



Indonesia Tax Info August 2017

Tax Regulation Updates on Certain Energy & Resources Activities

1. Tax Treatment in the Geothermal Energy Activities

The Indonesian Minister of Finance ("MoF") has issued regulation number 90/PMK.02/2017 ("PMK-90") dated 7 July 2017 concerning procedures for calculation, settlement and reporting of the Government Share, Income Tax, VAT and other levies on proceeds from geothermal energy enterprises for generation of energy/electricity.

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PMK-90 is the second amendment of MoF Decision number 766/KMK.04/1992 ("KMK-766"), with purpose to provide the tax treatments and also the audit and objection procedures for the holders of geothermal exploitation concessions ("pemegang kuasa perusahaan sumber daya panas bumi"), Joint Operation Contract ("JOC") and geothermal license holders (pemegang izin perusahaan sumber daya panas bumi) that are mentioned in the definition of "Entrepreneur" under PMK-90.

Government Share

PMK-90 stipulates the Entrepreneur's obligation to settle the Government Share (34% of Taxable Income). Taxable income will be calculated according to the prevailing Income Tax Law for holders of geothermal business concessions and geothermal license holders. In contrast, a JOC's Taxable Income will be calculated based on Income Tax Law No 7 of 1984. PMK-90 also introduces

treatment for production bonuses; those that have been paid to the local government can now be offset against / reimbursed from the Government Share.

Import Taxes

PMK-90 provides clarification on the importation facility based on the prevailing tax regulations (i.e. Import Duty exemption, and non-collection of VAT, LGST, and Article 22 Income Tax) related to import of operational goods by an Entrepreneur for the purposes of geothermal activities. Special consideration is applicable to a JOC contractor if there is a specific arrangement on import taxes facility according to the Joint Operation Contract.

VAT

Previously, there was a requirement on VAT Reimbursement procedure (i.e. refund request letter, original VAT invoices, tax payment slips) and postponement of VAT settlement for delivery of geothermal exploration services and drilling services, while in PMK-90 this procedure is deleted / no longer applicable. This seems to be a simplification of the VAT reimbursement procedures. Further, PMK-90 also stipulates the applicable VAT treatment on acquisition of goods/services by the Entrepreneur is based on the prevailing VAT Law.

Income Tax

PMK-90 provides clarification on the applicable tax rate, which for a holder of geothermal business concession or geothermal license holder shall be the income tax rate in accordance with the prevailing Income Tax Law (i.e. 25%), while for a JOC contractor it shall refer to the income tax rate in accordance with 1984 Income Tax Law (i.e. progressive rate from 15% up to 35%).

Depreciation

The calculation of depreciation expense on fixed assets owned and used by the Entrepreneur shall be done based on Article 11 of the latest Income Tax Law with due attention to MoF Decision number 521/KMK.04/2000 concerning Types of Assets Included in the Groups of Tangible Assets for the Purpose of Depreciation for Contractors that Conduct Oil and Gas Exploration and Exploitation in the context of Production Sharing Contracts with the State Oil and Gas Mining Company (Pertamina).

Audit

- The MoF may submit a request for an audit to the Supervisory Agency for Development and Finance (BPKP) in order to test the Entrepreneur's compliance in fulfilment of the Government Share obligation.
- If, based on the result of an audit, there is an underpayment of Government Share, the Entrepreneur must settle such underpayment to the Geothermal Account no later than 30 days after the issuance of an assessment or collection notice by the Director General of Budget for the underpayment based on the audit result report.
- Any late payment shall be subject to an administrative penalty amounting to 2% per month for a maximum of 24 months and a part of a month shall be calculated as one full month. The administrative penalty in the form of fine is imposed from when the deadline for making the deposit has been exceeded.
- In the case that based on the result of the audit there is an overpayment of Government Share, such excess may be offset against the obligation for Government Share in the subsequent period.

Objection

- The Entrepreneur may file an objection against the assessment or collection notice for the underpayment of Government Share based on the audit result.
- The objection shall be filed:

- after the Entrepreneur makes payment of the amount of Government Share in the assessment notice or collection notice.
- in the Indonesian language
- within no longer than 3 months from the date of the assessment or collection notice to the Minister of Finance, attn.: Director General of Budget. If it submitted after the deadline, the Entrepreneur's objection shall be rejected by the MoF through the Director General of Budget through issuance of a rejection letter.
- Submission of an objection must be accompanied by the following documents:
 - explanation and reasons for the submission;
 - detailed calculation of Government Share payable, prepared by the Entrepreneur;
 - valid receipt on the payment; and
 - other relevant supporting documents.
- Based on the results of examination, the MoF through the Director General of Budget shall issue a decision on the objection filed by the Entrepreneur.

PMK-90 shall become effective after 30 days from the date of its enactment.

2. Cost Recovery and Income Tax Treatment in the Upstream Oil and Gas Activities

An amended government regulation concerning Cost Recovery and Income Tax Treatment for the Upstream Oil and Gas business has finally been issued by Government of the Republic of Indonesia. Government Regulation Number 27 of 2017 ("PP-27") revokes Government Regulation Number 79 of 2010 ("PP-79") and has come into effect as of 19 June 2017. The update is to encourage more discoveries of national Oil and Gas reserves and stimulate the investment climate as well as to provide legal certainty for upstream Oil and Gas business activities.

