2 Indonesia

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I. Introduction

As an ethnically diverse country with a vast population of 237 million people, Indonesia is the world's sixth populous nation in 2008. The island of Java which area is the size of New York holds over 100 million people and thus, makes it one of the most densely populated areas in the world.

By the time of the Renaissance, the islands of Java and Sumatra had already enjoyed a 1,000-year heritage of advanced civilization spanning two major empires. During the 7th-14th centuries, the Buddhist kingdom of Sriwijaya flourished on Sumatra. At its peak, the Sriwijaya Empire reached as far as West Java and the Malay Peninsula. Also by the 14th century, the Hindu Kingdom of Majapahit had risen in eastern Java. Gadjah Mada, the empire's chief minister from 1331 to 1364, succeeded in gaining allegiance from most of what is now modern Indonesia and much of the Malay Archipelago as well.At the outset of 1602, the Dutch began to establish themselves as rulers by controlling over the undersized kingdoms that had replaced Majapahit.

During the first decade of the 20th century, an Indonesian independence movement began and expanded rapidly, particularly between the two World Wars. Its leaders came from a small group of young professionals and students, some of whom had been educated in the Netherlands. Many, including Indonesia's first president, Soekarno (1945-67), were imprisoned for political activities. The Japanese occupied Indonesia for three years during World War II (1942-1945). On August 17, 1945, three days after the Japanese surrender to the Allies, a small group of Indonesians, led by Soekarno and Mohammad Hatta, proclaimed independence and established the Republic of Indonesia. Dutch efforts to reestablish complete control met strong resistance. After four years of warfare and negotiations, the Dutch transferred sovereignty to a federal Indonesian Government. In 1950, Indonesia became the 60th member of the United Nations.

I.1 Geography, Climate, and Natural Resources

Indonesia is the largest archipelago in the world with 17,508 islands according to the Indonesian Naval Hydro-Oceanographic Office with the total area is 1,919,440 sq km that consists of land 1,826,440 sq km and water 93,000 sq km. The five big islands take place of the total area are Sumatra, Java, Kalimantan, Sulawesi, and Papua. Indonesia also has land boundaries on the north with Malaysia (1,782 km), on the south with East Timor (228 km), and on the west with Papua New Guinea (820 km).

The climate in Indonesia is tropical because its location is near the equator line. There are only dry and wet seasons that take turn in a year. The East Monsoon, from June to September, brings dry weather while the West Monsoon, from December to March, brings rain. The transitional period between these two seasons is interspersed by the occasional heavy rain shower, but even in the midst of the West Monsoon season, temperatures range from 21C (70F) to 33C (190F) except at higher altitudes which can be much cooler. Heaviest rainfalls are usually recorded in December and January and humidity is generally between 75 percent and 100 percent.

Indonesia is rich in minerals although only less than half the country's geology has been explored. Oil and gas accounts for a major part of the nation's foreign exchange earnings. Apart from oil and gas, exploitation of geothermal reserves are being accelerated, coal production is increasing. Copper is found throughout the archipelago. There are also large deposits of nickel oxide, bauxite, gold, lead, manganese, silver, titanium, uranium, zinc, etc. In the case of agriculture resources, major agricultural products for domestic consumption and export include rice, corn, cassava, soybeans, timber, rubber, palm oil and various spices for which it has for centuries been famed. While in the field of fishery, shrimp has also become a major foreign exchange earner.

I.2 Socio-Culture

Indonesian language (locally called Bahasa Indonesia) initially has no word for philosophy as an entity separated from theology, art and science. Instead, Indonesians have a generic word, that is, budaya or kebudayaan, which includes a totally of the life of a society. Philosophy, science, theology, religion, art and technology are once manifestations of a society's life, which are included in the meaning of the world budaya. Some arts in Indonesia have been influenced by several cultures. The famous Javanese and Balinese dances, for example, contain aspects of hindu culture and mythology. But as a matter of fact, the diversity of Indonesian culture has come as a result of a long process of acculturation between the original customs and myriad of influences.

Constitutional guarantees of religious freedom apply to the six religions recognized by the state, namely Islam (86.1 percent), Protestantism (5.7 percent), Catholicism (3 percent), Hinduism (1.8 percent), Buddhism (about 1 percent), and Confucianism (less than 1 percent). On the resort island of Bali, over 90 percent of the population practices Hinduism. In some remote areas, animism is still practiced.

More than 300 local and regional languages exist along a side the official language, Bahasa Indonesian, which is a standardized dialect of Malay that has long been used as a lingua franca in the region. This "Standard Indonesian" has been the official language in all formal and most written communications and publications since the country's independence from Dutch rule in 1945. Local languages such as Javanese (spoken by 45 percent of the population), Sundanese (14 percent) and Madurese (7.5 percent) are principally used in informal situations. Languages sometimes even switch within conversations and meeting.

I.3 Government and Current Political Situation

On April 9th 2009, Indonesia held its fourth 'democratic' parliamentary election since its independence in 1945. Through general election, people elect 560 People Representative Council members and 128 members of Regional Representatives Council. Both of this representative's council is part of People Consultative Assembly which is the highest power holder in Indonesia. This political process is taking place in local government as well such in provincial and regency level. In the election on 9 April, 38 parties contested but only 9 won seats. Parties in Indonesia are generally classified as being secular ("nationalist") parties or Islamic parties. The Islamic parties appeal to either the "traditionalist" stream of Islam, which has incorporated elements of pre-Islamic and Hindu practice and tends to be more tolerant in outlook, or to the stricter more Middle Eastern-influenced "modernist" Islam.

The biggest surprise is the overwhelming rise of Democratic Parties (PD). Based on the official General Election Commission (KPU) count, PD emerged as the largest party followed by the Golongan Karya Party, headed by Vice President Jusuf Kalla, and the Indonesian Democratic Party of Struggle (PDIP) led by former President Megawati Sukarnoputri. The four leading Islamic parties – the Islamist Prosperous Justice Party (PKS), the National Mandate Party (PAN), the United Development Party (PPP), and the National Awakening Party (PKB) – did badly, with their combined votes plummeting from 44 percent in the previous 2004 elections to 25 percent this time.

Table 1: The Final Results of Legislative Election - Five Major Winners

Parties	Votes		Seats in People Representative Council	
	Number	Percentage	Number	Percentage
Demokrat	21,703,137	20.8%	150	26.8 %
Golongan Karya	15,037,757	14.4%	107	19.1%
PDI Perjuangan	14,600,091	14.0%	95	17.0%
Partai Keadilan Sejahtera	8,206,955	7.9%	57	10.2%
Partai Amanat Nasional	6,254,580	6.0%	43	7.7%

Source: General Election Commission

II. Overview of Macroeconomic Activity and Fiscal Position

During 2008, Indonesian's economy maintained adequate performance amid the global turmoil. Overall economic growth reached 6.1 percent in 2008, slightly below the 6.3 percent recorded in the previous year. This growth was driven by private consumption and exports. The high consumption growth during 2008 was supported by continued strong purchasing power and improving levels of consumer confidence. Factors bolstering public purchasing power include rising incomes from the surge in export commodity prices, higher income levels for middle and upper income earners and the government safety net policy in the form of Direct Cash Transfers to compensate for the impact of the fuel price hike midway through the year.

The balance of payments came under pressure from the dynamics of the global economy during 2008. In the first half of the year, the balance of payments recorded a fairly strong surplus. Rising oil and international commodity prices had a positive effect on export growth. Alongside this, robust domestic demand spurred vigorous growth in imports of capital goods, raw materials and even consumption items. Sharply rising imports shifted the current account into deficit in Q2/2008. At the same time, the capital and financial account and particularly portfolio investments continued to chart a surplus. The capital account surplus was buoyed by the issue of global bonds and foreign capital inflows, especially on the Government Bond market, which saw significantly increased activity in Q2/2008. Early in the second half of 2008, pressure on the balance of payments mounted from the deepening world economic crisis.

The combined deficits in the current account and the capital and financial account contributed to a surging balance of payments deficit in the final quarter of the year. Measured for 2008 overall, the estimated balance of payments deficit came to 2.2 billion US dollar. At end-December 2008, international reserves stood at 51.6 billion US dollar. This represented a comfortable level of reserves, equivalent to 4.0 months of imports and servicing of official debt.

The crisis triggered a global liquidity crunch and fuelled perceptions of risk on emerging markets, including Indonesia, while generating negative financial market sentiment. These factors prompted foreign investors to offload significant amounts of rupiah assets. Pressure mounted on the rupiah from early Q4/2008, causing the rupiah to fall 15.5 percent. However, looking at 2008 overall, the average value of the rupiah was fall only 5.4 percent at Rp9,666 to the US dollar.

Concerning prices, inflationary pressure in Indonesia remained strong until Q3/2008, but began to ease in Q4/2008. The high inflation until Q3/2008 was fuelled primarily by soaring international commodity prices, led by oil and food. This upswing impacted administered prices when the government was compelled to raise its prices for subsidized fuels. Early in the second half of 2008, inflationary pressure began to subside in line with the downturn in international commodity, food and energy prices. In other developments, Indonesia benefited from a very good year of food crop production which, combined with slowing aggregate demand, contributed to lower inflationary pressure. In regard to fundamentals, falling inflationary pressure was also attributable to success in mitigating expectations of inflation that had mounted sharply in the wake of the fuel price hike.

II.1 Macroeconomic Activity

II.1.1 International Environment

The slowing world economic growth and falling of global commodity prices has been create heavy pressure in 2008 the balance of payments. In response to these developments, the balance of payments in 2008 recorded a 1.9 billion US dollar deficit, representing considerable drop from the preceding year's surplus of 12.7 billion US dollars. This deficit brought international reserves down 9.3 percent to 51.6 billion US dollars at end-2008, equivalent to 4 months of imports and servicing of official external debt.

Table 2: Indonesia Balance of Payment

(millions of US$)

	Description	2005	2006	2007	2008
1)	Current Account	278	10,836	10,492	606
	Goods, net (Balance of Trade)	17,534	29,660	32,754	23,309
	Non Oil and Gas	13,321	22,875	27,048	15,549
	Oil and Gas	4,212	6,785	5,671	7,760
	Service, net	(9,122)	(9,874)	(11,841)	(13,011)
	Income, net	(12,927)	(13,790)	(15,525)	(15,334)
	Current Transfer, net	4,793	4,863	5,104	5,643
2)	Capital and Financial Account	345	3,025	3,591	(1,706)
	Capital Account	333	350	546	353
	Financial Account	12	2,675	3,045	(2,059)
	Direct Investment	5,271	2,188	2,253	2,479
	Portfolio Investment	4,190	4,277	5,566	1,753
	Other Investment	(9,449)	(3,790)	(4,775)	(6,291)
3)	Total (1 + 2)	623	13,885	14,083	(1,100)
4)	Net Errors and Omissions	(179)	644	(1,368)	(845)
5)	Overall Balance (3 + 4)	444	14,510	12,715	(1,945)
6)	Reserved and Related Items	(444)	(14,510)	(12,715)	1,945
	Reserve Assets Changes	663	(6,902)	(12,715)	1,945
	IMF Purchases	(1,107)	(7,608)	0	0
	Memorandum :				
	International Reserve	34,724	42,586	56,920	51,639
	(In months of imports and official foreign debt repayment)	4.0	4.6	5.8	4.0

1) (-) surplus; (+) deficit

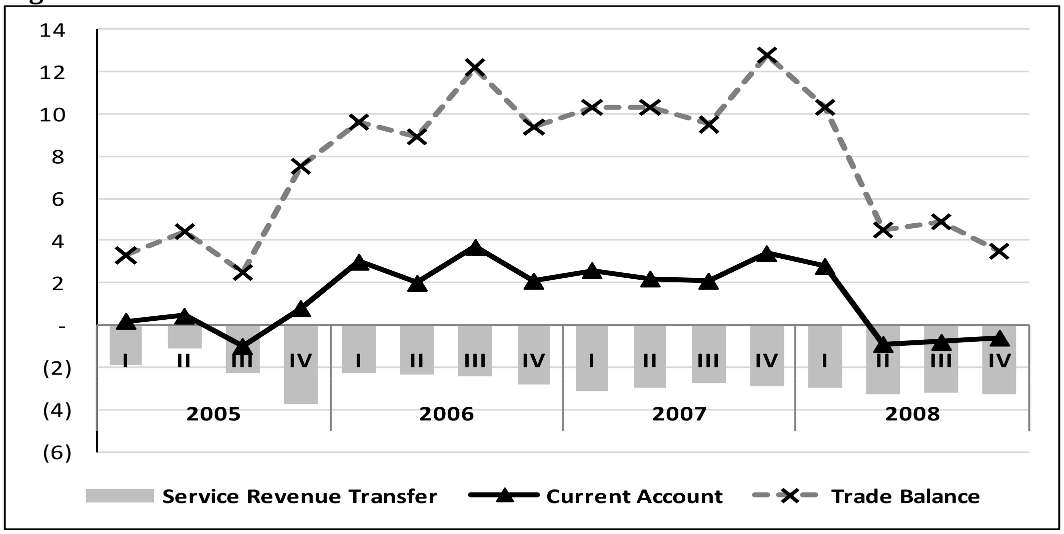
Source: Bank Indonesia and BPS-Statistics Indonesia

The collapse in export commodity prices and worsening slowdown the world economy in second half of 2008 was worsening deteriorating global sentiment that triggered a massive selling of financial market assets by foreign investors in Indonesia and a soaring deficit in the capital and financial account. Exacerbating this was. In the current account, export growth tapered off due to slowing global economic growth and falling prices for exported commodities. While exports subsided, the leveling of import growth was slowed to some extent by the still robust domestic demand, which trimmed the current account surplus from 2.8 billion US dollars in QI-2008 to only 0.6 billion US dollars at end of year.

(1) Current Account

In 2008, the current account recorded a 0.6 billion US dollar surplus. Despite posting a strong surplus in Q1/2008, the current account steadily weakened during the subsequent three quarters due to steadily rising imports. On one hand, import growth was driven by rapidly escalating domestic demand, indicative of the strength of the domestic economy. However, export growth tapered off due to uncertainty global economic growth and sliding export commodity prices. Alongside this, the services, income and remittances account also charted a 22.7 billion US dollar deficit, largely unchanged from the 22.3 billion US dollar deficit one year before.

Figure 1: Current Account



Source: Bank Indonesia and BPS-Statistics Indonesia

The strong merchandise exports in 2008 were bolstered mainly by non-oil and gas exports at 107.6 billion US dollars (FOB), representing 15.5 percent growth over the same period one year before. Driving force for this high growth came from the agriculture and mining sectors, in which growth reached 32.9 percent and 22.7 percent mainly in response to rising commodity prices. On the other side, non-oil and gas imports reached 100.2 billion US dollars (FOB), with growth at 39.4 percent (yoy). In disaggregation by region, export growth in 2008 was dominated by primary commodity exports from the Sumatra and Kalimantan-Sulawesi-Ambon-Papua (Kali-Sulampua) regions. During the first half of the year, rising demand and prices for primary commodities fuelled strong export momentum in Sumatra and Kali-Sulampua.

In the oil and gas sector, buoyant natural gas exports contributed to a trade surplus. Oil and natural gas exports were recorded at 15.4 billion US dollars and 16.3 billion US dollars, representing 22.8 percent and 32 percent growth over the same period one year earlier. Crude oil imports again climbed at a vigorous pace (23.8 percent, yoy). Accordingly, Indonesia's oil balance of trade posted an 8.4 billion US dollar deficit. Despite this, brisk growth in natural gas exports enabled the oil and natural gas sector to chart another annual surplus at 7.8 billion US dollars.

Tables 3: Major Commodities Export and Import

Commodities	Growth (%)		2008	
	2006	2007	Value (millions of US$)	Growth (%)
1) Exports				
Non Oil and Gas	20.7	15.6	107,607	15.5
Agriculture	255.4	14.7	4,950	32.9
Mining	130.1	17.2	14,742	22.7
Manufacturing	(7.0)	15.2	87,915	13.6
Oil and Gas	13.4	8.4	31,683	27.4
2) Imports				
Non Oil and Gas	8.0	14.6	100,170	39.4
Consumptions Goods	18.4	46.8	9,033	24.7
Raw Materials	7.8	12.0	70,513	37.9
Capital Goods	5.4	11.0	20,623	52.8
Oil and Gas	3.0	16.7	23,922	24.6

Source: Bank Indonesia and BPS-Statistics Indonesia

Merchandise imports were up sharply in all categories, with imports of consumer goods, raw materials and capital goods forging ahead at 24.7 percent, 37.9 percent and 52.8 percent. Consumption goods imports climbed as a result of major increases in international foodstuff prices. Imports of raw materials and capital goods, however, were influenced not only by increased prices but also higher import volume.

(2) Capital and Financial Account

In 2008, this account posted a 1.7 billion US dollar deficit, down considerably from the 3.6 billion US dollar surplus one year earlier. Foreign direct investment (FDI), however, was little changed from one year before. Direct investment transactions resulted in a 2.5 billion US dollar surplus, slightly higher than the previous year, which recorded a surplus of 2.3 billion US dollars. Despite this, quarterly figures for long-term capital inflows (FDI) were relatively stable during 2008 before mounting in QIV-2008 on a merger of domestic banks by foreign investors.

During 2008, foreign investors booked a net sale of Bank Indonesia Certificates (SBIs) at 2.0 billion US dollars. However, in Government Bond (including foreign currency bonds), foreign investors charted a 5.3 billion US dollar net purchase. Taken together, portfolio investment produced total net inflows of 1.8 billion US dollars in 2008. Other investment transactions posted a 6.3 billion US dollar deficit, up from one year earlier. The increased deficit is explained by higher drawing on corporate lines of credit spurred by heavy corporate foreign exchange demand to pay for imports in 2008. In contrast, drawing on government program loans came slightly below the original target. The undisbursed portion of program loans, amounting to about 111 million US dollars, will be carried over to program loans in 2009.

External influence on the 2008 balance of payments was also visible in key balance of payments ratios. In analysis by structure, the capital and financial account was again dominated by portfolio capital inflows and external debt, both susceptible to external shocks. Although exports showed quite positive performance, expanding in ratio to GDP from the preceding year, the much more vigorous growth in imports meant that the current account charted only a thin surplus.

Indicators of external vulnerability in relation to foreign debt showed further improvement, in keeping with the still positive performance of exports. Indonesia's external debt position at 149.0 billion US dollars in December 2008 was still offset by expansion in the domestic economy, including a positive trade balance. Easing of the debt service burden was visible in various debt burden indicators, with progressive decline in the debt to GDP ratio, debt to export ratio and the debt service ratio at levels within the safety limits established by the World Bank.

