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# *Overview of Indonesian Taxation and challenges in doing business in the energy sector (from the service providers perspective)*

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# *Agenda*



*Taxation of Services Sector*



*Selected Industry Update*

# ***Taxation of Services Sector***

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# ***Taxation Framework***

- Broad tax demarcation between PSC activities and service sector activities.
- PSC sector tax arrangements follow the “uniformity principle” (i.e. deductions follow cost recovery, lock down of tax rates, etc.), PTK 007 (procurement), GR 79 (tax and cost recovery regulation), etc. PSCs also usually operate as branches.
- Service sector tax generally follows the general tax rules (with variations for drilling, etc.). Service sector usually operates as Indonesian entities (with foreign ownership restrictions). Some branches also but these are actually quite difficult.
- Today’s focus is on the service sector but happy to discuss PSCs also if interested. Service sector tax rules also quite fragmented.

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## ***Service Sector Framework***

### ***Non Drilling***

- **25% tax rate based upon actual profits, 20% dividend WHT (reduced to 15% under the Norway tax treaty), 2% creditable withholding tax by PSC client.**
- **VAT due at 10% on imports, on cross-border services (via self-assessment) and on in-country supplies. – more later.**
- **Import Duty, VAT and “Article 22” Income Tax prepayment due on imports. Master list relief may be available for start up capital and/or temporary imports. – more later**
- **Individuals taxed at 20% for non-residents, while 30% for residents (worldwide income). Residency occurs after 183 days.**

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## ***Service Sector Framework***

### ***Drilling***

- As above unless a PE (i.e. via a foreign drilling company acting in a “consortium” with an Indonesia entity) – regulatory issue?
- If a PE, still a 25% tax rate but based on a “deemed profit” of 15% of turnover (effectively taxed at 3.75% of turnover). Tax remitted directly. No WHT.
- Also 20% branch profit remittance tax (reduced to 15% under the Norway treaty). This means total tax of up to 6% (3.75% + 2.25%) (before treaty). Most in the industry actually prefer this.
- Special de minimus exclusions for mob/demob. etc. where  $\leq 10\%$  of contract value. No margin is permitted.
- Deemed salaries for expatriates (PEs and Indo Cos). Tax Office may still challenge.

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# ***Indonesian Tax System – General Features***

- **Self Assessment Tax System**
  - **Heavy reliance on audits**
  - **Refunds of tax require an audit**
  - **Wide powers of document request**
  - **Exchange of information developments**
  - **Large tax treaty network**
  - **Statue of limitations 5 years (Customs 2 years – valuation/classification)**

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## ***Indonesian Tax System – General Features (cont'd)***

- **Conventional VAT system – VAT rate 10%. Also for exported services (exception applies for certain services)**
  - PSC are “VAT collectors”. Sub - contractors generally in a perpetual VAT refund position.
  - Self assessed VAT on cross border service payments.
- **Broad system of WHT on services**
  - Domestic 2% (generally)
  - Cross border 20% (before treaty relief)
  - Requires Certificate of Domicile (Indonesian Form DGT 1)
- **Importation of Goods**
  - Article 22 (2.5% - 7.5%)
  - VAT 10%
  - Duty (varies)
  - Relief may be available



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# ***Structuring Issues***

## ***Local Contracting***

- PTK 007 etc. requires PSCs to award contracts only to locally incorporated entities. Very little work can therefore be provided directly by offshore entities
- Foreign service entities will therefore generally need either
  - a) a local “agent” (who will enter into the contract with the PSC clients); or
  - b) to set up an Indonesian subsidiary (with all necessary licenses, etc.)
- An agent will obviously retain a margin but can arrange work permits etc.
- PSC clients are VAT collectors (as above) and an agent may be in perpetual VAT refund. ForeignCo may need to provide support (or explore “Consortium” structures)
- Longer term an Indonesian entity subsidiary is probably preferred
- VAT cash flow to manage

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## ***Structuring Issues (cont'd)***

### ***PEs***

- Irrespective of whether an agent etc. is used any in-country activities can create a PE (e.g. more than three months of service under Norwegian treaty)
- This can result in “Norwegian” profits being taxed by Indonesia

### ***Import Taxes***

- Imports are subject to Import Duty, VAT, and Article 22 Income Tax
- May be able to access exemptions (old PSCs). Otherwise there is a series of regulatory exemptions (new PSCs)

### ***Work permits***

- Foreigners need a work permit to work legally. Need a sponsor
- This can be problematic especially for short term work
- Watch PE risk (see above)

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## ***Commercial and Regulatory Issues***

- Local content rules? Long term game changer – ambitious sub-sector targets.
- PSC clients: Cost recovery rules tied into procurement regulations – sometimes direct appointment.
- Regulatory changes common – need to stay abreast of changes.
- Restrictions on expatriate employment.

