
<td>• Requires 100% domestic capital</td>
</tr>
<tr>
<td></td>
<td>• Liquor business requires a Business License Certificate (“SIUP”), a Business License Certificate of Liquor Business (“SIUP-MB”), a distribution network, and a “special place”</td>
<td>• Requires a recommendation of the Minister of Industry</td>
</tr>
</tbody>
</table>
### FDI in specific sectors – Negative Investment List (continued)

<table>
<thead>
<tr>
<th>Sector Heading</th>
<th>Sub-sector Heading</th>
<th>Regulation of PDI</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Culture and Tourism</strong></td>
<td>Homestay; Tour agent and guide service; Art studio and gallery</td>
<td>Reserved for UMKMK</td>
</tr>
<tr>
<td></td>
<td>Film studio, dubbing facility, processing laboratory, printing and/or duplication</td>
<td>Maximum 49% foreign shareholding</td>
</tr>
<tr>
<td></td>
<td>Filming, editing and subtitling facility; Film making, distribution and promotional activities</td>
<td>Requires 100% domestic capital</td>
</tr>
<tr>
<td></td>
<td>Art gallery and art performance building</td>
<td>Maximum 67% foreign shareholding</td>
</tr>
<tr>
<td></td>
<td>Hotel, guest house, and MICE; Tour service; Catering; Spa and cultural tourism business</td>
<td>Maximum 51% foreign shareholding; Compliance with the regional regulations</td>
</tr>
<tr>
<td></td>
<td>Outbound tour operator</td>
<td>Maximum 49% foreign shareholding</td>
</tr>
<tr>
<td></td>
<td>Inns, Bed and Breakfast, and other accommodation service</td>
<td>Maximum 51% foreign shareholding; if partnering with UMKMK</td>
</tr>
<tr>
<td></td>
<td>Recreational and entertainment business</td>
<td>Compliance with local regulations</td>
</tr>
<tr>
<td></td>
<td>Bar/alleys/kareoke, and other accommodation service</td>
<td>Golf business: Maximum 100% foreign shareholding for Kaltim, Sulawesi, East Nusa Tenggara, Bengkulu, and Jambi</td>
</tr>
<tr>
<td></td>
<td>Restaurant</td>
<td>Maximum 49% or 51% foreign shareholding, depends on type</td>
</tr>
<tr>
<td></td>
<td>Natural tourism out of conservation areas</td>
<td>Maximum 51% foreign shareholding</td>
</tr>
<tr>
<td><strong>Transportation</strong></td>
<td>Container, cargo, heavy equipment transportation; Water and air transportation services</td>
<td>Maximum 49% foreign shareholding</td>
</tr>
<tr>
<td></td>
<td>International shipping (excluding cabotage)</td>
<td>Maximum 60% foreign shareholding for investors from ASEAN countries</td>
</tr>
<tr>
<td></td>
<td>Maritime cargo handling service</td>
<td>Maximum 49% foreign shareholding</td>
</tr>
<tr>
<td></td>
<td>Crossing harbor and river and lake harbor provision and business</td>
<td>Requirement to cooperate with a company appointed by the government</td>
</tr>
<tr>
<td></td>
<td>Passenger transportation and people's shipping</td>
<td>Requires 100% domestic capital</td>
</tr>
<tr>
<td></td>
<td>Commercial air transportation</td>
<td>Maximum 49% foreign shareholding; Domestic shareholder must hold majority</td>
</tr>
<tr>
<td></td>
<td>Transport service provider; Internet interconnection service</td>
<td>Requires a special license</td>
</tr>
<tr>
<td><strong>Communication and Informatics</strong></td>
<td>Community based broadcasting; Telecommunication and internet kiosk; Home and building cable installation</td>
<td>Reserved for UMKMK</td>
</tr>
<tr>
<td></td>
<td>Telephone value added service provider (e.g. content service, call center, etc.)</td>
<td>Requires a partnership with small enterprise</td>
</tr>
<tr>
<td></td>
<td>Data communication system service provider; Telecommunication device testing agency</td>
<td>Maximum 95% foreign shareholding</td>
</tr>
<tr>
<td></td>
<td>Fixed and mobile telecommunication network provider; Internet interconnection service</td>
<td>Maximum 65% foreign shareholding</td>
</tr>
<tr>
<td></td>
<td>Fixed network telecommunication, mail and internet service provider</td>
<td>Maximum 49% foreign shareholding</td>
</tr>
<tr>
<td></td>
<td>Public radio and television broadcasting agency</td>
<td>Requires a special license</td>
</tr>
<tr>
<td><strong>Banking</strong></td>
<td>Pension fund</td>
<td>Requires 100% domestic capital</td>
</tr>
<tr>
<td><strong>Finance</strong></td>
<td>Leasing and non-leasing financing</td>
<td>Maximum 86% foreign shareholding</td>
</tr>
<tr>
<td><strong>Manpower and Transmigration</strong></td>
<td>Foreign and non-foreign exchange bank</td>
<td>Requires 100% domestic capital</td>
</tr>
<tr>
<td></td>
<td>Foreign and non-foreign exchange bank</td>
<td>Requires 100% domestic capital</td>
</tr>
<tr>
<td></td>
<td>Conventional People’s Credit Bank (“BPR”), Sharia BPR, and foreign exchange trader</td>
<td>Requires 100% domestic capital</td>
</tr>
<tr>
<td><strong>Health</strong></td>
<td>Pharmaceutical industry</td>
<td>Maximum 75% foreign shareholding</td>
</tr>
<tr>
<td></td>
<td>Hospital management and health assistance services (e.g. health aid and patient evacuation in emergency situations); Specialist/sub-specialist hospital service (200 beds); Health care providers (mental rehabilitation, specialist medical, dental, laboratory and medical clinic)</td>
<td>Maximum 67% foreign shareholding</td>
</tr>
<tr>
<td></td>
<td>Traditional medicine practitioner and business industry; Pharmaceutical including raw material, wholesaler, and drug store; Pharmacy; Health care providers (hospitals, health research center, health service facility, ambulance, etc.); Health professionals (e.g. specialist doctor, etc.)</td>
<td>Requires 100% domestic capital</td>
</tr>
<tr>
<td><strong>Security</strong></td>
<td>Security consultancy and worker provider services; Money and valuable goods transport escorting services; Security equipment implementation; education and training services; Animal provider services</td>
<td>Requires an operational license from the Headquarters of the Republic of Indonesia Police</td>
</tr>
</tbody>
</table>

Maximum 49% foreign shareholding |

Maximum 49% foreign shareholding |

Maximum 75% foreign shareholding |

Maximum 75% foreign shareholding |

Maximum 86% foreign shareholding |

Maximum 86% foreign shareholding |

Maximum 86% foreign shareholding |
Foreign investment restrictions

Fields of activity and local JV Partner

As indicated, initial investment proposals to BKPM need to be in fields currently open to foreigners, as do applications for expansion of existing facilities.

As explained, foreign investment will usually require a JV arrangement between the foreign investor and at least one local partner, either from inception of the project, or within a specified period for those companies which have approval to be wholly-owned foreign-in the initial stages. The selection of a reliable and understanding local shareholder and partner is essential, as unsuccessful foreign investment ventures can be associated with a background of tense relationships between local and overseas shareholders.

BKPM may maintain lists of potential local partners in certain fields from time to time, while banks, embassies and accounting firms can often provide information of a similar nature. In addition, accounting and investigation services firms can undertake independent, confidential corporate intelligence and research into the background and integrity of prominent local corporate and individual subject targets.

Minimum investment and equity participation

Foreign investors can hold up to 100% equity initially, except for certain industries where 49%, 65%, or 95% are the maximum foreign ownership, but this varies within sectors and business fields. The old foreign investment law prior to 2007 expressly provided for where 100% foreign ownership is initially permitted, for the foreign shareholder to divest a minority share to an Indonesian shareholder within 15 years. Whilst this is not specifically included in the Foreign Investment Law, a general view is that it notionally is contained in the spirit of the law, and 5% is the intended minimum divestment.

Legal form

The Foreign Investment Law specifies that foreign investment shall be in the form of a limited liability company, except for certain industries where 49%, 65%, or 95% are the maximum foreign ownership, but this varies within sectors and business fields.

Oil & Gas

Under Law No.22/2001 concerning Petroleum & Natural Gas (“the Oil & Gas Law”), the oil & gas sector was administered by two state owned legal entities: BP Migas for upstream operations, and the Malaysian credited financing company for downstream operations. Prior to establishment of BP Migas in 2002, regulation of the oil & gas sector was conducted by the State owned oil & gas company, PEMTAMINA.

BP Migas had responsibility for management of the upstream operation of joint cooperative contracts which are predominately in the form of a Production-Sharing Contract (PSC), while the foreign party/contractor is responsible to BP Migas for the execution of the operation. BPH Migas had responsibility for granting licenses and supervising the operation of the downstream business.

In November 2012 a Constitutional Court Ruling dismantled the legal basis for upstream oil & gas regulation by BP Migas following application by various prominent organizations on the grounds the 2001 law did not adequately manage the nation’s natural resources for the benefit of the Indonesian people. Industry commentators have referred to the dismantlement of BP Migas to be negative for investment sentiment at the time when oil production is declining. A temporary oil & gas regulatory authority or “Task Force” SK Migas, has been established at the MEMR. A Presidential Regulation is to be issued in January 2013 that will reorganize and regulate SK Migas.

Under the Oil & Gas law, the industry is one of two that allows foreign participants to invest in the upstream oil & gas sector through a local branch of an overseas company (capped a Permanent Establishment or PE, which is referred to further in Chapter 10 on Taxation).

Banking

The banking industry is regulated by the Central Bank, Bank Indonesia, and this is generally free from interference from government. Banking is the only other sector in addition to upstream oil & gas which allows foreign investors to invest directly into a local branch of a foreign bank. Foreign banks are allowed to open branches in Indonesia; however, the government extends this advantage only to the world’s 200 largest banks by assets and only if they have a minimum Standard & Poor’s or Moody’s credit rating of A. Further, the 300 largest banks in the world by assets can have a Representative Office in Indonesia to perform asset and research monitoring or to support a branch opening, but are restricted from offering banking services. No foreign bank branch licences have been issued for many years with foreign banks entering the market through M&A involving existing banks.

Single Presence Policy

Based on Bank Indonesia Regulation No.39/16/PBI/2006 dated 5 October 2006, a ‘Single Presence Policy’ in respect of Indonesian banks provides for no single person, an entity or group of companies to own more than 25% or otherwise be a ‘controlling shareholder’ in more than one Indonesian bank.

Exceptions to the Single Presence Policy allowing an investor to be a controlling shareholder in more than one Indonesian bank are:

• the investor is a controlling shareholder in two banks and also a holding company in two banks and one of the banks is a JV bank
• an investment holding company is established through divestment, merger or reconstruction of an existing bank holding company.

A shareholder who meets the criteria as a ‘controlling shareholder’ will be subject to PBI 8/16/PBI/2006, as well as PBI 14/8/PBI/2012 which is summarized below.

Shareholding thresholds and limitations

Pursuant to Bank Indonesia Regulation No.14/8/PBI/2012 dated 13 July 2012 concerning Commercial Bank Share Ownership, the maximum amount of bank share ownership for a single shareholder depends on the category of shareholder. Shareholders that are related through share ownership or family ties, or that are deemed to be acting in concert with one another, will be treated as a single party in determining the overall ownership cap that applies:

• banks and non-bank financial institutions: 40% of a bank’s paid-up capital (subject to Bank Indonesia approving a higher amount: see below)
• non-bank financial institutions: 30% of a bank’s paid-up capital. Non-bank financial institutions with a long-term focus, such as insurance companies and pension funds, will be allowed to own up to 40% of an Indonesian bank. Other investors, including fund management firms, hedge funds and special-purpose vehicles, will be restricted to a 30% stake
• individual shareholders: 20% of a bank’s paid-up capital (25% if the bank is a Shariah bank)

The Central Government is exempted from the limits (as is any agency that is called on to rescue a failing bank). That means the limits do not apply to state-owned banks.

The regulation only affects future transactions. Existing bank shareholders that exceed the ownership thresholds are not required to divest unless the bank’s Good Corporate Governance (“GCG”) or “soundness” rating (as determined by Bank Indonesia) is 3, 4 or 5 as at the 31 December 2013 cut-off date. GCG ratings range between 1 to 5, with 1 being the best. Foreign investors, including Singapore’s United Overseas Bank and OCBC Bank, HSBC and Malaysia’s CIMB and Maybank, which already own majority stakes in Indonesian banks will not be automatically forced to cut their stakes to comply with the new limits. Existing shareholders of Indonesian banks that exceed the limits will be assessed on their financial strength and corporate governance at the end of 2013. After 31 December 2013, existing bank shareholders need to sell down to the 40% cap within 5 years to 2018 if GCG ratings are down graded to 3 or worse on three consecutive assessments.

