In line with this edition’s theme of Digitalization, I would like to express my appreciation to the Government of Indonesia for its effort in transforming itself, not only in encouraging the digitalization of the private sector, but also in reaching complete E-governance with the newly signed Government Regulation No.24/2018 on Electronic Integrated Licensing Service.

Under this platform, business licenses can now be issued by Ministers, the heads of institutions, Governors, Regents or Mayors in accordance to their authority, or by other officials who have been delegated by the issuing authority to approve business license applications. This online platform have shown the Indonesian Government’s intention in making sure that the people can continually receive reports of government performance in an actual and transparent manner. In addition, it also reduces budget costs, while further promoting efficiency in day-to-day matter.

Nevertheless, the existing structures of the Indonesian legal system continue to impose obstacles for foreign investors in various fields of law, such as labor, tax, corporate, compliance and litigation. Thus, we have asked some of the most high profile and expert law firms, coming from Indonesian as well as those with international background and experience, to discuss these issues and to share their insights with you as a reader exclusively for our Newsletter.

We wish you a pleasant reading and the best success.

Cassandra S. Paulira
Head of Corporate Services
New Regulation on Electronic Money

With effect as of 4 May 2018, Regulation of BI No. 20/06/PBO/2018, brings some changes regarding Electronic money. In this regulation, electronic money is classified based on the scope of its administration into closed loop and open loop electronic money, and based on the value storage media into server based and chip based electronic money, as well as based on the recording of identity of its users into unregistered and registered electronic money. One major aspect especially for foreign investors might be that 51% of shares of an electronic money issuer must be owned by domestic parties while foreign parties are only allowed to own a maximum of 49% of the shares. Please also note that in case there is any foreign ownership portion, the calculation of such foreign ownership portion shall include direct and indirect ownership pursuant to the assessment by Bank Indonesia.

Once a license as Electronic Money Operator was obtained, it is valid for a period of 5 years. It can be renewed upon application which must have been submitted by no later than 6 months prior to its expiry. The new regulation requires electronic money issuers to record the float fund in the account of immediate liabilities or other liabilities and to place not less than 30% of Float Fund in cash, or in the form of commercial banks based on business activities BUKU 4 for electronic money issuers. In case of other issuers, another option is to place it in giro with a Bank classified in BUKU 4. A maximum of 70% of the Float Fund must be placed in commercial papers/financial instruments by the government/Bank of Indonesia.

Corporate Law

Indonesia Introduces Know-Your-Beneficial-Owner-Principle for Corporations

With the intention to prevent and eradicate criminal activities related to money laundering and/or terrorism financing through corporations, the government issued Presidential Regulation No. 13 of 2018 on 1 March 2018 bringing along a deadline of 05 March 2019 to comply with it. One important aspect of the new regulation is that now corporations, including foreign investment companies, are required to identify, verify and report their Beneficial Owner(s) in accordance with the Principle and procedure provided in the new regulation. In this context, one major aspect is that the regulation defines the Beneficial Owner as an individual with the effect that it aims to penetrate several layers of any shareholding structure or arrangements to eventually identify and verify a certain individual as the “ultimate beneficial owner” of a corporation. This could especially have an impact in case a corporation has one or several so-called “nominee” shareholders. In this context, it is also important to point out that the information of a Beneficial Owner will be made publicly available if they are not protected under the Residence Administration Law 2006.

It is expected that corresponding implementing regulations will be issued shortly for further guidance especially on the specific procedures. We advise you to monitor the current developments and are happy to assist you with this.
Compliance

Compliance Implications Concerning Electronic Money and Know-Your-Beneficial-Owner-Principle

Under compliance aspects, electronic money operators are required to apply risk management effectively and consistently. Furthermore, they have to apply information system security standards, to apply interconnection and interoperability, to fulfill the obligation of processing electronic money transactions domestically, to apply the principles of anti-money laundering, prevention of terrorism financing and to apply the principle of consumer protection.

In regard to the newly introduced Know-Your-Beneficial-Owner-Principle, please note that the new regulation requires the subsequent implication of the reporting of the Beneficial Owner of a corporation to fulfill the compliance requirements. Corporations not implementing the Know-Your-Beneficial-Owner-Principle may be subject to sanctions in accordance with the provisions of relevant laws and regulations.

If you have any questions regarding your company’s compliance in accordance with these new requirements, please do not hesitate to contact us.

