Dear Members, dear Readers,

Following the general elections in April 2019 and the following election result announcement in the middle of May 2019, the re-elected president of Southeast Asia’s largest economy, Mr. Joko Widodo, gave his first speech on his vision for Indonesia for the 2019-2024 period. His “Indonesian Vision” speech mentioned the five interrelated key subjects that will be the government’s main focus of attention: (1) reforming the bureaucracy, (2) infrastructure development, (3) investment realization, (4) development of human capital, and (5) more efficient use of the state budget. For the third subject in particular, the President underlined the efforts his government will take in eradicating the hurdles that are still present in issuing investment licensing. With that said, we can expect even more improvements in regards to the licensing system, which should further facilitate doing business in Indonesia.

Additionally, in order to keep up with today’s digitalized era, as well as to reach a bigger audience, we are pleased to inform you that this Newsletter will also be available in our Social Media accounts. We sincerely hope that through this digital approach, we can continue to keep you updated with fresh and inspiring articles on Indonesia’s Law and Taxes.

The Network Law & Taxes could not be completed without your valuable expertise and support. Please know that you have my deepest gratitude and I look forward to continuously working with all of you to move our countries and companies forward.

Cassandra S. Paulira
Head of Corporate Services
Agrarian Law

Indonesian Land Titles for Foreign Legal Entities

Owning or otherwise controlling land is often one of the main requirements of a project. The Indonesian Agrarian Law, Law No. 5 of 1960 governs property ownership and land title rules in Indonesia.

The most complete land title stipulated is the “Hak Milik”, i.e. ownership in civil law terms. It is equivalent to freehold in common law jurisdictions. However, except for certain legal entities designated by the Indonesian government, it can only be held by individual Indonesian citizens. Legal entities including the Indonesian subsidiaries of international corporations, are generally excluded from owning land under Hak Milik. Under a “Hak Pakai”, ensuring the right to use land for a specific and pre agreed purpose, and under a “Hak Sewa”, ensuring the right to use the property in return for rental payments, a leasehold is however possible. These “right to use”-titles are open to foreigners domiciled in Indonesia, as much as to legal entities and even representative offices. The same applies to “Hak Guna Usaha” titles, giving the title holder the right to exploit the land for the purposes of agriculture, fisheries or cattle breeding.

Maximum possible control over land by an international corporation is in fact most commonly secured by changing the property ownership right from Hak Milik to “Hak Guna Bangunan (HGB)”. HGB gives the holder the right to construct, develop and own buildings on the land. A HGB title can be granted to legal entities established under Indonesian Law and domiciled in Indonesia (including foreign direct investment companies, so-called “PT PMA”) as well as to Indonesian individuals. It is the title most PT PMA companies use to hold real estate. It can be instituted either by government resolution or agreement between the landowner (holding Hak Milik) and the acquirer of the HGB.

While Hak Milik is the only land title that does not need to be extended, the same or a new title may be granted on the same land for all other titles. For instance, HGB initially has a duration of up to to 30 years and is extendable for another 20 years.

Philipp Kersting
Registered Foreign Advocate,
Maqdir Ismail & Partners
+62 21 3911191
philipp.kersting@luther-services.com

Investment

Bali Moratorium on Hotel Business Licenses

According to a letter from former Balinese Governor (I Made Mangku Pastika), dated December 27, 2010, three regions in Bali are currently prohibited from approving any further developments of new hotels and villas, namely Badung, Denpasar and Gianyar.

The concentration of accommodation services, including cottages and guesthouses (Pondok Wisata), non-starred hotels (Hotel Melati) and starred hotels (Hotel Berbintang) is considered too high in these areas, thus harming the island’s economy. The Governor therefore suspended the issuance of accommodation licenses in these main touristic areas.

Through the restriction, an equally distributed economy by shifting tourism to other, less developed areas is targeted. The goal is to create a sustainable Balinese economy, not relying only on the southern part of the Island. The Balinese Hotel Moratorium is applicable since January 5, 2011 and has not been effectively revoked so far.

Nevertheless, exceptional cases are known, in which hotel licenses have continued to be issued in the restricted areas. The regency’s and Governor’s approval might be given under certain circumstances. The size and class/level appear to be the major criteria for exceptional new licenses, as especially new 4 and 5-star hotels were completed in the first quarter of 2018. Any planned or ongoing projects in the affected areas should rely on intense and anticipated discussions with authorities in order to secure their rights.