Note: (1) Indonesia Financial Services Authority: Pursuant to Law No. 21/2011 concerning Financial Services Authority, the Financial Services Authority or “OJK” was established in January 2013 as an independent institution with integrated authority to license, review and investigate overall activities of the Indonesian financial services sector, including banking, insurance and non-bank financial institutions. The Government Regulation is still being drafted as at the date of this publication. The extent to which the OJK will replace the supervisory functions and regulatory roles of Bank Indonesia, the MFO, and BAPEMAM-LK is still unclear with the establishment of the “watchdog” being only in infancy stages. Further details will be included in the next updated edition of KPMG’s “Investing in Indonesia.”
For foreign or domestic investors that require a shareholding interest of more than 40% or a “controlling interest”, application needs to be made to Bank Indonesia for approval. The bank should have a soundness rating at least 1 or 2, financially strong - CAR tier 1 of minimum 6%, be publicly listed and have a recommendation from the bank’s home regulator. An Indonesian bank that is acquired will need to sell at least 20 per cent of its shares to the public within five years of the transaction. Additional capital must also be committed by agreeing to buy hybrid debt securities issued by a local lender that are convertible into equity. A bank that receives approval to own more than 40% of a local bank will first be allowed to reach that 40% threshold. To raise its stake further, the local target bank must be assessed by Bank Indonesia to be financially strong and well-governed for three consecutive assessment periods within five years from the time Bank Indonesia approves the transaction. Notes accompanying the guidelines suggest that such assessments will be conducted in June and December each year. If the local bank does not meet those criteria, ownership will remain capped at 40%.

**Foreign investor criteria**

Any prospective controlling shareholder who is a foreign investor must meet the following additional requirements:

- the investor is committed to support the economic development of Indonesia by owning shares in the bank
- the investor has obtained recommendation from the financial services supervisory authority of the country of origin
- the investor is ranked at least: (a) one level above the lowest investment grade, for banks; (b) two levels above the lowest investment grade for non-bank financial institutions; and (c) three levels above the lowest investment grade for non-bank financial institutions.

**Minimum capital requirements for commercial banks and Capital Equivalency Maintained Assets (“CEMA”) for foreign banks**

In December 2012 Bank Indonesia issued a new regulation that sets a minimum capital of IDR 100 billion for foreign banks, to strengthen the country’s banking system. Under the new regulation, Bank Indonesia requires a minimum 8% capital adequacy ratio for banks with the soundest risk profile rating 1 and 14% for banks with a risk profile rating 5 worst. To calculate the minimum capital based on risk profile, Bank Indonesia requires banks to implement an Internal Capital Adequacy Assessment Process (ICAAP). Bank Indonesia will perform Supervisory Review and Evaluation Process (ISREP) on the ICAAP, which includes review of the sufficiency of active supervision from the banks’ management; capital adequacy assessment; review of monitoring and enforcement mechanisms.

In particular for foreign bank branches operating in Indonesia, Bank Indonesia requires maintenance of a portfolio of assets called Capital Equivalency Maintained Assets (“CEMA”) which is designed to serve as a liquidity buffer in the event of liquidity/solvency problems (or a “ring fence”). CEMA must be maintained at: (1) a minimum 8% of a bank’s total liabilities as of September and March; and (2) at least IDR 1 trillion if the 8% of total liabilities is less than IDR 1 trillion.

Foreign branches must comply with the first CEMA requirement by June 2013 and with the second by December 2017.

**Insurance**

The insurance industry is governed by Law No.2/1992 concerning Systems of Insurance Undertakings and regulated by the MOF. The main features of the law are as follows:

- **Foreign JV companies may be formed to operate in the non-life insurance (both General and Life), reinsurance and brokering with certain levels of minimum paid-up capital**
- **Foreign JV companies must have an Indonesian shareholder with at least 20% of shares at the date of establishment.**

There are currently 41 life and 81 non-life insurance companies in Indonesia. Foreign investors are involved in 17 JV life insurance companies, which have more than half of the life market share, and 18 JV non-life insurance companies, which have only around a 10% non-life market share.

Although there are no restrictions on establishing a new insurance company and obtaining a license from the regulator, there have been no new insurance licenses issued during the last 10 years.

Current regulations require an insurance company’s minimum capitalization to be IDR 70 billion (approximately USD 7.7 million) by the end of 2012, increasing further to IDR 100 billion (approximately USD 11.1 million) by 31 December 2014. This capital increase requirement was made to force insurance companies to consolidate.

The GOI is open to foreign investment in the insurance industry; foreign investors can own up to an 80% ownership interest in a local insurance company. Note however that the MOF is likely to scrutinize a purchaser’s credentials and track record in the insurance industry before approving a license transfer.

**Other financial institutions**

Other financial institutions including financing companies (finance, venture capital and infrastructure finance) and Securities companies (Asset management, Underwriting, and Brokerage) are supervised and regulated by the MOF and BAPEPAM-LK, the Capital Market and Financial Institution Supervisory Board.

Presidential Regulation No.9/2009 concerning Financial Institutions reformulates the types of services that a financing company may provide, and encourages the financing of infrastructure that was covered and regulated in a previous Presidential Decree No.61/1988. A venture capital company may be involved in equity participation, quasi-equity participation, and profit and revenue sharing. A finance company can be engaged in lending, factoring, consumer finance and credit cards. An infrastructure financing company can conduct direct lending, refinancing, and provide subordinated loans.

Financing companies are prohibited from acquiring funds from time deposits, checking accounts and saving accounts; however, they may now issue Promissory Notes provided they do so with due regard to the prudential principles set out in Presidential Regulation No.9/2009. To operate in Indonesia, finance companies need to secure a business license from the MOF as regulated through Ministerial Regulation No.84/PMK.01/2006 concerning Finance Companies. Other related regulations are:

- Ministerial Regulation No.30/PMK.010/2010 concerning the Implementation of Know Your Customer Principle for Non-Bank Financial Institutions
- BAPEPAM-LK Regulation No.PER-06/BL/2009 concerning the Guidelines of the Examination of Finance Companies.

Any party wishing to engage in capital markets activities, particularly a securities company, must obtain an operating license and approval from the registration from BAPEPAM-LK. Based on Ministerial Decree No.153/PMK.010/2010 concerning Share Ownership and Equity of Securities Companies, there are several requirements:

- Investment Manager, Underwriter combined with Investment Manager, and Brokerage combined with Investment Manager should at least have IDR 25 billion, IDR 75 billion and IDR 55 billion paid up capital, respectively
- Foreign Non-Financial Securities Financial Institutions may own up to 85% of the paid in capital of JV securities companies
- Foreign securities companies that are licensed or regulated by their respective local regulators may own up to 95% of paid up capital of a JV securities company
- Both foreign and local investors may purchase up to 100% shares of local or JV securities companies both in the primary and secondary market
- Foreign ownership of a private securities company is limited to a foreign legal entity that operates in the financial services sector area or in securities.

Financing companies may have foreign equity participation up to a maximum of 85% of paid-up capital.

**Mining**

On 12 January 2009, Law No.4/2009 on Mineral and Coal Mining (“the New Mining Law”) came into effect, replacing the Mining Law No.11/1967 which provided for foreign investment in coal and minerals mining in Indonesia to be based on contractual agreements with the GOI. Under Mining Law No.11/1967, there were essentially two ways any party could hold exploration and mining rights in Indonesia:

- a Contract of Work or “COW” (for minerals)/ Coal Contract of Work or “CCOW”
- a Kuasa Pertambangan (Mining Authorization or “KP”)

No foreign entity could have an equity interest directly or indirectly in a company which held a KP. A KP could only be owned by an Indonesian legal entity owned 100% by Indonesians or an Indonesian national. In practice however, many foreign entities controlled mining operations of a KP first through nominees until such practices were expressly abolished by Law No.25/2007, and then through various often complex contractual agreements with a KP holder which were designed to give the foreign entity the economic benefit in the mining project albeit without any share ownership in the KP holder.

Unlike KPs, COWs or CCOWs were allowed to be owned by foreign-owned Indonesian entities. Standard forms of contract were developed over the years for each generation of COWs which differ in the conditions that were required to be amended to be consistent with the New Mining Law by January 2010. This is yet to occur and negotiations between COW mining companies and the GOI/MEMR are continuing. It is still not clear what provisions of the new law existing COWs must conform to. It is expected that the amendments to existing COWs may include the following:

- applicable taxes
- ownership of minerals
- ownership of plant and equipment at site
- mine development requirements

The New Mining Law requires that no new COWs are to be granted, and instead both foreign and domestic investors will be granted the same form of license (discussed below). Existing COWs are to remain effective until their expiry but certain terms were required to be amended to be consistent with the New Mining Law by January 2010. This is yet to occur and negotiations between COW mining companies and the GOI/MEMR are continuing. It is still not clear what provisions of the new law existing COWs must conform to. It is expected that the amendments to existing COWs may include the following:

- mine owners prohibited from using affiliates (without prior approval from the MEMR) to carry out mining operations, and owners are also obliged to use local (national) mining companies

**Note:** (1) Indonesia Financial Services Authority; Pursuant to Law No. 21/2011 concerning Financial Services Authority, the Financial Services Authority was established in January 2013 as an independent agency with integrated authority to regulate, supervise, examine and investigate overall activities of the Indonesian financial service sector, including banking, insurance and nonbank financial institutions. The Government Regulation is still being drafted as at the date of this publication. The extent to which the OJK will replace the supervisory functions and regulatory roles of Bank Indonesia, the MOF and BAPEPAM-LK is still unclear with the establishment of the “watchdog” being only in infancy stages. Further details will be included in the next updated edition of KPMG’s “Investing in Indonesia.”
• mining owners are prohibited from contracting out the actual mining function
• more onerous post-mining reclamation (rehabilitation and reforestation) obligations, possibly involving financial bonds
• a reduction of the mining area granted under the COW or CCOW to bring it into line with the maximum mining areas provided in the New Mining Law. If a COW or CCOW holder is able to provide an activity plan over its larger mining area which satisfies the MEMR that the entire area will be utilized, the MEMR will allow the COW or CCOW holder to retain the larger mining area despite the area limitations in the New Mining Law
• potential for increased corporate social responsibility obligations in the form of “Community Development & Expansion Projects”
• minimum coal pricing, Domestic Market Obligations (DMO), and requirements for domestic processing and refining of coal/minerals before export.

How far reaching the amendments to existing COWs’s are intended to be is not clear from the law. There is at least the potential for increases in mining cost structures and impacts on general operations.

Under the New Mining Law, a license based system has been introduced. The framework of the New Mining Law is applicable to both foreign and local investors including State-owned enterprises, Regional State owned enterprises, Indonesian limited liability companies (including PMA) and Co-operatives. The law is built around the granting of a License (“IUP”) from a regional/provincial government or the central government. WUP areas for coal or metal minerals are granted through a competitive tender process administered by the relevant level of government, and WUPs for non-metal minerals or rocks by direct application to the relevant level of government. Once the WUP has been awarded, an IUP for coal or the relevant mineral is granted to the winner. Which level of government (central, provincial or regional) has authority to award the WUP and IUP depends on a range of factors including the geographical location of the mine, the location of any captive jetty and refining/processing facilities, and whether the entity has any foreign ownership. Separate Exploration and Production Operation licenses are issued, with the holder of an Exploration IUP being guaranteed to receive a Production Operation IUP automatically issued, provided certain conditions are met. The New Mining Law requires that existing KPs all be converted to IUPS, and this process is nearing its completion. The MEMR maintains a new “Clean and Clear List” which provides some comfort that an IUP has been validly issued, does not overlap with other contracts or licenses, but not whether it is free of other competing land uses.

The New Mining Law removed the legal certainty provided under the contract-based COW system when replaced by the license based IUP regime leaving investors open to potential for increases in mining cost structures and impacts on general operations.

The New Mining Law, and there remains a lack of clarity around the operation of the law and various subsequent Implementing Regulations. in practice, mining companies have exploited a range of different ways from doing nothing until more clarity is obtained, to aggressively restructuring mining activities and operations to comply with their interpretation of the law.

