DOING BUSINESS IN INDONESIA

GEOGRAPHY AND CLIMATE

Investment in Indonesian presents a broad overview of the economic and social background of the country together with discussions on taxation and investment. It provides a guide to those contemplating doing business in Indonesia as it reviews the opportunities for and conditions under which foreign investment may be made in Indonesian.

The country, which has an area of approximately 1,900,000 square kilometres. Its climate varies from tropical. There are two well-marked seasons the dry season lasting and the rainy season. Temperatures near to coast seldom rise above 32°C. The climate is drier further north where extremes of temperatures are common.

Jakarta, a city in the centre of the country, is now the capital. Jakarta has communication links with most parts of the world. The connections are through satellite, telephone, telex, telefax, mail services and courier services. Currently telephones services are being expanded and modernized.

The information set out in this publication is by no means exhaustive. Potential investors and other readers are therefore advised to seek professional advice before taking investment decisions concerning in Indonesian.

CONDUCTING BUSINESS IN INDONESIA

The main legislation governing foreign direct investment in Indonesia is Capital Investment Law. The general investment policy covered under this current Law includes the following:

Certain investment facilities can be granted based on certain investment criteria. Examples include absorbing a large number of manpower, included in high priority scale business, infrastructure development, undertaking transfer of technology, a pioneer industry or located in remote, less developed or border areas.

A foreign investor has the right to employ expatriates in certain positions by obtaining the proper permit and fulfilling the obligation to improve skills and expertise of local manpower through training.

Domestic and foreign investors are equal treatment. Certain national interests must still be considered, such as limitation on investment in certain strategic sectors or in sectors which are reserved to develop local micro, small or medium business players.

To cut the length of time required to do business in Indonesia, a one-stop integrated service is being developed both by the central government and regional government to simplify the licensing process. An online application system has also been developed to submit applications. Further development in this licensing area is still required to implement a full one-stop integrated service.

The government has the right of foreign investors to repatriate profit from Indonesia which can be in the form of payment of dividend, reduction of capital, payment liquidation proceeds or payment of royalties or technical fees. The government has the right to defer the repatriation of profit if the investor has any unsettled legal liabilities in Indonesia.

The government will not perform nationalization of foreign investments unless based on the Law. In the case of nationalization, the government shall provide compensation based on market value. To be more focused in attracting more investors, the government has also set several key and priority investment sectors which include infrastructure, energy, oil and gas.

SETTING UP A COMPANY

Foreign Capital Investment (FCI)

The common type of presence for a foreign investor who wants to invest and engage in business in Indonesia is by establishing an incorporated limited liability company, commonly known as a Foreign Capital Investment company. There must be two parties holding shares in a FCI company. These can be a legal entity or an individual.

The shareholders must also appoint at least one director and one commissioner of the FCI company. The director serves as management of the FCI company and has he authority to represent the FCI company, while the commissioner supervises and provides advice to the director.

Representative Office

Foreign companies are permitted to establish a representative office in Indonesia. However, a representative office has more restrictions on its activities. A representative office can only perform marketing or promotion activities, market research or promotion activities, market research and review of business opportunities in Indonesia. Representative offices are available for foreign companies engaged in certain sectors which include trading, services, and oil and gas.

An exception applies to representative offices of foreign companies engaged in construction services. This type of representative office is allowed to deliver construction services in Indonesia under a joint operation with a local construction company.

Branch

A branch office is generally not allowed, except for the banking sector.

Others

Other types of presence for conducting business in Indonesia include Production Sharing Contract with the government. This is common in the oil and gas mining upstream sectors.

INDONESIA TAXATION

Resident taxpayers have to settle their tax liabilities by direct payments, third-party withholdings, or a combination of both. Foreign companies in Indonesia have to settle their tax liabilities for their Indonesian-sourced income through withholding of the tax by the Indonesian party paying the income.

Tax rate for corporate

A flat rate of 25% applies for corporate taxpayers. The normal tax period is January to December. If corporate taxpayers would like to use a different tax period, they would have to obtain an approval from the Director General of Tax (Directorate General of Taxation) and then maintain the approved tax period consistently. Branch (or Permanent Establishment Company) profits are subject to the same corporate tax rate of 25%, but the after-tax profits are subject to withholding tax at 20%, regardless of whether the profits are remitted to the home country. However, a reduced withholding tax rate may be applicable where a tax treaty is in force.

Tax Incentives

The Directorate General of Taxation, on behalf of the Minister of Finance and based on the recommendation of the Investment Coordinating Board Chairman, may provide tax concessions to Indonesian Limited Liability companies following their investment in certain designated business area or in certain designated regions.

Tax Calculation

Taxable business profits are calculated on the basis of normal accounting principles as modified by certain tax adjustments. Deduction is allowed for all expenditure incurred to obtain, collect, and maintain taxable business profits. A timing difference may arise if an expenditure recorded as an expense for accounting cannot be immediately claimed as a deduction for tax.

Transfer Pricing

Transaction between related parties must be dealt with consistently using the arm's length transaction. If the arm's length principle is not allowed, the Directorate General of Taxation is authorized to recalculate the taxable income or deductible costs arising from such transactions applying the arm's length principle.