Philipp Kersting
Registered Foreign Advocate,
Maqdir Ismail & Partners
+62 21 3911191
philipp.kersting@luther-services.com
Agrarian Law

Land Ownership for Foreign Individuals in Indonesia

It is a general principle in Indonesia that land can only be owned by Indonesian citizens. Foreign individuals therefore commonly control residential property indirectly through arrangements often referred to as “nominee” or “trustee” structures. In these arrangements, the foreigner typically provides capital for an Indonesian individual to purchase land on his behalf. The Indonesian individual so acquires a “Hak Milik” (ownership)-title in his/her name. This structure is not stipulated in the property laws of Indonesia and developed from a structure created for foreigners married to Indonesian citizens. Although widely practiced, these types of arrangements may not be considered legally safe, since the involved Indonesian citizen will be considered the legal owner, no matter what agreement might exist between him/her and the foreigner. Trust or nominee arrangements therefore very much remain a matter of trust rather than one of legal certainty.

However, a foreign investment limited liability company (PT PMA) can hold direct rights over land through a leasehold certificate, such as “Hak Guna Bagunan” (HGB), which includes the right to develop and use (commercially). Incorporating a PT PMA company in Indonesia with a suitable business field is the closest a foreign individual can legally get to a freehold/ownership situation. A PT PMA requires a comparably high paid-up capital (min. IDR 2.5 billion) and will incur costs for ongoing corporate and financial compliance. The use of a PT PMA is therefore typically only commercially viable in case the involved asset(s) reach exceed a certain value.

An exception applies to foreigners wanting to purchase apartments or office space in Indonesia within a building with a “Strata” title status. The Strata-title enables the foreigner, who resides in or has a regular presence in Indonesia, to own the apartment or office space within a building, while expressly excluding any rights to the land on which the building is situated.

Philipp Kersting
Registered Foreign Advocate,
Maqdir Ismail & Partners
+62 21 3911191
philipp.kersting@luther-services.com

Luther LLP in collaboration with Maqdir Ismail & Partners

Luther LLP is one of the largest continental European law firms in Singapore. With our further law firms in Yangon and Shanghai as well as our corporate services offices in Kuala Lumpur, Delhi-Gurgaon, Shanghai and Singapore, we offer a comprehensive range of services to our clients. In Indonesia we have formed a strong collaboration with Maqdir Ismail & Partners in order to service our clients in their ventures in this interesting market. Maqdir Ismail & Partners are highly regarded for their expertise particularly in litigation, corporate law as well as in mergers and acquisitions.
The Indonesian Tax Authority (ITA) has provided clearer additional guidelines (PMK-35) regarding what constitutes a Permanent Establishment (PE). This is particularly important since a PE is subject to tax in Indonesia. Effective 1 April 2019 the further guidance provides definitions for some commonly used PE terminology, such as “Place of Business”, “Preparatory or Auxiliary Activities” and “Essential and Significant Activities”. In addition, PMK-35 provides the following clarifications:

A. Construction, Installation or Assembly Projects Construction, installation and/or assembly projects in Indonesia may be deemed a PE, although performed out of the country and/or subcontracted to an onshore or offshore entity, if the project runs longer than the time test stated in the Tax Treaty (DTA) between Indonesia and the related country. Projects that may be deemed a PE include: Construction consultancy services, providing assessment, planning, design, monitoring, construction management, surveys and technical testing or analysis; Construction work, including development, operation, maintenance, demolition or redevelopment; and Integrated construction work, including design or engineering models, procurement and implementation.

B. Insurance Agents, an agent of an insurance company that is not established or domiciled in Indonesia will be deemed as a PE when that company receives insurance premiums from Indonesia and/or bears the risk for an insured party that is residing, domiciled, or present in Indonesia. This does not apply for reinsurance.

C. Time Test, any service performed by an individual in Indonesia on behalf of a foreign entity longer than 60 days within any 12-month period may be deemed a PE, unless Stated otherwise in the applicable DTA.

Please note that in particular under the DTA with Germany and Switzerland fees for certain services are subject to Indonesian withholding tax regardless of this time test.