Key implementing regulations for the New Mining Law issued to date (and the areas key subjects which they regulate) are:

• Ministerial Regulation No.18/2009 on “Change of investment terms in COW and CCOW companies” dated 19 August 2009 - requirements for COW and CCOW holders to obtain approval of MEMR to certain corporate actions, including changes in shareholding
• Ministerial Regulation No.26/2009 on “Implementation of Mineral and Coal Mining Services” dated 30 September 2009 - requirements for mining companies when using service providers, with the key principle being that preference must be given to local/national service providers over foreign-owned providers
• Ministerial Regulation No.34/2009 on “Preferential supply of domestic Mineral and Coal demands” dated 31 December 2009 - obligations of mining companies to sell a certain percentage of their production to the domestic market
• Government Regulation No.22/2010 on “Mining area” dated 1 February 2010 - umbrella regulation setting out the determination of mining areas within Indonesia (including Peoples Mining Area, WUPs and State Reserve Areas)
• Government Regulation No.23/2010 on “Mining business activities” dated 1 February 2010 as amended by Government Regulation 24/2012 - umbrella regulation setting out general requirements for holders of mining business license
• Government Regulation No.55/2010 on “Supervision, consultation and guidance on mining activities” dated 5 July 2010 - intergovernmental arrangements regarding the supervision of the mining sector within Indonesia
• Ministerial Regulation No.17/2010 on “Determination of the reference price for Mineral and Coal sales” dated 23 September 2010 - requirements for mining companies to sell their coal/minerals with reference to a Government benchmark price
• Government Regulation No.78/2010 concerning Reclamation and Post Mining dated 20 December 2010 - umbrella regulation governing obligations of mining companies to carry out reclamation and rehabilitation work at completion of mining activities

• Ministerial Regulation No.7/2012 concerning Adding Value to Minerals Through Processing and Refining Activities dated 6 February 2012 - requirements for mining companies holding licenses for mineral production to carry out onshore processing prior to export.
• On 5 November 2012 an Indonesia Supreme Court decision determined that the MEMR had no right to regulate exports, including mineral export quotas, which should be controlled by the MOT.

Majority or wholly foreign-owned companies holding an IUP need to gradually divest shares of the mining company to an Indonesian participant (being Central/Regional Governments, Central/Regional Government owned companies or 100% Indonesian owned private companies) starting 5 years from commencement of production, such that by the end of the 10th year from when production starts, the foreign shareholding is no greater than 49%.

There are still a number of implementing regulations yet to be issued, including ones on value adding requirements for coal, pricing of divestments under the mandatory divestment regime and the rules regarding tendering of new WUP areas. At the time of writing, the New Mining Law was still subject to review by the Constitutional Court, limiting release of new or revisions to implementing regulations. Speculation in the media and uncertainty in industry and other circles has been continuing as a result.

Possible areas of concern for investors
• Forest concessions are issued to Indonesian companies for specific activities, such as industrial estate forestry, natural wood forestry and rattan wood forestry. A number of forestry activities are restricted to domestically owned businesses. Other industries where foreign investment regulation is complex and opaque are through Ministerial Regulations, decrees or other authorities including Shipping, Sea Ports and Telecommunications.

As indicated, navigating the Foreign Investment Law, Negative List and other regulations, Ministered decrees or regulations, or specific industry laws that also can regulate foreign investment is fraught with danger without professional advice and support. A good example of this is the Shipping industry where some or all of the following (depending on the sector) may need to be considered in addition to the Negative List:
• the INL and ASEAN country exemptions referred to in the INL
• Law No.17/2008 regarding Shipping
• Government Regulation No.20/2010 concerning Water Transport

• Government Regulation No.9/1999 concerning Commodities future trading and Decree No.33/2001 concerning Implementation and Utilization of Sea Transport
• Presidential Decree No.61/1988 concerning Financial Institutions
• Presidential Instruction No.S/2005 on National Sailing Industry empowerment and Ministry of Transportation Regulation
• Regulation No.71/2005 which applies the principle of Cabotage
• Discussions with BKPM and the Ministry of Transportation.

Recent trends in FDI, opportunities, risks and challenges

With a thriving democracy, South East Asia’s largest economy, and reporting an annual economic growth rate of over 6%, Indonesia has become the primary FDI destination in South East Asia. With GDP expected to reach USD 1 trillion, the future looks bright for the world’s fourth-largest nation. Of Indonesia’s population of 248 million with more than 50% under the age of 29 – this provides a potentially large pool of skilled and unskilled labor, as well as an emerging young entrepreneurial generation of new consumers. This together with strong FDI inflows in recent years further points towards an attractive economic environment.

Economically strong, politically stable and reform minded, Indonesia has been referred to as an “emerging global powerhouse” with FDI now exceeding pre-1997 Asian Economic Crisis levels, notwithstanding economic growth economic growth is still being fueled to a large degree by domestic consumer spending.

However, there are risks and challenges in investing and doing business in this emerging, high growth market, and Indonesia continues to be a difficult country to do business, relative to Western or more developed Asian markets. Whilst many of the country risks that prevailed in the 10 year period following the 1997 Asian Economic Crisis have now gone away or are manageable, regulatory risk around foreign investment laws, underpinned by legal uncertainty from conflicting or unclear laws, regulations and decrees as well as the need for ongoing government reforms to the judicial system are major factors that need to be carefully considered in evaluating investment opportunities. In addition:
• Corruption is still endemic in government and some other circles, but not uncommonly viewed by many foreign investors, particularly those which have had a presence in Indonesia or Asia for a long time, as being manageable, except perhaps if an investor needs to...
formally comply with FCPA or UK Anti-bribery Act due diligence. What are considered common practices forming part of day-to-day business in Indonesia in order to get things done might not pass corporate governance standards in developed, Western markets.

Notwithstanding this, KPMG is seeing a recent increase in the willingness of multinational corporations to investigate fraudulent and other improper practices of employees and suppliers of Indonesian subsidiaries, as well as reviewing compliance with global or head office Anti-money laundering (“AML”) and Anti-bribery and corruption (“ABC”) policies as well as with local laws. In Indonesia, a myriad of local laws, regulations and decrees administered by various different regulatory authorities are more onerous than corresponding Foreign Corrupt Practices Act (FCPA) and UK Bribery (UKBA) laws

- In 1999 the GOI implemented Law No.22/1999 regarding formal insolvency concepts and administrations. Commercial Court judges have limited experience in
- of Payments is not commonly used, and as a result terminate and severance benefits: refer to Chapter 9
- Labor introduced in 2003 imposed onerous obligations on employers, particularly those operating labor-intensive businesses. The revised Law No.13/2003 on
- employers, particularly those operating highly labor-intensive businesses. The revised Law No.13/2003 on
- Regional Governance or the “General autonomy Law” designed decentralize certain powers to the regencies.
- Practices Act (FCPA) and UK Bribery (UKBA) laws are more onerous than corresponding Foreign Corrupt
- to get things done might not pass corporate governance standards in developed, Western markets.

Indonesia FDI Realization by Country of Origin

<table>
<thead>
<tr>
<th>No.</th>
<th>Country</th>
<th>Investment Value (in USD Million)</th>
<th>2011 Q3 2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Singapore(1)</td>
<td>5,123</td>
<td>3,489</td>
</tr>
<tr>
<td>2</td>
<td>Japan</td>
<td>1,516</td>
<td>1,787</td>
</tr>
<tr>
<td>3</td>
<td>South Korea</td>
<td>1,219</td>
<td>1,237</td>
</tr>
<tr>
<td>4</td>
<td>United Kingdom</td>
<td>419</td>
<td>897</td>
</tr>
<tr>
<td>5</td>
<td>United States of America</td>
<td>1,488</td>
<td>735</td>
</tr>
<tr>
<td>6</td>
<td>British Virgin Islands</td>
<td>517</td>
<td>722</td>
</tr>
<tr>
<td>7</td>
<td>Mauritius</td>
<td>73</td>
<td>659</td>
</tr>
<tr>
<td>8</td>
<td>Australia</td>
<td>90</td>
<td>653</td>
</tr>
<tr>
<td>9</td>
<td>Taiwan</td>
<td>243</td>
<td>641</td>
</tr>
<tr>
<td>10</td>
<td>Netherlands</td>
<td>1,354</td>
<td>619</td>
</tr>
<tr>
<td>11</td>
<td>Malaysia</td>
<td>618</td>
<td>431</td>
</tr>
<tr>
<td>12</td>
<td>France</td>
<td>134</td>
<td>149</td>
</tr>
<tr>
<td>13</td>
<td>Switzerland</td>
<td>9</td>
<td>134</td>
</tr>
<tr>
<td>14</td>
<td>Hong Kong (SAR)</td>
<td>135</td>
<td>133</td>
</tr>
<tr>
<td>15</td>
<td>People’s republic of China</td>
<td>128</td>
<td>86</td>
</tr>
<tr>
<td>16</td>
<td>Luxembourg</td>
<td>48</td>
<td>84</td>
</tr>
<tr>
<td>17</td>
<td>Seychelles</td>
<td>80</td>
<td>80</td>
</tr>
<tr>
<td>18</td>
<td>India</td>
<td>42</td>
<td>76</td>
</tr>
<tr>
<td>19</td>
<td>Germany</td>
<td>158</td>
<td>66</td>
</tr>
<tr>
<td>20</td>
<td>United Arab Emirates</td>
<td>7</td>
<td>32</td>
</tr>
<tr>
<td>21</td>
<td>Other Countries(2)</td>
<td>6,073</td>
<td>5,542</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>19,475</td>
<td>18,252</td>
</tr>
</tbody>
</table>

Notes:
(1) Singapore as the leading Country of origin for FDI in Indonesia is misleading in that many investors from a range of countries choose to structure their investments through existing HoldCos or NewCos domiciled in Singapore for tax and other transaction structuring purposes. In addition, it is recognised that not insignificant levels of domestic Indonesian investment is routed through Singaporean holding or investment companies, inflating or distorting reported FDI levels.
(2) Countries of which investment value less than USD 30 million
Source: Indonesia Investment Coordinating Board

Indonesia FDI Realization by Sector

<table>
<thead>
<tr>
<th>No.</th>
<th>Country</th>
<th>Investment Value (in USD Million)</th>
<th>2011 Q3 2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Manufacturing</td>
<td>6,588</td>
<td>8,400</td>
</tr>
<tr>
<td>2</td>
<td>Mining and Quarrying</td>
<td>3,756</td>
<td>3,280</td>
</tr>
<tr>
<td>3</td>
<td>Transportation, Warehousing, and Communications</td>
<td>3,799</td>
<td>1,873</td>
</tr>
<tr>
<td>4</td>
<td>Agriculture, Hunting, Forestry, and Fishery</td>
<td>1,264</td>
<td>1,324</td>
</tr>
<tr>
<td>5</td>
<td>Wholesale and Retail Trade, Restaurants, and Hotels</td>
<td>1,068</td>
<td>1,126</td>
</tr>
<tr>
<td>6</td>
<td>Electricity, Gas, and Water Supply</td>
<td>1,865</td>
<td>1,072</td>
</tr>
<tr>
<td>7</td>
<td>Other Industries</td>
<td>582</td>
<td>652</td>
</tr>
<tr>
<td>8</td>
<td>Finance, Insurance, Real Estates, and Business Services</td>
<td>199</td>
<td>328</td>
</tr>
<tr>
<td>9</td>
<td>Construction</td>
<td>354</td>
<td>196</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>19,475</td>
<td>18,252</td>
</tr>
</tbody>
</table>

Notes: The data tabulated above from BKPM excludes investments in the Oil & gas, Banking, Non-banking financial services, leasing, investment for which investment approvals and licenses are granted and issued by the relevant Ministry of regulatory authority. Portfolio and Household investment is also excluded.
Source: Indonesia Investment Coordinating Board

Deal origination can be a challenge in Indonesia. Whilst a Company Registry is maintained by the Ministry of Trade, there is no company search function in Indonesia which complicates target identification of thousands of private companies where deal opportunities potentially exist, often in highly fragmented industries. This is further compounded by a lack of enforcement by regulatory authorities on private company annual corporate filling obligations. Moreover, once targets are identified and deals reach MOU stage, for example, with pricing on transactions considered to be “over cooked” across many sectors which is frustrating dealing negotiations and completion right across the transaction cycle. The extent pricing will “cool” in 2013 and deal flow generally be impacted ahead of the 2014 National and Presidential elections is open to speculation, but some views are beginning to be formed by industry players and commentators and in other circles.

