INDONESIAN INVESTMENT INCENTIVES

I. GENERAL INCENTIVES

The Indonesian government provides duty and tax relief for approved investments and exporters. It refunds import duties, value-added tax (VAT), and luxury taxes for (i) approved imports for new investments, (ii) locally-produced capital goods for approved investments, and (iii) inputs used in the production of non-oil exports.[1] The Indonesia Investment Coordinating Board (Baden Koordinasi Penanaman Modal/BKPM) aims to approve a company's application for the import duty exemptions within two weeks.

Exporters are eligible for exemptions on import duties, VAT and luxury taxes on materials and intermediate goods used in the production of goods for export. An exporter is defined as an entity that exports at least 65 percent of its good. A Customs facility for exporters at the ports of entry allows eligible exporters to process and receive their import duty exemptions within seven days.

INVESTMENT LAW

The 2007 Investment Law (Law No. 25/2007), enacted on April 26, 2007, provides for the framework of new fiscal incentives. Investments qualifying for the incentives include investments that are, amongst others, new and the expansion of existing investments, labor-intensive; high-technology; promote innovation, research and development; environment friendly; utilize locally-produced capital goods; involve infrastructure; located in remote areas; or partnered with small-scale companies. Both foreign and domestic investors will qualify for the same incentives.

Incentives are most likely to involve tax reductions, breaks, and deferments. Applicable only to investments by limited liability companies, it calls for the exemption from or reduction of import duty on the import of raw/auxiliary material and of capital goods, machinery, or other production equipment that cannot be domestically produced.

CORPORATE INCOME TAX (CIT)

Although the Indonesian government does not grant tax holidays[2] to investors, it does provide for income tax reductions to certain companies through regulations on income tax and investment incentives. They are detailed in the below sections.

Income Tax Law

The Indonesian government promotes business through some income tax reductions through the Income Tax Law. On September 2, 2008, the Indonesian House of Representatives passed a new income tax law, titled "Fourth Amendment to the Law No. 7 of the Year 1983 on the Income Tax." The House's Special Committee on the Income Tax Bill had finalized the draft bill in early June 2008. The bill lowers the corporate income tax from 30 percent to a flat rate of 28 percent in 2009 and 25 percent in 2010. It also (i) grants a 5 percent tax reduction to companies with 40 percent of its shares listed on the Indonesian Stock Exchange, (ii) exempts certain intercompany dividend taxes, (iii) and halves the tax rate for companies with less than IDR 5 billion in revenue which includes small-medium enterprises. The new income tax law will take effect on January 1, 2009.

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[1] "Country Commerce: Indonesia," The Economist Intelligence, January 2009

[2] Indonesian Parliament revoked the corporate income tax holiday system in 2000. The tax holiday was previously provided under Government Regulation No. 45/1996.

In greater detail, the new bill amends corporate income taxes as follows:

- The **corporate income tax** is reduced from the current rate of 30 percent to a flat rate of 28 percent in 2009 and 25 percent in 2010.
- **Public companies** with at least 40 percent of their shares listed on the Indonesian Stock Exchange are entitled to a 5 percent reduction from the standard corporate income tax. The public should comprise at least 300 persons with each person holding less than 5 percent of the paid-up capital. As a result the effective tax rate is 23 percent in 2009 and 20 percent in 2010.
- Locally registered companies with a revenue of IDR 5 billion (approximately USD 535,600) or under are entitled to a 50 percent reduction of the normal corporate income tax rate. Accordingly, their effective income tax rate will be 14 percent in 2009 and 12.5 percent in 2010. This measure should promote **micro, small and medium enterprises[3].**
- **Intercompany dividends** between locally registered companies are exempt from income tax if the recipient company owns at least 25 percent of the dividend-paying company.
- Grants received by educational and research and development ("R&D") organizations and used for educational and R&D purposes are exempt from income tax.
- **Contributions** for scholarships, national disasters, social infrastructure, R&D, and educational facilities are tax deductible expenses.

Investment Incentives Law

The Indonesian government grants corporate income tax (CIT) incentives to specific industries through (i) Government Regulation (GR) No. 1/2007 titled "Income Tax Facility for Investments on Certain Sectors and Locations," issued January 1, 2007; (ii) GR No. 62/2008, issued on September 23, 2008, to expand the list of preferential industries; and (iii) their implementing regulations, Ministry of Finance (MOF) Decree No. 16/ PMK.03/2007, dated March 15, 2007.