Tables 4: Indonesia Outstanding and Repayment Foreign Debt

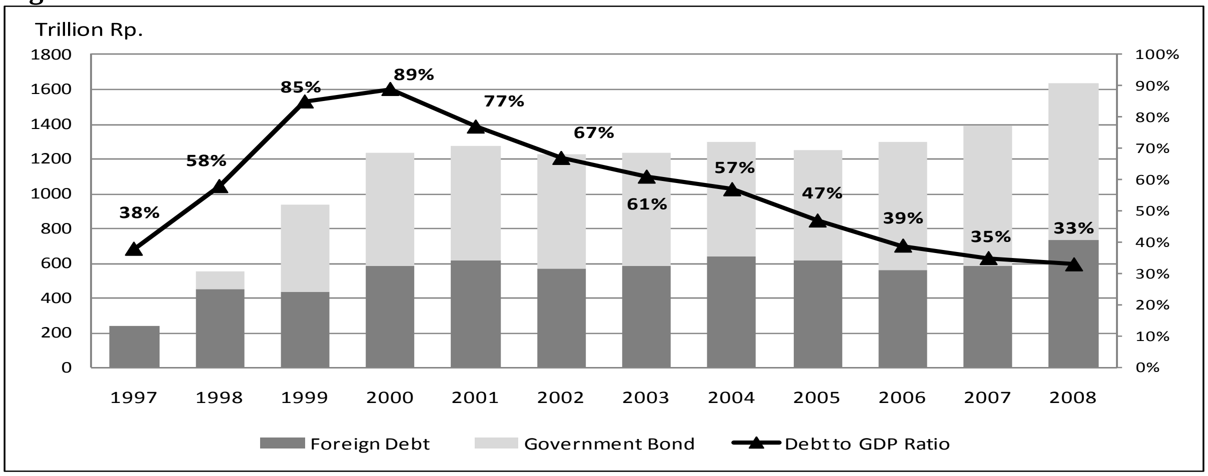
million of US$

	2006		2007		2008	
	Outstanding	Repayment	Outstanding	Repayment	Outstanding	Repayment
Government	67,722	17,056	69,340	9,189	77,821	9,355
Private	50,983	22,681	53,909	27,463	60,651	35,710
Financial Institution	6,560	10,402	7,465	11,315	8,807	16,939
Non-Financial Institution	44,423	12,279	46,444	16,148	51,843	18,771
Others						
Securities Owned by Non Resident	6,646		13,391		10,668	
Total	128,736	39,737	136,640	36,652	149,141	45,065

Notes
1. Excluding currency and deposits and other debt plus liabilities in SDDS IMF Report
2. Including overseas branches

Source: Bank Indonesia and BPS-Statistics Indonesia

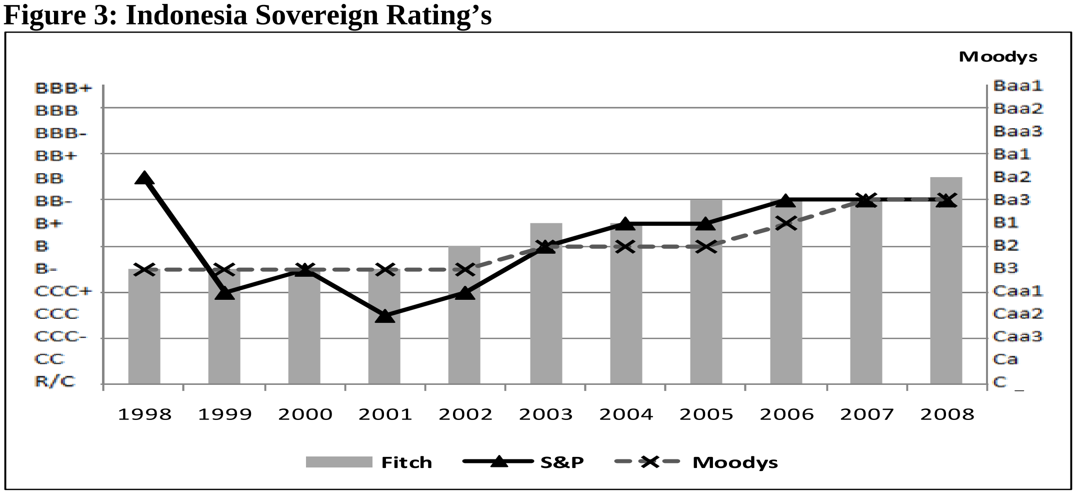
Figure 2: Trend Debt to GDP Ratio



Source: Ministry of Finance

The trends in external debt described above are closely linked to the upgrading of Indonesia's sovereign rating amid the wave of downgrading on the global level. During the first half of 2008, Indonesia's sovereign credit rating was upgraded in line with the solidly maintained fundamentals of the economy. Fitch Rating, the international rating agency, upgraded Indonesia one notch to BB (from BB- previously) in February 2008. This is one indication that investment risk in Indonesia is being regarded in a more favorable light by international rating agencies, although Indonesia has yet to reach investment grade. The improvement in rating also received positive responses from creditor countries and multilateral financial institutions, enabling the Government and also private sector borrowers to raise external debt on more favorable terms and conditions.

Figure 3: Indonesia Sovereign Rating's



Source: Ministry of Finance

(3) Foreign Direct Investment

The rise in net inflows of FDI to Indonesia has taken place in two main surges, with support from policies for trade and investment liberalization. First was characterized by the rapid growth in FDI in export-oriented manufacturing of textiles and textile products, as indicated by expansion in textile exports during the 4 years leading up to 1993. The second wave of FDI growth took place in early 1995 in response to the investment liberalization policy of June 1994 that eased restrictions on foreign ownership, lowered import tariffs and opened some sectors previously declared closed to foreign investment.

The slowing FDI growth in Indonesia is also evident from the relatively limited change in Japanese FDI in Indonesia compared to other developing nations in Asia. The FDI stock of Japanese companies in Indonesia plunged by a drastic near 10 billion US dollars from the pre-crisis level of 17.2 billion US dollars in 1996 to 7.9 billion US dollars at the end of 1997. One decade later, in 2006, this FDI position stood at only 7.5 billion dollars, with investment rising to 8.3 billion US dollars in 2007. This contrasts dramatically with Thailand, where Japanese FDI was almost on par with the 1996 level before mounting to 20 billion US dollars at the end of 2007. Similarly, when compared with other countries in the region, such as Singapore, Malaysia and the Philippines, Indonesia has charted the slowest post-1997 crisis growth in FDI from Japan.

The government has already made various efforts to attract foreign investors to invest in Indonesia. The objective of the effort is to improve business certainty. Through Law no. 25/2007 of foreign investment and Presidential Instruction no. 6/2007 of policies to accelerate the development of the real sector and the empowerment of micro, small and medium size businesses, government guarantees the certainty of foreign business in Indonesia from the risk of nationalization, the determined of open and closed business sectors, and integrated services of better structured bureaucracy.

Tables 5: FDI in Indonesia by Economic Sector

million of US$

Sector	2001	2002	2003	2004	2005	2006	2007
Manufacturing	(1,724)	(1,169)	(450)	834	5,265	1,691	3,413
Financial Institution	84	1,409	667	238	781	1,028	1,268
Trade	(129)	230	(353)	(214)	60	382	249
Construction	(305)	39	61	(18)	130	85	205
Mining-Quarrying	(234)	(242)	232	98	1,227	322	240
Agriculture	(119)	385	180	141	12	230	396
Services	(406)	(677)	(933)	228	547	591	1,046
Housing	(342)	0	0	(18)	18	(14)	(4)
Others	(104)	168	2	607	301	599	116
TOTAL	(3,279)	145	(596)	1,896	8,337	4,914	6,929

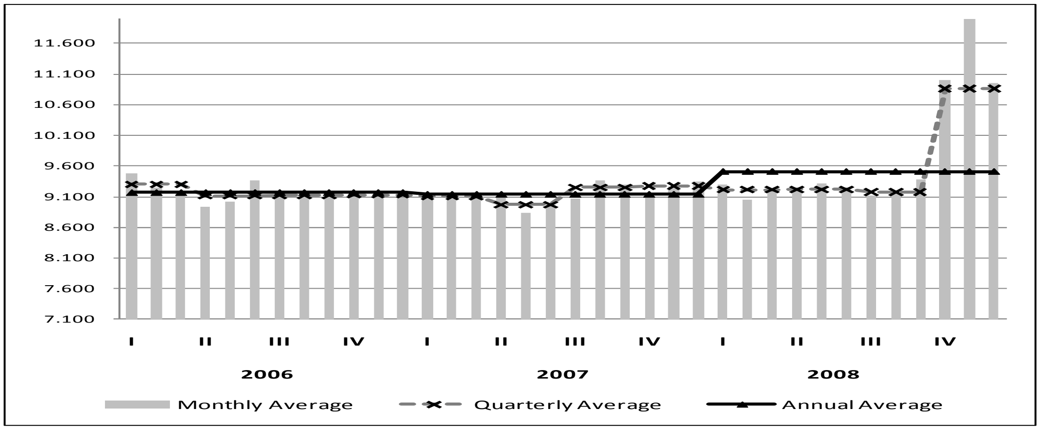
Source: Bank Indonesia and BPS-Statistics Indonesia

(4) Exchange Rate

In general, the rupiah exchange rate movement was stable up to September 2008, supported by the performance of the current account and prudent macroeconomic policy. Nonetheless, the rupiah came under pressure accompanied by increased volatility in the fourth quarter of 2008. The dynamics of the rupiah exchange rate during 2008 were influenced to a large degree by developments in the global financial crisis, turbulent commodity prices and slowing global economy which led to deteriorating investor perceptions and market expectations. This external turmoil produced very wide fluctuation in the rupiah, especially since the beginning of the fourth quarter of 2008. Nevertheless, consistent and prudent macroeconomic policy accompanied by actions to stabilize the rupiah was generally sufficient to curb excessive pressures.

During 2008, the exchange rate saw considerably higher volatility compared to the previous year, while maintaining a depreciating trend. Averaged over the year, the rupiah weakened 5.4 percent from Rp9,140 per US dollar in 2007 to Rp9,666 per US dollar in 2008. At year end, the rupiah was trading at Rp10,900 per US dollar, having lost 13.8 percent (point-to-point) from the previous year-end close at Rp9,393 per US dollar. The depreciation of Rupiah it was followed regional currencies condition.

Figure 4: Average Rupiah Exchange Rate



Source: Bank Indonesia and BPS-Statistics Indonesia

II.1.2 Domestic Environment

(1) Economic Growth Rate (GDP)

During 2008 as a whole, Indonesia's economic growth reached 6.1 percent (yoy), ahead of neighboring countries even in spite of the significant impact of the world economic slowdown on the domestic economy, most importantly in QIV-2008. Analyzed by distribution, private consumption and exports again dominated GDP in 2008. However, the share of private consumption to GDP eased in comparison to 2007, in contrast to the mounting share of exports. GDP is explained to some extent by export growth driven by soaring commodity prices in the first half of 2008. Accordingly, export demand and private consumption retained their place as the most important contributors to total economic growth in 2008.

On the demand side, the effect of weakening global demand in the first half of 2008 was still offset by high world commodity prices. As a result, exports and investments maintained growth. The vigorous growth in exports and investment bolstered public purchasing power, with household consumption forging ahead in the first half of the year. In the second half of 2008, however, Indonesian exports were hit by the downturn in global economic growth and heightened uncertainty on financial markets, and slowed significantly during the final quarter of the year. The worsening outlook for the world economy also prompted business to postpone investment spending and to pursue efficiency improvements, resulting in slowed investment growth with knock-on effects on public purchasing power. Some businesses began lay off workers, driving down purchasing power even further. On the other hand, softening domestic demand was matched by reduced need for imports, with import growth slowing considerably in the last quarter of 2008.

Table 6: GDP Growth and GDP Components Distribution on Demand Side

Items	2005	2006	2007	2008 I	2008 II	2008 III	2008 IV	2008
1) GDP Growth (%)								
Total Consumption	4.3	3.9	4.9	5.5	5.5	6.3	6.4	5.9
Private Consumption	4.0	3.2	5.0	5.7	5.5	5.3	4.8	5.3
Government Consumption	6.6	9.6	3.9	3.6	5.3	14.1	16.4	10.4
Investment	12.4	1.3	2.0	18.4	10.7	9.5	12.5	12.6
Domestic Demand	6.3	3.2	4.1	8.7	6.8	7.2	7.9	7.7
Net Exports	12.0	12.8	6.8	(1.7)	(1.9)	9.0	25.5	7.3
Exports of Goods and Service	16.6	9.4	8.5	13.6	12.4	10.6	1.8	9.5
Imports of Goods and Service	17.8	8.6	9.0	18.0	16.1	11.0	(3.5)	10.0
GDP	5.7	5.5	6.3	6.2	6.4	6.4	5.2	6.1
2) Distribution of GDP (%)								
Total Consumption	67.3	66.3	65.4	63.9	64.5	63.7	69.2	65.3
Private Consumption	59.6	58.3	57.6	57.6	56.7	55.7	58.9	57.2
Government Consumption	7.7	8.0	7.8	6.4	7.8	7.9	10.4	8.1
Investment	24.4	23.4	22.5	23.9	23.4	23.9	24.3	23.9
Domestic Demand	91.7	89.7	87.9	87.8	88.0	87.6	93.5	89.2
Net Exports	8.8	9.4	9.5	9.7	9.2	8.5	10.9	9.6
Exports of Goods and Service	45.3	47.0	48.0	50.5	50.8	48.9	48.0	49.6
Imports of Goods and Service	36.5	37.6	38.6	40.8	41.6	40.5	37.1	40.0

Source: Bank Indonesia and BPS-Statistics Indonesia

Despite slowing growth in the last two quarters of 2008, investment growth for 2008 overall reached 12.6 percent (yoy), up from the previous year. Analyzed by component, investment growth in 2008 was driven mainly by non-construction investment, estimated to have climbed 28.1 percent (yoy). This represents a sharp increase over growth in 2007. In contrast, construction investment grew by an estimated 7.6 percent (yoy), down from one year earlier. Growth in Government investment is also estimated lower due to the low rate of realized Government capital expenditures. The strong investment growth during the January-November 2008 period was dominated by Foreign Direct Investment (FDI), in contrast to sluggish performance in domestic investment. The largest share of FDI flowed into the transportation and telecommunications sector, while domestic investment was led by manufacturing.

In disaggregation by sector, slowing growth marked several sectors during 2008, most importantly manufacturing, mining, trade, construction and services. Slowing growth in manufacturing, mining and trade resulted mainly from sagging external demand and falling commodity prices. Contrasting this was improved growth in some sectors, notably agriculture, electricity, gas and water utilities and the transportation and communications sector. Growth in agriculture benefited not only from the influence of rising global food prices, but also improving productivity and climatic conditions. In the electricity, gas and water utilities and transportation and communications sectors, growth was fuelled primarily by vigorous domestic demand. Analyzed by contribution to growth in 2008, the most important sectors were manufacturing, the trade, hotels and restaurants sector and transportation and communications.

Table 7: GDP Growth and GDP Components Distribution on Sector

Items	2005	2006	2007	2008 I	2008 II	2008 III	2008 IV	2008
1) Growth (%)								
Agriculture	2.7	3.4	3.4	6.3	4.8	3.4	4.7	4.8
Mining and Quarrying	3.2	1.7	2.0	(1.7)	(0.5)	2.1	2.1	0.5
Manufacturing	4.6	4.6	4.7	4.3	4.2	4.3	1.8	3.7
Electricity, Gas Water Supply	6.3	5.8	10.3	12.3	11.8	10.4	9.3	10.9
Construction	7.5	8.3	8.6	8.0	8.1	7.6	5.7	7.3
Trade Hotel and Restaurant	8.3	6.4	8.4	6.9	8.1	8.4	5.6	7.2
Transportation and Communication	12.8	14.2	14	18.3	17.3	15.5	15.8	16.7
Finance Rental and Business	6.7	5.5	8.0	8.3	8.7	8.6	7.4	8.2
Service	5.2	6.2	6.6	5.9	6.7	7.2	6.0	6.4
GDP	5.7	5.5	6.3	6.2	6.4	6.4	5.2	6.1
2) Distribution of GDP (%)								
Agriculture	14.5	14.2	13.8	13.8	14.3	14.7	11.8	13.7
Mining and Quarrying	9.4	9.1	8.7	8.4	8.2	8.1	8.4	8.3
Manufacturing	28.1	27.8	27.4	27.1	26.7	26.5	26.9	26.8
Electricity, Gas Water Supply	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7
Construction	5.9	6.1	6.2	6.2	6.2	6.2	6.5	6.3
Trade Hotel and Restaurant	16.8	16.9	17.3	17.2	17.3	17.5	17.7	17.4
Transportation and Communication	6.2	6.8	7.3	7.7	7.8	7.9	8.6	8.0
Finance Rental and Business	9.2	9.2	9.4	9.6	9.5	9.3	9.8	9.5
Service	9.2	9.2	9.3	9.3	9.3	9.1	9.6	9.3

Source: Bank Indonesia and BPS-Statistics Indonesia

If the world economic slowdown persists, some industry subsectors have potential for significant downturn due to weakening external demand. These are subsectors in which a significant proportion of output is exported, i.e. non-ferrous basic metals production, bamboo, wood and rattan-based manufacturing and the oils and fats industry. Confirmation of these indications is provided by the Bank of Indonesia production survey index for export-oriented subsectors, which underwent significant decline in QIV-2008.

(2) Inflation

Overall, inflationary pressure in 2008 stood reasonably high. CPI inflation climbed sharply during 2008 to 11.06 percent (yoy) from the previous year's level recorded at 6.59 percent. The inflationary pressure was fuelled by surging global commodity prices, led by oil and food. Analyzed by category of goods, the rise in 2008 CPI inflation is explained by increases in the transportation, foodstuffs and processed food categories. Higher inflation in the transportation category was related primarily to the 28.7 percent hike in subsidized fuel prices in May 2008. The steep inflation in the foodstuffs and processed food categories at 16.35 percent and 12.53 percent respectively, was linked most importantly to heavy pressure from imported inflation, especially in early 2008. Other high inflation categories included the housing, water, electricity and fuels category driven by rising household fuel prices in line with the kerosene to LPG conversion program.

Table 8: Inflation and its Contribution by Categories

Categories	Weight (100%)	Based on 2007 = 100 (% yoy)		
	2007=100	2006	2007	2008
Food Stuff	19.6	12.9	10.7	16.4
Processed Food, Beverages, Cigarette and Tobacco	16.6	6.4	5.7	12.5
Housing, Water Supply, Electricity, Gas and Fuel	25.4	4.8	4.9	10.9
Clothing	7.1	6.8	7.5	7.3
Medical Care	4.4	5.9	3.5	7.9
Education, Recreation and Sport	7.8	8.1	6.9	6.7
Transportation, Communication and Financial Service	19.1	1.0	0.5	7.5
CPI	100.0	6.2	5.6	11.1

Source: Bank Indonesia and BPS-Statistics Indonesia

Analyzed by influencing factors, mounting CPI inflation in 2008 is explained mainly by heightened inflation in administered prices. Government decisions concerning administered prices, most importantly to raise subsidized fuel prices May 24, 2008, combined with escalating global foodstuff prices were responsible for escalating inflationary pressure. Core inflation similarly mounted, but more from increased pressure from external factors and inflation expectations. Pressure from the demand side temporarily heightened, but subsequently weakened during QIV-2008.

Table 9: Core and Non-Core Inflation and Its Contribution

Percent (yoy)

Year	Core		Volatile Foods		Administered Prices		CPI
	Inflation	Contribution	Inflation	Contribution	Inflation	Contribution	Inflation
2006	6.0	3.5	15.5	2.7	1.8	0.4	6.6
2007	6.3	3.8	11.4	2.1	3.3	0.7	6.6
2008	8.3	5.5	16.5	2.6	15.9	2.9	11.1

Source: Bank Indonesia and BPS-Statistics Indonesia

(3) Money Supply

The movement in monetary indicators in 2008 was also strongly affected by global factors and the dynamic of the domestic economy. Mounting global pressures in the second half of 2008 also led to temporary liquidity shortage on the money market. Moreover, privately held demand deposits saw markedly reduced growth alongside the stock market downturn reflected in the plunging Indonesia Composite Index (ICI). This condition has led to slowing growth in the narrow measure of money circulating in the economy (M1). With the context of persistent inflationary pressure, this suggests a weakening in purchasing power reflected in the progressively steeper correction in real M1 growth until the end of 2008.