The Minister of Finance recently expanded the types of services that are subject to 0% export VAT beyond the existing zero rating for contract manufacturing, repairs and maintenance and construction services. The new list now also includes:

• Freight forwarding services related to exporting goods;
• Technology and information services that include computer system analysis services, computer system design services, IT security services, contact center services, etc.;
• Research and development services;
• Rental of transportation equipment (airplanes and ships) for international shipping and air transportation services;
• Business and management consulting services that include legal consultancy services, architectural and interior design services, marketing services, accounting and bookkeeping services, financial statement audit services, tax services, etc.;
• Trading services, i.e. identifying domestic sellers to export their goods; and
• Interconnection services, satellite and/or communication/ data connectivity services, e.g. international call and short messages to offshore cellular service providers, satellite transponder services, etc.

In order to qualify for the 0% export VAT:
Offshore customers must be non-residents and do not have a permanent establishment in Indonesia and Service providers:
(i) Must have written contracts with their offshore customers, which clearly state the type of services to be provided, the details of activities performed onshore to be utilized offshore and the value/fees for these services; and
(ii) Must have valid proof of payments received from their offshore customers.

If these conditions are not met the transactions are deemed to be local sales and the standard 10% VAT rate applies. In addition, some administrative requirements must be met in order to qualify for the 0% VAT rate.
The Minister of Finance has issued a Regulation (PMK-192) regarding the implementation of foreign tax credits (FTC).

**Maximum Allowable FTC**
According to PMK-164, when calculating the maximum allowable FTC, taxpayers are required to choose the lower of:
- The actual tax paid in a certain country; or
- The portion of tax payable due to income from that certain country.
PMK-192 has now introduced a third limitation:
- The tax amount as per the Tax Treaty (DTA) between Indonesia and the source country, with the assumption that Indonesian tax residents are considered as non-residents and taxed at non-resident rates in the source country. If this amount is lower than the other two options, then the tax credit is limited to this amount. If the DTA states that a certain type of income is only taxable in Indonesia, then no FTC is allowed.

**Foreign Losses**
PMK-192 states that foreign losses cannot be considered as deduction when calculating taxable income, including business losses from a foreign branch or representative office.

**Trust**
PMK-192 includes a definition of a Trust and states that income from a Trust should be reported when it is received. The source country of the income would be the country where the Trust is established.
If the Trust is required to pay foreign tax on its income, then the Trust’s foreign tax return or evidence of tax paid by the Trust can be utilized to claim a FTC against the Indonesian tax payable.

**USD Bookkeeping**
For companies which conduct USD Bookkeeping: if the FTC is in another foreign currency, then it should be converted to USD using BI middle rate, or, if unavailable, the daily spot exchange rate.

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**Property Tax**

**Encouraging the Property Sector through Tax Relief for Luxury Residences**

In recent years, the Indonesian property sector has been facing a noticeable slowdown. In an attempt to boost the performance of this specific sector, the Indonesian government introduced some new regulations, particularly in the field of taxation. These include Minister of Finance (MoF) Regulation No.86/PMK.010/2019 (PMK 86, amendment to PMK 35), dated 11 June 2019, and MoF No.92/PMK.03/2019 (PMK 92, amendment to PMK 253), dated 19 June 2019. PMK 86 stipulates the luxury-goods sales tax rates (LST) on luxury goods other than vehicles, while PMK 92 refers to article 22 regarding income tax on very luxury goods.

As per the prevailing regulation, luxury residence is now subject to a LST of 20%. According to the old regulation, luxury residences could be classified into two categories. (i) houses and town houses with non-strata title, with a selling price of more than or equal to IDR 20 billion; and (ii) apartments, condominiums, town houses with strata title and the like with a selling price of more than or equal to IDR 10 billion. However, with PMK 86, the threshold of the selling price has been revised to currently IDR 30 billion, regardless of the type of residence.

Further to the above, very luxury residences are subject to income tax article 22, stipulating an LST rate of now 1%, which has been reduced from the previous rate of 5%. According to the former regulation, very luxury residences have been (i) landed properties with a selling price of more than IDR 5 billion or more than 400 m² of building area, and (ii) apartments, condominiums, and the like with a selling price of IDR 5 billion or 150 m² of building area. As to the new regulation, the selling price for both categories has been raised to a uniform threshold of IDR 30 billion, while the building area parameters remain the same.

It is expected that the implementation of the new regulations will boost business with luxury residences, entailing a positive impact on the overall performance of the domestic property sector.