Of the 23 preferential industries, relevant industries include (i) industrial machinery and equipment (diesel motors, water pumps, compressors, metal processing machines, textile machinery, and injection molding equipment); (ii) electric motors and generators; (iii) electronics, and (iv) automotives.

The above mentioned regulations provides four tax incentives to both domestic and foreign direct investment, either for new investment or expansion of existing plants. However, the incentives will not extend to investors who have received preferential tax rates due to their location in special economic development zones or industrial parks. The income tax incentives are as follows:

1. A deduction of 30 percent of the total investment value from net income. The deduction is to be spread over a 6-year period at 5 percent per annum;

2. Accelerated rates of amortization and depreciation. The MOF decree halved the depreciation period and doubled the depreciation rates for fixed assets;

3. A dividend income tax for foreign taxpayers of up to 10 percent or the rate stipulated in the applicable Double Taxation Agreements, whichever is lower; and

[3] The Law on Small Enterprises Number 9 of 1995 defines a small enterprise as a business unit with revenue of IDR 1 billion or under, and a medium enterprise as a business unit with revenue of more than IDR 1 billion but under IDR 50 billion.

4. An extended loss carry-forward period to 10 years with a possible one-year extension from the previous 5 years. The government will grant the additional one-year extension if the company meets the certain conditions, amongst others. These conditions are (i) employment of more than 500 Indonesian workers for at least five consecutive years, (ii) the investment required a minimum investment of IDR 10 billion (USD 1.1 million) in local socio-economic infrastructure, and (iii) usage of domestically-produced raw material or components reached or exceeded 70 percent by the fourth year of operations.

In accordance with Article 2(3) of Government Regulation No.1/2007, the MOF Decree Article 2 stipulates that the MOF's Directorate General of Taxation (DGT) will grant the investment incentives based on proposals sent from the National Coordinating Board of Investment (Badan Koordinasi Penanaman Modal/BKPM). Upon receipt of the investment proposal, the MOF's Directorate General of Taxation (DGT) to issue its decision. If the DGT fails to issue a decision within the 10 working days, then the proposal is deemed as accepted.

VALUE ADDED TAX (VAT)

- **VAT for Exporters**: Companies that export at least 65 percent of their goods are exempt from VAT.

- **VAT on Exported Goods**: Exports are subject to a 0 percent VAT rate. Accordingly, companies are entitled to a refund on the input VAT on the exported good. Notably, the input VAT refund process takes a long time to process, and arbitrary government tax audits may reject valid claims.

- **VAT on Imported Capital Goods**: Companies do not have to pay VAT on imported capital goods, including machinery, factory equipment and their spare parts.

- **VAT on Capital Goods Used to Produce Taxable Goods**: Companies do not have to pay VAT on such capital goods used to produce goods subject to VAT. As of April 1, 2010, they must pay the tax on those goods if they have not begun production within three years.

IMPORT DUTIES

For projects approved by the Indonesia Investment Coordinating Board (BKPM):

- **Raw materials that are not adequately available in domestic market:**
  - If the import duty is less than or equal to 5 percent, the entity is entitled to a 100 percent duty exemption for two production years.
  - If the import duty is greater 5 percent, the entity is entitled to a 50 percent duty reduction for two production years.
- **Companies expanding existing production capacity by at least 30 percent** are entitled to import duty relief on raw materials, capital goods, intermediate goods, and spare parts for two production years.

FREE TRADE AND SPECIAL ECONOMIC ZONES

Free Trade Zones

Free trade zones and free ports (FTZ/FPs) are entitled to import duty, value-added tax, and luxury tax exemptions as provided under Law No. 36/2000 on FTZs.

Batam received FTZ status in August 2007. BBK FTZ/FPs governing bodies are responsible for issuing import licenses for iron, steel, used capital goods, optic disks, agricultural tools and machineries, color printers, copying machines and multi-function machines, and other goods. The FTZ area for Batam includes the Batam, Tonton, Setokok, Nipah, Rempang, Galang and Galang Baru islands. Batam's primary industries include electronics, manufacturing and shipbuilding. The Bintan FTZ area comprises the Bintan and Lobam islands and specializes in the garment and electronics sectors. The Karimun FTZ area, which has a deep-sea port, includes the Karimun and Karimun Anak islands. Batam, Bintan and Karimun ("BBK")