An investment Summit being convened in Jakarta in February 2013 by “The Economist” is examining issues relating to the “resilience of Indonesia’s economy and future growth challenges against the backdrop of a gloomy world economy” and domestic political uncertainties ahead of the 2014 general elections. Conversely, OECD expects Indonesia’s economy “to remain immune from the impact of the global turmoil, shielded by rising investment and domestic consumption…”

It is also important to recognize that for foreign investors who originate and diligently complete the right deal with the right partner, a not uncommon story is for the Indonesian investment and business to be a highly profitable one.
6. Business Structures and Establishment

The Company Law

The Company Law issued in 1995 stipulates the legal framework for companies. Previously, business was regulated by the provisions of the Indonesian Commercial Code and Indonesian Civil Code. These were drafted in the last century based on Dutch Colonial Law. The 1995 Company Law was most recently amended by Law No.40/2007 concerning Limited Liability Company.

Legal entities for doing business

There are a number of legal forms of entities that can engage in business in Indonesia:
- Sole Proprietor: proprietor has unlimited liability
- General Partnership (FA or “Firma”): partners have joint and several unlimited liability
- Limited Partnership (CV): silent partners have limited liability
- Shareholder and notarization by a public notary
- State-Owned Corporation (BUMN): company owned by the government and reliant upon the state to fund any deficit
- Branch of a foreign corporation: foreign companies may have a presence other than through a direct investment, and this is discussed later in this Chapter.

Establishment and application procedures for incorporation of a PMA

The provisions relating to the PT are contained in the Articles of Association (“AoA”) formed by the Notarial Deed of Establishment.

The AoA contained in the Deed address, among other things:
- Rights and duties of shareholders
- Rights and duties of commissioners and directors
- Name of the company, its purpose, duration, domicile
- Authorized capital and the division into shares
- Number of shares taken by founders
- Dividends.

Once the nature of the project and size of investment have been established, registration must be made with BKPM. The registration must be supported by copies of:
- AoA for both foreign and local parties, or a copy of a passport for individual shareholders
- tax payer registration number (NPWP) and operating license (SIUP) of local party
- letter of Power of Attorney (“POA”) from shareholders
- description of business activities.

Licenses and permits

If the project meets with BKPM approval, an initial investment approval will be issued, which permits the process of the establishment of the company to get started until it obtains legal status from the MOLHR and is registered in the Company Registry with the MOT. Once a PMA company is established, it is necessary to apply to BKPM for a Principle License (for manufacturing company) or Permanent Business License (for services company). These licenses will enable the company to apply for other necessary licenses: import licenses, permit for factory location, work permits for expatriates and Nuisance Act Permits. The Principle License normally has up to a five year validity (which can be extended). The Principle License can only be used until the PMA reaches the commencement of commercial operations or production.

The official date of commencement of commercial operations is triggered by the issuance of a Permanent Business License (IUT). An IUT is active as long as a company is still operating. Prior to commencement of commercial production, a Quarterly Activity Report must be submitted in standard format to BKPM and Bank Indonesia detailing, among other things, disbursements of foreign currency financing approved in the BKPM application. Bi-annual reports are required after the IUT is issued.

An important aspect of the investment application process is the compilation and approval of BKPM Master Lists, which detail the imported capital equipment and initial raw materials required, as inputs to the proposed investment. The imported items must be verified as suitable and relevant for the proposed project. Only items on the approved Master Lists are available for import duty relief and other concessions that will be documented in Exemption Certificates on imported equipment or materials.

Deed of Establishment, Authorized and Paid-up capital

The Deed of Establishment requires the approval of the MOLHR, which will ensure that the terms do not contradict the Company Law, or other laws, regulations and policies. The MOLHR has issued standard forms of Establishment Deeds to simplify approval requirements. There are requirements that at least 25% of the Authorized capital must be subscribed at the time of the company’s establishment, and all issued shares must be fully paid up before the operation permit is obtained. The Company Law stipulates minimum Authorized share capital to be IDR 50 million, of which at least 25% must be issued and fully paid up.

In practice, as a general guide BKPM will require share capital for a small to medium sized company engaged in trading activities to have share capital in a range of USD100,000. There are no formalized Thin Capitalization rules in Indonesia, however a “general rule of thumb” applied by BKPM is 1/3 equity and 2/3 debt. This can vary depending on the nature of business and scale of investment. Investors in the manufacturing sector typically are expected to have a debt to equity ratio of 3:1 or less, while those in the agricultural or mining sectors may have ratios of 6:1 or greater. The expansion of existing facilities funded with retained earnings, new equity or loan capital, also requires approval by BKPM.
Incorporation is not finalized until MOLHR approval is entered in the public register by the Court of Justice, and a notice published in the State Gazette. Care must be taken during this establishment phase, as the directors will be jointly and severally liable on a personal basis for their dealings with third parties.

The Deed of Establishment can be drafted by a lawyer or a notary, and a notary public will attend to the requisite approvals and registrations.

Shareholders and Directors

A company must have two shareholders upon establishment, even for a PMA initially permitted 100% foreign ownership.

Article 33 of the Foreign Investment Law expressly prohibits or deems unenforceable nominee arrangements in making investments in limited liability companies. Any agreement and/or statement providing for share ownership in a limited liability company to be for and on behalf of another party is null and void. Such nominee arrangements are however not uncommon in Indonesia.

Companies may have one or more directors, one of which must be the President Director. The Board of Directors (“BOD”) oversees the day-to-day operations. The directors are usually full-time employees of the company or a related party or group company. Under the Company Law, a company is also required to have a Board of Commissioners (“BOC”). These are non-executives who oversee the activities of the directors. They supervise the corporate governance aspects of the company and the policies of the BOD. Under certain circumstances they may perform some executive functions on a temporary basis if all the members of the BOD have been dismissed or there are no members of the BOD available for whatever reason. Minimum requirements are one BOD and one BOC member, and these cannot be the same person.

The BOD is required to present an Annual Report (that includes the financial statements of the Company) after it has been examined by the BDC at a General Meeting of Shareholders (“GMS”) within six months of the company’s financial year end. Generally, financial year ends are the same as the calendar year; however companies are allowed to have a different financial year. The Establishment Deed may impose other obligations.

The Company Law requires annual and extraordinary GMSs as required by the AoA. Unless stated to the contrary in the Establishment Deed, shareholders will hold one vote for each share, and a simple majority is all that is needed for voting purposes. The Company Law prohibits the directors from voting on behalf of shareholders. Directors acting as proxies of the shareholders will have no voting rights.

Tax regulations require the books to be maintained in Indonesian language and IDR currency. However in certain cases companies may seek permission from the MOF to maintain records in other languages and currencies.

In addition, the following types of companies are required to present audited financial statements to the regulating government ministries:

- Publicly-listed companies
- Companies involved in accumulating funds from the public (such as banks and insurance companies)
- Companies issuing debt instruments
- Companies with assets of IDR 25 billion or more
- Bank debtors whose financial statements are required by the bank to be audited
- Certain types of foreign entities engaged in business in Indonesia that are authorized to enter into agreements
- Certain types of state-owned enterprises

Financial statements and statutory filing and audit obligations

Companies over a certain size and foreign-owned companies are required to prepare annual statutory financial statements in accordance with Indonesian Financial Accounting Standards. The Company Law, as well as regulations issued by the MOT, set out requirements for the filing of annual financial statements. Filings are required within six months of an entity’s financial year end. These statements, which are required to be audited by an Indonesian registered Public Accountant, are to be filed at the MOT.

Under Article 68 of the Company Law, financial statements of a private company with assets and/or turnover exceeding IDR 50 billion are required to be audited. Furthermore, MOT decree No.121/MPP/Kep/2/2002 regarding “Submission of annual financial statements” stipulates that a private company with assets of at least IDR 25 billion is required to submit annual financial statements (audited) to the MOT at the latest 6 months after financial year end.

According to MOT No.121/MPP/Kep/2/2002 concerning Submission of Company Annual Financial Statements, every PMA Company must submit annual audited financial statements to the Directorate of Business Development & Regulations of the MOT.

Loss of limited liability

The Company Law stipulates that a company must have at least two shareholders to retain its limited liability status. If a company is left with only one shareholder and this situation persists for six months or more, then that shareholder will be liable for the company’s liabilities and losses, and the company may be dissolved.

Options open to foreigner other than incorporating a PMA company

Background

In Chapter 5, the opportunities for non-Indonesians to seek approval for investment in sectors open to foreigners was discussed. Foreigners can also have a business presence in Indonesia through entities other than PMA companies. These options are set out below.

Representative office

Trade promotion can be encouraged through the establishment of a Representative Office. The representative, who may be an expatriate or an Indonesian national, is not usually permitted to carry out any direct business activities, such as accepting orders, bidding for tenders, importing, exporting, signing contracts or distributing.

The activities of a Representative Office are restricted to the issue and collection of information, and the provision of assistance to local agents and distributors as well as marketing and promotional activities. An exception applies to Representative Offices of foreign companies engaged in construction services, which are allowed to provide construction services in Indonesia in a joint operation with a local construction company.

Applications are generally made to BKPM. Some foreign investors initially enter the Indonesian market through a Representative Office, and later as business opportunities grow, apply for establishment of a PMA company in order to commence proper trading activities.

Care must be taken in establishing a Representative Office due to the possibility or risk that group company transactions otherwise not taxable in Indonesia may become assessable due to the existence of a Permanent Establishment or “PE” for tax purposes. This is discussed further in Chapter 10 on Taxation.

Branch

The oil & gas sector and foreign bank branches were addressed in Chapter 5.

Agent or distributor

A foreign company that wishes to sell its products in Indonesia will usually appoint one or more Indonesian agents or distributors. The agent or distributor may apply for a work permit for the employment of an expatriate, who is familiar with the foreign company’s products.

Technical assistance or franchise agreement

A local company may sign a contract with a foreign party to supply technical assistance and management services or support.

It would be normal for the local company to employ foreign experts, supplied in accordance with the agreements, and for fees to be charged based on an agreed mechanism or structure.

Government contracts

Where technology or expertise is not available domestically, the GOI can enter into contracts with foreign companies. A company would normally enter into a contract in conjunction with local contractors, or may act as a subcontractor to a local contractor. The contract permits the company to establish a presence in Indonesia for the purpose of undertaking a project.
Introduction
The IDR is freely convertible into foreign currency and Indonesia has no restrictions on foreign exchange and the repatriation of funds. Though Indonesia does not restrict the transfer of foreign currency to or from foreign countries, incoming investment capital inflows require approval. Moreover, all foreign exchange transactions between an onshore entity and an offshore counterparty must be reported to Bank Indonesia. Foreign banks, JV banks and more than 30 national banks are licensed to carry out foreign exchange transactions.

Currency
The Indonesian Parliament passed Law No.7/2011 concerning Currency (“the Currency Law”) in June 2011 requiring use of Indonesian currency in domestic transactions. The most interesting issue in the Currency Law which could cause problems for businesses is the mandatory use of the IDR for all transactions conducted in Indonesia under Article 21 (1) and the prohibition against refusing to accept IDR under Article 23 (1). Exemptions include certain transactions related to the state budget, income and grants from/to foreign countries, “international trade transactions”, foreign currency savings in banks and international financing transactions, which can be open to broad interpretation in practice. Failure to comply with the Currency Law may result in penalties of up to IDR 200 million and/or imprisonment for one year. An Implementing Regulation scheduled to be issued in June 2012 is yet to be rolled out. Most investors, banks and business owners are relying on a Guidance Note that limits the operation of the law to cash transactions.

The IDR is not allowed to be transferred out of Indonesia; however it may be transferred from residents to non-residents within Indonesia for amounts up to IDR 500 million without any documentation. However, the non-resident entity must state the reason for the transfer. Both residents and non-residents may hold foreign currency accounts in Indonesia.

For any incoming or outgoing transaction above USD 10,000 or equivalent, both parties must report the reason for the transaction to Bank Indonesia. For resident domestic individuals or entities, a Tax Identification Number is also required.

Margin trading of foreign currency against the IDR is strictly prohibited in the onshore market.

7. Repatriation of Foreign Exchange

also guaranteed for capital repatriation. Proceeds from an investment’s sale are remitted at the exchange rate at the time of transfer, unless the company’s investment agreement specifies another rate. Reinvested profits receive the same treatment as initial capital.

Remittance notification
Carrying more than IDR 100 million out of Indonesia requires prior approval from Bank Indonesia (BI), while any person carrying IDR 100 million or more into the country must verify the funds with Indonesian Customs upon arrival.