**Investment**

**New Regulations for Construction Services in Indonesia**

The Government of Indonesia has recently enacted the General Works and Housing Minister’s Regulation No. 09/PT/MI/2019 (Regulation 09) introducing changes to the business activities of foreign Construction Services Companies to be acknowledged as Foreign Construction Company Representative Office (Badan Usaha Jasa Konstruksi Asing / BUJKA) in Indonesia. Below please find an outline of some key changes imposed by Regulation 09, differing notably from the previous regulatory regime:

1. Business Licenses eligible for the acknowledgement as BUJKA shall now be applied directly via the Online Single Submission (OSS) system. These Business Licenses are divided into Representative License (Izin Perwakilan) and Foreign Investment License (Izin PMA).

2. A BUJKA Representative Office (RO) is supposed to hire an Indonesian national as Chief Officer (Penanggungjawab BUJK / PJBU). In the event that this is not feasible, an Indonesian national should at least be hired as Technical Chief Officer (Penanggungjawab Teknis BUJK / PJTBU). To qualify as a PJTBU, the applicant should possess a grade 9 (nine) professional expert competence certificate or an ASEAN Architect certificate or an ASEAN Chartered Professional Engineer certificate.

3. To extend an existing Izin Perwakilan/Representative License, a BUJKA should provide a corresponding evaluation result. Under Regulation 09, such evaluation result shall be applied in the OSS System.

4. The new Regulation 09 does also provide a mechanism to apply for an Izin PMA revocation through the OSS system. Such revocation may now be effected after the BUJKA foreign company has duly settled all its legal obligations, e.g. tax debts or administrative sanctions (if any). Previously, a revocation has only been realized as a sanction imposed by the respective authorities.

**Landung Anandito**  
Senior Associate Tax  
+ 62 21 5056 0405  
landung.anandito@roedl.com

**Markus Schlueter**  
Partner  
+ 49 221 949 909 342  
markus.schlueter@roedl.com
Indonesia needs to adopt the international tax development associated with the implementation of the minimum standards according to action plan Number 14 of the OECD/G20 Base Erosion and Profit Shifting (BEPS) regulations concerning the prevention and resolution of international tax disputes. Therefore, the Minister of Finance (MoF) issued MoF Regulation No. 49/PMK.03/2019 (PMK 49), dated 26 April 2019, regarding MAP revoking the previous PMK 240 on the same subject. The main objective of PMK 49 is to provide legal certainty pertaining to the procedure, timeline, and follow-up actions of the Mutual Agreement Procedure (MAP) requirements.

Taxpayers may request a MAP when the Competent Authority (CA) on the part of the treaty partner does not treat the taxpayer appropriately in accordance with the tax treaty. Besides, the MAP may also be requested by Indonesian citizens with dual residency, by the Indonesian Director of Tax or the Tax Authority of a treaty partner through the relevant CA.

Upon approval of the request, the Tax Directorate General (DGT) shall conduct bilateral negotiations with the CA of the contractual partner within 24 months after either receiving the MAP request from the CA of the treaty partner, or after submitting the request to the CA of the treaty partner. During the negotiation process, the DGT is authorized to request additional information, to visit the business location of the applicant, to perform a tax information exchange, and/or to conduct a tax audit. Meanwhile, the CA of the treaty partner may only request additional information through applying for an exchange of information with the DGT and/or through a direct request during the negotiation process. If the aforementioned provisions are not met, the negotiations may be discontinued. Nevertheless, the applicant may as well withdraw his request prior to the agreement coming into force. The result of the negotiations may either be an agreement or a disagreement, while in the latter case the DGT or the Indonesian taxpayer will still need to perform follow-up actions depending on the result.

In conclusion, PMK 49 does provide legal certainty with regard to MAP, being expected to offer alternatives as to the resolution of international tax disputes.

Lidya Irawan
Manager Tax
+ 62 21 5056 0405
lidya.irawan@roedl.com

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Rödl & Partner
PT Roedl Consulting
GOP 9, Wing A, 3rd floor
Jl. Grand Boulevard
BSD Green Office Park, BSD City
15345 Tangerang, Indonesia
Phone: +62 (21) 5056 0405
Fax: +62 (21) 5056 0412
Email: jakarta@roedl.com
www.roedl.com
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Contact: cassandra@ekonid.id

German-Indonesian Chamber of Industry and Commerce (EKONID)
Jl. H. Agus Salim No. 115 | Jakarta 10310
PO 3151 | Jakarta 10031 Indonesia
Tel. + 62-21 3154685 | Fax. + 62-21 3157088, 3155276
Email: info@ekonid.id
Internet: www.ekonid.com

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