# ***Selected Industry Update***

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## ***Industry developments – oil and gas sector***

### ***Gross production split***

- Introduction of new PSC scheme based upon the sharing of a “Gross Production Split” – MoEMR Regulation No.8/2017. Gross sharing concept is based on a gross production split without regard to cost recovery mechanism.
- Option for new tender, PSC extension and existing PSC. New PSC (not extension) should use gross split.
- Key features remain the same:
  - a) ownership of the natural resources remain with the State until point of delivery;
  - b) control over management of operations is with SKK Migas; and
  - c) all capital and risks should be borne by Contractors.
- Contractor’s base splits for oil and gas are 43% and 48% respectively.
- The new scheme is believed to create a more competitively attractive investment climate for oil and gas activity in Indonesia, reducing bureaucracy and improving returns.

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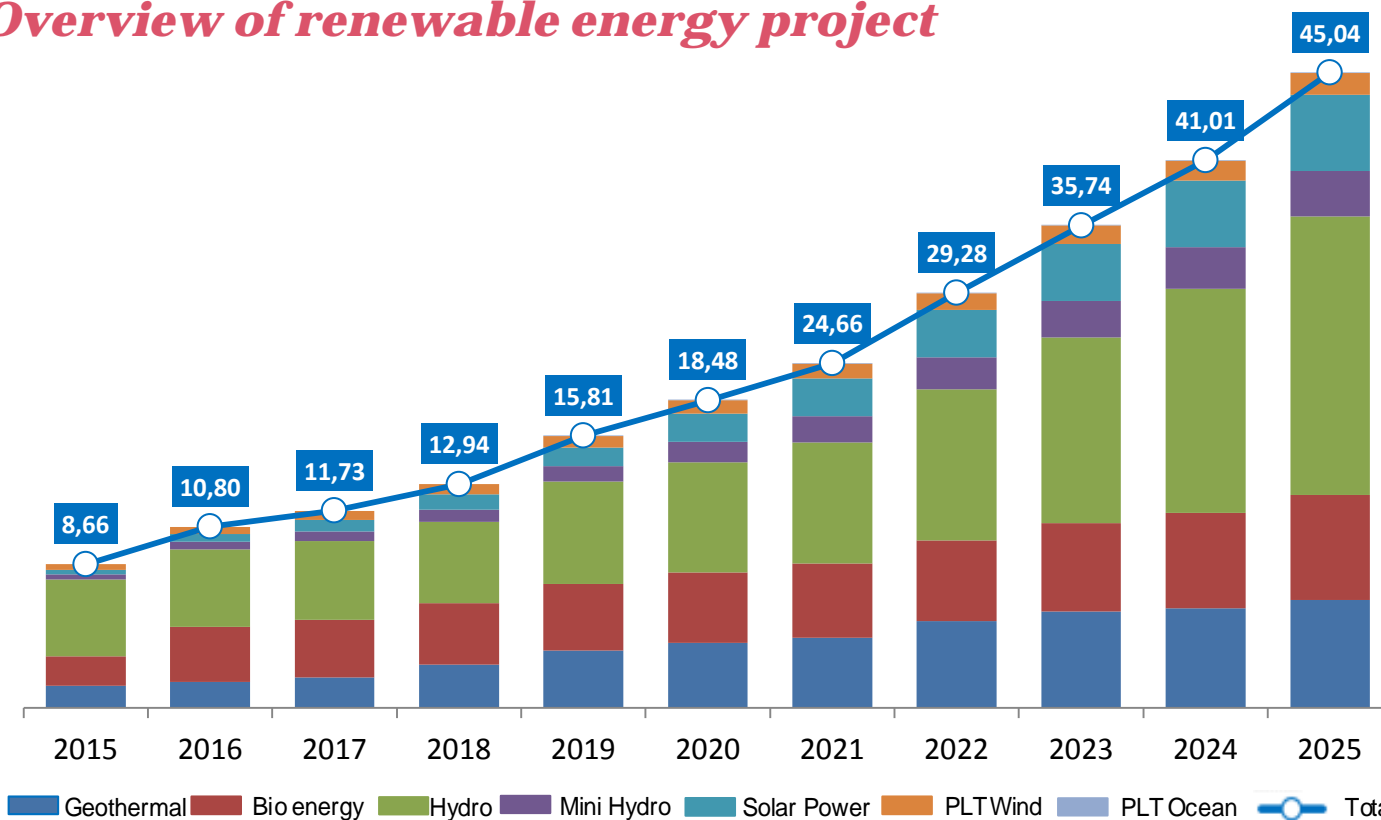
## ***Industry developments – oil and gas sector (cont'd)***