Restrictions on trade-related payments
According to Bank Indonesia Regulation No.12/22/PBI/2011 regarding Income of Foreign Exchange derived from Export and Withdrawal of Foreign Exchange of Foreign Debt issued in September 2011, export payments and loans obtained from overseas have to be received in Indonesia through the Indonesian banking system. The regulations were meant to create a stable source of foreign exchange by forcing exporters to repatriate their earnings and ensuring that loan proceeds are actually remitted to the country.

The regulation requires the export proceeds to be received by a domestic bank no later than 90 days after the date of Declaration of Goods Exported (PEB).

For import payments, amounts exceeding IDR 100 million require completion of a form issued by Bank Indonesia. Indonesia blocks the import of several goods and requires special licenses for the import of others.
8. Domestic and Foreign Trade

Trading in Indonesia
The trade sector includes import, export and distribution in the domestic market for imported and locally produced goods. In general, PMA companies in manufacturing are permitted to:

- Import or buy on the domestic market: capital goods.
- Sell their own products directly to a large-scale retailer.
- Export their own products, and processed goods of other PMA and domestic companies.
- Sell their own products to third parties or other parties, or a Producer Importer Identification Number or API-P (from BKPM for PMA companies and from MOT for domestic companies), issued to importers conducting import of goods for their own use, such as raw and supporting materials and/or to support production in manufacturing activities. An API is valid for five years and can be extended, if required. The license is applicable for the entire Indonesian customs territory.
- Import complementary goods from affiliates outside Indonesia, and sell them into the domestic market (production companies only).
- Sell their own products directly to a large-scale retailer.

Note that distribution activities are closed to foreign investors across all industry sectors. Retailing is also closed except for large scale hypermarket businesses, with scale or size specifically based on sqm of floor and other space.

Imports
Importing into Indonesia
Importation of goods into Indonesia must be declared to the country will need to establish a relationship with a local import and distribution agent. This relationship can be facilitated by seconding foreign experts to assist the local trading company in business, technical and management matters, as described in Chapter 5. Another alternative is to establish a Representative Office to conduct market research and promote the parent company's product range.

Certain goods subject to import restrictions
In order to protect local industry and/or to maintain economic and political stability, restrictions on imports are imposed at three levels:

- Prohibited - for example, motorized vehicle tires, electric light bulbs, matches, certain types of textiles, batteries, iron sheets, fully assembled automobiles and motorcycles, radio and television sets, explosives, narcotics and certain traditional Chinese medicines.
- Restricted to State owned companies - such as fuel for vehicles, ships and aircraft.
- Restricted to Sole Agencies who must be approved by the GOI, including CBU (Completely Built-Up) motor vehicles of a type not assembled in Indonesia.

The classification of goods subject to import restrictions periodically changes. Intending importers should consult with the MOT.

Exports
Exporting from Indonesia
Any organization that possesses a Principle (manufacturing) License or Permanent Business (trading or services) Licence is permitted to export. PMA companies may be formed for the purpose of exporting Indonesian products and manufactured goods.

Certain goods subject to export restrictions
Goods in the following categories are subject to export restrictions:

- Prohibited: goods including some categories of rubber, scrap metal and antiques are prohibited from being exported due to considerations such as preserving nature, guaranteeing supply of raw materials for small industries or craftsmen and preserving goods with historic and cultural value.
- Restricted to certain approved exporters: textiles, plywood and coffee.
- Restricted to approved exporters only: certain basic commodities can only be exported if domestic demand has been met. Examples are flour, palm oil, sugar and petroleum. Approval is also required for certain metals: silver, gold, copper and aluminum.

Taxes on exports
Commodities such as palm oil, rattan and wood are subject to Export Tax. The Export Tax is calculated based on the export reference price which is set by a decree of the MOT and valid for a certain period of time. Export duties are aimed at meeting objectives such as guaranteeing fulfillment of domestic demand, protecting natural resources and maintaining stability of local market prices of certain commodities. Export duty is calculated based on the export duty tariff and Harmonized System classification. The MOF is authorized to decide goods that are exempted from export duty.

Customs procedures that apply to exports
Exported goods are subject to inspection in Indonesia only in the following circumstances:

- Where application has been made for restitution or exemption from duties and taxes of imported commodities.
- Where suspicion exists that goods are subject to ban or restriction.

ASEAN Free Trade Area (AFTA)
Background and history
The ASEAN Free Trade Area (AFTA) is a free trade area covering the members of Association of South East Asian Nations (ASEAN). Under AFTA, ASEAN will become a free trade area with no tariff or non-tariff barriers on cross border transactions between ASEAN countries by 2015. Unlike the European Union, AFTA does not apply a common external tariff on imported goods. Each ASEAN member may impose tariffs on goods entering from outside ASEAN based on its national prevailing tariffs. Key objectives of AFTA are to:

1) make ASEAN a more competitive production base for global markets;
2) attract more FDI; and
3) improve intra-ASEAN trade.

India is a member of AFTA and one of the first six signatories together with Malaysia, Thailand, Brunei Darussalam, Singapore and the Philippines or “the ASEAN-6.” The primary mechanism for achieving the objectives of AFTA is the Common Effective Preferential Tariff (CEPT) scheme where ASEAN members are to apply a tariff rate of 0% to 5% on a wide variety of imports originating within ASEAN. The general rule is that local ASEAN content must be at least 40% of the FOB value of the goods. Effective 1 January 2010 the above original ASEAN-6 had largely established a complete free trade area, having eliminated import duties on 99% of products on the Inclusion List. For Cambodia, Laos, Myanmar and Vietnam, collectively referred to as “CLMV”, 49.27% of the Tariff Lines in the Inclusion List are already at 0%. In 2015, the ASEAN-6 and CLMV are scheduled to become a complete free trade area.

Export incentives
The government has the stated aim of encouraging exports. A number of incentives exist, including:

- the foreign exchange arising from proceeds of sales abroad may be retained or sold to third-parties by the exporter.
- VAT on exports is at the rate of 0%, enabling exporters to claim refund of input VAT.

Import duties may be reimbursable, or not payable on imports, under various special schemes for export manufacturers.

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- VAT on exports is at the rate of 0%, enabling exporters to claim refund of input VAT.

Import duties may be reimbursable, or not payable on imports, under various special schemes for export manufacturers.
9. Labor and Employment

CEPT has an Inclusion List that lists products which are subject to the CEPT scheme; however ASEAN members have the option of excluding products from the CEPT in three cases:

1. Temporary exclusions – products for which tariffs will ultimately be lowered to 0% to 5%, but which are being protected temporarily by a delay in tariff reductions

2. Sensitive products – commodities such as rice, sugar and wheat. Senior ASEAN members (Indonesia, Malaysia, Singapore, Thailand, Brunei, Philippines) had until 2010 to reduce the tariff levels to 0% to 5%; while Vietnam had until 2013, Laos and Myanmar until 2015 and Cambodia until 2017

3. General exceptions – products which an ASEAN member deems necessary for the protection of national security, public morals, the protection of human, animal or plant life and health as well as protection of articles of artistic, historic or archaeological value.

Impact of AFTA

It has generally been concluded that AFTA has affected trade structures especially around procurement in ASEAN countries. However, the overall effects, especially export structures, vary from country to country and from industry to industry.

Impacts of AFTA on Indonesia

Positive

- Bigger market opportunities for Indonesian products given a combined ASEAN market population of around 600 million people and a variety of income levels in ASEAN countries
- Lower production costs for Indonesian producers which require raw/auxiliary materials from other ASEAN countries
- Wide range of available products in the domestic market in terms of quality and price levels
- Bigger opportunity to have business cooperation with other ASEAN countries.

Negative and other considerations

- Other than Free Trade Agreements (“FTAs”) within member countries, ASEAN countries also have FTA agreements with other countries which are: China, Korea, India, Japan, Philippines, Australia and New Zealand which have been in effect from 2010. The China – ASEAN FTA is considered to have negatively impacted the Indonesian economy with the Indonesian domestic market flooded with the low price products, competing with national products
- Readiness of government institutions at both central and regional level to properly train employees in preparation for liberalized investments and open trade of goods and services, including general awareness and English language skills
- Risk of rising labor costs with free flow of labor entering the country, or entry of cheap labor
- Readiness of infrastructure and national logistics systems.

Indonesian labor laws, regulations and landscape

The main employment laws in Indonesia are Law No. 13/2003 on Labor, Law No.2/2004 on Industrial Relations Dispute Settlement and Law No.21/2009 on Labor Unions. The “Manpower law” is designed to safeguard interests of employees. Law No.2 on dispute settlement deals with employee-related complaints or disputes, the law on Labor Unions protects the employees’ right to form a labor union and imposes criminal sanctions on anyone, including the employer, who engages in anti-union activity. There is also Law No.3/1992 on Workers Social Security. The main regulatory authority is the Ministry of Manpower & Transmigration (“MOMT”) or “Manpower Affairs”.

Employers generally consider Indonesia’s labor laws and regulations to place overly onerous obligations on employers, particularly in respect of ability to terminate and the level of severance and termination benefits payable. For highly labor intensive industries and businesses, this can make wage and benefit levels uncompetitive compared to other neighboring countries for certain sectors. A lack of training, cultural background and difficulty in terminating non-performing workers often mean that staff numbers can reach higher levels than an investor may initially anticipate. Attempts by governments in the past to make aspects of the law more friendly to employers has led to street demonstrations and is politically sensitive.

Notwithstanding the above, Indonesia still has one of the lowest average wage rates in Asia, and continues to be very low by Western standards.

Resource pool of skilled Indonesian workers

Indonesia has a large pool of workers, with a reported labor force of 117 million people in 2011, and a labor force participation rate of 68%. These statistics exclude the self-employed, informal sector. With the high birthrate in recent decades and the drift away from traditional village life, the potential workforce is growing at almost two million per year. 60% of the Indonesian workforce is concentrated in Java and Bali, and workers continuously migrate from rural to urban areas in search of jobs.

Despite the large population, a prevailing condition that now exists is that the country’s resource pool is now being “stretched very thin” with demand for skilled and experienced Indonesian professionals and technicians across various disciplines to meet demand of foreign investors and high growth local industries, including services and commerce & industry generally. This is considered to be a function not only of rapid economic growth but deficiencies in the education system which the government is looking to address, recognizing this is a long term and challenging exercise.

Levels of wages and benefits

Basic salary and wage levels can vary considerably with geographic location and across industries.

According to Law No.13/2003 Article 89, each province/city is given the power to frame its own Provincial Minimum Wage or “UMP” which is reviewed and set annually on the basis of agreement between corporates, organizations and labor unions as finally determined by the Governor of each province. Regulation of the minimum wage is stipulated in Articles 88, 89, and 90:

a. Provincial or district/city-based minimum wage
b. Provincial or district/city-based sectoral minimum wage
Once a year each provincial government adjusts the UMP based on a Governor Decree on Minimum Wage. A Remuneration Council, a non-struc- tural tripartite organization which consists of government, entrepreneur associations and labor organization representatives (as stipulated under Presidential Decree No.107/2004) makes recommendations on the UMP based on a "decent living needs survey." There is an anticipation that when regional autonomy is fully implemented at provincial level, there will be a Regency Minimum Wage ("UMK") for each city in every province based on recommendations from the Regent Mayor and the Remuneration Council.

In November 2012, the Government of Jakarta raised the UMP for Jakarta by 44% to IDR 2.2 million (USD 228) based on Governor of Jakarta Regulation No.189/2012 concerning the 2013 Provincial Minimum Wage, recording its highest ever increment. Companies that are not able to meet the requirement have the option to enter into dialogue with workers which is required to be completed before the new minimum wage is scheduled to be implemented in January 2013. The Confederation of Indonesian Labor Unions (KSPSI) is monitoring compliance with new UMP.

Under Law No.13/2003, an employer is prohibited from paying below the minimum wage which covers basic salary and a fixed allowance, the salary component comprising at least 75%.

Working hours under the Labor Law are 7 or 8 hour days depending on whether 5 or 6 days are worked per week, with additional hours considered overtime which is calculated based on formulae in the law.

An employee with at least 12 months service is entitled to a Religious Festivity Allowance or "THR" of an additional one month salary. Other aspects of the law deal with workers social security, employee facilities, annual leave as well as various other paid leave including illness, marriage, maternity and death (which may be higher or better under Company Rules or HR policy than what is stipulated in the law). There are special benefits for female employees working between 11pm and 7am under a Minister of Manpower Decree.