Several highlights on PP-27 are as follows:

Incentives

In addition to the existing investment credit incentive, PP-27 has added the following incentives for the upstream business:

- Domestic Market Obligation ("DMO") Holiday and accelerated depreciation;
- Tax incentives in accordance with the provisions of the laws and regulations;
- Other non-tax state revenue incentives, including among others a policy on the use of state owned goods/assets by the Contractor in the Oil Operation and other facilities.

A new provision on sliding scale split

The dynamic profit sharing rate is intended to distribute the risks and benefits from changes that may affect Oil and Gas activities, among others: changes in Oil and/or Gas price, Oil and/or Gas production level, ratio of revenue and Oil Operation cost. Previously, the production sharing was only based on a fixed percentage of production volume without considering the conditions of price, production level, etc. However, it is still unclear whether this dynamic profit sharing can be applied by existing Production Sharing Contracts ("PSC") in which the percentage of sharing has been locked in the contract.

Cost related to processing of Liquefied Natural Gas

PP-27 clarifies that the cost related to processing of LNG up to the point of delivery is included as exploitation cost, while PP-79 only mentioned the processing cost of LNG as exploitation cost.

Cost Recoverable

The following costs are now recoverable under PP-27 (previously included in the list of non-recoverable costs under PP-79):

- Cost for community development and environment during exploitation phase

- Employees' income tax borne by the Contractor paid as a tax allowance (using gross-up method)
- Interest recovery incentive

Cost related to damaged tangible assets

Under PP-27, the residual book value of tangible assets which can no longer be used due to natural factors or force majeure can be directly treated as operating cost. In PP-79, the depreciation on such tangible assets should be continued in accordance with the asset's useful life.

Income Tax Calculation

- PP-27 specifies the time line to issue a tax assessment, whereby the tax assessment must be issued within 12 months after a properly completed tax return is received by the Directorate General of Taxes ("DGT").
- Income Tax on First Tranche Petroleum ("FTP") shall be calculated when the FTP accumulation received by a Contractor exceeds the remaining amount of unrecovered operating costs (equity split position is reached). The procedures for calculation and payment of Income Tax on FTP shall be further regulated under a DGT Regulation.

Tax Facilities

- a) PP-27 introduces the following tax facilities: Tax Facilities during exploration and exploitation stage

The following tax facilities are applicable for contractors in both the exploration and the exploitation stage:

1. Exemption from collection of Import Duty on import of goods used in the context of Petroleum Operations.
2. VAT or Luxury Goods Sales Tax payable are not collected on:
 - ✓ acquisition of certain Taxable Goods and/or certain Taxable Services;
 - ✓ import of certain Taxable Goods;
 - ✓ utilization of certain Intangible Taxable Goods from outside the Customs Territory within the Customs Territory; and/or
 - ✓ utilization of certain Taxable Services from outside the Customs Territory within the Customs Territory;
 which are used in the context of Petroleum Operations.
3. Non-collection of Article 22 Income Tax on import of goods that have obtained the facility of exemption from collection of Import Duty as mentioned in point 1.
4. Reduction of Land and Building Tax ('LBT') amounting to 100% of the Oil and Gas Land and Building Tax payable as set forth in the SPPT (notification of tax due) for the exploration stage, and 100% reduction of subsurface LBT for exploitation stage of the PSC.

Tax facilities in the exploitation stage shall be granted by the MoF based on considerations of project economics from the MoF.

- b) Sharing Facilities

PP-27 provides more clarity on the facilities sharing arrangement:

1. In the event that there is excess capacity at facilities for field processing, transportation, storage and sales, with the approval of SKK Migas, the Contractor may utilize such additional capacity to be used by another Contractor based on a Cost Sharing arrangement.
2. The charging of the Cost Sharing shall be allocated from one Contractor to the other Contractor with the amount of the cost charged to each Contractor equal to the total overall cost that is incurred.

3. The charging of the Cost Sharing by a Contractor in the context of utilization of State-Owned Goods shall be exempted from withholding tax and not subject to VAT if the criteria below are fulfilled:
- ✓ The facilities are owned by the State;
 - ✓ SKK Migas approval has been obtained; and
 - ✓ The utilization of the sharing facility is not intended to earn any profit.

c) Parent Company Overhead ('PCO') Allocation

Under the PSC and prevailing MoF Regulation, the PCO allocation is considered as recoverable cost with a maximum of 2% and with several administrative requirements and approval from SKK Migas. PP-27 confirms that PCO allocation cost is not subject to withholding tax and VAT.

Tax on the Income from Uplift and Transfer of Participating Interest

PP-27 stipulates that the income received from Uplift and Transfer of Participating Interest is only subject to 20% and 5% / 7% of the gross amount respectively. It further elaborates that taxable income after deduction of final income tax on uplift and transfer of participating interest shall not be subject to further income tax (Branch Profit Tax).

Separately, in relation to the participating interest transfer transaction, PP-27 mandates that the Contractor shall report the value of transaction not only to the DGT but also to the Directorate General of Oil and Gas.

Audit Mechanism

PP-79 only stipulates that upon conducting audit the DGT shall determine the amount of cost that can be claimed by the Contractor during the exploration stage. Meanwhile, PP-27 also allows the DGT to also determine the amount of cost during the exploitation stage after receiving a recommendation from SKK Migas.

In addition, PP-27 stipulates that the audit mechanism will be through joint audit among the government bodies, while a further implementing regulation which governs the detailed procedure will be issued through a MoF Regulation.

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