Table 10: Changes in Money Supply and It's Affecting Factors

billion of Rp

Items	2005	2006	2007	2008
1) Money Supply				
M2	169,687	178,859	261,129	240,647
M1	28,087	79,168	99,769	5,537
Currency	15,051	26,693	32,410	25,959
Demand Deposits	13,036	52,475	67,359	(20,422)
Quasi Money	141,600	99,691	161,360	235,110
2) Affecting Factors				
Net Foreign Assets	49,436	100,182	111,438	77,644
Net Claims on Central Government	882	7,587	(9,010)	(118,261)
Net Claims on Business Sector	123,039	98,228	203,925	307,831
Claims on Official Entities	1,140	10,887	17,206	10,419
Claims on Private Enterprises	121,899	87,341	186,719	297,412
Net Other Items	(3,672)	(15,334)	(57,027)	(26,568)

Source: BPS-Statistics Indonesia

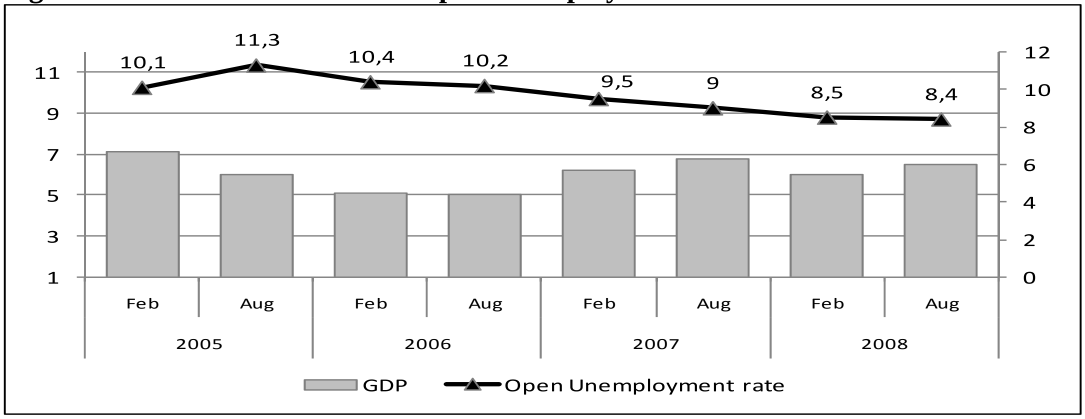
Tight liquidity on the money market was reflected in the rising liquidity premium, which widened progressively for longer tenors. With conditions tightening on the money market, some banks customarily supplying liquidity reviewed their credit lines and credit limits with individual counterparties. Following this, banks with long positions on the money market chose to shift their liquidity to Bank Indonesia short-term monetary instruments, rather than hold cash in interbank placements, to provide greater assurance of their liquidity amid susceptibility to financial market turmoil. Under these conditions, outstanding SBIs fell dramatically from the end-2007 position of Rp247.9 trillion to only Rp179.8 trillion at end-2008.

The relatively tight condition of the money market prompted banks to work more aggressively to mobilize depositor funds. From the end of July, banks competed more vigorously for prime customers by offering high deposit rates. In response to these conditions, Bank Indonesia announced policies including refinements to monetary policy implementation on the rupiah money market and simplification combined with relaxation of the minimum reserve requirement. Banking liquidity quickly improved from the actions taken under these policies and more expansionary Government financial operations at end-2008.

(4) Employment

In August 2008, Indonesia's workforce was recorded at 111.95 million persons, an increase of 470 thousand over February 2008 or 2.01 million persons compared to August 2007. Workforce expansion was also matched by growth in numbers of employed person to 102.55 million, up 503 thousand from February 2008 or 2.62 million compared to the previous August. Open unemployment in August 2008 was down from before at 8.39 percent compared to 10.01 percent in August 2007. The improving condition of the labor market was largely attributable to the first half performance of the agriculture sector in 2008 and the position of agriculture as one of Indonesia's largest sources of employment.

Figure 5: Economic Growth and Open Unemployment



Source: BPS-Statistics Indonesia

Employment was up in all sectors. The strongest employment growth was recorded in the social services sector (1.08 million persons), followed by trade (667 thousand persons) and transportation (220 thousand persons). The rising employment in the transportation and communications sector was consistent with the high growth rate of that sector in 2008. Labor productivity improved in the manufacturing, construction and the transportation and communications sectors, but in other sectors maintained a stable trend.

In 2008, unemployment showed improvement in almost all regions of Indonesia. The steepest reductions in unemployment took place in the Kali-Sulampua and Sumatra regions. Unemployment persisted at high levels in Java, including Jakarta and Banten province. On the other hand, quite low levels of unemployment were again recorded in Bali, Nusa Tenggara, the Maluku and Papua.

II.2 Fiscal Position

Table 11: Summary of Government Finance and Operation

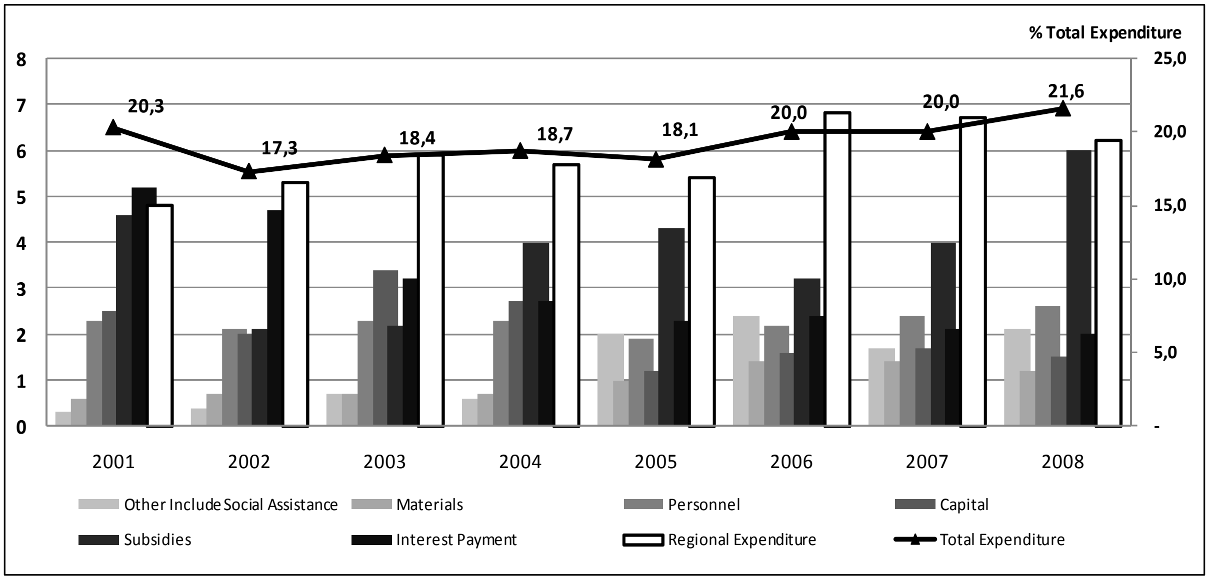
Description	Realization in 2007			2008						
	Amount (Billion Rp.)	Percentage		Stated Budget		Revised Stated Budget		Realization		
		GDP	Revised State Budget	Amount (Billion Rp.)	GDP (%)	Amount (Billion Rp.)	GDP (%)	Amount (Billion Rp.)	GDP (%)	Revised State Budget (%)
1) Total Revenues and Grants	708,658	18.7	102.1	781,354	17.4	894,991	20.0	978,616	21.8	109.3
Domestic Revenues	706,954	18.7	102.4	779,214	17.4	892,042	19.9	976,316	21.8	109.4
Tax Revenues	491,835	13.0	100.0	591,978	13.2	609,228	13.6	658,667	14.7	108.1
Non-Tax Revenues	215,119	5.7	108.4	187,236	4.2	282,814	6.3	317,649	7.1	112.3
Oil and Gas	132,893	3.3	115.9	126,203	2.8	192,789	4.3	168,871	3.8	87.6
Grants	1,704	-	44.3	2,140	-	2,949	0.1	2,300	0.1	78.0
2) Total Expenditures	757,245	20.0	100.6	854,660	19.1	989,494	22.1	985,663	22.0	99.6
Central Government Expenditures	503,977	13.3	101.2	573,431	12.8	697,071	15.5	693,031	15.5	99.4
Personnel Expenditures	903,730	2.4	92.3	128,169	3.0	123,542	2.8	112,763	2.5	91.3
Materials Expenditures	54,150	1.4	87.7	52,397	1.2	67,476	1.5	55,184	1.2	81.8
Debt Interest Payment	79,551	2.1	95.2	91,366	2.0	94,794	2 .1	88,623	2.0	93.5
Subsidies	150,214	4.0	142.9	97,875	2.2	234,405	5.2	275,291	6.1	117.4
Capital Expenditures	64,407	1.7	89.8	101,539	2.4	79,126	1.8	73,273	1.6	92.6
Grants Expenditures	-	-	-	-	-	-	-	-	-	-
Social Assistance	50,678	1.3	97.1	67,402	1.6	59,702	1.3	56,934	1.3	95.4
Other Expenditures	14,604	0.4	56.4	34,683	0.8	38,025	0.8	30,964	0.7	81.4
Regional Budget	253,268	6.7	99.6	281,230	6.3	292,423	6.5	292,632	6.5	100.1
3) Primary Balance		0.8	121.9	18,060	0.4	291	-	-	-	-
4) Budget Surplus/(Deficit)	(42,299)	(1.3)	83.7	(73,306)	(1.6)	(94,503)	(2.1)	(56,407)	(1.3)	59.7
5) Financing	42,299	1.3	-	73,306	1.6	94,503	2.1	56,407	1.3	59.7
Domestic Financing	66,223	1.9	-	89,975	2.0	107,617	2.4	75,115	1.7	69.8
Domestic Bank	8,420	0.4	140.3	300	-	(11,700)	(0.3)	(11,700)	(0.3)	100.0
Domestic Non-Bank	57,803	1.5	96.1	89,675	2.0	119,317	2.7	86,815	1.9	72.8
Privatization (net)	304	-	15.0	1,500	-	500	-	82	0.0	16.4
Sales of Banking Restructuring Program	2,413	0.1	144.8	600	-	3,850	0.1	2,810	0.1	73.0
Government Bond Sales, Net	57,086	1.5	97.6	91,575	2.0	117,790	2.6	85,923	1.9	72.9
Government Investment Funds	(2,000)	(0.1)	100.0	(4,000)	(0.1)	(2,823)	(0.1)	(2,000)	0.0	70.8
Foreign Financing (net)	(2,392)	(0.6)	190.6	(16,669)	(0.4)	(13,114)	(0.3)	(18,708)	(0.4)	142.7
Foreign Withdrawal (gross)	33,998	0.9	80.5	42,989	1.0	48,141	1.1	44,467	1.0	92.4
Amortization	(57,922)	(1.5)	105.8	(59,658)	(1.3)	(61,255)	(1.4)	(63,175)	(1.4)	103.1

Source: Ministry of Finance

II.2.1 Government Expenditure

In the past four years, the realization of the central government budget is largely the realization of the nondiscretionary expenditures. The nondiscretionary expenditures budget ratio to the total central government expenditure in this period increased, from 66.5 percent in 2005 to 68.6 percent of the total estimated realization of the central government budget in 2008.

Figure 6: Trend of Expenditure as Percentage of GDP



Source: Ministry of Finance

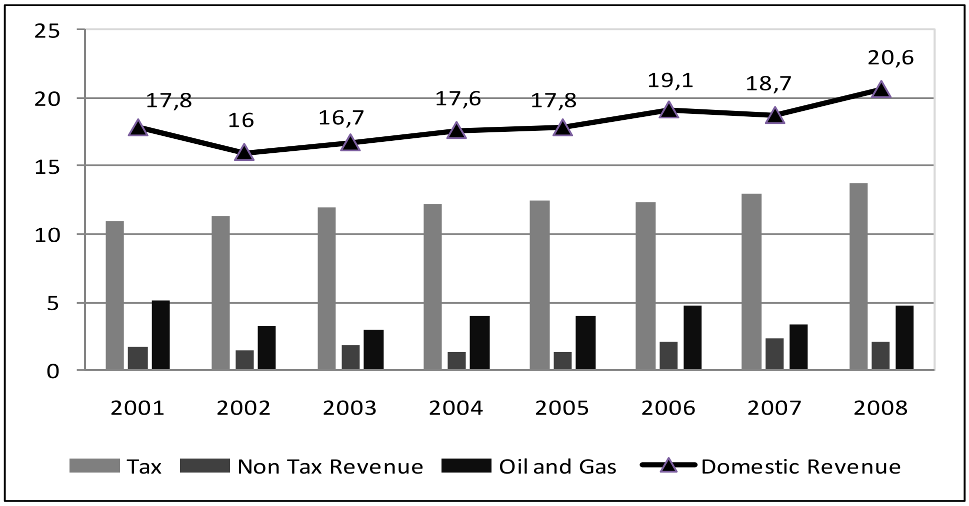
With the shift in policy from the budget allocation of expenditure from goods consumption to capital expenditure and social assistance has create relatively higher direct impact for the national economy, whereas expected growth economy can be further increased. In addition, changes in species composition of this expenditure expected to be healthier state budget, so that the sound of fiscal can be maintained.

With the Central Government reform and improved budgetary allocations policy in the years 2005-2008, the realization of capital expenditure in nominal terms increased by Rp38.3 trillion, or grow an average 29.4 percent per year amount Rp32.9 trillion (1.2 percent of GDP) in 2005 to Rp64.3 trillion (1.6 percent of GDP) in 2007, and is expected to reach around Rp71.2 trillion (1.5 percent of GDP) in 2008. The increase in the realization of significant capital spending in this period shows government attention on the development of infrastructure in Indonesia.

II.2.2 Government Revenue

Revenues and grants mounted significantly in the fiscal outcome of 2008, a result of various Government policies and the impact of macroeconomic conditions. Annual growth in revenues and grants reached 38.6 percent, up considerably from the 2007 growth of 11 percent. Major contributions to this achievement came from the taxation and oil and natural gas sectors. These conditions enabled the revenues and grants outcome to mount to 109.6 percent of the Revised 2008 Budget. In the taxation sector, revenues were up 34.2 percent to 108.1 percent of the Revised 2008 Budget, well ahead of the preceding year's growth of 20 percent. Also reflecting improved taxation performance was the tax ratio at 14.7 percent of GDP, having climbed from the 2007 tax ratio of 12.4 percent of GDP.

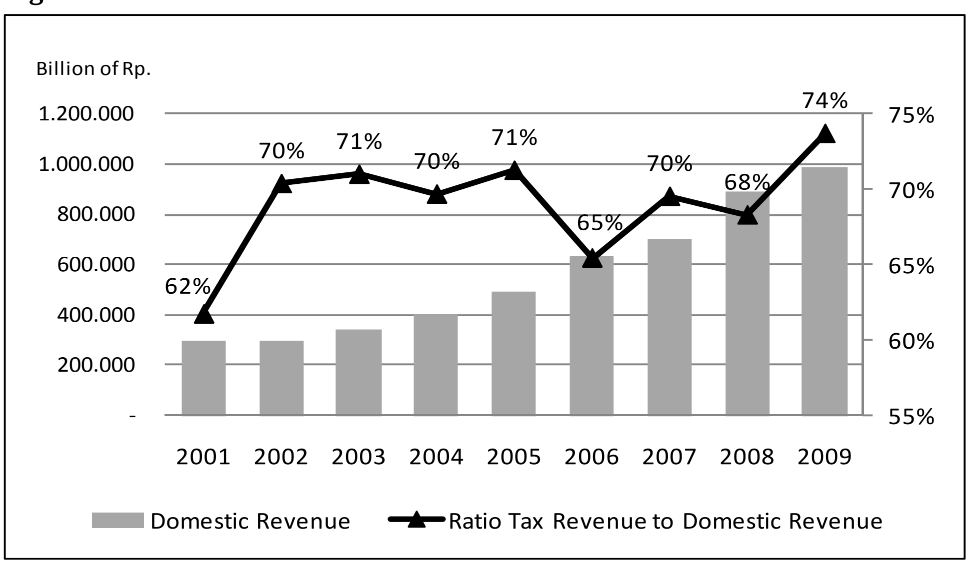
Figure 7: Total Revenue (Percentage of GDP)



Source: Ministry of Finance

This rise in taxation revenues was closely linked to the effects of intensified tax compliance, broadening of the tax base, modernization of tax administration, tax enforcement and other, similar policies. Intensification of tax compliance in 2008 focused on maximizing tax potential in booming sectors, such as the palm oil, coal and construction industries and a program for mapping, profiling and benchmarking of taxpayers. Law enforcement focused on the excise sector in order to eradicate traffic in illegal tobacco. Besides policy enhancements, conditions in the external sector also contributed to more robust tax revenues. Soaring prices for oil and other international market commodities resulted in significant increases in oil and natural gas income tax, import duties and export taxes until about midway through QIII-2008.

Figure 8: Tax Revenue



Source: Ministry of Finance

Table 12: Development of Tax Revenue Component

Fiscal Years	Domestic Tax					International Tax		% Tax Revenue to Total Domestic Revenue
	Income Tax	VAT	Land Building Tax	Excises	Other Tax	Import Duties	Export Tax	
2001	94,576	55,957	6,663	17,394	1,384	9,026	541	61.7
2002	101,873	65,153	7,828	23,189	1,469	10,344	231	70.4
2003	115,016	77,082	10,905	26,277	1,654	10,845	230	71.0
2004	134,904	887,567	14,680	29,172	1,832	12,444	298	69.7
2005	180,253	102,670	17,037	32,245	2,198	16,591	980	71.3
2006	210,714	128,308	21,008	36,520	2,773	16,573	419	63.6
2007 (Audited)	238,431	154,527	29,677	44,679	2,738	16,699	4,237	69.5
2008 (Audited)	305,015	195,464	30,697	45,718	3,354	17,821	11,158	63.6
2009 (Budget)	357,400	249,508	36,669	49,495	4,273	19,160	9,336	73.7

Source: Ministry of Finance

II.2.3 Public Borrowing

The operation of the Revised 2008 Budget was marked by significant excess deficit financing. Until mid-QIII-2008, deficit financing operated smoothly through issuances of Government Bonds. However, in September 2008, the Government Bonds market began to face significant upward pressure in yields. Faced with this situation, the Government decided to halt issuances of Government Bonds from October 2008. Deteriorating bond prices on the international market also led the Government to postpone the issue of foreign currency Sharia Government Securities (SBSN) at end-2008. As a result, the deficit financing outcome in the 2008 budget fell far short of target. At end-December 2008, new issuances of rupiah and foreign currency Government Securities (SBN) totaled only Rp86.9 trillion and 4.2 billion US dollars. After deducting the value of maturing Government Bond (SUN) and buyback transactions, net issuance of Government Securities came to Rp85.9 trillion, considerably below the Rp117.8 trillion targets in the Revised 2008 Budget. Alongside this, the Government engaged in buyback of Government Bond during April, October and November in an effort to stabilize prices for this instrument.

Asset sales under the privatization programmed were on target as of December, while the sale of banking assets by Asset Management Company (PT PPA) fell short. The Government was able to raises about Rp0.6 trillion from privatization sales, slightly above the Revised 2008 Budget target of Rp0.5 trillion. However, PT PPA sales under the bank restructuring program netted only about Rp0.6 trillion, well below the Rp3.9 trillion targets in the Revised 2008 Budget. As a result, net disbursement from external borrowings was under target.

III. Tax Structure: Institutions and the Reality

III.1 Overview of the Role of Taxation in Indonesia

"Pajak" in Indonesian for tax and taxes whereas "perpajakan" is defined as taxation in Indonesian. Indonesian taxation is based on Article 23A of UUD 1945 (1945 Indonesian Constitution), where tax is an enforceable contribution exposed on all Indonesian citizens, foreign nationals and residents who have resided for 183 days or more in any continuous 12-month period. Indonesia has a stratification of taxation including Local Tax (Pajak Daerah) and Central Government Tax. The central government through the Directorate General of Taxes administers national taxes that consist of personal and corporate income taxes, value added tax and land building tax.