Industrial relations and Labor Unions

The reformation in labor politics in Indonesia was commenced by the issuance of Ministerial Regulation No.5/1998 concerning Labor Union Registration, which ended the monopoly of All-Indonesian Workers Union Confederation ("KSBSI"). Following enactment of Law No.13/2003, many local labor unions representing many different industries have emerged and registered their establishment with the MOMT.
Outsourcing Agreements for Labor Supply also need to be registered with the local MOMT office. In addition, employment between the labor supply company and its workers assigned to user companies may be based on Definite Period Employment Agreements or Indefinite Period Employment Agreements, but the labor supply company must have written agreements with its workers that are also registered at the local MOMT office.

Transitional Provisions are in place to 19 November 2013 and a number of uncertainties still need to be clarified, including the implications of non-compliance.

Worker’s Social Security scheme

Under Law No.3/1992 or the JAMSOSTEK Law, companies with a payroll exceeding IDR 1 million per month, or employing 10 or more staff, must enroll their employees in the JAMSOSTEK program.

JAMSOSTEK is a government social security scheme, mandatory by law, to which an employee and employer must make monthly contributions based on a percentage of basic salary for: (i) employee work accident insurance, (ii) retirement benefit fund, (iii) life insurance, and (iv) health care benefit coverage. The first three are mandatory. Health care benefit contributions are payable only if the employer does not provide equivalent or better health benefits.

Contribution fees need to comply with the standard provisions in Government Decree No.14/1993. Fees can vary across job classifications and industries, but generally fall in a range of 4.24% to 8.74% of basic salary. Employee contributions are made by the employer except for retirement benefit insurance to which the employee also contributes.

Both permanent and contract employees need to be covered by JAMSOSTEK. Expatriates are required to be enrolled unless covered by an equivalent scheme in his or her home country.

Termination and severance benefits

Under Manpower Affairs Law No.13/2003: Article156, a company has an obligation to pay severance, gratuity and other compensation:

- in the general occurrence of employees resigning voluntarily or terminating working relations with the employer in the normal course, but only if company policy provides for this. Following a Ministerial Letter issued in 2005, employers are no longer obligated to provide this benefit
- to employees being involuntary terminated or retrenched when a company is demonstrably committed to either termination before the normal retirement age, or providing termination benefits as a result of an offer made in order to encourage voluntary redundancy.

The termination and severance payment needs to be the higher of that provided under Law No.13/2003, the Company Regulations or CLA. In general terms, minimum severance pay is based on one month’s salary or wages for each year of service, up to a maximum of 9 months pay.

The termination of employees needs to be handled carefully. Most employment contracts or agreements provide for an initial 3-month probation period, after which staff may be terminated only on strong grounds and usually only after several warnings, notifiable in writing. Termination by notice or salary in lieu of notice is not permitted in Indonesia; however, terminations should involve negotiations in bipartite meetings, mediation or conciliation, and labor court approval as a last measure. An employee also has a right of appeal to Manpower Affairs.

Manpower Affairs must also be advised of imminent staff retrenchments, due to downturn or discontinuation of business activity.

The multiplier of the severance, gratuity and compensation is based on period of service which is set out in Law No.13/2003.

In practice, changes in ownership usually do not trigger mass resignations. Resignations are more likely to be limited to long serving employees who consider a relatively large compensation payment attractive. Risks can exist in high growth, specialised industries or sectors where there is strong demand for scarce, quality resources.

Employment of expatriates

The government classifies jobs into those closed to foreigners, those open only while nationals are being trained and those open for other reasons. Manpower Affairs regulates the employment of foreign citizens for certain positions and for certain time periods only as determined and specified in Ministerial Decree No.40/2012 concerning Restricted Positions for Foreign Employees. Accordingly, expatriate employment requires government approval, and foreigners must obtain a Limited Stay Visa (VITAS), Limited Stay Permit Card (KITAS) and Work Permit through their sponsoring employer. Work Permits are usually valid for a one to 12-month period extendible subject to approval from the MOMT upon expiration. Certain other formalities are normally required, such as a Multiple Exit and Re-Entry Permit (“MERP”), a Blue Book, a Police Report Certificate, a Foreign Domicile Certificate, a Certificate of Family Composition of Foreign Citizen, a Temporary Residence Card for Foreigner, a Certificate of Police Registration and a report on the existence/arrival of the foreign citizen. Once an expatriate has a KITAS, he or she can bring a spouse and children to Indonesia.

An employer must obtain Expatriate Manpower Utilization Plan (RPTKA) approval from Manpower Affairs, the master document for processing individual Work Permits for expatriate employees. It contains information on the position that will be held by the expatriate, the number of expatriates required by the employer, the duration for employing the expatriate, the proposed commencement date for employing the expatriate and details on the Indonesian worker appointed as the counterpart (position, education and work experience).

In general, the government will expect the number of expatriates in any organization to reduce over time, and may require the employers who employ foreign workers to:

- appoint workers of Indonesian citizenship as accompanying working partners for expatriates to facilitate transfer of knowledge, technology and expertise
- educate and train workers of Indonesian citizenship until they have the qualifications required to hold the positions currently occupied by expatriates.

Visa Procedures

The Indonesian Embassies, Consulate Generals and Consulates are the governing authorities outside of Indonesia that help to apply for visas to Indonesia. These authorities state that a foreigner is required to obtain an appropriate entry visa prior to entering Indonesia. The type of visa required will depend on the purpose of trip and nationality of the foreigner. Certain nationals are exempted from the requirement to obtain an entry visa in advance of their travel to Indonesia. Citizens of certain countries are eligible to apply for a visit visa on arrival at designated airports and seaports.

Employee entitlements and benefits relating to change in ownership

Under Manpower Affairs (Law No.13/2003 dated 25 March 2003) or “Law No.13/2003” Article 163.1, employers are liable to pay severance, gratuity and other compensation to those employees who elect not to continue their employment in the event of a change in ownership of the employer. This will normally occur as part of a transaction involving an acquisition. The Courts and lawyers have had differing practical interpretations on what is a “change of ownership” in recent years.

Law 13/2003 requires the amount of severance, gratuity and compensation to be calculated based on formulae prescribed in the law and under two scenarios:

- scenario (a): an employee elects to resign – voluntary resignation
- scenario (b): employer decides to terminate employment – involuntary resignation.
**10. Taxation**

**Summary data**

<table>
<thead>
<tr>
<th>Corporate Tax Rates</th>
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<tbody>
<tr>
<td><strong>Rate (%)</strong></td>
</tr>
<tr>
<td>25 (flat rate)</td>
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</tbody>
</table>

Article 17 Law No. 36/2008

Listed companies which meet certain conditions are eligible for a 5% reduction in the corporate tax rate.

A company with gross turnover less than IDR 50 billion (approximately USD 5.5 million) is eligible for a 50% reduction of the corporate tax rate on the proportion of taxable income which results when IDR 4.8 billion is divided by the gross annual turnover. Where gross turnover is below IDR 4.8 billion, the reduction applies on all taxable income. Article 31E Law Number 36/2008.

**Rate (%)**

<table>
<thead>
<tr>
<th>Taxable income</th>
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<tbody>
<tr>
<td>5 &lt; IDR 50 million</td>
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<tr>
<td>15 IDR 50 million – IDR 250 million</td>
</tr>
<tr>
<td>25 IDR 250 million – IDR 500 million</td>
</tr>
<tr>
<td>&gt; IDR 500 million</td>
</tr>
</tbody>
</table>

Articale 17 Law No. 36/2008

Indonesia has a self-assessment system under which returns are considered final if not queried by the Indonesian Tax Office ("ITO") within five years.

**Residence**

Any corporate organization incorporated in Indonesia is subject to taxation. Corporate organizations include limited liability companies, other companies, partnerships, cooperatives, foundations, pension funds and associations.

Non-resident Indonesian individuals present in Indonesia for less than 183 days per year and corporate organizations incorporated overseas receiving or accruing income from Indonesia are subject to taxation. These tax corporate organizations are obliged to register for tax purposes if they have a PE in Indonesia. Certain types of income payable to non-residents by resident taxpayers are subject to WHT.

Representative Offices of foreign companies are also required to register as taxpayers, even though they may not be a PE. This is necessary as the Representative Office will have to withhold tax on payments to employees and third parties and lodge relevant tax returns.

**Permanent establishment**

A PE generally covers Representative Offices, management base offices, branch offices, office buildings, plants, warehouses, dependent agencies and may also include construction projects, mines or other places of extraction of natural resources, as well as consultants providing services in Indonesia.

This is very broadly defined so that the presence of an employee in Indonesia performing work for a foreign company is sufficient to establish the existence of a PE. Foreign companies should be beware of inadvertently creating a PE, and should take positive steps to enter into one of the formal arrangements permitted in Indonesia.

**General**

In Indonesia, taxes are levied under three laws that were introduced in December 1983. These cover:

- **General Tax Provisions and Procedures**
- **Income Tax**
- **VAT on goods and services, and Sales Tax on Luxury goods (STLG).**

With certain exceptions, **Withholding Tax (WHT)** is imposed on payments to onshore and offshore parties, including payments such as dividends, interest, royalties and fees paid for services. The GOI also collects taxes on land and buildings, stamp duty and import duties. Local governments collect various other taxes.

The official tax year runs from January 1 to December 31. Companies may adopt different year-ends in their AoA and may change their financial years with prior approval. A financial year cannot exceed 12 months for tax purposes.

**Personal Tax Rates**

In Indonesia, the official tax year runs from January 1 to December 31. Companies may adopt different year-ends in their AoA and may change their financial years with prior approval. A financial year cannot exceed 12 months for tax purposes.

**Residence**

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Representative Offices of foreign companies are also required to register as taxpayers, even though they may not be a PE. This is necessary as the Representative Office will have to withhold tax on payments to employees and third parties and lodge relevant tax returns.

VAT registration is available only to registered taxpayers.

**Permanent establishment**

A PE generally covers Representative Offices, management base offices, branch offices, office buildings, plants, warehouses, dependent agencies and may also include construction projects, mines or other places of extraction of natural resources, as well as consultants providing services in Indonesia.

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**Capital Gains**

Capital gains, regardless of the reason for the disposal of the asset, are taxable. A taxable gain, except for land and buildings, is defined as the net proceeds less the adjusted tax basis at the time of disposal. The tax rate is 25%.

When capital losses are disposed, they are deductible from the capital gains realized in the same year. Capital losses can be carried forward for 10 years and may be used against future capital gains.

**Dividends**

Dividends and other shares of profit derived by resident companies, cooperatives, state-owned enterprises or regional government-owned enterprises from participation in the capital of an enterprise established in Indonesia, may not be included in taxable income in certain situations. Companies, which do not meet these conditions, will be subject to tax on such income. Dividends and shares of profits from other sources must be included in taxable income. Foreign tax credit is allowed on any tax withheld on foreign-source dividends. A credit is however not available for foreign tax on underlying profits.

**Losses**

The carry forward of tax losses is limited to five years, commencing the first year after the loss was incurred. This period may be extended for up to 10 years under special facilities available for certain regions and/or industries. There is no provision for the carry-back of losses. Changes in shareholders do not affect the validity of the carried forward losses.

Capital losses are treated the same as operating losses provided that the losses are reasonable based on sound market practice. No foreign sourced losses can be included in the tax computation.

**Grouping/Consolidation**

No provision exists for group or consolidated income tax returns under Indonesian law.

**Tax Depreciation/Capital Allowances**

Depreciable property is defined as tangible property owned and used in the business or owned for the production, recovery and securing of income, which has a useful life of more than one year. Land is not depreciable, except for certain industries.

Buildings and other immovable property are depreciated only using the straight-line method. For all assets other than buildings and other immovable property, depreciation is calculated using either the declining balance or the straight-line method at a company’s option.

Once applied, taxpayers are not allowed to change the method of depreciation without the ITO’s approval. Special rules apply in the oil & gas and mining sectors.

**Amortization of Expenditure**

The acquisition price of intangible property with a useful life of more than one year must be amortized consistently using either the straight-line or declining balance method over the useful life of the asset, following the rates of depreciation for tangible assets. For mining industries, forestry and other natural resources businesses, the taxpayer must use the unit of production method with a maximum of 20% per year.

**Interest**

Interest on funds borrowed by a company for the purposes of obtaining, collecting and maintaining income is deductible from gross income. However, where funds are used to derive income subject to final tax (such as interest on domestic bank deposits) no deduction is available.

Interest may also be disallowed as a deductible item if such changes might be considered excessive, such as interest rates in excess of commercial rates. Interest-free loans from shareholders may in certain cases create the risk of the imposition of deemed interest and WHT obligations for the borrower.
Tax Administration

Registration

All taxpayers are required to register for income tax purposes. A non-resident foreign company is only obliged to register if it has a PE as defined in the domestic tax law or applicable DTA. Upon registration, a taxpayer identification number (NPWP) is obtained. The ITO may register any entity or person which, in its opinion, should be registered as a taxpayer. Subsequently, that entity or person must meet all obligations stated in the law.

