



## Indonesia Tax Alert September 2021 Energy, Resources and Industrial (ER&I)

New regulation issued on transfer of participating interest in an oil and gas block

The Indonesian tax treatment of upstream oil and gas production sharing contracts (PSCs) under a cost-recovery arrangement is regulated by Government Regulation (GR) Number 79 of 2010, as amended by GR Number 27 of 2017 (PP-79); whereas the tax treatment of PSCs under a gross-split arrangement is regulated by GR Number 53 of 2017 (PP-53).

Although the tax treatment related to the transfer of a participating interest (PI) in a PSC is covered by both PP-79 and PP-53 as well as the implementing Minister of Finance (MoF) Regulation Number 257/PMK.011/2011 (PMK-257), on 31 August 2021, the Indonesian government issued GR Number 93 of 2021 (PP-93) superseding the relevant PI transfer provisions in PP-79 and PP-53. The purpose of the issuance of PP-93 is to provide legal certainty, create a conducive investment climate in the upstream sector, and support the restructuring of the state-owned oil and gas company.

PP-93 clarifies that a PI in a PSC is an immovable asset that may be owned directly or indirectly. The transfer of a PI is deemed to generate income for the contractor of the PSC and thus, it is subject to final income tax. PP-93 also provides a tax exemption if the transfer satisfies certain conditions.

The following table summarizes the key provisions of PP-93:

Topic	Direct transfer	Indirect transfer
Description of transfer (PP-93 provides further guidance on indirect transfers)	The contractor transfers its own PI in a PSC block to another party.	The PI in a PSC block is transferred to another party by selling the shares in the contractor owning the PI or the shares in the direct or indirect owner of the contractor, regardless of the number of levels of ownership.
Final income tax rate (no change in PP-93 from PP-79/PP-53)	<ul style="list-style-type: none"> <li>• 5%, if the transfer is carried out during the exploration stage; or</li> <li>• 7%, if the transfer is carried out during the exploitation stage.</li> </ul>	
Tax base (PP-93 clarifies the tax base on an indirect PI transfer)	<ul style="list-style-type: none"> <li>• The actual transfer price by any name and in any form; or</li> <li>• The arm's-length value (for a related party transfer).</li> </ul>	The fair market value of the PSC, taking into account the proportion of the share ownership and the PI percentage being transferred.
Timing of tax is due (PP-93 amends the time the tax is due on an indirect PI transfer)	<p>The earlier of:</p> <ul style="list-style-type: none"> <li>• The time of payment for the PI;</li> <li>• When the transfer of the PI becomes effective; or</li> <li>• When the transfer of the PI has been approved by the Ministry of Energy and Mineral Resources.</li> </ul>	The end of the fiscal year in which the transfer of the PI occurs.
Conditions for the transfer of PIs to qualify for exemption from final income tax (PP-93 introduces a new tax exemption for indirect PI transfers)	<p>A direct transfer of a PI during the exploration stage may be tax-exempt if all of the following conditions are met:</p> <ul style="list-style-type: none"> <li>• The contractor does not transfer its entire PI to the other party;</li> <li>• The contractor has owned the PI for more than three years;</li> <li>• Exploration activities have been conducted; and</li> <li>• The transfer is not carried out for profit.</li> </ul> <p>A direct transfer of a PI during the exploitation stage that is carried out to meet the contractor's obligation under a PSC contract or relevant law may be tax-exempt.</p>	<p>An indirect transfer of a PI during the exploration and exploitation stages may be tax-exempt if one or more of the following conditions are met:</p> <ul style="list-style-type: none"> <li>(a) The gain from the transfer of shares has already been subject to income tax under the prevailing regular income tax regime;</li> <li>(b) The transfer has already been subject to final income tax in Indonesia under the prevailing Income Tax Law;</li> <li>(c) The transfer is conducted as part of a restructuring, in which an approval for a tax-neutral restructuring has been obtained from the Directorate General of Taxation (DGT); and/or</li> <li>(d) The transfer is conducted as part of a restructuring, which is not for profit, and the ultimate parent entity remains unchanged.</li> </ul> <p>PP-93 provides examples for each of the conditions above.</p> <p>With respect to transfers that fall within point (d) above:</p> <ul style="list-style-type: none"> <li>• The transfer must be notified to the DGT by the fourth month after the fiscal year ends;</li> <li>• The notification to the DGT must be accompanied by certain supporting documents, such as transaction documents, audited financial statements, restructuring approval, etc.; and</li> <li>• The DGT has the authority to audit the contractor to ensure that the transfer is not conducted to generate a profit and that the ultimate parent entity remains unchanged.</li> </ul>