PERSONAL INCOME TAX

The Indonesia tax system distinguished individual tax subjects into non-resident and resident tax subject. An individual who resides in Indonesia, an individual who is present in Indonesia for more than 183 days within any 12-month period, or an individual who within a particular year is present in Indonesia and intends to reside in Indonesia, is regarded as a resident tax subject.

Tax rates

Most income earned by individual resident taxpayers is subject to income tax. Dividends received by individual resident taxpayers from Indonesian companies are subject to 10% final tax. Non-resident individuals are subject to withholding tax at 20% in respect of their Indonesia-sourced income. Concessions are available however, where a tax treaty is in force.

Tax liabilities for a particular year must be paid to the State Treasury through a designated tax-payment bank and then accounted for at the Directorate General of Taxation office through the filling of the relevant tax returns.

Personal Income Tax Returns must be filled on an annual basis within three months after the end of fiscal year. Filing extension is allowed for a maximum of two months by submitting a written notification. Late tax payments are subject to a 2% tax penalty per month, while for late reporting the administrative penalty is IDR 100,000.

VALUE ADDED TAX (VAT) AND LUXURY-GOODS SALES TAX (LST)

With a few exceptions, VAT is applicable on deliveries (sales) of goods and services within Indonesia at a rate of 10%. VAT on export of goods is zero-rated while the import of goods is subject to VAT at rate of 10%. Zero-rated VAT is also applicable on exported services, but subject to Ministry of Finance limitation. Currently, only certain exported services, are subject to the 0% VAT rate.

The VAT law allows the government to change the VAT rate within the range of 5% to 15%. However, since the enactment of the VAT law in 1984, the government has never changed the VAT rate.

In addition to the VAT, some goods are subject to Luxury-goods Sales Tax upon import or delivery by the manufacturer to another party at rates ranging from 10% to 200%.

ACCOUNTANCY

The financial statements of a company must comply with the requirement. In addition, they must comply with the Statements of Accounting Standards issued from time to time by the Indonesian Accounting Standard Board. These accounting standards in content, form and style are broadly similar and consistent with those issued by the International Accounting Standards Committee.

Accounting Period

Business entities generally use the 1 January to 31 December calendar year as their accounting year. For tax purposes the fiscal year in the most cases is also the calendar year; however, companies are allowed to choose a fiscal year that does not start on 1 January.

Bookkeeping Currency

Accounting books and financial statements are prepared using the company's functional currency. An entity may present financial statements using a currency other than its functional currency. Functional currency is the currency of the primary economic environment in which an entity operates; this is usually the currency in which sales prices or costs for the company's goods and services are denominated and settled.

For most business entities in Indonesia, the functional currency is generally the Indonesian Rupiah; however, there are a number of companies whose functional currency is a currency other than Rupiah.

For tax purposes, the prevailing tax regulation in Indonesia only allows a company to use US Dollar currency, as an alternative to Rupiah, in its accounting books. The company should obtain approval from the tax authority before it is eligible to use US Dollar currency in its accounting.

Bookkeeping Language

By law, all accounting books, records and financial statements should be prepared using the Indonesian language. A company is allowed to use other languages only after obtaining permissions from the Ministry of Finance.

Accounting Basis

Business entities must apply the accrual basis, the effects of transactions are recognized when they occur (which is not necessarily the same as when cash is received or paid) and when certain criteria for recognizing and measuring those transactions are met.

Accounting Books

Companies are required to maintain accounting records and prepare annual financial statements in accordance with Financial Accounting Standards issued by Indonesia's accounting standards-setting body, the Indonesian Financial Accounting Standards Board. They must keep journals and ledgers as well as appropriate memorandum records. Entities that have no public accountability are allowed to adopt Financial Accounting Standards for Entities that have no Public Accountability, which is simpler than the full of Financial Accounting Standards.

Financial Statements

A complete set of financial statements consists of a statement of financial position, a statement of comprehensive income, a statement of changes in equity and notes to the financial statements. Financial statements are presented on a comparative basis with the same information from the previous year.

AUDIT REQUIREMENT

Statutory audit by a qualified auditor is mandatory for the following types of entities, which are required to submit their annual financial statements to the Ministry of Trade:

- Publicly-listed company
- Companies involved in accumulating funds from the public (such as banks and insurance companies).
- Companies issuing debt instruments.
- Companies with assets of 25 billion Rupiah or more.
- Bank debtors whose financial statements are required by the bank to be audited.
- Certain types of foreign entities engaged in business in Indonesia that are authorized to enter into agreements.
- Certain types of state-owned enterprises.

Audit are conducted based on auditing standards promulgated by the Indonesian Institute of Certified Public Accountants. Auditing standards is from International Standards on Auditing.

Public companies are required to submit to the capital market regulator, audited annual financial statements within three months after the end of the annual financial statements period.

For interim financial statements, the submission to authority should be conducted within one month after the date of the interim financial statements if not audited; within two months if statements are reviewed, and within three months if the statements are audited.