A taxpayer must deregister with the ITO when it ceases to be a taxpayer in Indonesia. The ITO will generally perform a tax audit in order to ensure that the taxpayer has met all obligations. Until the ITO deregisters the company, all obligations stated in the tax law continue to apply.

Tax Installments

Corporate and individual taxpayers must pay monthly income tax installments. For most taxpayers, installments are based on the income tax payable, as reflected in the annual corporate income tax return of the prior year, after deducting taxes withheld and collected by other parties in that prior year divided by 12. Banks and other taxpayers which are required to submit periodical financial reports should base their installments on such reports, as adjusted for tax purposes.

Returns

Companies are required to self-assess and lodge annual corporate income tax returns. Consolidated returns for commonly owned entities are not permitted. The returns must be lodged with the relevant ITO within four months after the end of the calendar year or tax year and this deadline may be extended for two months by notifying the ITO.

Withholding taxes - Transactions between Residents

WHT is imposed at various rates on various amounts payable either by a resident corporation, a PE of a foreign company or certain individuals appointed as WHT collectors, to other residents. In most cases, the withholding liability arises when the expense is incurred, not when the payment is made. The regulations are numerous and the following is a summary of the main types of transactions subject to WHT and the related WHT rate.

Amounts payable to resident individuals:
- Compensation for work or services (including pensions)
- Dividends: 10% (final)
- Royalties – 15%
- Interest –
  - bank interest: 20% (WHT is final on interest from local banks)
  - bonds and certain other securities: 15% (final)
  - other interest: 15%

Amounts payable to resident companies and PEs:
- Royalties – 15%
- Interest –
  - bank interest: 20% (WHT is final on interest from local banks)
  - bonds and certain other securities: 15% (final)
  - other interest: 15%
- Rental and other income relating to the use of real property – 10% (final)
- Prizes and awards – lotteries: 25%.

Amounts payable to non-resident companies and PEs:
- Royalties – 15%
- Interest –
  - bank interest: 20% (WHT is final on interest from local banks)
  - bonds and certain other securities: 15% (final)
  - other interest: 15%
- Rental and other income relating to the use of real property – 10% (final)
- Rental of equipment and vehicles: 2%
- Services: 2% (includes technical services, management services, other services)
- Amounts payable to local banks are exempt from WHT.
- Dividends – 15%, unless the following two conditions are satisfied for which the dividend would be exempt from WHT:
  - the dividend is sourced from retained earnings
  - the shareholder company owns at least 25% of paid up capital.

The purchase of goods is generally not subject to WHT, except for certain goods as stipulated by the ITO.

Disposal of Property

Tax is also imposed at source on proceeds of disposal of property,
- Shares listed on the Indonesian stock exchange - 0.1% (final)
- Founders shares are subject to an additional 0.5% (final) on listing.
- Transfer of title of land and buildings - 5% income tax (final) and 5% title transfer tax (duty).
- Sale of unlisted shares held by a foreign shareholder in an Indonesian company - 5% of proceeds (final), unless protected by DTA.

Exemption

Where the WHT is a prepayment of the recipient's income tax liability, the recipient may be able to apply for an exemption from withholding in certain circumstances.

Tax Holidays

Tax holidays may be available for significant investments in the following "pioneer" industries:
- Basic metals industry
- Petroleum refining industry and/or organic basic chemicals derived from petroleum and natural gas
- Industrial machinery
- Renewable resources industry
- Telecommunications equipment.

The facility is only available to companies established after August 2010. To qualify, applicants must invest a minimum of IDR 1 trillion (approximately USD 109 million) and provide a statement of agreement to deposit 10% of this amount in a bank in Indonesia before submitting the application. Successful applicants will be entitled to an exemption from corporate income tax for an initial five to ten years and a reduction of 50% to the corporate tax liability for the following two years after expiry.

The regulations introducing these facilities provides for possible expansion on scope and period in the future.

Direct Tax Incentives for New Enterprises

New entities established under the Foreign Investment Law may apply for an exemption from the income tax payable on the importation of capital goods and raw materials. New enterprises must secure an exemption certificate from the ITO where the new entity is registered. The exemption is granted for capital goods indicated in the BKPM Master list and must be applied for each year.

Investment in certain business and or certain regions

Income tax relief is available for investments in 25 selected sectors (52 sub-sectors) and/or 15 selected locations (77 sub-locations), effective 22 December 2011.

The tax relief for the selected sectors/regions comprise of four incentives:
- Additional tax deduction of 5% of the realized capital investment (depreciable and non-depreciable assets) each year up to six years (revoked if the assets are transferred during facility period)
- Option to use accelerated tax depreciation at double normal rates.
- The period for tax loss carry forward may be extended to 10 years (instead of five years)
- WHT on dividends to non-resident shareholders is reduced to 10% or a lower DTA rate).

The selected business sectors are economic sectors that have high priority on a national scale, particularly in respect of boosting exports. The selected regions are remote regions, which are economically potentially worthy of development but whose economic infrastructure is generally inadequate and where access by public transport is difficult, including marine waters with a depth of over 50 meters where the seabed has mineral reserves, including natural gas.

Free Trade Zones (FTZ) and Free Port Areas (FEA)

FTZ and FEAs are treated as if they were outside of the Indonesian customs territory. There are no import duties and other taxes on the importation of goods. Goods delivered to locations within Indonesian are treated as imports and subject to normal customs and other impositions.

The regulations provide specific area coordinates and boundaries, including maps of the area coverage of the above Free Trade Zones and Free Ports.

Business activities conducted in the Free Trade Zones and Free Port Areas include trading, maritime, industry, transportation, banking, tourism and other activities. The other activities are subject to further stipulation by separate Government Regulations. The regulations stipulate that the economic development of the Free Trade Zones and Free Port Areas must be conducted in accordance with the regional master plan. These Government Regulations do not revoke any agreements, arrangements or cooperation, as well as any licenses or facilities granted prior to the stipulation of the 2007 Government Regulations. These will still apply until expiration.

Aid-funded Projects

Goods, materials and construction equipment imported by a main contractor in connection with an approved government project funded by foreign loans or grants are entitled to the following relief:
- Exemption from import duty
- No collection of VAT and STLG
- Income tax is borne by the government for primary contractors, consultants and suppliers working on such projects.

Imported Goods

The duty and tax relief available for the importation of goods are summarized in “Indirect and Other Taxes”.

International Tax

Double Tax Relief

Indonesia grants a credit for WHTs directly paid on income received or accrued in a foreign country. There is no credit for taxes on underlying profits. The credit is only granted if the income is taxable in Indonesia as being part of worldwide earned income. The credit is limited to the lesser of the tax payable in Indonesia on the foreign income or the amount of the foreign tax paid.

If the foreign tax is reduced or refunded, the credit will be reduced and the tax payable in Indonesia will have to be increased by the amount of the reduction or refund in the year that such refund or reduction is made.
**Withholding Taxes**

**Transactions with Non-residents**

WHT is imposed at 20% on various amounts payable to non-residents, unless the non-resident has a PE in Indonesia, whereby the rates applicable to payments to residents apply. The WHT may be reduced if the foreign resident is exempt or eligible for a reduced WHT rate by virtue of a DTA.

In order to qualify for any relief under a relevant tax treaty, non-residents must provide a certificate from the tax authority in their country of residence (Form DGT1 for most taxpayers).

Banks, pension funds and certain others using custodian banks may use an alternative form (Form DGT2) which requires only certification of the tax residency status, without engaging in cross border transactions. The WHT applies only if the payment is made to the foreign resident and there is a corresponding receipt.

In addition to the power of the ITO to adjust transfer prices, there are “thin capitalization” considerations and controlled foreign company rules. These are summarized below.

**Transfer Pricing**

Any transaction determined to be “non-arm’s length” may be subject to adjustment by the ITO, including:

- Unreasonable selling prices
- Unreasonable purchase prices
- Allocation of overhead costs
- Interest rates applied to inter-company loans
- Payments of commissions, license fees, franchise fees, rentals, royalties and compensation for managerial, technical and other services
- Purchases of a company’s assets by shareholders (owners) or parties having a “special relationship” at prices that are lower than market prices
- Sale of goods to foreign partners through third parties having no substantive business (such as a dummy company, letterbox company or re-invoicing center).

A special relationship includes:

- A relationship between two or more taxpayers that are under common ownership or control, whether directly or indirectly
- A relationship between a taxpayer that owns 25% or more of the capital of another party, or a relationship between a taxpayer that owns 25% or more of two or more parties, and the relationship between the two or more parties last mentioned
- A family relationship, either of the same blood or by marriage in one straight descent line and one degree sideways.

The limited regulations/guidelines which have been issued with regard to Transfer Pricing are now largely in line with the 2010 OECD Transfer Pricing Guidelines although guidance to auditors and the rules prior to November 2011 suggest that a hierarchical approach should be taken to the selection of methodology and the limited nature of the guidelines allows for broad interpretations.

The ITO may enter into Advance Pricing Agreements (APAs) on cross-border transactions with companies and other tax jurisdictions. The ITO issued a regulation covering the policies and procedures that will be adopted in establishing such APAs in late 2010.

**Application of “Thin Capitalization” concepts**

Where a special relationship exists, interest may be disallowed as a deduction where such charges are considered excessive, such as interest rates in excess of commercial rates. Interest-free loans from shareholders may in certain cases create a risk of deemed interest being imposed, giving rise to withholding tax obligations for the borrower.

The law allows the MOF to issue a decree defining the maximum ratio of debt to equity in determining deductible interest. Such a decree, proposing a maximum 3:1 ratio for all industries, was issued in 1984. However, a subsequent decree postponed its implementation indefinitely. The DGT last issued a draft proposal for a 5:1 ratio; however it has never been finalized. Special rules on tax deductibility of interest apply in the mining and oil & gas sectors.

**Controlled Foreign Company (CFC) Provisions**

Effective January 1, 2009, the CFC type rules whereby Indonesian resident shareholders may be subject to tax on deemed dividends have changed. A CFC is now defined as a foreign unlisted corporation in which an Indonesian resident individual or corporate shareholders, either individually or as a group, hold 50% or more of the total paid in capital. Listed corporations are not CFCs. The Indonesian shareholders shall be deemed to receive dividends within 4 months after filing the tax return, or 7 months after the end of the fiscal year where there is no obligation to file an annual tax return or there is no specific deadline of filing in the country of residence of the CFC.

**Residence**

The tax law distinguishes between resident tax and non-resident tax payers. A resident tax payer is defined as any individual present in Indonesia for more than 183 days in any consecutive 12-month period, or any individual present in Indonesia and intending to reside in Indonesia. Resident individuals are taxed at the normal rates on taxable income, i.e. worldwide gross income less allowable deductions and non-taxable income.

**Taxable income**

Gross income is broadly defined as any economic benefit received or accrued by a taxpayer, whether originating from within or outside Indonesia. Gross income includes wages, salaries, bonuses and other compensation for work performed, honoraria, lottery prizes and awards, gross profits from a business, gains from the sale or transfer of property, dividends, interest, royalties, rent and income from the cancellation of indebtedness.

Interest income earned by individuals from time deposits held in Indonesia is subject to a 20% final WHT, accounted for by the paying bank. This income is not subject to further taxation in the hands of the recipient.

Income from the rental of land and buildings is subject to 10% final WHT. Corporate tenants must deduct the 10% tax from amounts payable to the lessor.

**Capital Gains Tax**

Similar to companies, capital gains derived by individuals are taxable as normal income.

**Dividends**

Dividends are taxable to individuals. Dividends received from domestic taxpayers are subject to a final WHT of 10%. A foreign tax credit may be available for any foreign taxes paid on dividends received from overseas.

**Employment Income/Employee Benefits**

Companies paying amounts to resident individuals in excess of a small daily sum are required to withhold tax at standard rates, except for rental and certain professional services where lower rates of withholding may apply.

It is common practice for salaries and certain other amounts payable to individuals to be expressed on a “net of tax” basis. By special concession, Indonesian nationals are allowed the full benefit of non-taxable income allowances and the lower bands of tax rates against part-year employment income. In all cases, the occupational support deduction is limited to the lower of 5% of gross income, or IDR 500,000 per month, (maximum IDR 6,000,000/year).