Tax revenue has a very important role in sustaining the operation of Government fiscal not only in current expenditure and capital expenditure but also in managing and controlling the macro economics policy. The main sources of revenue to finance government expenditures in the past had been dominated by non-tax revenues, especially that of oil and gas, and foreign loans. In 2008, more than 90 percent of total national taxes revenue was contributed by income tax and VAT. Furthermore, the Indonesian tax revenue structure shows that corporate taxpayers are still the biggest contributor to the state budget. The contribution of individual taxpayers only amounts to 28 percent of the total tax revenue. This is very low compared to the contribution of individual taxpayers in other countries such as in Japan (60 percent).

A severe problem on the revenue side is that the national taxes base extremely small in the country. There are approximately 220 million inhabitants in Indonesia but concerning the income tax, merely only 10 millions are registered as taxpayers supporting the total public expenditure in the country. To improve the current condition requires more reforms and it should be highlighted that an effective, fair and transparent tax administration is prerequisite for good governance. Hence the objective DGT is accelerating the modernization program that is currently being implemented.

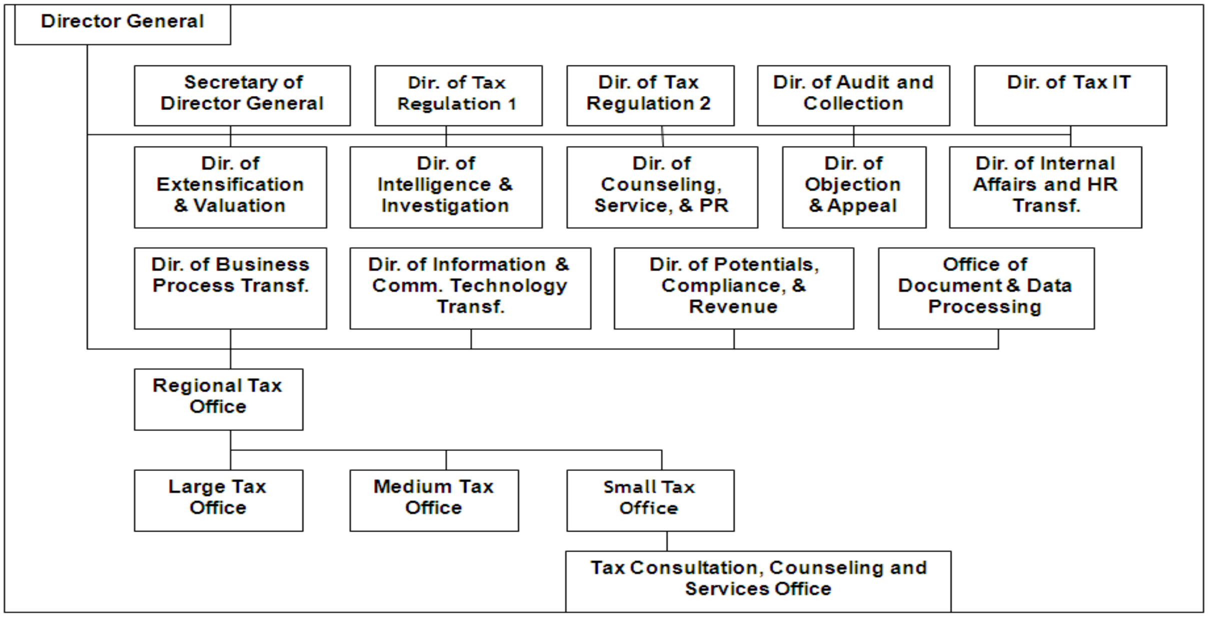
III.2 Tax Administration in Indonesia

The Directorate General of Taxes (DGT) as an Indonesian tax authority plays an important role in collecting revenue for the Indonesian Government. Its vision is to be a world class public service in tax system and management, trusted and honored by people. The mission is to collect domestic taxes revenue effectively and efficiently to support Government's Budget independence based on existing tax regulations. Moreover, the main duties of DGT are: formulating the tax policy, collecting tax revenue, and administering taxation in national scale.

III.2.1 Organization Structure

The Directorate General of Taxes (DGT) is one of the directorates under the Ministry of Finance (MOF). In conducting its operation, DGT is led by a Director General, supported by 1 Secretariat of DGT, 12 Directorates, 1 Large Office of Data and Document Processing, and 31 Regional Tax Offices. Currently, in summary, the tax offices under The Regional Tax Office consist of: 3 Large Taxpayer Offices, 10 Specialized Taxpayer Offices, 28 Medium Taxpayer Offices, 300 Small Taxpayer Offices, and 132 Tax Consultation, Counseling and Service Offices.

Figure 9: Organization Chart



III.2.2 Tax Administration Reform

Tax Administration Reform in Directorate General of Taxes is as parts of The Ministry of Finance of the Republic of Indonesia a comprehensive reform of the public financial management system in customs and tax administration. With respect to tax administration, the Government's objective is to encourage increased and more predictable revenues through improved compliance and a broader tax base. To this effect, the DGT carried out a first phase of reform, which among others consisted in the introduction of Medium and Small Taxpayer Offices, modeled after the two existing Large Taxpayer Offices. The MTOs have been established, and half of the projected 300 STOs. In addition, to lead the first and second phases of the reform, DGT created three Transformation Directorates: Internal Compliance and Resources (which includes Human Resources), Information and Communication Technology Development, and Business Processes

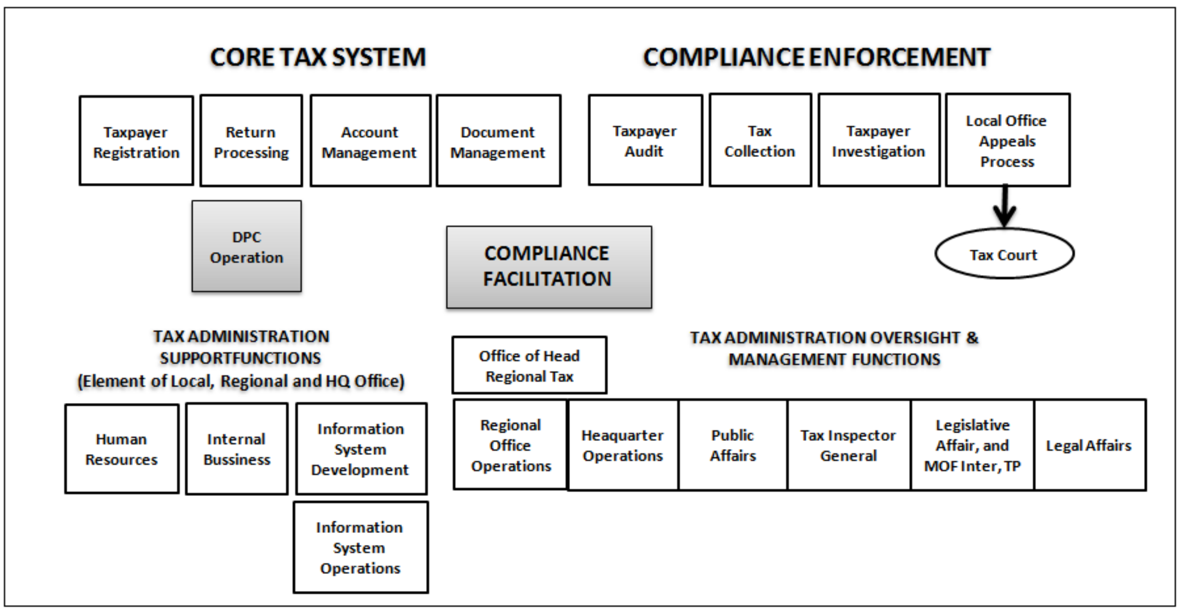
In the second phases of the reform, DGT intend to address the structural issues affecting DGT's efficiency and effectiveness, among which are: need for an upgrade and integration of the core tax systems, improvement of the human resource regime, and strengthening of the oversight and management functions. To this effect, DGT is preparing a Program for Indonesian Tax Administration Reform (PINTAR), to be financed by the World Bank with assistance from other development partners.

To more precisely define the scope of PINTAR, the main functions of DGT have been grouped as described in Diagram below. The Core Tax Systems involve all actions, functions and procedures to process the taxpayer's compliance with the law. These systems need to be improved to better serve the taxpayers, detect and process non compliance and error more efficiently, eliminate unnecessary duplication of data across the systems, and provide reliable and timely statistical and other data for compliance facilitation and enforcement and generally for decision-making. This component will address the management and archiving of all documentation referring to the Registration and Return Processing as well as Compliance Enforcement functions. In addition, this component will address the systems development and maintenance capacity within the two key Tax Administration Support Functions: Information Communications Technology Development and Information Communications Technology Operations. Another key Support Function, Human Resources Management and Development, was deemed to be critical in view of impending changes and the need for highly qualified staff to support the new systems.

Compliance Enforcement involves all actions aimed at the detection of tax evasion, the forced collection of arrears and fines, and the Administrative Appeals Process. These functions have already received considerable support from development partners and will be receiving further support from the World Bank through a Public Financial Management Multi-Donor Trust Fund. Compliance Facilitation is the provision of assistance to taxpayers to ensure that the latter fully enjoy their rights and are able to comply with their obligations without undue costs (in time and money). This function was deemed to have been adequately addressed at present.

Oversight and Management Functions involve planning at the strategic and operational levels, direction, and control. This includes measuring the accomplishment of goals, the performance of the organization and of staff, information quality, process integrity, and service excellence (i.e., quality control and internal auditing). Development partner assistance has been provided in these areas, in particular on the first phases of strategic planning and the beginnings of goal measurement, including conducting surveys for measuring taxpayers satisfaction PINTAR would address the strengthening of Reform Management, including change management and program administration strengthening, improvement of the internal and external communications units, and quality control.

Figure 10: Tax Administration Main Function Groups



III.3 Current Tax System

The 1984 tax reform has been changed Indonesia tax system into the *self assessment system*, where taxpayers are trusted to do their tax obligations, such as: taxpayers must register themselves to tax offices and in return, they will be given a Taxpayer Identification Number (TIN/NPWP), taxpayers themselves calculate all their income, taxpayers themselves calculate the amount of tax owed, taxpayers themselves calculate their tax credits, taxpayers themselves pay the remaining amount tax have to be paid, taxpayers themselves must fill out their tax returns, including all their tax obligations, truthfully, completely, and clearly, and taxpayers submit their tax returns to tax offices. On the other hand, the responsibilities of tax officials are to provide counseling, tax education, tax service, and to monitor (including tax audits) the taxpayers' compliance. The new Tax Law enacted in 1984 stipulates not only the rights of taxpayers, but also their obligations, including administrative penalties and criminal sanctions to taxpayers.

In 2007, the Indonesian Parliament approved the third amendment of the new General Tax Provisions and Procedures Law and also the fourth amendment of the Income Tax Law. The General Tax Provisions and Procedures law were signed by the President on July 17, 2007 and shall come into force as from January 1, 2008, while the Income Tax law were signed by the President on September 23, 2008 and applied from January 1, 2009. Moreover, the third amendment of The Value Added Tax and Sales Tax on Luxury Good Law was passed from Indonesia House of Representative in September 16, 2009 and will come to effect in April 1, 2010.

III.3.1 Corporate Income Tax

(1) Tax Rates

A flat rate of 28 percent applies from 2009 and will be reduced further to 25 percent in 2010. Public companies that satisfy a minimum listing requirement of 40 percent and other conditions are entitled to a tax discount of 5 percent of the standard rate, giving them an effective tax rate of 23 percent in 2009 and 20 percent in 2010. Small enterprises, i.e. corporate taxpayers with an annual turnover of not more than Rp50 billion, are entitled to a tax discount of 50 percent of the standard rate for taxable income of up to Rp4.8 billion.

Table 13: Income Tax Rates for Corporate and Permanent Establishments

Year	Tax Rate	
	Corporate & PE	Qualifying Public Companies [1]
2009	28%	23%
2010 & after	25%	20%

Source: Republic of Indonesia, Law Number 36 Year 2008 on Income Tax Article 17

(2) Taxable Income

The object of tax is income, which is defined as any economic benefit received or accrued by a taxpayer, whether originating from within or outside of Indonesia, which is used for consumption, or which increases the wealth of the taxpayer, in whatever name or form. For a company, income can be defined as follows:

a. Gross profits from business;
b. Gains upon the sale or transfer of property (realized capital gains);
c. Interest, dividends, and royalties (subject to certain exceptions);
d. Rents;
e. Income from debt forgiveness and;
f. Surplus on revaluation of assets (favorable tax rate may apply).

Exchange gains or losses resulting from normal movements in currency exchange rates are, in most cases, included in taxable income in the current fiscal year irrespective of whether they are realized or unrealized. Gains or losses arising from a change in currency rates resulting from a government regulation or decree (revaluation or devaluation) may be subject to special concessions.

(3) Capital Gains Tax

Capital gains and losses are in the main included as ordinary income and taxed accordingly, except for transactions in stock on the Indonesian stock market and on private property. The gain/loss is ignored and tax is instead charged on the transaction value as follows:

Stock	0.1% of transaction value – final,	except for founder shares sold by founder 0.5% of transaction value
Land and building	5 % of transfer value – final tax for individuals and foundations non-final tax for corporations.	

[1] To be eligible, a public company must have at least 40 percent of the outstanding shares owned by at least 300 persons, each holding less than 5 percent, and this condition must be maintained for at least 6 months in a year.

(4) Exempt Income

Excluded from the definition of taxable income are, among others:

a. Gifts or donations that are not related to the business or profession of the parties involved;
b. Dividends received by a resident company from another resident company, provided:
   1. The dividend is sourced from retained earnings;
   2. The recipient owns at least 25 percent of paid up capital.

The holding companies no longer need to undertake any other business activities due to removal of the ”active business” criteria for holding companies. Therefore any interest expense incurred in relation to the holding company’s investment will not be deductible since the dividends received are not taxable.

c. Income received by venture capital companies in the form of profits or dividends, as long as the investee companies meet certain requirements and the companies are not listed on the stock exchange and.
d. Income or profits received by an investment fund company as long as all income or profits are distributed to shareholders.

(5) Deductions

The taxable income is determined after deducting allowable deduction cost from gross income. The lists of allowable deduction cost are as follows:

a. The costs of deriving, recovering and conserving such income including, the costs of materials, wages, salaries of employees, employee bonuses, honoraria, cash allowances, interest, rent, royalties, travel expenses, waste treatment costs, insurance premiums, administrative costs, and taxes other than income tax;
b. Promotional and sales costs;
c. Bad debts, provided strict conditions are fulfilled;
d. Depreciation of the acquisition cost of property and amortization of costs incurred in obtaining rights and other costs that have a useful life of more than one year;
e. “Zakat” donations if paid to an approved body by a Moslem individual or Moslem-owned business;
f. Losses from the sale or transfer of assets;
g. Foreign exchange losses;
h. Costs of research and development performed in Indonesia;
i. Scholarships, apprenticeships and training costs;
j. Donations (as regulated by Government Decree) in relation to: National disasters, Research and development in Indonesia, The provision of educational facilities, and Development of sports;
k. The provisioning of reserves for re-forestation and closure/maintenance of industrial waste storage locations are deductible for these business sectors (as further regulated by Minister of Finance Decree);
l. Goodwill (“Muhibah”) can be capitalized and amortized;
m. Office refreshments;
n. Prior year losses;
o. Contributions to a pension fund approved by the MOF.

Entertainment costs are an allowable deduction where they relate to securing, acquiring and collecting income, but substantiation requirements exist. Full details of each expense are required to be lodged with the annual tax return.

Moreover there are also some non-allowable deductions cost from gross income, the list as follows:

a. Benefits-in-kind (BIKs) (e.g., free housing, 50 percent of the acquisition and maintenance costs of certain company provided cars), except food and drink provided to employees in the workplace, employee benefits required for job performance, such as protective clothing and uniforms, transportation costs to and from the place of work, accommodation for ship crews and the like, the cost of providing BIKs in remote areas, and 50 percent of the acquisition and maintenance costs of cellular phones;

b. Private expenses;
c. Non-business gifts and aid, except Islamic alms (“Zakat”);
d. Provisions: However, certain types of provision d. are claimable as deductible expenses: provision for doubtful accounts for banking and financing companies, insurance claims provision for insurance companies, deposit security provision for the Deposit Security Blanket Institution (LPS), reclamation provision for mining companies, forestation provision for forestry companies, and area closure and maintenance provision for industrial waste processing businesses;
e. Income tax payments;
f. Tax penalties;
g. Profit distributions;
h. Employer contributions for life, health and accident insurance and contributions to unapproved pension funds, unless the contributions are treated as part of the taxable income of employees;
i. Expenses relating to income which is taxed at a final rate, e.g., interest on loans relating to time deposits;
j. Expenses relating to income which is exempt from tax, e.g., interest on loans used to buy shares where dividends to be received are not subject to income tax;
k. Salaries or compensation received by partnership or firm as members where their participation is not divided into shares.

(6) Losses

Losses may be carried forward for a maximum of five years. However, for a limited category of businesses in certain regions or businesses subject to certain concessions, the period can be extended for up to ten years. The carrying-back of losses is not allowed. Tax consolidation is not available.

(7) Capital Allowances

Expenditure incurred in relation to assets with a beneficial life of more than one year are categorized and depreciated from the month of acquisition by the consistent use of either the straight-line or the declining-balance method, as follows:

a. Category 1–50 percent (declining-balance) or 25 percent (straight-line) on assets with a beneficial life of four years. Examples of assets in this category are computers, printers, scanners, furniture and equipment constructed of wood/rattan, office equipment, motorcycles, special tools for specific industries/services, kitchen equipment, manual equipment for agriculture, farming, forestry and fishery industries, light machinery for the food and drink industries, motor vehicles for public transportation, and equipment for the semi-conductor industry.
b. Category 2 – 25 percent (declining-balance) or 12.5 percent (straight-line) on assets with a beneficial life of eight years. Examples of assets in this category are furniture and equipment constructed of metal, air conditioners, cars, buses, trucks, speed-boats, containers and the like. The category also covers machinery for agriculture, plantations, forestry activity, fisheries, and for food and drink, and light machinery, logging equipment, equipment for construction, heavy vehicles for transportation, warehousing, and communication, telecommunications equipment, and equipment for the semi-conductor industry.
c. Category 3 – 12.5 percent (declining-balance) or 6.25 percent (straight-line) on assets with a beneficial life of 16 years. Examples of assets in this category are machines for general mining other than in the oil and gas sector, machines for the textile, timber, chemical, and machinery industries, heavy equipment, docks and vessels for transportation and communication, and other assets not included in the other categories.
d. Category 4 – 10 percent (declining-balance) or 5 percent (straight-line) on assets with a beneficial life of twenty years. Examples of assets in this category are heavy construction machinery, locomotives, railway coaches, heavy vessels, and docks.

e. Building category – 5 percent (straight-line) on assets in the permanent building category with a useful life of 20 years; or 10 percent (straight-line) on assets in the non-permanent building category with a useful life of ten years. Included in the cost of the buildings is the land and building transfer duty (DAL&BR) on building rights.

Intangible property or costs, including the cost of extending building use rights, rights for business use, rights for use and DAL&BR on land rights with a useful life of more than one year, should be amortized on the following bases, as appropriate:

a. By using the straight-line or the declining-balance method at the rates specified in categories 1, 2, 3, and 4 under Depreciation, based on the useful life of the property:
   1. Category 1 - 4 years;
   2. Category 2 - 8 years;
   3. Category 3 - 16 years;
   4. Category 4 - 20 years.