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**BKPM Regulation 13/2017**

The Investment Coordinating Board (Badan Koordinasi Penanaman Modal/“BKPM”) issued a new regulation on investment: Regulation No. 13 of 2017 on The Guidelines and Procedure for Capital Investment Licensing and Facilities (“BKPM 13/2017”). It contains a number of changes to procedures and requirements for investors who have invested and those contemplating an investment in Indonesia. We would like to provide an overview of changes to the procedure of obtaining investment licenses.

BKPM 13/2017 limits the requirement to obtain a Principle License (now referred to as Investment Registration, Pendaftaran Penanaman Modal) to cases in which the relevant investment:
- includes construction yet to be completed;
- may apply for investment facilities;
- could cause mid- or major-level environmental damage;
- touches the fields of defense, energy, infrastructure or the management of natural resources;
- needs investment approval due to sectoral regulations.

Investments that do not fall under the above categories, will not require an Investment Registration (Principle License) provided the relevant limited liability company (PT) fulfils the following requirements:
- having the status of foreign owned limited liability company (PT PMA);
- holding a taxpayer identification number (NPWP);
- occupying a place of business/office.

The details on procedures for the granting of a Permanent Business License (Izin Usaha) without a prior Investment Registration procedure, will depend on further regulations to be issued or the establishment of unwritten policies by BKPM.

According to Art. 34 (2) of BKPM 13/2017, a PT PMA that has not yet met the requirement of being a “large scale business” can only obtain a Permanent Business License that is valid for one year and may be extended for another year. The requirement of being a “large scale business” is deemed met if:
- the PT PMA has net assets of more than IDR 10 billion or annual sales of more than IDR 50 billion; or
- the specific business line’s requirements for meeting the “large scale business” requirement are stipulated otherwise in special laws or regulations.

Since many businesses will not initially or probably at no point in time require net assets above the aforementioned threshold or reach IDR 50 billion in sales during their first few years of operation, it will be crucial, how BKPM will implement this requirement practically.

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**Legal Audit in Indonesia**

A legal audit is commonly known as legal due diligence in Indonesia. It is a process during which a thorough examination is performed on certain facts, actions or documents in order to assess compliance and suitability. With the rapid development of business models in today’s world, the role of legal audits is of high relevance as regulatory authorities are changing legal frameworks more rapidly in their reactions to digitization and increasing globalization.

The reason for this is obvious. Failure to comply with certain laws and regulations leads to fines and penalties or even interruption of operations. Scrutiny on legal matters is also beneficial in that it is a key part of good corporate governance to mitigate potential risks, that it maintains a company’s consistency with the latest regulatory developments, and that it prevents conflicts that may disrupt a company’s progress.

The complexity and the scope of the audit itself may vary, subject to its purposes. In general, a proper legal audit begins with a preliminary questionnaire followed by a document review and assessment, site visit and interviews. A conference with relevant parties is often scheduled to confirm matters before a final report is submitted and a legal opinion is rendered. The areas that this scrutiny must address consist of: incorporation and corporate legal history of the entity and its shareholding structure; acts of the board of directors and related documentation; validity of licenses and permissions, regulatory compliance, employment affairs, agreements and commercial arrangements, and pending and threatened litigation.

In a nutshell, while a legal audit may be a complex process to go through, the benefit of avoiding or mitigating risks typically outweigh the cost and effort. Not only is a legal audit necessary, but also beneficial in today’s challenging business world. This applies to Indonesia in particular, given its often contradictory regulatory approach and often unclear authorities of regulatory bodies.
Arbitration

Will the Real BANI Please Stand Up – An Update

As has been widely reported before, there had been a split within Badan Arbitrase Nasional Indonesia ("BANI") between the groups often referred to as "BANI Mampang" and "BANI Sovereign", with each claiming to be the rightful BANI. This split had led to legal uncertainty in Indonesia since 2016. However, the Supreme Court has recently reached decision number 232 K/TUN/2018 on May 8, 2018 (the "Supreme Court Decision") in an administrative dispute brought by BANI Mampang that would likely shed some light on which entity is rightfully entitled to call themselves BANI.

The Supreme Court Decision reversed an Administrative High Court Decision and held that the Minister of Law and Human Rights Decree Number AHU-00664837.AH.01.01 dated June 20, 2016 on the establishment of BANI Sovereign (the "MOLHR Decree") was null and void. The Supreme Court Decision lends credence to BANI Mampang's legality to use the name BANI, as BANI Sovereign's legality had previously hinged on the MOLHR Decree. Also, BANI Mampang is the only rightful party to use the name BANI and Badan Arbitrase Nasional Indonesia based on a Jakarta Commercial Court Decision that previously ruled in favor of BANI Mampang on a trademark dispute.