**Taxation of Individuals**

**Introduction**

An employer is obligated to withhold, remit and report tax on income received by an employee in connection with employment. Individuals who are resident in Indonesia for tax purposes are required to obtain a personal tax registration number (NPWP) and file an individual tax return, unless he or she receives net income below the non-taxable income threshold (discussed below).
For the individual taxpayer – IDR 15,840,000/year
determining taxable income:

- Resident individual taxpayers can also deduct the following in
  oil & gas and mining contractors, the cost of benefits-in-
  home leave, motor vehicles, children's education expenses
  excluded from taxable income because the benefit was not
  in the form of cash. For example, the medical expenses of
  by the employee or his or her family from an employer not
  the taxable income of an employee and is not an allowable
  deduction from gross income in determining the taxable
  income. The payer of the income is responsible for the WHT due
  on the income paid to the non-resident.

Payments to non-residents in the form of dividends, interest,
royalties, rent for property, compensation for services, prizes
and awards, pensions and other periodic payments, rentals,
insurance premiums or the deemed gain from the disposal of
shares in unlisted Indonesian companies in Indonesia are
also subject to a 20% WHT, unless reduced or exempted
by an applicable DTA. This 20% WHT can be treated as a
prepayment of tax if a non-resident becomes a resident
taxpayer.

The tax year is the calendar year.

Personal Allowances
Resident individual taxpayers can also deduct the following in
determining taxable income:

- For the individual taxpayer – IDR 15,840,000/year
- For a married taxpayer who is the principal earner – an
  additional IDR 24,300,000/year (as of 1 January 2013)
- For each lineal family member by blood or marriage
  who is a full dependent (up to a maximum of three
  dependants) – an additional IDR 1,320,000/year per
  dependant (IDR 2,025,000/year as of 1 January 2013).

Resident individual taxpayers are also allowed the following tax
deductions:

- For occupational support, an additional allowance of 5% of
  gross income up to a maximum of IDR 6,000,000/year (IDR 24,300,000/year as of 1 January 2013)
- For dependants (IDR 2,025,000/year as of 1 January 2013)

Tax Administration
Payment of Tax
Income tax withheld by employers from payments of
wages, salaries, honoraria and other payments to individuals
subject to tax, must be remitted on a monthly basis by the
10th day of the following month.

Employers must file a monthly tax return by the 20th day of
the following month outlining total compensation and
taxes withheld. From 2009 there is no obligation to file an
annual employer tax return. However, the December tax
return to be lodged on the 20th of January, must detail, by
individual, all taxes paid and income earned during the year
by employees and other individuals subject to withholding.
Any income tax payable as shown in such December tax
return must be remitted before the filing date of January 20.
Individuals must pay monthly installments based on regular
non-employment income declared in the previous year’s tax
return.

Individual tax returns may be subject to tax audit. Payment of
tax audit assessments is due within one month
following issuance by the ITO. There is a five-year statute of
limitations.

Other Issues
Expatriates
Under the tax law, resident individuals including expatriates
are taxed on worldwide income. The ITO has issued a
schedule of salary guidelines, the most recent version of
which was issued in April 2002. The guidelines address the
industry of employment, nationality and job title. They are
used by the ITO in circumstances that indicate that salaries
are not being properly declared for employee income tax
purposes.

For expatriates commencing or terminating employment
during the year, annualization of income is required for
calculating the taxable pay on the part-year income. This
effectively pro-rates the non-taxable income allowances
and the lower bands of tax rates. As such, the timing of
arrival in or departure from Indonesia of expatriates is of no
significance for tax purposes.

Expatriate employees of drilling companies are taxed on a
deemed salary basis, for which separate regulations exist.

Indirect and Other Taxes
Value-Added Tax
Overview
A person or body, in whatever form, which in the course of
its operation, produces, imports or exports taxable goods,
conducts trading activities or renders taxable services, is
required to register as a “Taxable Entrepreneur” with the
ITO. However, only a resident or a PE can obtain a VAT
registration. Registration by non-residents is not allowed.

The rate of VAT is 10% but under the law the government
can amend this rate to a minimum of 5% and a maximum
of 15%. VAT is levied on exports at 0%.

Goods and Services Subject to VAT
VAT is imposed on:

- The delivery of taxable goods (tangible or intangible) in
  Indonesia by “Taxable Entrepreneur”
- The importation of taxable goods
- The rendering of taxable services in Indonesia
- Utilization of intangible taxable goods from outside the
  Indonesia
- Utilization of offshore taxable services in Indonesia
- Export of taxable goods by a “Taxable Entrepreneur”
- The activities of self construction
- The disposal of fixed assets by a Taxable Entrepreneur,
  including the transfer in the course of a merger (except
  where VAT on the original acquisition could not be
  credited)

Special schemes for VAT apply to sales of cigarettes, pre-
recorded cassette tapes and compact discs.

Collection, Filing and Payment of Tax
VAT is determined by applying the tax rate of 10% to the
sale, replacement or import price. The sales price is the
money value including all costs of delivery, installation,
insurance, technical and maintenance, commission,
guarantees, interest and others, as long as they relate to
the delivery of goods. Compensation for services is the money
value, including all costs, which relate to the delivery of the
services.

Excluded from the sales price, are sales tax and discounts
and rebates, as long as these are included on the tax
invoice.

For imported goods, the import value is the value used as
the basis for calculating the import duty together with other
levies imposed on the basis of the provisions in the customs
law, but excluding VAT and STLG.

In cases where a special relationship exists between two
parties involved in a transaction, the ITO may substitute a
market price that becomes the basis on which the VAT is
charged.

Monthly remittances to the government are required for
the excess of output VAT over input VAT. Output VAT is
charged by a taxable entity on its sales of goods and
services. Conversely, input VAT is the VAT incurred on
purchases of goods and services used in the business.

If input VAT exceeds output VAT for any month, it can
be carried forward to the next month or a refund can be
claimed (except input VAT for certain transactions). A refund
claim triggers a tax audit. Input VAT, supported by a valid
tax invoice, is only creditable if it is reported within three
months after the end of the period stated in the tax invoice.

There is a self-collection obligation in relation to input VAT
on offshore services purchased from non-residents for the
benefit of residents.

Monthly VAT returns must be filed by the 20th of the
following month.

Certain government bodies, production sharing contractors
and mining companies are subject to special rules as they
are designated VAT collectors. These bodies are obliged to
remit VAT related to their purchases directly to the ITO.
Exemptions and Reliefs

The principal activities not subject to VAT are as follows:
- Goods produced by mining or drilling that are taken directly from their source: crude oil, natural gas, geothermal energy, sand and gravel, coal (before processed into briquettes), and ores (iron, tin, gold, copper, nickel, silver and bauxite).
- Basic necessities needed by the population as a whole: rice, corn, sugar, soybeans and salt.
- Money, gold ingots and negotiable instruments
- Banking, insurance, leasing services and securities
- Manpower services
- Social, health, religious and education services
- Public transportation, postal services, non-commercial broadcasting
- Entertainment services
- Hotel and catering services
- Government services.

There are also goods and services that are granted an exemption from VAT.

Relief for Export Manufacturers

There are a number of relief schemes to allow exporter manufacturers to operate on a virtually VAT and duty-free basis. Such schemes include bonded zones, economic development zones (KAPET) and free trade areas. The Government has approved a number of Bonded Areas located throughout Indonesia.

Free trade areas and free ports are located in Indonesia but are considered outside the customs area and, therefore, goods brought into these areas are exempt from import duties, VAT and STLG. Business activities that can be carried out in a free trade area include, among others, trade, services, mining, transportation, banking and manufacturing.

Sabang, Batam, Bintan and Karimun are currently the free trade areas in operation.

An import incentive is granted to a manufacturer who imports raw materials to be used for processing, assembling, or installing in goods, provided those goods will be 100% exported. A manufacturer must be registered in order to be entitled to this incentive. A bank guarantee or customs bond is required for the full amount of the import duty, excise and VAT that would otherwise have been payable. When goods are exported, the quantity or bond is released. A refund can be granted on any import duty, excise and tax paid on imported goods that are later used in producing items for export.

Sales Tax on Luxury Goods

The VAT law also imposes a STLG on deliveries of luxury goods by manufacturers in Indonesia and on the importation of luxury goods. The rates vary depending on the category of the goods. The current rates range from 10% up to 75%, although the Law allows for a maximum of 200%. Conceptually, this tax is charged only once. Like VAT, STLG is charged at 0% on the export of luxury goods and any STLG suffered may be reclaimed. STLG is calculated by multiplying the applicable rate against the sales price or import price, excluding VAT. The STLG payable on the purchase of luxury goods cannot be credited against the VAT collectable when the goods are subsequently sold.

It is necessary to determine the applicability of the STLG on a case-by-case basis as the rules are complex and subject to change. There is an exemption from STLG on certain items for public use.

Customs Duties

Customs duties are imposed on items imported into Indonesia. Customs duties are generally imposed on an ad valorem basis.

Duties are payable based on the Harmonized System (HS) classification. Duties are based on the cost, insurance and freight (CIF) value of the imported item and, in general, are imposed at rates of 0% to 20% for most goods, 25% to 80% for cars, and 170% for alcoholic drinks.

The Indonesian customs procedures are based upon General Agreement on Tariffs and Trade (GATT) principles.

Some key features of the current system are:
- Ports have a “red and green channel” system for imported goods. Red channel goods are all inspected. Green channel goods are not normally inspected unless there is some justification.
- Duties and taxes shown on the import declaration must be paid through a designated bank in order for the goods to be released.
- Valuation of goods is based on GATT conventions.
- The accuracy of the declaration and value is subject to subsequent audit of the importer’s records.

Simplified procedures apply for goods entering bonded areas. Special rules apply for imports in the oil & gas sector, and goods for government projects funded by loans or grants from other governments.

Import duties are not payable in certain circumstances, including:
- Imports used in the production of exports where the manufacturer is located in a bonded zone or free trade area.
- Certain imports by the petroleum, geothermal and mining industries.

Other relief includes:
- For certain goods which are imported on a temporary basis, the importer may pay 2% of the import duty and VAT each month for the period of usage. The remaining amount can be guaranteed. If the goods are not re-exported, the full amount of import duty and taxes plus a 100% penalty on the import duty must be paid.
- Import duty tariffs are reduced to 5% on importation of goods by approved foreign and domestic investment companies using Master list facilities.

Excise Duties

Excise duties are levied on specific products whose consumption is restricted or controlled, namely alcoholic beverages and tobacco products.

Stamp Duty

A stamp duty tax of either IDR 3,000 or IDR 6,000 is charged on certain documents such as receipts, agreements, powers of attorney and other legal documents.

Tax on Land and Buildings

This is a tax levied on the holding of land or buildings within Indonesia. The ITO, or in practice delegated regional authorities, will initially determine who the taxpayer is and issue a Report On The Tax Object to that property. Normally, the owner is responsible for paying the tax due.

Tax Rate and Method of Calculation

Tax is currently imposed at 20% or 40% of the full statutory rate, which is 0.5% of the sales value. Thus, the actual tax rate is 0.1% or 0.2%. The sales value is the actual transaction price or, in the absence of a transaction, the price of a similar holding can be used. The law provides that the sales value is to be fixed every three years, except for certain areas where it is fixed annually.

The tax is to be determined for the tax year, being the calendar year, based on the condition of the land and buildings as at 1 January. Specific calculation formulae are stipulated for plantations, mining and forestry businesses.

Property Title Transfer Tax

A transfer tax is payable on every transfer of title of land, or land and buildings. The taxpayer is the recipient of the rights.

The definition of “transfer” is broadly defined, and includes:
- A sale and purchase transaction.
- An exchange of assets.
- A grant or a gift.
- A testamentary grant.
- The enforcement of a judicial ruling with permanent legal force.
- A business merger, liquidation or expansion.

Exemptions

Tax is not imposed on certain transfers, such as:
- Transfers of title to the state for the public interest.
- Transfers to diplomatic representatives and certain international organizations.
- Donations for certain religious and community purposes.

Collection of Tax

This tax becomes payable before the transfer is legalized. A lawyer or notary cannot legalize any legal documents in relation to a transfer if the tax has not been paid. The ITO is granted the power to review the property title transfer tax. If any underpayment is found, the ITO can issue a tax assessment.

Payroll Taxes

There are no additional payroll taxes in Indonesia other than the employee income tax withholding system. However, JAMSOSTEK (social security contributions) are based on payroll, most of which are borne by the employer.

Regional and Local Taxes

Local governments collect regional and local taxes. These taxes include:
- Entertainment tax.
- Advertisement tax.
- Motor vehicle taxes.
- Hotel and restaurant tax.
- Street lighting tax.
- Tax on the use of underground and surface water.
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