Membership of the category is determined on the basis of the nearest useful life (e.g., an intangible asset with a useful life of six years may fall under Category 1 or Category 2, while an intangible asset with a useful life of five years is under Category 1).

b. The costs of incorporation and expansion of the capital of an enterprise are claimed in full in the year in which the expenditure is incurred or are amortized using either the declining-balance or straight-line method at the following rates:
   1. Category 1 – 50 percent declining-balance; 25 percent straight-line
   2. Category 2 – 25percent declining-balance; 12.5percent straight-line
   3. Category 3 - 12.5 percent declining-balance; 6.25 percent straight-line
   4. Category 4 – 10 percent declining-balance; 5 percent straight-line
c. Costs incurred for acquiring the right to oil and natural gas concessions with a beneficial life of longer than one year are amortized using the production-unit method.
d. Costs incurred in the acquisition of mining rights, forest concessions, and other rights to exploit natural resources and natural products with a beneficial life of longer than one year are amortized using the production-unit method but not may not exceed 20 percent per annum.
e. Costs incurred before the commencement of commercial operations with a useful life of longer than one year are capitalized and amortized according to the rates set out in point 2 (above).

Subject to DGT approval, corporate taxpayers and PEs who maintain rupiah accounting may undertake a revaluation of their non-current tangible assets for tax purposes. This may be carried out once every five years. Each revaluation must include all business-related assets which are owned by the company and located in Indonesia, except for land and buildings (these may be omitted). Before requesting the DGT's approval, the company concerned must determine that it has settled all of its outstanding tax liabilities

The revaluation must be conducted on a market or fair value basis. The market values must be determined by a government-approved appraiser. These are subject to DGT adjustments if the values, in DGT's view, do not represent the fair or market values of the assets. Once approved, the depreciation applied to depreciable assets must be based on the new tax book values (approved values) on the basis of a full useful life (in other words, as if the assets were new). The excess of the fair market value over the old tax book value of the revalued assets is subject to final income tax at a rate of 10 percent. Subject to DGT approval, taxpayers facing financial difficulties may pay this tax in installments over 12 months.

Fixed assets falling under categories 1 and 2 must be retained at least to the end of their useful life. Land, buildings, and assets falling under categories 3 and 4 must be retained for at least 10 years of the revaluation date. Additional final income tax at a rate of 18 percent is imposed on the original revaluation gains if the revalued assets are sold or transferred before the end of this minimum retention period (this does not apply to assets transferred to the government or transferred in the course of a tax-neutral business merger, a consolidation, or a business split).

(8) Dividend

Tax is withheld from dividends as follows:

a. Resident recipients. Dividends received from an Indonesian company by a limited liability company incorporated in Indonesia (PT), a cooperative, or a state-owned company (BUMN/BUMD), are exempt from income tax if the following conditions are met:
   1. the dividends are paid out of retained earnings;
   2. and the company earning the dividends holds at least 25 percent of the paid-in capital in the company distributing the dividends;

If these conditions are not met, the dividends are assessable to the company earning the dividends at the ordinary tax rates alongside the company's other income. Upon declaration, dividends are subject to Article 23 income tax at 15 percent, which constitutes a prepayment of the corporate tax liability for the company earning the dividends.

Dividends received by firma, commanditaires, foundations and similar organizations are always subject to 15 percent withholding tax. Dividends received by resident individual taxpayers are subject to final income tax at a maximum rate of 10 percent.

b. Non-resident recipients: 20 percent (lower for treaty countries) final withholding tax is due on dividends paid to a non-resident recipient.

(9) Tax Residence

A company is treated as a resident of Indonesia for tax purposes by virtue of having its establishment or its place of management in Indonesia. A foreign company carrying out business activities through a permanent establishment (PE) in Indonesia will generally have to assume the same tax obligations as a resident taxpayer.

(10) Tax Payments

Resident taxpayers and Indonesian PEs of foreign companies have to settle their tax liabilities either by direct payments, third party withholdings, or a combination of both. Foreign companies without a PE 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.

a. Monthly tax installments (Article 25 income tax) constitute the first part of tax payments to be made by resident taxpayers and Indonesian PEs. As a prepayment of their current year corporate income tax liability, a monthly tax installment is generally calculated using the most recent corporate tax return. Special installment calculations apply for new taxpayers, finance lease companies, banks and state-owned companies.
b. The tax withheld by third parties on certain income (Article 23 income tax) or tax to be paid in advance on certain transactions (e.g., Article 22 income tax on imports) constitute other prepayments for the current year corporate tax liability of the income recipient or the party conducting the import.
c. If the total amounts of tax paid in advance through the year (Articles 22, 23, and 25 income taxes) and the tax paid abroad (Article 24 income tax) are less than the total corporate tax due, the company concerned has to settle the shortfall before filing its corporate income tax return. Such a payment is referred to as Article 29 income tax.
d. Certain types of income earned by resident taxpayers or Indonesian PEs are subject to final income tax. In this respect, the tax withheld by third parties (referred to as Article 4.2 income tax) constitutes the final settlement of the income tax for that particular income.
e. For foreign companies without a PE in Indonesia, the tax withheld from their Indonesia-sourced income by the Indonesian party paying the income (Article 26 income tax) constitutes a final settlement of their income tax due.

III.3.2 Individual Income Tax

Resident individuals are taxed on their worldwide income, regardless of where such income arises or for whom work or services are performed. Non-resident individuals are exempted from the worldwide income reporting obligation and tax is imposed only on income derived in Indonesia. Deductions are limited to individual personal allowances.

(1) Tax Rates

Most income earned by individual tax residents is subject to income tax at the normal tax rates:

Table 14: Individual Income Tax Rate

Taxable Income	Rate	Tax (Rp)
On the first Rp. 50,000,000.00	5%	2,500,000
On the second Rp. 200,000,000	15%	30,000,000
On the third Rp. 250,000,000	25%	62,500,000
On the fourth and over Rp. 500,000,000	30%	30% of the relevant amount

The following concessional tax rates are applicable to income earned by individual residents in the forms of a lump-sum pension payment from a government-approved pension fund, old-age security saving payments from the state social security organizer (Jamsostek), and severance payments:

Table 15: Individual Lump sum Income Tax Rate

Taxable Income	Rate	Tax (Rp)
On the first Rp.25,000,000.00	---	0
On the second Rp.25,000,000	5%	1,250,000
On the third Rp.50,000,000	10%	5,000,000
On the fourth Rp.100,000,000	15%	15,000,000
On the fifth and over Rp.200,000,000	25%	25% of the relevant amount

(2) Main Personal Relief

Annual non-taxable income (PTKP) for residents individuals are as follows:

Table 16: Individual Main Personal Relief

	Amount
Taxpayer	15,840,000
Spouse	1,320,000
Each dependent (max of 3)	1,320,000
Occupational expenses (5% of gross income, max Rp.500,000/month)	6,000,000
Employee contribution to Jamsostek for pension fund (2% of gross income)	Full amount
Pension maintenance expenses (5% of gross income, max Rp.200,000/month)	2,400,000

Previously, a married woman has to report her income in her husband's tax return unless there is a prenuptial agreement. Based on the new law, a married woman can choose to have her own tax identification number and report her own income tax return separately from her husband. The tax calculation method will be the same as for married couple with prenuptial agreement.

(3) Tax Residence

Indonesian tax law distinguishes between resident and nonresident taxpayers. Residents are defined as individual who are present in Indonesia for 183 days or more in any continuous 12-month period, or who reside in Indonesia during the fiscal years and intend to remain there. Nonresident taxpayers are individuals present in Indonesia for fewer than 183 days with no intention to reside. Nonresidents need not register for tax purposes. Resident individual taxpayers are taxed on their worldwide gross income less allowable deductions and nontaxable income. Nonresident employees in the oil and gas sectors are taxed on deemed salaries based on job titles. The provisions of tax treaties may override these rules.

(4) Taxable Income

Income is defined as any economic benefit received or accrued by a taxpayer that is used for consumption or that increases the wealth of the taxpayer, in whatever name or form. The following types of income are subject to tax:

a. Compensation or payments received or earned in connection with work or services.
b. Lottery, prizes, and awards.
c. Gross profits from individual business activities.
d. Gains from the sale or transfer of assets.
e. Refunds of tax payments already deducted as expenses.
f. Interest.
g. Dividends, in whatever name or form, paid by a corporation, payments of dividends by an insurance company to policy holders.

(5) Tax-Exempt Income

The followings are the types of income which are exempt from tax:

a. Benefits in-kind:
    1. Unless these amounts are taken as a deduction in determining the taxable income of the employers
    2. Unless the employer is tax exempt or is subject to tax on a final tax or deemed profit basis
b. Income tax borne by the employer (unless grossed-up)
c. Gifts or assistance received from a close family member, and religious, educational or social institutions or small scale entrepreneurs including co-operatives, unrelated to the business or profession of the parties involved
d. Inheritances
e. Payments from an insurance company because of accident, illness, or death of the insured, and payments of scholarship insurance
f. Proceeds from disposal of certain domestic mutual fund/investment funds

(6) Tax Payments

A substantial part of individual income is collected through withholding by third parties. Employers are required to Withhold Article 21/26 income tax on a monthly basis from the salaries and other compensation payable to their employees. If an employee is a resident taxpayer, the amount of tax withheld should be based on the normal tax rates (as set out above). If he/she is a non-resident taxpayer, the withholding tax is 20 percent of the gross amount (and may be set at a lower rate under a tax treaty). Various other payments to individuals also call for withholding tax obligations from the payers. These include, among others: pension payments made by government-approved pension funds; severance payments; old-age security saving payments from Jamsostek; scholarships; fees for services; prizes/awards.

Typically the amount of tax withheld from this income is based on normal tax rates. Fees for certain professionals, such as lawyers, notaries, accountants, architects, doctors, actuaries and appraisers, have a special withholding tax rate of 7.5 percent. Interest earned on severance payments transferred to a manpower severance pay management board is subject to a 20 percent final tax, if the board is a bank, or to a 15 percent withholding tax under Article 23, if the board is not a bank.

(7) Deemed Salaries

Expatriate employees working for oil and gas drilling companies are deemed compensated at specified amounts, which vary by position, resulting in the following deemed taxable income:

Table 17: Deemed Salaries

	US $ per month (gross before tax)
General managers	11,275
Managers	9,350
Supervisors and tool pusher	5,830
Assistant tool pushers	4,510
Other crew	3,245

The deemed taxable income takes into account all compensation for their employment.

III.3.3 Withholding Taxes

Indonesian income tax is collected mainly through a system of withholding taxes. Where a particular income item is subject to withholding tax, the payer is generally held responsible for withholding or collecting the tax.

(1) Article 21 – Salaries and Other Payments to Individuals

Employers are required to withhold Article 21 income tax from the salaries payable to their employees and pay the tax to the State Treasury on their behalf. The same withholding tax is applicable to other payments to non-employee individuals (e.g., fees payable to individual consultants or service providers). Resident individual taxpayers without an NPWP are subject to a surcharge of 20 percent in addition to the standard withholding tax.

(2) Article 22 - Imports

Article 22 income tax is typically applicable in the following events:

a. Import of goods;
b. Sale of goods to the government calling for payments from the State Treasury, the State Budget General Directorate, or certain state-owned companies;
c. Sale/purchase transactions of steel, automotives, cigarettes, cement, and paper products.
d. The sale/purchasing of very luxurious goods.

Table 18: The Tax Rate for the Designated Events

Description	Tax Rate	Tax Base
The import of goods- using an Importer Identification (API)	2.5%	Import value, i.e. CIF value plus duties payable
The import of goods- without API	7.5%	Import value, i.e. CIF value plus duties payable
The sale of goods to the government requiring payment from State Treasury and certain state owned company [1]	1.5%	Selling price
The purchasing of steel product [2]	0.3%	
The purchasing of automotive product [3]	0.45%	Selling price
The purchasing of paper product [4]	0.1%	Selling price
The purchasing of cement [5]	0.25%	Selling price
The purchasing of luxury goods [6]	5%	Selling price

Notes:

1. The tax does not apply, either automatically or given an Exemption Certificate issued by the DGT, on the following types of imports:
   a. Goods exempted from import duties and VAT;
   b. Good that have been temporarily imported (i.e., goods for re-export);
   c. Goods for re-importing (i.e., to be repaired or tested for subsequent re-exporting).
2. Article 22 income tax constitutes a prepayment of corporate/individual income tax liabilities for all above.
3. In no. (1) Tax collector (State Treasury, state-owned company, etc.) must withhold Article 22 income tax from the amount payable to a particular supplier (vendor). In the other events, the importer or the buyer of the designated goods must pay Article 22 income tax in addition to the amounts payable for the goods imported or purchased.
4. The state-owned companies under (1) include PT Telkom, Pertamina, Bulog, Bank Indonesia, PLN, PT Indosat, PT Garuda Indonesia, PT Krakatau Steel and state-owned banks.

5. Vendors of goods under no's (2) – (6) can only collect Article 22 income from buyers if they have been appointed by the DGT to undertake this role, i.e., if there has been a specific DGT Appointment Decision.
6. Tax exemption applies to certain categories of goods or to the importing/purchasing of goods for non-business purposes.
7. Taxpayers without an NPWP are subject to a surcharge of 100 percent in addition to the standard tax rate.

(3) Article 4 (2) – Final Income Tax

Resident companies, PEs, representatives of foreign companies, organizations, and appointed individuals are required to withhold final tax from the following gross payments to resident taxpayers and PEs:

Table 19: Final Income Tax Rate

Description	Tax Rate
Rental of land and/or buildings	10%
Proceeds from transfer of land and building right	5% ; 1%
Fees for constructions work performance	2% ; 3% ; 4%
Fees for constructions work planning	4% ; 6%
Fees for constructions work supervision	4% ; 6%
Interest on time or saving deposits and on Bank Indonesia Certificates (SBIs) other than that payable to bank operating in Indonesia and to government-approved pension funds	20%
Interest on bonds other than that payable to banks operating in Indonesia and government-approved pension funds [1]	15%
Sale of shares on Indonesian stock exchanges Founder shareholders may opt to pay tax at 0.5% of the market price of their shares upon listing. If they do not opt for this, gains on subsequent sales are taxed under normal rules	0.1%
Income from lottery prizes	25%
Forward contract derivatives [2]	2.5%

Notes:

1. If the recipient is a mutual fund registered with the Capital Market Supervisory Board (BAPEPAM), the tax rate is zero percent for 2009-2010, 5 percent for 2010-2013 and 15 percent thereafter. If the recipient is a non-resident taxpayer, the tax rate is 20 percent or a lower rate in accordance with the relevant tax treaty.
2. Applicable to the "initial margin".

(4) Article 23 – Residents

Certain types of income paid or payable to resident taxpayers are subject to Article 23 income tax at a rate of either 15 percent or 2 percent of the gross amounts:

Table 20: Resident Tax Rates

	Description	Rate
1)	On gross amount for the following payments: Dividends;	15 %
	Interest, including premiums, discounts, and loan guarantee fees;	15 %
	Royalties;	15 %
	Prizes and awards.	15 %
2)	On gross amount for the following fee: Rentals of assets other than land and buildings;	2%
	Technical services;	2%
	Management services;	2%
	Consulting services;	2%
	Appraisal services;	2%
	Drilling services for oil and gas mining except for those performed by a PE;	2%
	Accounting services;	2%
	Mining services other than oil and gas support;	2%
	Support services for oil and gas mining;	2%
	Flight and airport support services;	2%
	Forest felling services;	2%
	Waste processing services;	2%
	Labor supply/outsourcing services;	2%
	Intermediary/agency services;	2%
	Custodianship and storage services except for those performed by stock exchanges, KSEI, and KPEI;	2%
	Sound dubbing services;	2%
	Film mixing services;	2%
	Computer and software-related services;	2%
	Installation services (i.e. of electricity, machinery, or telephone equipment) except for those rendered by qualifying construction companies;	2%
	Maintenance and improvement services (i.e. for electricity, machinery, or telephone equipment) except for those rendered by licensed construction companies;	2%
	Manufacturing services (Maklon);	2%
	Investigation and security services;	2%
	Event organization services;	2%
	Packaging services;	2%
	Provision of space and/or time for the dissemination of information;	2%
	Pest eradication services;	2%
	Cleaning Services;	2%
	Catering Service.	2%

(5) Article 26 – Non-Residents

Resident taxpayers, organizations, and representatives of foreign companies are required to withhold 20 percent tax from the following payments to non-residents:

a. On Estimated Net Income (ENI), being a specified percentage of the gross amount:

Table 21: Non Resident Estimated Net Income

Description	ENI	Effective Tax Rate
Insurance premiums paid to non-resident insurance companies:		
By the insured	50%	20%
By Indonesian insurance companies	10%	2%
By Indonesian reinsurance companies	5%	1%
Sale of non-listed shares by non-residents	25%	5%
Sale by non-residents of a conduit company where serves as an intermediary for the holding of Indonesian company shares/ PE	25%	5%

Where the recipient is resident in a country which has a tax treaty with Indonesia, the withholding tax rates may be reduced or exempted. Refer to withholding tax rates under treaties.

b. On gross amount, the object of tax would be: Dividends; Interest, including premiums, discounts (interest), swap premiums, and guarantee fees; Royalties, rents and payments for the use of assets; Fees for services, work, and activities; Prizes and awards; and Pensions and any other periodic payments. The notional annual is distributions of after-tax profits of a branch or PE. After-tax profits of a PE are exempt from withholding tax if they are reinvested in Indonesia in the form of equity participation in a company established and domiciled in Indonesia for which the PE acts as the founder or one of the founders

III.3.4 Value Added Tax and Sales Tax on Luxury Goods

Value Added Tax (VAT) is typically due on events involving transfers of taxable goods or provisions of taxable services in the Indonesian Customs Area. The taxable events include:

a. Deliveries of taxable goods in the Customs Area by an enterprise;
b. Importation of taxable goods;
c. Deliveries of taxable services in the Customs Area conducted by an enterprise;
d. Use or consumption of taxable intangible goods originating from outside the Customs Area in the Customs Area;
e. Use or consumption of taxable services originating from outside the Customs Area in the Customs Area;
f. Exportation of taxable goods by an enterprise.

Deliveries of taxable goods are defined very broadly and include the following:

a. Deliveries of a title to taxable goods according to an agreement;
b. Transfers of taxable goods according to a leasing-with-option or finance-lease agreement;
c. Deliveries of taxable goods to an intermediary trader or an auction official;
d. Own-use and/or free gift of taxable goods;
e. Remaining taxable goods and certain assets originally not for sale at a company's dissolution;
f. Deliveries of taxable goods within a company (e.g., between branches, or between the head office and its branches) unless the company, at the DGT's approval, centralizes its VAT reporting;
g. Deliveries of goods on consignment.

Table 22: VAT Non-Taxable Goods and Service

Goods	Services
1) Mining or drilling products extracted directly from their sources such as crude oil, natural gas, geothermal energy, sand and gravel, coal before being processed into coal briquettes, iron ore, tin ore, copper ore, gold ore, silver ore and bauxite ore;	1) Commercial art and entertainment services which are g. taxed under regional entertainment tax and Hotel services; 2) Social services such as orphanages and funeral services;
2) Basic commodities needed by society – rice, salt, corn, sago, soy beans, fresh meat, fresh vegetables and fresh fruit	3) Mail services with stamps; 4) Banks (including Syariah Banking), insurance, and finance leasing services;
3) Food and drink served in hotels, restaurants and the like	5) Broadcasting services not for advertising purposes;
4) Money, gold bars and securities.	6) Medical health services; 7) Religious services and Educational Services 8) Public transportation on land and water and i.e. international air transport; 9) Manpower services; 10) Public services provided by the government.