Some high-level observations on PP-93 include:

- Following the issuance of PP-93, the provisions relating to the transfer of PI in PP-79 and PP-53 are revoked. An MoF regulation will be issued as the implementing regulation for PP-93;
- In 2011, the MoF issued PMK-257 as the implementing regulation for the original PP-79. Under PMK-257 (which refers to the original PP-79), the profit after final income tax on the transfer of a PI is subject to Article 26(4) income tax (branch profit tax (BPT)). Although the requirement for BPT was removed in 2017 when PP-79 was amended, PMK-257 has not been updated to reflect the change. PP-93 includes a provision where the implementing regulations for PP-79 and PP-53 relating to the transfer of PI remain valid, unless they contradict PP-93. Since PP-93 clearly states that income from the transfer of PI after being subject to final income tax is not subject to further income tax, the BPT requirement under PMK-257 should no longer be valid; and
- Under PMK-257, the actual transfer value is used as the basis for calculating the final income tax for an indirect transfer of a PI. This value may not necessarily reflect the market value of the block being transferred. PP-93 addresses this issue by stating that the fair market value of the oil and gas block (taking into account the proportion of the share ownership and the PI percentage being transferred) is used as the basis for calculating the final income tax on an indirect transfer of a PI. However, PP-93 is silent on whether a valuation report from an independent third-party is required to determine the market value of the PSC.

PP-93 has a significant effect on the upstream oil and gas business. PSC contractors and potential investors that wish to transfer or acquire a PI in a PSC should review the tax implications of PP-93 on the PI transaction. Please contact your usual tax professionals at Deloitte Touche Solutions should you have any questions on PP-93 and its effect on your business.

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## Energy, Resources and Industrials (ER&I) Partners

Questions concerning any of the subjects or issues contained in this **Tax Alert** should be directed to our Energy, Resources and Industrial (ER&I) tax specialists below:



**Cindy Sukiman**  
Partner, Indonesia ER&I Leader  
Business Tax and International Tax  
[csukiman@deloitte.com](mailto:csukiman@deloitte.com)



**Ali Mardi Djohardi**  
Partner, Indonesia ER&I Tax Leader  
Business Tax  
[alimardi@deloitte.com](mailto:alimardi@deloitte.com)



**John Lauwrenz**  
Partner  
Business Tax and M&A  
[jlauwrenz@deloitte.com](mailto:jlauwrenz@deloitte.com)



**Turmanto**  
Partner  
Business Tax, Indirect Tax and  
Global Trade Advisory (Customs)  
[tturmanto@deloitte.com](mailto:tturmanto@deloitte.com)

You may also get in touch with your usual contact in our firm, or any of the following Tax Partners:

**Business Tax**  
**Melisa Himawan**  
**Tax & Legal Leader**  
mehimawan@deloitte.com

**Business Tax**  
**Dionisius Damijanto**  
ddamijanto@deloitte.com

**Business Tax**  
**Heru Supriyanto**  
hsupriyanto@deloitte.com

**Business Tax and  
Business Process Solutions**  
**Ratna Lie**  
ratnalie@deloitte.com

**Business Tax**  
**Reggy Widodo**  
rwidodo@deloitte.com

**Business Tax, Business Process  
Solutions and Gi3**  
**Roy Sidharta Tedja**  
roytedja@deloitte.com

**Business Tax and  
Tax Management Consulting**  
**Yan Hardyana**  
yhardyana@deloitte.com

**Global Employer Services and  
Business Process Solutions**  
**Irene Atmawijaya**  
iatmawijaya@deloitte.com

**Global Employer Services**  
**Sri Juliarti Hariani**  
shariani@deloitte.com

**Transfer Pricing**  
**Roy David Kiantong**  
rkiantong@deloitte.com

**Transfer Pricing**  
**Balim**  
bbalim@deloitte.com

**Transfer Pricing**  
**Sandra Suhenda**  
ssuhenda@deloitte.com

**Transfer Pricing**  
**Shivaji Das**  
shivdas@deloitte.com

**Deloitte Touche Solutions**  
The Plaza Office Tower, 32nd Floor  
Jl. M.H. Thamrin Kav 28-30  
Jakarta 10350, Indonesia  
Tel: +62 21 5081 8000  
Fax: +62 21 2992 8303  
Email: iddttl@deloitte.com  
[www.deloitte.com/id](http://www.deloitte.com/id)

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