It is still hard to say which of the two BANIs is conclusively legitimate, because in another ongoing dispute at the South Jakarta District Court, the court held that the governing board of BANI Mampang was illegitimate. The case is currently under review by the Jakarta High Court.

In light of the above, the Supreme Court Decision seems to confirm BANI Mampang's legality by revoking the MOLHR Decree confirming the establishment of BANI Sovereign. The aforementioned ongoing case at the South Jakarta District Court is not directly related to the BANI institution but to the legitimacy of the board of BANI, and the result will have an impact on the governing board of BANI. If parties considering arbitration clauses have grave concerns of a possible dispute on the choice of forum, they may consider incorporating an agreement on ad hoc arbitration in Indonesia.

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To attract greater capital investment in Indonesia, in early 2018 the Government, through Ministry of Finance PMK No. 35/PMK.010/2018 (“PMK 35”), issued a revised regulation concerning its Tax Holiday Program. With the new policy the Government aims to simplify the process and to broaden the potential application. The revisions of the previous policy are:

1. The Applicant must be incorporated in Indonesia and considering a new capital investment. Previously the Applicant was required to be a new entity.
2. The pioneer industry groups which can participate in the Tax Holiday Program have been expanded.
3. The government now also provides the opportunity to add more pioneer industries to its list. If a Taxpayer considers its business is a pioneer industry, it can apply to the Government for approval.
4. PMK 35 now also allows businesses that have an economic infrastructure cooperation with the Government and Business Partnerships (KPBU/ Kerjasama Pemerintah dengan Badan Usaha) to participate in the Tax Holiday Program. The previous regulation was limited to economic infrastructure using schemes other than with the KPBU.
5. To participate in the Tax Holiday Program, the Applicant must meet the Debt-to-Equity Ratio requirements in accordance with Regulation PMK 169 and must not yet have been issued a decision on the granting or a notification of rejection of the Corporate Income Tax reduction by the Minister of Finance. PMK 35 stipulates that successful Applicants will be entitled to a tax facility reduction of 100% of the amount of corporate tax payable. The duration of the tax facility depends on the value of the investment and ranges from 5 years for investments between IDR 500 million and 1 trillion, and 20 years for investments of IDR 30 trillion or more.

Late last year, Indonesia completed the last step in the introduction of new transfer pricing regulations. While the regulations covering the master file, local file and country by country reporting were issued in 2016, the implementing regulations for country by country (“CbyC”) reporting were not completed until December 2017. For German headquartered companies these regulations have limited impact. However, if the HQ is in another country, the changes can be very relevant. The most important features are:

- For subsequent years, the deadline is 12 months after the financial year end.
- The online notification report and the CbyC report must be submitted online in XML, unless that is not possible.
- The deadline for US based groups was extended until 31 May 2018.
- The Directorate General of Taxation (“DGT”) issued a template for the preparation of the CbyC report. There are not many differences with internationally accepted standards, although some parts have to be translated into the Indonesian language.

The local file and master file regulations have remained unchanged since they were first issued in 2016 and no additional guidance has been issued.
The Directorate General of Tax (DGT) and the Directorate General of Immigration (DGI) recently issued a cooperation agreement No. KEP-144/PJ/2018 and IMI-UM.01.01-2015. This regulation provides for the exchange of information, joint intelligence activities, collaboration within law enforcement and training in tax and immigration processes. During a press conference at the end of May this year, DGT stated that the purpose of this cooperation is to help enhance and enforce tax compliance activities. The regulation states that DGT will provide DGI with taxpayer’s identity data and DGI will provide DGT information regarding passports, transit data details and visa and stay permits. As a result, a taxpayer may be banned from leaving the country if he/she has a tax payable of IDR 100 million or more and shows no intention to settle the tax due. A travel ban may also be imposed if an individual is undergoing an investigation for a tax criminal act.

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**Tax Audits and Litigation**

### Taxation of Foreign Representative Office: Differentiated Treatment for Different Functions

As companies continue to expand their operations on a global scale, multinational presence becomes virtually inevitable. Consequently, parts of the business operations are executed under a foreign jurisdiction, e.g. by establishing a foreign representative office (RO), giving rise to the question of how cross-border taxation has to be handled. In Indonesia, the taxation treatment depends on the individual functionality of the RO itself.