(1) Tax Rates and Tax Base

The VAT rate is typically 10 percent, which can be reduced or increased by the government using a government regulation to 5 percent or 15 percent. However, VAT on export of taxable goods is fixed at zero percent. The effective VAT rate on deliveries and import of tobacco products is 8.5 percent.

VAT for a particular taxable event is calculated by applying the VAT rate to the relevant tax base. In most cases, the tax base is the transaction value agreed between the parties concerned. For certain events or situations, other parameters must be used as the tax base, including:

a. Market value for transactions between related parties, remaining inventories of taxable goods at a company's dissolution, and sales of (non-inventorial) assets originally not for sale;
b. Cost of sales for own-use or free gifts and internal deliveries of taxable goods (e.g., between branches, from the head office to branches);
c. Auction price for deliveries of taxable goods to an intermediary trader of an auction officer;
d. 10 percent of selling price for used cars;
e. 5 percent of the total service charges, provisions, and discounts for factoring services;
f. Average selling price for video and audio recording products;
g. 4 percent of total costs incurred or paid, exclusive of the acquisition price of land, for the self-construction of a building;
h. Retail selling prices for deliveries or import of tobacco products;
i. 10 percent of the actual billing for package shipment services.

By law all goods and services, unless stated differently, constitute taxable goods or taxable services. The legal negative list sets out the following goods and services categorized as non-taxable goods or non-taxable services:

(2) Relief for Export Manufacturers

There are a number of relief schemes to allow exporter manufacturers to operate on a virtually VAT and duty-free basis. Such schemes include bonded zones, economic development zones (KAPET) and free trade areas. The Government has approved a number of Bonded Areas located throughout Indonesia. Free trade areas and free ports are located in Indonesia but are considered outside the customs area and, therefore, goods brought into these areas are exempt from import duties, VAT and STLG. Business activities that can be carried out in a free trade area include, among others, trade, services, mining, transportation, banking and manufacturing. Sabang, Batam, Bintan and Karimun are currently the free trade areas in operation.

An import incentive is granted to a manufacturer who imports raw materials to be used for processing, assembling, or installing in goods, provided those goods will be 100 percent exported. A manufacturer must be registered in order to be entitled to this incentive. A bank guarantee or customs bond is required for the full amount of the import duty, excise, VAT and STLG that would otherwise have been payable. When the goods are exported, the guaranty or bond is released. A refund can be granted on any import duty, excise and tax paid on imported goods that are later used in producing items for export. Under this facility, 25 percent of the goods may be sold on the domestic market provided the duties and taxes are paid on that portion.

(3) VAT Reporting

Companies and individuals designated as taxable enterprises are bound to report their business activities and settle VAT liabilities thereon on a monthly basis. Typically VAT is to be accounted for on a decentralization basis. Hence, a company carrying out business activities through a number of business units (branches) in the working areas of different tax offices (KPP) must register each with the relevant KPP. It is in this context that internal deliveries of taxable goods within a company are subject to VAT.

Based on specific DGT approval, a company may centralize its VAT reporting and thereby may exclude internal deliveries of taxable goods from the VAT scope. To obtain DGT approval, a company must satisfy a number of conditions, including sales administration centralization and the restriction of the business units to be centralized from any deliveries of taxable goods. However, companies who file e-tax returns may choose to centralize their VAT reporting without regard to the fulfillment of the other conditions, merely by submitting a written notification to the DGT.

Despite this default VAT reporting basis, companies registered with certain tax service offices (Special Tax Office, Large Tax Office, and Medium Tax Office) are required to centralize their VAT reporting. VAT liabilities are typically to be settled by an input-output mechanism. A vendor of taxable goods or a taxable service is typically to charge VAT to the buyer. From the vendor's perspective, it is an output tax. The buyer has to pay the VAT to the vendor which, from its perspective, is an input tax. To the extent that the goods are relevant for running the buyer's business, the input tax can be credited against its own output tax. Similarly, the vendor will also offset the output tax against its own input tax on the acquisition of taxable goods or taxable services. If the accumulated output tax for a particular month exceeds the accumulated input tax for the same period, the taxpayer concerned has to settle the difference by the 15th of the following month. On the contrary, if the accumulated input tax for a particular month exceeds the accumulated output VAT, the taxpayer may ask for a refund on a monthly basis or carry over the overpaid VAT to the following months.

Import VAT on goods and self-assessed VAT on the consumption or use of foreign taxable services or intangible goods may be understood in the context of the standard input-output mechanism. Because the non-resident vendor or service provider cannot charge VAT (issue tax invoices) to the Indonesian buyer/importer, the Indonesian buyer/importer has to pay the VAT for and on behalf of the non-resident vendor or service provider. To the extent that goods/services imported or procured are relevant for running the importer/service recipient's business, the input VAT (import VAT and self-assessed VAT) should be claimable as a tax credit.

A deviation from the standard mechanism, however, prevails for deliveries of taxable goods and services to VAT collectors. Presently, a VAT Collector can be either the State Treasury or a PSC company including Pertamina.

(4) Input-Output Mechanism

As the name implies, a VAT Collector is required to collect the VAT due through a taxable enterprise (vendor) on the delivery of taxable goods or services to it and to pass the VAT payment directly to the government rather than to the vendor or the service provider. A company engaged in deliveries of taxable goods or services to a VAT Collector tends accordingly to be in an overpaid VAT position.

VAT must be accounted for to the DGT on a monthly basis. Input tax for a particular tax period (month) in principle must be claimed as a tax credit against the output VAT of the same tax period. However, the claim can still be made within three months after the end of that particular tax period to the extent that the input tax has not yet been expensed or a tax audit has not yet commenced.

The validity of particular tax invoices is keys to successfully claiming the input tax as a tax credit. A tax invoice must contain the following minimum information to qualify as a standard tax invoice:

a. The name, address and tax ID number of the taxpayer delivering the taxable goods or services;
b. The name, address and tax ID number of the purchaser;
c. The type of goods or services, the quantity, the sales price or compensation and any discounts;
d. The VAT that has been collected;
e. The sales tax on luxury goods that have been collected (if any);
f. The code, serial number and date of issue of the invoice;
g. The name, position and signature of the authorized g. signatory to the invoice.

Failure to satisfy the minimum information requirement will classify the tax invoice as just a simple tax invoice, which cannot be claimed as a tax credit.

Moreover, a tax invoice must be issued in the allowable time. In a particular situation, a tax invoice can be issued within two months after the occurrence of the underlying event (a delivery of taxable goods or services without any payment). Issuing a tax invoice in the next three months, in a particular situation, may still preserve the status of the tax invoice as a standard tax invoice; however, at this stage, the issuer is liable to an administrative penalty at 2 percent of the VAT base. Issuing a tax invoice after the three month period, besides triggering the same administrative penalty, will render the VAT invoice completely invalid. For the purpose of crediting input tax, the DGT deems the following documents to bear the status of a standard tax invoice:

a. Import declarations (PIBs) together with tax payment slips or tax collection slips issued by Customs;
b. Export declarations (PEBs);
c. Instruction letters for the distribution of milled flour and sugar from the state organizer of staple distribution (Bulog or Dolog);
d. Pertamina delivery invoices;
e. Telephone/telecommunications service bills, electricity bills, airway bills, or delivery bills issued for domestic air transportation services;
f. Tax payment slips for the self-assessed VAT on the use or consumption of foreign taxable services or intangible goods;
g. Sales invoices issued for deliveries of port services.

For new enterprise, taxpayers which not has been started the production can still credited the VAT paid on purchases of capital goods. However, if within a certain time the taxpayers were failed to produce goods the VAT has been credited and has been refund must be re-paid. The time limit for the taxpayers which failed to produce goods is within 3 (three) years from the Input Tax credits, and apply to all business sectors

(5) VAT Refunds

By default, having conducted a tax audit, the DGT has to decide on a VAT refund application within 12 months after receipt of the complete set of the application. If no decision is made within 12 months, the application is considered legally approved.

If overpaid VAT has resulted from export activities or deliveries of taxable goods and services to VAT Collectors, the DGT's time to issue a decision is reduced to two months for low-taxable companies or four months for high-risk taxable companies. If no decision is made within these time periods, the application is by law considered approved. Nevertheless, if the VAT refund application is processed in the course of a complete tax audit, the 12-month period rule applies.

For this purpose, the following types of companies (exporters and/or suppliers taxable goods or services to tax collectors) are categorized as low-risk taxable companies:

a. Manufacturers who process at least 75 percent of their products using their own manufacturing facilities;
b. Public companies (having their shares listed in Indonesian stock exchanges);
c. State-owned companies.

The other companies are categorized as high-risk taxable companies.

Relevant supporting documents for a VAT refund must be delivered to the DGT within a month of the application date. Any documents delivered beyond a month may be ignored by the DGT in the calculation of the VAT refund.

A taxpayer designated as an obedient taxpayer is entitled to obtain early (pre-audit) VAT refunds. Such a refund is to be based only on a verification of the VAT returns and must be granted within a month after a completed VAT refund application is received. The DGT may conduct a tax audit after the early VAT refund is granted. If it proves, based on the tax audit, that the taxpayer has received a higher VAT refund than it should, the excess amount is subject to an administrative penalty at 100 percent. The obedient taxpayer designation is a status granted by the DGT to taxpayers who fulfill certain criteria, such as filing of tax returns on time within a certain period, no tax in arrears, no criminal involvement, etc. With reference to these criteria, the DGT every year designates certain taxpayers as obedient taxpayers. Once a taxpayer is granted this status, the company is eligible to apply for early VAT refunds. It has to notify the DGT in writing if it does not want to use the privilege.

(6) Sales Tax on Luxury Goods

The VAT law also imposes a STLG on deliveries of luxury goods by manufacturers in Indonesia and on the importation of luxury goods. The rates vary depending on the category of the goods. The new rates range from 10 percent up to 200 percent. Conceptually, this tax is charged only once. Like VAT, no STLG is charged on the export of luxury goods. STLG is calculated by multiplying the applicable rate against the sales price or import price, excluding VAT. The STLG payable on the purchase of luxury goods cannot be credited against the VAT collectable when the goods are subsequently sold. In broad terms, some of the main types of goods subject to STLG include: passenger vehicles; alcoholic beverages; certain food and non-alcoholic beverage products; household appliances and electronic goods; cosmetics and luxury homes and apartments. It is necessary to determine the applicability of the STLG on a case-by-case basis as the rules are complex and subject to change. There is an exemption from STLG on certain items for public use.

III.3.5 Tax Treaties

Indonesia's tax treaties provide for tax benefits in the form of withholding tax exemptions for service fees and for reduced withholding tax rates on dividends, interest, royalties, and branch profits received by residents of a country with which Indonesia has signed a tax treaty. Tax exemption on the service fees is typically granted only if the foreign party earning the income does not have a PE in Indonesia.

To claim the reduced rates, the foreign party must, at a minimum, present its certificate of residence (CoR) to the DGT through the Indonesian party paying the income. Without this document, the party is not entitled to the tax benefit and tax is withheld at a rate of 20%. For interest, dividends, and royalties, only the beneficial owner is acknowledged as the party entitled to the tax treaty benefits. "Beneficial owner" is not clearly defined in the tax law and regulations. However, conduit companies, pass-through companies, paper companies and the like are declared as non-beneficial owners. The withholding tax rates applicable under tax treaties are summarized below:

Table 23: Tax Treaties

Country	Dividends		Interest	Royalties	Branch Profit Tax
	Portfolio	Substantial Holdings			
Algeria	15%	15%	15% / 0%	15%	10%
Australia	15%	15%	10% / 0%	15% / 10%	15%
Austria	15%	10%	10% / 0%	10%	12%
Belgium	15%	10%	10% / 0%	10%	10%
Brunei	15%	15%	15% / 0%	15%	10%
Bulgaria	15%	15%	10% / 0%	10%	15%
Canada	15%	10%	10% / 0%	10%	15%
China	10%	10%	10% / 0%	10%	10%
Czech Republic	15%	10%	12.5% / 0%	12,5%	12,5%
Denmark	20%	10%	10% / 0%	15%	15%
Egypt	15%	15%	15% / 0%	15%	15%
Finland	15%	10%	10% / 0%	15% / 10%	15%
France	15%	10%	15%/10%/ 0%	10%	10%
Germany [1]	15%	10%	10% / 0%	15% / 10%	10%
Hungary [4 5]	15%	15%	15% / 0%	15%	20%
India	15%	10%	10% / 0%	15%	10%
Iran [9]	7%	7%	10% / 0%	12%	7%
Italy	15%	10%	10% / 0%	15% / 10%	12%
Japan	15%	10%	10% / 0%	10%	10%
Jordan [4]	10%	10%	10% / 0%	10%	20%
North Korea	10%	10%	10% / 0%	10%	10%
South Korea [2]	15%	10%	10% / 0%	15%	10%
Kuwait [5]	10%	10%	5% / 0%	20%	10% / 0%
Luxembourg [1]	15%	10%	10% / 0%	12,50%	10%
Malaysia [7]	15%	15%	15% / 0%	15%	12,50%
Mauritius [6]	10%	5%	10% / 0%	10%	10%
Mexico	10%	10%	10% / 0%	10%	10%
Mongolia	10%	10%	10% / 0%	10%	10%
Netherlands [3]	10%	10%	10% / 0%	10%	10%
New Zealand [4]	15%	15%	10% / 0%	15%	20%
Norway	15%	15%	10% / 0%	15% / 10%	15%
Pakistan [1]	15%	10%	15% / 0%	15%	10%
Papua New Guinea [9]	20%	15%	15%/10%/ 0%	15%	20%
Philippines	20%	15%	15%/10%/ 0%	15%	20%
Poland	15%	10%	10% / 0%	15%	10%
Portuguese	10%	10%	10% / 0%	15%	10%
Qatar	10%	10%	10%	5%	10%
Romania	15%	12,50%	12.5% / 0%	12.5% / 15%	12,50%
Russia	15%	15%	15%	15%	12,50%
Seychelles	10%	10%	10% / 0%	10%	20%
Singapore	15%	10%	10% / 0%	15%	15%
Slovakia	10%	10%	10% / 0%	15% / 10%	10%
South Africa [4 5]	15%	10%	10% / 0%	10%	20%
Spain	15%	10%	10% / 0%	10%	10%
Sri Lanka [4]	15%	15%	15% / 0%	15%	20%
Sudan	10%	10%	15% / 0%	10%	10%
Sweden	15%	10%	10% / 0%	15% / 10%	15%
Switzerland [1 8]	15%	10%	10% / 0%	12,50%	10%
Syria	10%	10%	10%	20 % / 15%	10%
Taiwan	10%	10%	10% / 0%	10%	5%
Thailand	20%	15%	15%	15%	20%
Tunisia	12%	12%	12% / 0%	15%	12%
Turkey	15%	10%	10% / 0%	10%	10%
Ukraine	15%	10%	10% / 0%	10%	10%
United Arab Emirates	10%	10%	5% / 0%	5%	5%
United Kingdom	15%	10%	10% / 0%	15% / 10%	10%
United States	15%	10%	10% / 0%	10% / 0%	10%
Uzbekistan	10%	10%	10% / 0%	10% / 0%	10%
Venezuela	15%	10%	10% / 0%	20% / 10%	10%
Vietnam	15%	15%	15% / 0%	15%	10%

Notes:

1. Fees for technical, management and consulting services rendered in Indonesia are subject to withholding tax at rates of 5 percent, 7.5 percent, 10 percent and 15 percent for Switzerland, Germany, Luxembourg and Pakistan respectively.
2. VAT is reciprocally exempted from the income earned on the operation of ships or aircraft in international lanes.
3. A re-negotiated tax treaty has been effective since 1 January 2004. The zero-rated tax on qualifying interest is suspended pending an agreement between the Indonesian and the Dutch tax authorities regarding the method of application.
4. The treaty is silent concerning branch profit tax rate. The Indonesian Tax Office (KPP) interprets this to mean that the tax rate under Indonesian Tax Law (20 percent) should apply

5. Tax only applies if the profits are remitted
6. Effective only from 1 January 1999 to 31 December 2004.
7. Subject to protocol ratification, Labuan may be excluded from the territory of Malaysia for tax treaty purposes and the withholding tax on interest, dividends, and royalties may be reduced to 10 percent.
8. Subject to r ratification, the tax on royalties may be reduced to 10 percent.
9. Not yet effective, pending the exchange of ratification documents.

(1) Thin Capitalization

Indonesia does not have specific thin capitalization rules. However, the general law authorizes the Indonesian Ministry of Finance to determine the debt-to-equity ratio of companies for tax calculation purposes.

(2) Controlled Foreign Companies

To curb tax evasion by resident taxpayers through offshore investments, the Ministry of Finance is authorized to determine when a dividend is deemed to be derived from a foreign company established in certain countries where an Indonesian resident taxpayers holds at least 50 percent of the paid-up capital of the foreign company or together with other resident taxpayers, holds at least 50 percent of the paid-up capital. This applies only if the foreign company does not trade its share on the stock exchange.

If no dividends are derived from offshore company, the resident taxpayers must calculate and report the deemed dividend in its tax return; otherwise, the Ministry of Finance will do so. The dividend is deemed to be derived either in the fourth month following the deadline for filling the tax return in the offshore country, or seven months after the offshore company's tax year ends if the country does not have specific tax filing deadline requirement.

III.3.6 Stamp Duty

Stamp duty is nominal and payable as a fixed amount of either Rp6,000 or Rp3,000 on certain documents. Examples of documents subject to stamp duty are as follows:

(1) Letters of agreement and other letters (such as authorization letters, letters bestowing gifts, or declarations) which are prepared for the purpose of being used as evidence of act, fact, or condition of a civil nature.
(2) Notary's deeds and their copies.
(3) Deeds prepared by a designated land notary ("Pejabat Pembuat Akta Tanah").
(4) All documents bearing a sum of money which:
a. State the receipt of money;
b. State the recording or deposit of money in a bank;
c. Contain notification of a bank balance;
d. Contain the acknowledgement of debt wholly or partly paid or compensated;
e. Are in the form of valuable documents such as drafts, promissory notes, or acceptances;
f. Are in the form of securities, in whatever name or form;
g. Are in the form of cheque.
(5) Documents to be used as instruments of evidence before a court:
a. Ordinary letters or internal papers
b. Paper originally exempt from stamp duty on the basis of their purpose of use, if they serve other aims or are used by other parties, and deviate from their original purpose.

The Rp6,000 rate is applicable to (1), (2), (3), and (5). For (4), the rate is Rp.6,000 when the money value stated in the document is more than Rp1 million, and Rp3,000 when the value is between Rp250,000 and Rp1 million. Values below Rp250,000 are not subject to stamp duty. For cheque, the rate is Rp3,000 regardless of the monetary value stated.

III.3.7 Land and Building

(1) Land and Building tax

Land and Building (L&B) tax is a type of property tax chargeable on every piece of land and/or building unless stated differently. The negative list containing L&B not subject to L&B tax includes those: used merely for the public interest in the areas of religious and social affairs, health, education and national culture, and not for the purpose of profit earning; used for a cemetery, ancient heritage or the like; constituting protected forests, natural reserve forests, tourism forests, national parks, Grazing land controlled by a village, and state land not yet charged with any right; used by a diplomatic representative, based on the reciprocal treatment principle; used by an agency or representative of an international organization, as determined by the MOF.

L&B tax rate is specified at 0.5 percent. The actual tax due for a particular object is calculated by applying the tax rate to the taxable sale value (NJKP) of the object. NJKP is a predetermined proportion of the sale value of the tax object (NJOP) of a particular L&B. NJKP is currently stipulated to be either 20 percent (for NJOP up to Rp1 billion) or 40 percent (for NJOP above Rp1 billion). The government can increase the NJKP rate up to 100 percent of the NJOP. Hence, the effective L&B tax at present is either 0.1 percent or 0.2 percent of the NJOP.