Special Economic Zones

The Special Economic Zones Law (Law No. 39/2009), dated October 14, 2009, entitles companies located in the Special Economic Zones (SEZ) to fiscal and non-fiscal incentives listed under Chapter 6 of the law. The incentives are listed below as follows:

Fiscal Incentives:

- Suspension of import duties
- Exemption on excise tax for imported raw and supporting materials used in the production process
- Exemption of value added tax (VAT)
- Exemption of luxury excise tax
- Exemption of income tax on imported goods
- Exemption or relief from regional taxes
- Reduction in land and building taxes

Non-fiscal Incentives:

- Easier access to land rights
- Expedited process for business and other permits
- Facilitated process to obtain work permits for foreign workers, particularly company directors. Work permits will be valid for the duration of the foreign worker's tenure.
- One-stop center for permits and licenses

Article 3 of the SEZ Law defines an SEZ as comprising of multiple zones for export processing, logistics, industrial, technological development, tourism, energy, or other economic development purposes. Stipulating the criteria for a proposed SEZ, Article 4 requires that a SEZ (a) is located in accordance to the Regional Spatial Plan (*Rencana Tata Ruang Wilayah*/RTRW), (b) spatially close to international trade routes, (c) assigned clear demarcation, (d) does not pose potential environmental problems, and (e) supported by the local government(s). Under Article 12(1), a SEZ must become operational within three years after its designation as a SEZ. The law also allows the Batam, Bintan, and Karimun FTZs to convert into a SEZ within the next 70 years.

II. INDUSTRY-SPECIFIC INCENTIVES

Electronics

CIT

- Please refer to the ***"Investment Incentives Law"*** section.

VAT

- No industry-specific VAT incentives found.

Luxury Taxes

The Indonesian Ministry of Finance (MOF) issued Decree No. 137/PMK.011/2008 on October 7, 2008, titled "Second Amendment to MOF Regulation No. 620/PMK.03/2004 concerning Non-Motor Vehicle Taxable- Goods Belonging to the Luxury Category." Decree 137 reduces the luxury sales tax from 10 percent to 0 percent on (i) television sets that are 21 to 29 inches, (ii) washing machines with a 6 to 10 kilogram capacity, and (iii) digital cameras selling at IDR 2 million (USD 180) or less. Digital cameras that sell for more than IDR 2 million is still subject to a 10 percent luxury tax. The MOF issued the luxury sales tax exemption to boost the electronic industry's performance and to dampen a surge in illegal imports.

Machinery

General

Machinery Restructuring Programs

The Indonesian Ministry of Industry (MOI) issued three decrees on "machinery restructuring programs" to revive the sugar processing industry, footwear industry and small-scale textile and footwear industry. The decrees are (i) Decree No. 91/M-IND/PER/11/2008, dated November 21, 2008, for the sugar processing industry, (ii) Decree No. 90/M-IND/PER/11/2008, also dated November 21, 2008, for the footwear industry, and (iii) Decree No. 94/M-IND/PER/11/2008, dated November 24, 2008, for the small-scale textile and footwear industry.

For the sugar processing and footwear industries, the machinery restructuring programs provides for a 10 percent reimbursement on newly purchased or installed machinery. If the machines have a 40 percent local content, the company will receive an additional 15 percent reimbursement. Reimbursements are capped at IDR 5 billion per company per year.

For the small-scale textile and footwear industry, companies are entitled to a 25 percent reimbursement on the purchased machinery and to an additional 30 percent if the machines meet the 40 percent local content requirement. Reimbursements are capped at IDR 2 billion per company per year.

CIT

- Please refer to the ***"Investment Incentives Law"*** section.

VAT

- As mentioned in the "***Value Added Tax (VAT)***" section, companies do not have to pay VAT on imported capital goods, including machinery, factory equipment and their spare parts. They also do not have to pay VAT on such capital goods used to produce goods subject to VAT. As of April 1, 2010, they must pay the tax on those goods if they have not begun production within three years.

- The Indonesian Ministry of Finance (MOF) issued Decree No. S-459/MK.03/2008 on September 3, 2008, to grant importers VAT exemption of 10 percent on textile machineries. Importers and/or businesses receiving imported textile machineries may obtain a VAT exemption letter from the head of their local tax office where they are registered. The MOF granted this tax relief to revive and upgrade the local textile industry.

Luxury Taxes

- No industry-specific incentives found.