A RO located in Indonesia and run by a German company, which does not perform any revenue-generating activities (from legal perspective such activities are not permitted to the most common RO forms anyway), does not fall within the definition of a “permanent establishment” (PE) as stipulated by the tax treaty, and is thus not subject to corporate income tax. Should this condition not or no longer be met, the RO will be considered as PE, and consequently become subject to a final income tax rate of 0.44 % of the export value generated through trading activities from the parent company to Indonesian customers, as stipulated in Circular Letter No. SE-02/PJ.03/2008 issued by the Director General of Tax. Once being deemed a PE, the RO will fully become subject to domestic taxation.

We have seen some cases in which ROs were deemed PE by the Indonesian tax authority, though they had initially been established for non-revenue-generating activities. In these cases, the tax authority will issue a tax assessment letter charging 0.44 % of the export value generated through trading activities from the parent company to Indonesian customers.

It is thus crucial to carefully keep record of all documents proving that the RO is neither directly nor indirectly involved in the sales activities of the parent company to Indonesian customers. A comprehensive analysis of the RO’s functionality, the assets used and the risks borne by the entire entity, complemented by the detailed documentation of all actual transactions will be required. On the other hand, the tax office may obtain a statement letter from a customer claiming that sales activities are carried out by a RO, and may use such statement letter as a basis to assess a RO to be a PE.

A tax dispute resolution process in Indonesia may take 2-3 years up to an appeal process before the Tax Court.

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### Tax Audits and Litigation

#### Tax Assessment Letter Based on Factual Data

These days, Indonesian tax authorities are getting perceptibly more offensive upon issuing Tax Assessment Letters (Surat Ketetapan Pajak/SKP) based on ‘factual data’ (Data Konkret). As it merely refers to factual data, what is the legal perspective of this SKP issuance without preliminary tax audit process?

According to Government Regulation No. 74 of 2011, factual data may be concluded from: clarification/confirmation of tax invoice, income tax withholding slip, tax data related to a taxpayer who fails to submit tax returns, and any transaction evidence or taxation data which may serve to calculate a taxpayer’s tax obligation. Basically, factual data may be any kind of data obtained or possessed by tax authorities.

According to Circular Letter No. SE-39/PJ/2015, tax authorities may initially send a Surat Permintaan Penjelasan atas Data dan/atau Keterangan (SP2DK) based on the collection and examination of factual data, in request for declaration/clarification in case a taxpayer is suspected to be not yet fulfilling his tax obligations.

Should the response still leave questions unanswered, the tax authorities may opt for a special tax audit according to Regulation No. PMK 184/PMK.03/2015 issued by the Minister of Finance, stipulating that in order to confirm the authenticity of the above factual data, tax authorities need to conduct a tax audit.

The issuance of a SKP without a tax audit process is highly arguable and, according to our experience, has a weak legal position. The process of tax dispute resolution in Indonesia may take 2-3 years up to an appeal process in front of the Tax Court.

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Debt-to-Equity Ratio in Indonesia

Investment laws and regulations in Indonesia, including the latest regulation number 13/2017 of the Investment Coordinating Board BKPM issued in December 2017, do not provide clear regulations regarding the debt-to-equity ratio applied to a foreign investment company (PMA). Pursuant to the BKPM Regulation, the investor must inject a minimum capital of IDR 10 bio as total investment (comprising equity and loans but excluding land and buildings) to obtain an investment registration, of which IDR 2.5 bio shall be injected as paid up capital. Accordingly, it is commonly assumed that BKPM applies a debt-to-equity ratio of 3:1 when it grants an investment registration. However, BKPM may apply different ratios, depending on the PMA’s envisaged business activities and investment size. Hence, the debt-to-equity ratio remains subject to BKPM’s discretion in individual cases.

The debt-to-equity ratio assumed by BKPM differs from the approach under Indonesian tax regulations. Pursuant to the Minister of Finance Regulation No. 169/PMK.010/2015 and its implementing regulation recently issued by the Director General of Taxation, DGT Regulation No. 25/PJ/2017, which govern the implementation of thin capitalization rules in Indonesia, the general debt-to-equity ratio is 4:1. Any borrowing costs exceeding this ratio are not allowed as deductible expenses. The term “debt” includes long-term and short-term debts as well as interest-bearing trade debts, while “equity” means capital respectively determined by the applicable financial accounting standards and non-interest-bearing loans from parties having special relationships with the corporate taxpayers.

The debt-to-equity ratio under the Tax Regulation is applicable for fiscal years from 2016 on and the requirement to report the respective calculation (and private overseas loan details) to the DGT as part of the company’s income tax return is effective from the fiscal year 2017 on. Failure to submit the calculation may trigger penalties as the annual corporate income tax return would be deemed incomplete.

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Debt-to-Equity Ratio

Debt to Equity Ratio

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