### ***Top five industry challenges – 2016 PwC survey***

- **Contract sanctity and PSC extensions.**
- **Lack of consistent policies and vision between the Ministry of Finance, Ministry of Energy and Mineral Resources and Ministry of Industry.**
- **New regulations (such as MoF Regulation No.218/PMK.02/2014 on reimbursement of VAT in the upstream sector).**
- **Uncertainty over cost recovery and SKK Migas/BPKP audit findings and the risk of suspense account treatment.**
- **Lack of singular body to objectively resolve government disputes across various departments and agencies.**

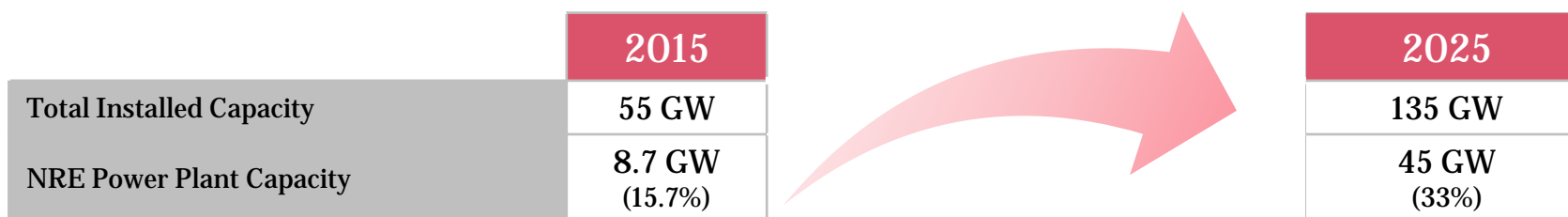
# Industry developments – renewable energy sector

## Overview of renewable energy project



	2025	
Geothermal	7.2	GW
Hydro	21	GW
Bioenergi	5.5	GW
Solar Power	6.4	GW
Wind	1.8	GW
Ocean	3.1	GW
<b>Total</b>	<b>45</b>	<b>GW</b>

Source: DIRECTORATE GENERAL OF NEW, RENEWABLE ENERGY AND ENERGY CONSERVATION



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# ***Industry developments – renewable energy sector (cont'd)***




## ***General industry challenges***

- Difficulty in obtaining land permits
- Permitting and licensing issues
- Financing for significant upfront expenditure
- Limited infrastructure
- Poor quality of data on working areas prior to tender rounds. This increases exploration risk of developers





## Industry developments – renewable energy sector (cont'd)

- New mechanism for purchasing renewable electricity, determined based on negotiations between IPP and PLN with benchmark to the regional electricity generation cost – MoEMR Reg 12/2017.

Renewable Energy Type	Method of Procurement	Tariff Determination	
		Regional Av. BPP > National Av. BPP	Regional BPP ≤ National BPP
 Solar PV & Wind Power	Open tender based on quota capacity	At maximum is 85% regional BPP	The regional BPP
	Benchmark Price	At maximum is 85% regional BPP	The regional BPP
 Hydropower	Direct Selection	Determined by the following direct selection process	
	Benchmark Price (≤ 10 MW)	At maximum is 85% regional BPP	At maximum is the regional BPP
 Biomass & Biogas	Direct Selection (> 10 MW)	Determined by the following direct selection process	