Import Duties

- The Indonesian government grants import duty exemptions and reductions for main equipment and support equipment. The 100 percent duty exemption applies to (i) qualified main equipment, (ii) its consumables, which are required to operate the equipment in the first year of production, and (iii) its spare parts that are no more than 5 percent of the main equipment's value. Support equipment is entitled to a 50 percent import duty reduction. Components for heavy machinery became duty-free as of October 1, 2005.[4]

- Under MOF Decree No. 135/KMK.05/2000, dated May 1, 2000, capital goods (including machinery, equipment, tools, and spare parts) used to develop or expand an industry has a maximum import duty of 5 percent for a 2-year period. If the industry uses local machines meeting a minimum of 30 percent Domestic Component Level, the incentive facility is for a 4-year period. The incentive does not apply to the motor vehicle assembly industry, except for the motor vehicle component industry. It also cannot be used in conjunction with other import-duty exemption facilities.

- Expanding on the above decree (MOF Decree No. 135/KMK.05/2000), the MOF issued Decree No. 176/PMK.011/2009 on November 16, 2009, to grant a two-year import duty exemptions on imported machinery, goods and materials used in new or expansionary investments in certain industries. The decree grants a two-year import duty exemptions on imported machinery, goods and materials used in new or expansionary investments in certain industries. It applies to manufacturing industries and seven service industries, comprising construction, mining, port, public healthcare, public transportation, telecommunications, and tourism and culture services. The import duty exemption does not apply to automotive assembly, except for the automotive component industry. Companies must apply with the Investment Coordinating Board (BKPM) for the import duty exemption.

  Eligible machinery, goods and material should either (i) not be produced in Indonesia, (ii) is locally produced but do not meet the companies' requirements, or (iii) is locally produced but in insufficient quantities to meet industry demand. Machinery refers to machines, equipment, auxiliary equipment, spare parts, and tools. Goods and materials refer to raw materials and components used to produce the goods. The duty exemption for machinery is valid for a two-year import period, starting from the application of the approved import duty exemption.

  Eligible investment projects include (i) establishing new companies or factories, or (ii) expanding, modernizing, rehabilitating, or restructuring equipment to increase the production quantity, quality or diversity. Existing manufacturing companies are eligible for the two-year import duty exemptions on machinery if the investment projects expand their production capacity by at least 30 percent. If the manufacturing company has domestically-produced machinery that comprises at least 30 percent of the total value of its machinery, it is entitled to the import duty exemption on goods and materials up to four production years. Decree 176 took effect on December 16, 2009, and is valid for two years before MOF's reevaluation of the import duty exemption facility.

[4] "Country Commerce: Indonesia," The Economist Intelligence, January 2009

Automotives

CIT

- Please refer to the ***"Investment Incentives Law"*** section.

Luxury Tax

Indonesia also applies a luxury tax that ranges from 10 to 75 percent based on engine capacity. The luxury tax scale on sedans is 30, 40, and 75 percent. Two- and four-wheel drive vehicles are subject to 10, 20, 30, 40, and 75 percent luxury tax rates depending on engine capacity. Buses have a 10 percent luxury tax. Pick-ups and truck are not subject to a luxury tax. The luxury taxes are detailed below.

- The current luxury tax rates for vehicles under Government Regulation 12/2006, dated April 15, 2006, are as follows:
    - **10 percent:** Passenger vehicles for 10 to 15 persons, including the driver, and 4x2 vehicles for less than 10 persons with an engine capacity no more than 1,500 cubic centimeters (cc).
    - **20 percent:** 4x2 vehicles for less than 10 persons with an engine capacity from over 1,500 to 2,500 cc and double-cabin vehicles weighing less than 5 tons.
    - 30 percent: Sedans, station wagons and 4x4 vehicles with an engine capacity of up to 1,500 cc
    - **40 percent**: Sedans, station wagons and 4x4 vehicles (spark ignition) with an engine capacity of over 2,500 to 3,000 cc; sedans, station wagons and 4x4 vehicles (compression ignition) with an engine capacity of over 1,500 to 2,500 cc; and 4x2 vehicles for less than 10 persons with an engine capacity from over 2,500 to 3,000 cc
    - **50 percent:** Vehicles for golf
    - **60 percent:** Motorcycles with an engine capacity of over 250 to 500 cc and special purpose vehicles for snow, beach and mountains
    - **75 percent:** Sedans, station wagons, 4x2 and 4x4 vehicles (spark ignition) for less than 10 persons with an engine capacity of over 3,000 cc; sedans, station wagons, 4x2 and 4x4 vehicles (compression ignition) for less than 10 persons with an engine capacity of over 2,500 cc; motorcycles with an engine capacity over 500 cc; and trailers.