NJOPs are to be determined by the DGT on behalf of the MOF and may be updated every one to three years depending on the economic development of the relevant regions. In accordance with MOF guidelines, NJOPs should take into account the market value of the L&B in the relevant regions. Where a piece of L&B is used for a business in the areas of plantation, forestry, mining, or breeding, the NJOP should also take into account the investment standard applicable thereon. L&B tax is payable annually pursuant to an official assessment issued by the DGT. The assessment process is typically initiated by the DGT submitting a Tax Object Notification Form (TONF) to a particular taxpayer. The form must be filled out by the taxpayer with the relevant data and returned to the DGT within 30 days. Based on the completed TONF and taking into account the NJOP-related information, the DGT issues a Tax Due Notification Letter (TDNL), presenting the official tax assessment made by the DGT. The taxpayer concerned has to pay the tax due within 6 months of receipt of the TDNL. Incorrectly filling in a TONF, late filing of the completed TONF, or ignoring the TONF can expose a taxpayer to a potential penalty of 25 percent of the L&B tax due.

An individual or an organization that “owns a right to a piece of land, and/or takes benefits there from, and/or owns, controls, and/or takes benefits from a building” can by law be regarded as the L&B tax taxpayer in respect of that piece of land and/or building. Each taxpayer is entitled to a non-taxable NJOP, which at present is stipulated to be Rp12 million. The MOF is authorized by law to make adjustments to the non-taxable NJOP.

(2) Tax on land and building rights transfer

A transfer of L&B rights will call for a tax on L&B right transfers to be charged to the transferor. The tax is specified to be 5 percent of the gross transfer value (tax base). This tax must be paid by the time the rights to L&B are transferred to the transferee. In general, the tax base is the higher of the transaction values stated in the relevant L&B right transfer deed or NJOP. However, in a transfer to the government, the tax base is the amount officially stipulated by the relevant governmental officer in the relevant document.

In a government-organized auction, the gross transfer value is the value stipulated in the relevant deed of auction. If the transferor is a corporate taxpayer not engaged in the property development business, the tax paid will constitute a prepayment of its corporate tax liability (Article 25 income tax). This tax is exempt if the transferor is a corporate taxpayer engaged in the property development business and the transfer is undertaken in the course of its business activities. Foundations and individual taxpayers, including individuals engaged in the business of L&B rights transfers, are also required to pay this tax on the transfers of L&B rights. In this respect, this tax constitutes a final tax. A notary is prohibited from signing a transfer of rights deed until the above taxes have been fully paid.

(3) Duty on the acquisition of land and building rights

A transfer of L&B rights will typically also give rise to a liability of DAL&BR to the party receiving or obtaining the rights. Qualified L&B rights transfers include sale-purchase and trade-in transactions, grants, inheritances, contributions to a corporation, rights separations, the buyer designation in an auction, and the execution of a court decision with full legal force, business mergers, consolidations, expansions, and prize deliveries. Acquisitions of L&B rights in certain non-business transfers may be exempt from DAL&BR. DAL&BR is to be based on the Tax Object Acquisition Value (NPOP), in most cases being the higher of the market (transaction) value or the NJOP of the L&B rights concerned. The tax due for a particular event is determined by applying the applicable duty rate (5 percent) to the relevant NPOP minus an allowable non-taxable threshold. The non-taxable threshold amount varies by region, the maximum being Rp60 million, except for inheritance which may reach Rp300 million. With a government regulation, the government may change the non-taxable threshold.

DAL&BR is typically due on the signing date of the relevant deed of L&B right transfer before a public notary. In a business merger, consolidation, or expansion, the duty is due on the date of signing of the merger, consolidation or expansion act. In an auction, the duty is due on the signing date of the Auction Report by the authorized officer. At the request of a taxpayer, the DGT may grant a DAL&BR reduction of up to 50 percent in respect of L&B rights transfers in business mergers or consolidation at book value as well as L&B rights obtained as compensation for the release of L&B rights for a public-interest governmental project. In certain non-business L&B rights transfers, at the request of a taxpayer, the DGT may also grant DAL&BR at 25 percent, 50 percent or 75 percent of the duty due. A notary is prohibited from signing a deed transferring rights until the DAL&BR has been paid.

III.3.8 Tax Incentives

(1) Investment in Certain Business Fields and or Certain Regions

Special treatments are granted to taxpayers who invest capital in certain sectors and or in certain regions, regardless they are domestic corporation (domestic capital or foreign capital) or foreign corporations. Generally, a taxpayer will qualify for the Incentives below if they can fulfill the requirements that investment in certain business anywhere in Indonesia or investment in the certain business in certain area in Indonesia. Within 6 years after the receiving the approval on such incentives, the Company is not allowed to use the Approved Assets for other purposes or transfer all or part of the Approved Assets unless they are replaced with other new assets.

The tax facilities for the selected sectors/regions comprise of 4 incentives:

a. Additional deductible expense in the form of Investment Allowance in the amount of 5 percent of Investment per year up to maximum of 6 years. The Investment shall be the cost of acquisition of fixed assets including land for main business activities (Approved Assets).
b. Accelerated depreciation or amortization of assets.
c. Withholding tax on dividend paid or payable to offshore at 10 percent or at the rate of prevailing tax treaty, whichever is lower.
d. Maximum 10 years of loss carry forward.

Tax incentives that are offered in Government Regulation No. 62 Year 2008 dated September 23, 2008 on Income Tax Facilities for Investment, comprised of following certain industries: Food Seasoning Industries; Textile Industries; Pharmacy Materials Industries; Rubber Goods for Industry Purposes Industries; Laboratories and Porcelain Electrical/Technical Equipment Industries; Iron and Steel Making, Steel Rolling Industries; Basic Non-iron Metals Industries; Machines and Their Equipment Industries; Electric Motor, Generator, and Transformator Industries; Electronics and Telematics Industries; Ground Transport Equipment Industries; Boat and Ship Making and Repairing Industries; Basic Non-Iron Metal Making Industries.

(2) Bonded Zones

The industrial companies which are located in the bonded areas are provided with many incentives as follows;

a. Exemption from import duty, excise, income tax of Article 22, Value Added Tax on Luxury Goods on the importation of capital goods and equipment including raw materials for the production process.
b. Allowed to divert their products amounted to 50 percent of their export (in term of value) for the final products, and 100 percent of their exports (in term of value) for other than final products to the Indonesian customs area, through normal import procedure including payment of customs duties.
c. Allowed to sell scrap or waste to Indonesian custom area as long as it contains at the highest tolerance of 5percent of the amount of the material used in the production process.
d. Allowed to lend their own machineries and equipments to their subcontractors located outside bonded zones for no longer than 2 years in order to further process their own products.

Exemption of Value Added Tax and Sales Tax on Luxury Goods on the delivery of products for further processing from bonded zones to their subcontractors outside the bonded zones or the other way around as well as among companies in these areas.

(3) Foreign-Grant or Foreign-Loan-Funded Governmental Projects

Goods, materials and construction equipment imported by a main contractor in connection with an approved government project funded by foreign loans or grants are entitled to the following relief:

a. Exemption from import duty;
b. No collection of VAT and STLG and
c. Income tax is borne by the government for primary contractors, consultants and
d. Suppliers working on such projects.

(4) Sunset Policy

Following the amendment of Tax Administration Law No 28 Year 2007, the Ministry of Finance issued the implementing regulation of Regulation Article 37A concerning Limited Tax Amnesty Policy (called the Sunset Policy). The Sunset Policy is applicable for both corporate and individual taxpayers who have been registered as taxpayer before January 2008 (old taxpayers), and also to individuals who just registered as taxpayer in 2008 (new taxpayers). The old taxpayers will not be charged with interest on underpaid tax declared in returns if: they submit their annual income tax return of 2006 and/or prior years showing underpayment of tax, no later than December 31, 2008, or they revise and submit their annual income tax return of 2006 and/or prior years showing underpayment of tax no later than June 30, 2008, or they submit the 1st revision (only) of their annual income tax return of 2006 and/or prior years showing underpayment of tax between July 1 and December 31, 2008. The new taxpayers will not be charged with interest on underpaid tax declared in returns if: they submit their annual income tax return of 2007 and/or prior years, no later than March 31, 2009, or; they revise and submit their annual income tax return of 2007 and/or prior years no later than June 30, 2008, or; they submit the 1st revision of their annual income tax return of 2007 and/or prior years (1st revision only) and file it between July 1 and December 31, 2008.

If the old taxpayers revise their annual income tax return of 2006 and/or prior years; or if the new taxpayers revise their annual income tax return of 2007 and/or prior years, and they file it between July 1, 2008 and December 31, 2008, then the revised annual income tax returns will not be subject to the Sunset Policy, meaning that they have to pay interest due to the late payment of income tax. In addition to the above “interest free” incentive, the said annual income tax returns or revised annual income tax returns will basically be “tax audit free”, meaning:

a. Should there be an on-going audit to income tax (only), the audit will be discontinued.
b. Should there be an on-going audit to all kind of taxes, the audit will be discontinued if:
    1. Income tax due based on the newly reported or revised income tax returns are bigger than the tax due based on the result of on-going audit; and
    2. Other taxes are not overpaid; and
    3. There is no evidence of criminal acts

c. Should there be an on-going audit to taxes other than income tax, such tax audit will continue if:
    1. The relevant non income tax returns claimed tax overpaid; or
    2. There is evidence of criminal acts; or
    3. The Audit Results Notification Letter (SPHP) has already been issued to the taxpayer.

III.3.9 Fiscal Exit Tax

Fiscal exit tax amounting to Rp2.5 million is payable by a resident upon each departure by air from Indonesia. Lower amounts apply on departure by sea or overland. This tax represents a prepayment of personal tax if paid by a tax-registered individual. Certain individuals (such as children under the age of 12) are exempted from paying this tax.

(1) Commencing January 1, 2009, fiscal exit tax will be applicable to individual taxpayers (at least 21 years old). If the individual has an NPWP then the fiscal exit tax is waived.

(2) In addition, commencing January 1, 2011, all individual taxpayers will not pay fiscal exit tax, irrespective of whether they hold an NPWP or not.

III.3.10 Accounting for Tax

Generally, for tax purposes a company's books must be maintained in accordance with the prevailing accounting standards unless the tax law stipulates otherwise. By default, the books must be stated in Rupiah, composed in Indonesian, and stored in Indonesia. Based on a specific DGT approval, foreign-investment (PMA) companies, PEs, and subsidiaries of foreign companies can maintain their books in USD and compose them in English. A collective investment contract (KIK) may qualify for maintaining USD accounting to the extent it issues USD-denominated investment funds. An application for DGT approval must be filed with the DGT office no later than three months before the commencement of the USD accounting year. The DGT is bound to decide on the application within a month. If no decision is made within a month, automatic DGT approval applies.

Companies governed by a Production Sharing Contract (PSC) or a Contract of Work (CoW) with the government may opt to apply USD accounting in English merely based on a written notification to the DGT. Such a notification must be submitted to the DGT office no later than a month before the commencement of the USD accounting year. A company may also compose their books in English but still maintain them in Rupiah. In such a case, the company must submit a written notification to the DGT no later than three months after the beginning of the year in which the books are composed in English.

The use of a foreign language other than English and a foreign currency other than USD in a company's books is not allowed. Irrespective of the currency and the language used, companies typically have to settle their tax liabilities in Rupiah (except for PSC companies) and file tax returns in Indonesian. With respect to corporate income tax, relevant assertions are to be presented in USD side by side with Rupiah in the annual corporate income tax returns. A company that has obtained approval to maintain USD accounting may return to Rupiah accounting based on a specific DGT approval. Once such approval is granted, the company may not re-apply for USD accounting approval during the 5 years from the cancellation of the USD accounting.

III.3. 11 Tax Assessments and Tax Audits

(1) Tax Assessments

Indonesian taxation relies on a self-assessment system under which taxpayers are trusted to calculate, pay, and report their own taxes by themselves in accordance with prevailing tax laws and regulations. However, the DGT may issue tax assessment letters to a particular taxpayer if it finds that, based on a tax audit or other information the taxpayer has not fully paid its tax liabilities. A tax assessment letter may also be issued by the DGT to a taxpayer who ignores a warning letter to file a tax return in a specified period. Failure to maintain books in accordance with the prescribed standards is another condition that may lead the DGT to issue an official tax assessment.

One tax assessment letter pertains only to one specific tax for one particular tax period or year and typically takes into account the following factors the tax due, the applicable tax credits, the resulting balance between the tax due and the tax credits (overpaid, nil, or underpaid), the administrative penalty (interest or a surcharge).

(2) Types of Tax Assessment Letter

The name of a tax assessment letter refers to the resulting balance between the tax due and the tax credits and accordingly there are three types of tax assessment letters:

a. Overpaid Tax Assessment Letter (OTAL) if the tax due is less than the tax credit amount;
b. Underpaid Tax Assessment Letter (UTAL) if the tax due exceeds the tax credit amount;
c. Nil Tax Assessment Letter (NTAL) if the tax due amount is equal to the tax credit amount.

Where a UTAL is issued, this could include one of the following administrative penalties:

a. Interest at 2 percent per month for a maximum of 24 months;
b. A 50 percent surcharge for income tax liability;
c. A 100 percent surcharge for withholding tax liability;
d. A 100 percent surcharge for VAT and LST liabilities.

Which penalties are applicable will depend on the type of wrongdoing the taxpayer has committed. The penalty amounts are determined by applying the relevant rate to the underpaid tax amounts.

(3) Statute of Limitation

Under the 2007 tax administration law, the DGT can issue an underpaid tax assessment letter for years up to 2007 only within 10 years after the incurrence of a tax liability, the end of a tax period (month) or the end of (part of) a tax year, but no later than 2013. For years from 2008 onward, the time spans to issue underpaid tax assessment letters is reduced to 5 years.

Once a tax assessment letter for a particular tax of a particular month or year has been issued, additional tax assessment letters may still be issued within the specified time limits (5 or 10 years depending on the tax years) to the extent there is a new data (novum) or certain information which was not (adequately) disclosed in the tax returns and/or during tax audits. The issue of an Additional Underpaid Tax Assessment Letter (AUTAL) will call for a 100 percent surcharge on the tax due as an administrative penalty. However, a taxpayer may avoid the surcharge if they voluntarily notify the DGT of the novum or the undisclosed information.

The tax due reported in a tax return is considered certain if no tax assessment letter is issued within the specified time limit. Nevertheless, a UTAL or AUTAL can still be issued beyond the specified time limit to a taxpayer who, by virtue of a court verdict, is found guilty of a taxation crime after the specified time limits. An UTAL or an AUTAL issued in such a situation will include an interest penalty totaling 48 percent of the underpaid tax.

(4) Tax Audits

According to Article 29 of Law concerning the General Provisions and Tax Procedures, the Directorate General of Taxes is authorized to perform audit to assess tax compliance (consist of risk based audit and routine audit) and for other purposes in respect of the implementation of the tax laws and regulations. Tax compliance audit is generated by 2 cases. The first case is mandatory by tax law in respect to the taxpayer’s rights and obligations, and The second case is audit which performed when DGT detect the risks or tax gap from the bussines sector or specific tax payer which proposed by bottom-up risk analysis and top-down risk analysis.

(5) The Objectives of Tax Audit

In the framework of exercising administrative supervision, the Directorate General of Taxes shall undertake audit for the purpose of assessing tax compliance and for other purposes in respect of the implementation of the tax laws and regulations.

a. Audit for the Purpose of Assessing Taxpayer's Compliance

The audit for the purpose of assessing taxpayer's compliance must be conducted when a taxpayer requests for refund of tax overpayment, however, it may also be conducted in the following conditions:

1. Taxpayer files tax return declaring tax overpayment, including particular taxpayer who has received pre-audit refund of tax overpayment;
2. Taxpayer files tax return declaring loss;
3. Taxpayer does not file tax return or is failure to file tax return on due date stated in Letter of Reprimand;
4. Taxpayer exercises merger, acquisition, spin off, liquidation, dissolution, or leaves Indonesia forever; or
5. Taxpayer files tax return selected through risk analysis (risk based selection) whereby there is an indication that tax obligations are not fulfilled.

The scope of audit for the purpose of assessing taxpayer's compliance may cover single tax, several taxes or all taxes. It may be dealt with one or several taxable periods, parts of taxable year, or one taxable year and it may cover previous years as well as the current year.

b. Audit for Other Purposes

The audit for other purposes shall be conducted with regard to implementing of tax laws or tax regulations regarding the following criteria:

1. Issuing taxpayer identification number ex-officio;
2. Terminating taxpayer identification number;
3. Confirming or revoking taxable person for Value Added Tax (VAT) purposes;
4. Taxpayer lodges objection;
5. Collecting material for determination of net deemed profit;
6. Verifying data and or information;
7. Determining whether taxpayer is located at remote area;
8. Designating one or more places where VAT is payable;
9. Audit in the framework of tax collection;
10. Determining the commencement of production or extending the time period of loss compensation relating to granting tax incentives; and or
11. Fulfilling information request from treaty partner country with respect to the implementation of exchange of information of the tax treaty.

The scope of audit for other purposes in respect of the implementation of the tax laws and regulations may cover determination, verification, or collection data and information in accordance to the purpose of audit.

(6) National Audit Plan

In 2008, DGT is developing National Audit Plan (NAP) to assess taxpayer compliance risk with focus on business sector which will be implemented for 2009. The National Audit Plan consists of two risk area levels which are national and regional. In the NAP 2008, Regional Office involve in designing national audit plan. Regional Office expected to enrich NAP with local knowledge in their territory in order to minimize the tax evader.

Table 24: National Audit Plan

	Component	Details
1)	Focus of Audit	
	National	Mining , Oil and Gas; Cement Industry; Basic Metal Industry; Construction; Sales, Service and Repair Car and Motorcycle and Retailers for gasoline; Domestic Wholesaler Except Car and Motorcycle Wholesaler; Retailer Except Car and Motorcycle Retailer and Household Repairing; Exporter; Importer; Star Hotel; Restaurant , Bar, Food and Beverage; Telecommunication; Real Estate; Advertising.
	Regional	The high risk business sector or transaction based on Regional Office inquiry that not selected in National Audit Focus.
2)	Priority of Audit	Routine Audit – Tax Refund Audit Risk Based Audit Other Routine Audit Other Purpose Audit
3)	Scope of Audit	
	Office Audit	Office audit is an audit held at Directorate General of Taxes office. It shall be carried out within 3 months and may be extended for at maximum 6 months as from the date of taxpayer fulfilling summon letter to the date of audit report.
	Field audit	Field audit is an audit conducted at the taxpayer's business premises, or other premises determined by Director General of Taxes. It shall be carried out within 4 months and may be extended for at maximum 8 months as from the date of audit warrant to the date of audit report. In case of transfer pricing audit, field audit may be extended for at maximum 2 years.

(7) Closing conference

At the end of a tax audit, the tax auditors will provide the taxpayer being audited with a written notification of the tax audit findings containing their proposed tax audit corrections. The taxpayer will typically have to respond to the notification in writing within 7 days. In certain cases, at the tax auditors' discretion, the time limit can be extended up to 21 days. By the end of the third week of the notification, a final discussion about the tax audit findings (closing conference) will be held between the tax auditors and the taxpayer.