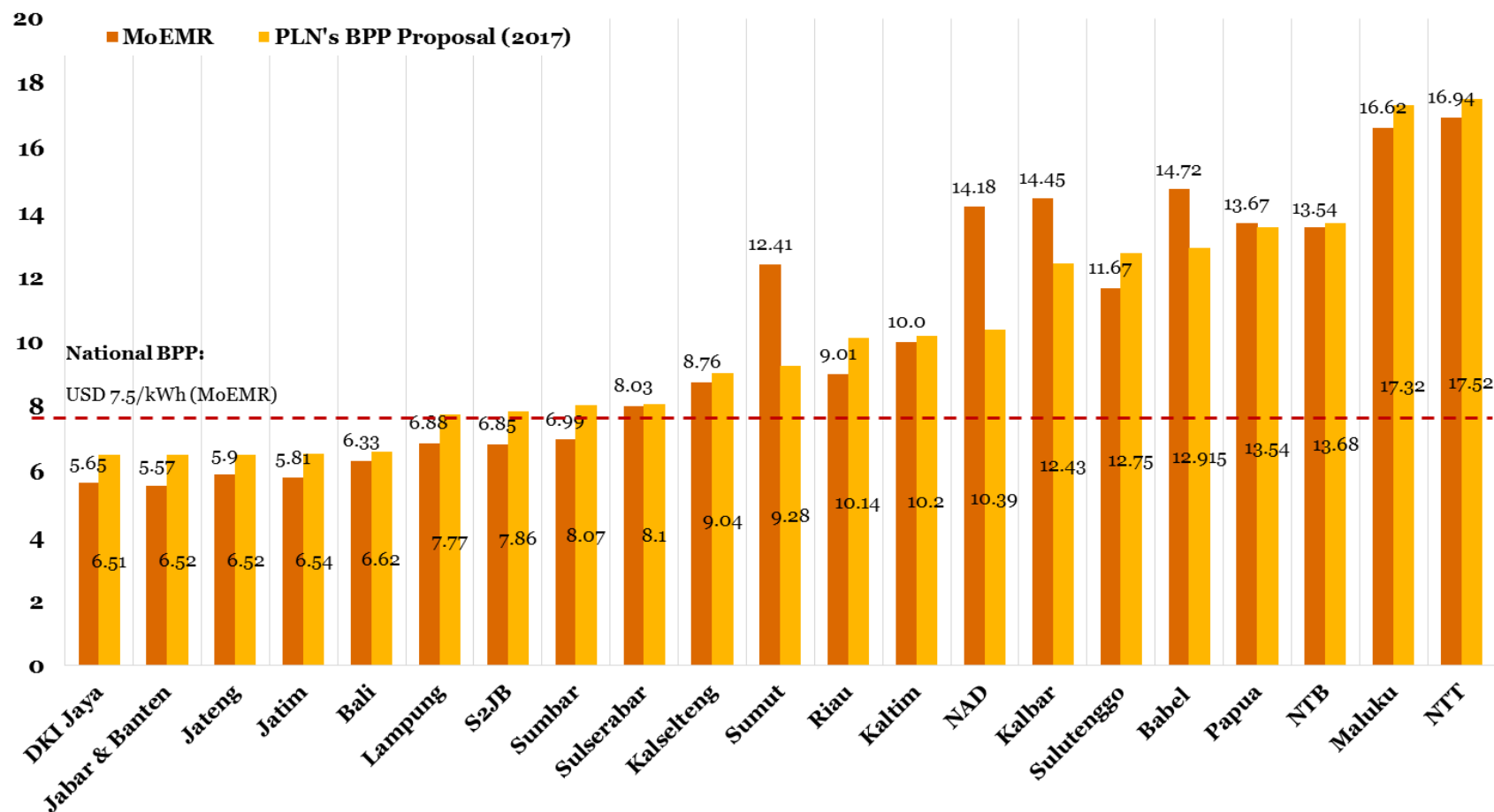
## *Industry developments – renewable energy sector (cont'd)*

Renewable Energy Type	Method of Procurement	Tariff Determination	
		Regional Av. BPP > National Av. BPP	Regional BPP ≤ National BPP
 Waste-to-energy	Benchmark Price	At maximum is 100% regional BPP	Including Java, Sumatera, Bali, or other power system regions, the tariff is based on mutual agreement of all parties (IPPs and PLN)
 Geothermal	Benchmark Price	At maximum is 100% regional BPP	Including Java, Sumatera, Bali, or other power system regions, the tariff is based on mutual agreement of all parties (IPPs and PLN)

based on MoEMR Regulation No. 12/2017

# Industry developments – renewable energy sector (cont'd)

Cost of Power Generation in Selected Regions of Indonesia (cents USD/kWh)



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# ***Thank you***

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