- Under the amended VAT and Luxury Tax Law (Law No. 42/2009), date October 15, 2009, the luxury tax ceiling rate will increase from 75 percent to 200 percent. Luxury cars are expected to fall into the highest bracket of 200 percent. The MOF will issue an implementing regulation to detail which goods are categorized as luxury goods and their corresponding luxury tax rates. Law 42 will take effect on April 1, 2010.

Import Duties

- No industry-specific incentives found. In general, the import duties on automotive parts, which is capped at 15 percent, is much lower then import duties on completely knocked down (CKD) vehicles, which range from 20 to 40 percent for passenger vehicles, which is lower than import duties on completely built up (CBU) vehicles, which range from 40 to 60 percent for passenger vehicles, to promote the local automotive industry.

III. GENERAL INVESTMENT RESTRICTIONS

Despite weathering the recent crisis, Indonesia has long-term structural issues impeding investment, such as poor infrastructure, corruption, an unreliable judicial system, tough labor laws, economic nationalism, and local autonomy measures. Regarding local autonomy measures, the Indonesian government embarked on an ongoing decentralization process in 2001 which has created issues between competing national and regional government authorities. After regional demand for greater local autonomy in managing local affairs, the government issued Regional Administration Law No. 22/1999 and the Intergovernmental Balance Law No. 25/1999 in 2001. Since then, some regional authorities use those laws to challenge foreign investor claims to resources gained through national concessions or impose restrictions that conflict with national regulations.

IV. INDUSTRY-SPECIFIC RESTRICTIONS

Electronics

Import Licensing and Ports Restrictions:

Through Decree No. 60/M-DAG/PER/12/2008 ("Decree 60"), dated December 24, 2008, the Indonesian Ministry of Trade (MOT) issued its third revision to the import restrictions originally introduced in Decree No. 44/M-DAG/PER/10/2008 ("Decree 44") regarding garments, foot wear, electronics, toys, and food and beverages. Only final consumer goods are subject to the import restriction. It does not apply to raw materials or intermediary goods, such as component parts. Decree 44 restricts the imports of the subject goods to five designated ports, in addition to international airports through December 31, 2010. Decree No. 60/M-DAG/PER/12/2008 adds the port of Pelindo in Dumai to previous list of ports and airports. The new list of designated ports include the port of Tanjung Perak (Surabaya), port of Tanjung Priok (Jakarta), port of Tanjung Emas (Semarang), port of Belawan (Medan), Soekarno-Hatta (Makassar), Pelindo (Dumai), and all international airports. Notably, electronics and other goods are exempt from the requirement of pre-shipment inspection in the countries of origin. Except for priority lane importers, only importers registered with the MOT can import the subject goods. They are titled as "registered importers of certain goods" (*Importir Terdaftar Produk Tertentu*/ITPT). While Decree 60 is effective from January 1, 2009, to December 31, 2010, the import restrictions took effect on February 1, 2009.

Machinery

Discontinued Importation of Used Trucks and Heavy Equipments:

The Indonesian Ministry of Trade (MOT) decided that it will no longer allow the importation of used trucks and heavy equipment after December 31, 2006. It will allow customs clearance of those goods with import declaration documents dated before December 31, 2006, to be released until February 28, 2007. In general, Indonesia prohibits the importation of used automotive products and parts.

The import of used trucks and heavy equipment was allowed under MOT Decree No. 38/M-DAG/PER/12/2005, dated December 29, 2005, on the Importation of Used Motor Vehicle. After consulting with the private sector, the MOT decided not to renew the Decree, which expired on December 31, 2006, to protect local producers. The consultation took place between the MOT, Ministry of Industry, Ministry of Transportation, the Association of Automobile Producers (GAIKINDO), the Association of Land Transportation Operator (ORGANDA), and the Association of Heavy Equipment and Truck Recondition (APARATI).

Automotive

- **Infrastructural Constraints:** Indonesian automotive exports are constrained by poor supporting infrastructure, such as the heavy congestion at and on the roads to the dedicated vehicle port at Tanjung Priok port. Car manufacturers had also complained in early 2008 about poor services provided at the port.

- **Ban on import of used vehicles** to promote domestic automotive manufacturing.

- Please refer to bullet point titled "Discontinued Importation of Used Trucks and Heavy Equipments" in the above "Machinery" Import Restriction Section