A closing conference will serve as the last opportunity for the taxpayer to reassert its position with regard to the tax audit corrections and to present the relevant supporting documents. The tax auditors may change some of the suggested corrections in light of the taxpayer's response to the tax audit findings notification and the closing conference discussion. The results of the final discussion are then summarized in a closing conference document. The taxpayer will have to state agree or disagree with each of the proposed corrections therein. The document should also set out which part of the taxpayer's arguments are accepted by the tax auditors and accordingly lead to the cancellation or reduction of some particular suggested corrections. By the end of the closing conference, the tax auditors and the taxpayer have to sign the closing conference document. For certain tax years (2008 onward), the corrections agreed to in the closing conference document will constitute a basis for the minimum amount the taxpayer must pay of the tax assessment issued based on the document.

III.3.12 Tax Collection Using Distress Warrant

Based on a legal tax collection instrument, the DGT may by law issue a Distress Warrant to a taxpayer. The instruments include the following documents:

(1) Tax Collection Letters;
(2) Underpaid Tax Assessment Letters;
(3) Additional Underpaid Tax Assessment Letters;
(4) Tax Objection Decision Letters (which demand an additional payment from the taxpayer);
(5) Tax Court Decisions (which demand an additional payment from the taxpayer);
(6) Correction Decision Letters (which demand an additional payment from the taxpayer).

The relevant taxpayer is required to pay the underpaid tax stated in a tax collection instrument within a month of the instrument date. Any late payments will trigger an interest penalty at 2 percent per month. Filing an objection, a revision request, an appeal, or a lawsuit is not an excuse for suspending the underpaid tax payment.

However, under the 2007 tax administration law, taxpayers are bound to pay only the minimum amount they have agreed in the closing conference provided that they file an objection or an appeal in respect to the particular tax assessment letter. The remaining part of the assessment not agreed during the closing conference will only be due after the DGT decides on the objection or the tax court rules on the appeal not in the taxpayer’s favor.

If the underpaid tax is not paid within the allowable time, as part of the execution of the Distress Warrant, the DGT may undertake the following steps:

(1) Issue a Warning Letter if the underpaid tax is not settled within 7 days of the due date;
(2) Issue a Distress Warrant if the underpaid tax is not settled within 21 days of the Warning Letter being issued;
(3) Issue a Confiscation Order if the underpaid tax is not settled within 48 hours of the Coercion Letter being issued;
(4) Publish an auction announcement with respect to the confiscated assets if the underpaid tax is not settled within 14 days of the Confiscation Order being issued;
(5) Undertake a public auction if the underpaid tax is not settled within 14 days of the auction announcement.

III.3.13 Tax Dispute and Resolution

A tax dispute between a taxpayer and the DGT will typically arise following the issuing of a Tax Collection Letter (TCL) by the DGT which the taxpayer does not agree with. A UTAL, an AUTAL, and a TCL constitute legal tax collection instruments based on which the DGT may issue a Distress Warrant if the taxpayer fails to settle the underpaid tax on time. The way the DGT executes the Distress Warrant may still give rise to another tax dispute between the parties. Apart from this, a tax dispute may also arise between 2 taxpayers because one taxpayer has withheld too much tax from the income payable to the other taxpayer. What follows is a discussion on the ways available to resolve such tax disputes.

(1) Objections and appeals

A taxpayer who does not agree with a tax assessment letter can file an objection with the DGT office within three months of the issue date. The Objection must state the tax due in accordance with the taxpayer’s calculation and set out the reasons for his/her disagreement with the DGT tax assessment. In accordance with the 2007 tax administration law, as far as an underpaid tax assessment is concerned, the taxpayer must pay at least the amount agreed during the closing conference before filing the Objection. With respect the unpaid portion of the assessment penalties will subsequently be applied if the taxpayer’s objection is rejected or a subsequent tax appeal to the Tax Court is unsuccessful. The DGT has to issue a decision on the tax Objection within 12 months of the filing date of the Objection. If no decision is issued by the DGT within 12 months, the objection is automatically deemed approved by the DGT. If the objection is rejected by the DGT, any underpayment is subject to a surcharged of 50 percent. However, the underpaid tax and the surcharge are not payable if the taxpayer files an appeal with the tax court in respect of the objection decision.

An Objection may also be filed by a taxpayer with the DGT office with respect to tax withheld by a third party. The same time limits to file the Objection and for the DGT to decide upon it apply to this type of Objection. A taxpayer who does not (fully) accept the DGT Objection decision can file an Appeal with the Tax Court within three months of the receipt of the DGT Objection. To the extent the DGT Objection Decision calls for a payment of tax due, according to the tax court law, at least 50 percent of the tax due must be settled before filing the Appeal. According to the 2007 tax administration law, this requirement is no longer applicable.. The Tax Court will typically have to decide on an Appeal within 12 months. Any underpaid tax amounts resulting from the tax court decision are subject to a surcharge of 100 percent.

(2) Another avenue for tax dispute resolution

The DGT, following a taxpayer request or by virtue of its official position, may correct or cancel a TCL, or their derivatives issued based on those letters. The derivatives include, among others:

a. Objection Decision Letters;
b. Decision Letters on the Reduction or Cancellation of Administrative Sanctions;
c. Decision Letters on the Reduction or Cancellation of a Tax Assessment;
d. Decision Letters on an Early Refund of Overpaid Tax.

A Correction Request is an alternative for a taxpayer to the Objection by which to solve a dispute with the DGT in respect of a particular tax assessment letter. This avenue is also applicable for other tax disputes arising from virtually any other DGT decision. However, lodging an objection is generally regarded as a more robust approach. The DGT has to issue a decision on an Amendment Request within 6 months of the filing date. If no decision is issued by the DGT within 6 months, the Correction Request is automatically deemed to be approved by the DGT.

Taxpayers who do not (fully) accept the DGT Decision on an Correction Request can file a lawsuit with the Tax Court within 30 days of the receipt of the DGT decision. A lawsuit against the DGT can also be filed with the Tax Court with respect to the execution of Distress Warrant. In this respect, the lawsuit must be filed no later than 14 days of the execution date. The Tax Court will typically have to decide on an appeal within 6 months.

(3) Reconsideration request to the Supreme Court

A Tax Court Decision is considered to be a final decision bearing full legal force. However, the parties involved in a tax dispute may file a Reconsideration Request with regard to a Tax Court Decision with the Supreme Court. This can be done only if any of the following conditions prevail:

a. Reconsideration Request must be filed with the Supreme Court within an allowable time limit. For those pertaining to conditions below, the time limit is 3 months after the condition is identified.
    1. The Decision has been based on a perjury, a deception, or false evidence from the part of the opposing party;
    2. A piece of important written evidence is found, which had it been considered previously would have led to a different Decision;
b. For those pertaining to conditions below, the time limit is 3 months after the court decision.
    1. Some part of the claim has been ignored without reason;
    2. Something not demanded was granted;
    3. The Decision is patently inconsistent with prevailing tax regulations.

IV. Country-Specific Fiscal Issues

IV.1 Income Tax Article 21 Given to the Worker

Ministry of Finance decree number 43/PMK.03/2009 legislate that government would bear the Income Tax Article 21 given to workers, whereas gross income above one month period individual personal relief and not more than Rp5 million. Workers who received this fiscal stimulus are working on three jobs specific business categories, namely agriculture, including plantations and farms, hunting and forestry (74 sub sector),fisheries with 19 sub-fisheries sector and manufacturing industry, which includes 370 business sub-sector.

The definition of workers, as affirmed in Director General of Taxes decree number 64/PJ/2009 is including employees and workers in company branch and from labor providers (outsourcing) which in three business categories mentioned as before. Moreover, workers on a company that does the job-order processing of goods (maklon) that meet the category of job processing industry. Government would bear the Income Tax Article 21 of given tax period February 2009 until November 2009. As of June 2009, Income Tax Article 21 that bears by the government is given to all workers, whether they already have a Taxpayer Identification Number (NPWP) or not. The amount of Income Tax Article 21 that workers would receive for the tax payable is based on the general rate of Income Tax Act excluding the increased tax rates 20 percent higher for those workers who don't have Taxpayer identification number (NPWP).

Income Tax Article 21 bears by the government should be paid in cash by the time income payments (salaries/wages) by the employer to the worker, the amount would be the value of Income Tax Article 21 that withhold by employers. As an example, an employee with gross monthly income Rp5 million, with a status of married and has 2 children and the relevant pension contributions paid Rp25,000 per month, income tax payable Article 21 a month would be Rp153,750. With the Income Tax Article 21 bear by the government, Income Tax Article 21 is not payable the employer paid to the state treasury, but given to the employee add as take home pay. Employee would be enjoying an increase take home pay, so the total income received is Rp4,975,000 (gross income minus pension contributions, without any deduction of Income Tax Article 21). In the case of an employer providing benefits of Income Tax Article 21 to the worker or bore Tax Article 21 payable on the income of workers, Income Tax Article 21 which is supported remains should be given to workers who receive an Income Tax Article 21 bear by the government.

IV.2 Large Taxpayers Office for High Wealth Individual

Large Taxpayer Office for High Wealth Individual is the Tax Office that administered individual taxpayers whom are registered in Jakarta region and meet certain criteria. This is the process of continuing tax administration modernization and form the government appreciation for individual taxpayers. The reason behind the establishment of this office is giving the high level of service to taxpayers in complying with the tax law.

The objectives from the establishment of Large Taxpayer Office for High Wealth Individual are as follows:

(1) Improving service effectiveness and efficiency high wealth individual taxpayers;
(2) Increasing high wealth individual taxpayers their understanding the rights and obligations;
(3) Improving oversight in accordance with the principles of good governance;
(4) Improving voluntary Compliance.

In the other hand, Large Taxpayer Office for high wealth individual would give taxpayers the advantage as follows:

(1) Services and oversight by professional human resources;
(2) A more personal service to enhance the understanding of taxpayer's rights and obligations;

(3) Handling tax issue with principles of transparency and openness;
(4) Providing a quick response and accurate to the taxpayer problems concerning the interpretation of the tax law;
(5) Uniform treatment and consistent for all taxpayers;
(6) Improved services in terms of tax payments through e-SPT and e-Filling.

IV.3 Preliminary Tax Refund Claim for Taxpayer with Certain Criteria

The General Tax Provisions and Procedures Law number 28/2007 article 17 D introduce preliminary tax refund claim for taxpayer with certain criteria such as the turn over limit, the number of deliveries, and the amount of refund claim under the decree of the Minister of Finance. The Minister of Finance decree that regulates this issue is number 193/PMK.03/2007 as amended by the Minister of Finance decree number 54/PMK.03/2009.

Based on this provision, the boundary for individual taxpayer who runs businesses or professional services is individual Taxpayers that practice bookkeeping with:

(1) Reported turn over in the Annual Income Tax Return maximum not exceeding the turn over limits an individual taxpayer that allowed to calculate net income using the standard calculation of net income;
(2) The Income Tax refund claim is less than Rp 1 million;
(3) The Income Tax refund claim not exceeding 0.5percent of the reported business turn over.

Moreover, the eligible Corporate Taxpayer that can be given a preliminary tax refund claim is taxpayers with:

(1) Reported turn over in the Annual Income Tax Return not exceeding Rp5 billion rupiah; and
(2) The Income Tax refund claim is less than Rp10 million.

In Value Added Tax, the Taxpayer that can be given a preliminary tax refund is taxpayer has submitted Income Tax Return and Value Added Tax Return with:

(1) The amount of delivery of taxable good or service according to the Value Added Tax Return in certain tax period maximum Rp400 million; and
(2) The Value Added Tax refund claim is less than Rp28 million.

IV.4 Challenge for Local Government in Administrated Land and Building Tax

Implementation of amendment Regional Tax and Retribution (PDRD) Law No. 28/2009 would decentralize administration of Land and Building Tax from Central Government (DGT) to Local Government. Currently, the Land and Building Tax database reaches 92 million tax objects, and it would be gradually distributed to the regions. As consequent the Local Government infrastructure must have a strong information technology for managing the very large data. If the technology is not sufficient, there would be an error in setting Sales Value of Tax Object (NJOP). Second challenge would be measuring compliance level. The audit of a Land and Building Tax could be problematic for local governments that not supported by the good administration system.

Moreover, in determining the amount NJOP (official assessment), Local Government should be reminded as neutral free from conflicts of interest. In supporting this condition Local Government have to have adequate quality of human resources to optimize revenues because have often found "inability" especially attention to the development and supervision of Land and Building Tax and Transfer.

V. Conclusion: Where We Stand and Where We Go?

V.1 World Economic Crisis

The world economic downturn will inevitably have a major bearing on the Indonesian economy. In order to respond the condition, the Government has prepared in a series of adjustments to macro assumptions.

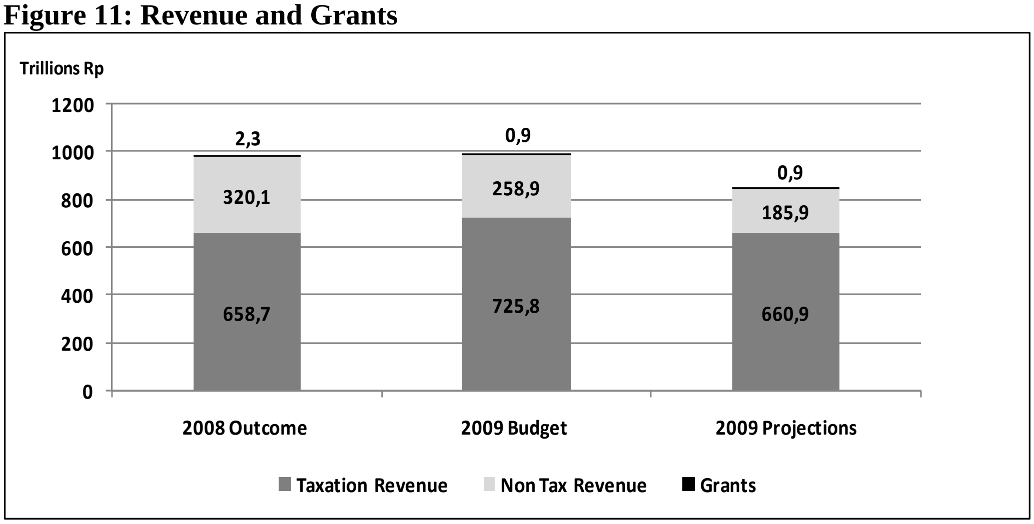
Table 25: Macroeconomic Indicators

Macroeconomic Indicator	2007	2008		2009	
		Target	Outcome	Budget	Projection
Economic Growth	6.3	6.4	6.2	6.0	4.5
Inflation (%)	6.6	6.5	11.1	6.2	6.0
3-Month SBI Rate (%)	8.0	7.5	9.3	7.5	7.5
Exchange Rate (Rp/US$)	9,140	9,100	9,692	9,400	11,000
ICP Oil Prices (US$/Barrel)	72.3	95.0	96.8	80.0	45.0
Crude Lifting (MBCD)	0.9	0.9	0.9	0.9	0.9

The changes in macroeconomic indicators brought about by the global financial crisis have necessitated changes in the targeted state revenues formulated in the 2009 Budget. In response to the changed aggregates, 2009 tax and non-tax revenues are projected significantly lower than before. The reduced taxation revenue projection for 2009 is explained by the smaller tax base suggested by the nationwide drop in income levels brought about by slowing economic activity. Alongside this, the projected reduction in non-tax revenues is largely the result of the changed crude oil price (ICP) assumption from 80 US dollar per barrel to 45 US dollar per barrel.

In the adjustments to the 2009 Budget, taxation revenues were calculated on the assumption of 4.5 percent economic growth, taking into account the effective implementation of the fiscal stimulus. However, if the fiscal stimulus does not proceed according to plan and economic growth drops below 4.5 percent, taxation revenues may fall short of the targeted level in the adjusted 2009 Budget. Tax revenues are targeted at Rp660.9 trillion, down Rp65.0 trillion from the 2009 Budget target. This adjustment to taxation receipts also takes into account the fiscal stimulus already envisaged in the 2009 Budget and the added new fiscal stimulus, such as concerning payroll tax. Alongside this, non-tax revenues are targeted lower at Rp185.9 trillion, or down Rp73.1 trillion from the 2009 Budget level.

Figure 11: Revenue and Grants



To prevent even worse deterioration in the economy due to the impact of the global crisis, the Government launch a countercyclical policy during 2009. The countercyclical policy, consisting of a fiscal stimulus, is aimed primarily at sustaining and/or strengthening public purchasing power to maintain growth in household consumption at 4.0 to 4.7 percent; maintaining corporate/business resilience in the face of the global crisis; and creating employment and mitigating the impact of job losses through the labour-intensive infrastructure construction policy. The total funds allocated for this fiscal stimulus programme amount to Rp 71.3 trillion.

Table 26: Fiscal Stimulus 2009

	Description	Allocation (Trillion Rp.)
1)	Tax Savings	43
	Reductions in Income Tax Rates	32
	Lower Corporate Tax Rate	18.5
	Lower Personal Income Tax Rate	13.5
	Income tax-free band raised to Rp. 15.8 million	11
2)	Tax/Import Duty Subsidies for Business/Targeted Households	13.3
	VAT on oil/gas exploration, cooking oil	3.5
	Import duties on raw materials and capital goods	2.5
	Payroll tax	6.5
	Geothermal tax	0.8
3)	Pro-Business/Jobs Subsidies + Budget Expenditures	15
	Reduce price for automotive diesel	2.8
	Discounted electricity billing rates for industrial users	1.4
	Additional infrastructure expenditures + subsidies + government equity injection	10.2
	Upscaling of Community Block Grants (PNPM)	0.6
Total Stimulus		71.3

V. 2 Anti-corruption Initiatives

Anti-corruption legislation was passed in 1999, including the creation of Commission for Eradication of Corruption (KPTPK). The law amended in 2001 to deal with issues not covered in the original legislation, including rules on gratuities received by public employed. Additional measures were taken in 2004. The institutional framework for fighting corruption was strengthened, through greater autonomy granted to The Anti-Corruption Commission (KPK) and the Anti-Corruption Court.

Future challenge for the Commission is to make the transformation of competency and integrity with other law enforcement agencies through the coordination and supervision of the authority. Another challenge is the ability to select and sort out cases of corruption in the sector, which qualified as a major source of corruption and have deterrent impact on the state and public interests. Recent initiatives to fight corruption include an increase in budgetary appropriations from 2008 to finance an increase in civil servants' compensation by 20 percent, the introduction of payment of a 13th monthly salary to civil servants and an increase in the value of food allowances received by military and police personnel.

V. 3 The Indonesia New Government Challenge

A Constitutional court recently dismissed a petition about alleged electoral irregularities filed by opposition presidential candidates Megawati Sukarnoputri and Jusuf Kalla. The decision would finalize the second term for the incumbent president Susilo Bambang Yudhoyono. The next test for the Indonesian process of democracy would be whether Susilo Bambang Yudhoyono as elected President and Boedino as Vice President that they lead could come up with the right move to demonstrate their commitment to address the pressing issues perceived by their voters the way the elected leaders in the neighboring countries have done recently. Indonesia voters have shown increasing intelligent, including Indonesian political elites as shown in the results of the elections.

There are several challenges faced by new government in the period 2009-2014. In the area of politics, marked by the weakness of the functions of political parties in the life of nation and state in the long run would cause difficulties check and balance of the implementation of various government policies and programs. This has been compounded by the poor condition of the existing bureaucracy. Even the entry of political intervention in the bureaucracy, red tape would be a major constraint policy implementation.

In the area of economics, Government has set the goal which is making Indonesia become “a new economic tiger” in Asia. It appears the new president Susilo Bambang Yudhoyono believes that democracy without a significant increase in economic welfare for the people will ultimately undermine the legitimacy of democratization. Vice President Boediono will likely be assigned to coordinate economic policies and make sure the bureaucracy that implements them is efficient and free from graft. Another challenge in economic areas would be Indonesia's readiness in facing AFTA in 2015. Theoretically, with the moderate economic openness, Indonesia government would pursue fiscal policy more effective.

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