2 Indonesia

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I. Introduction

The Republic of Indonesia, which is the official name for Indonesia, is located in South East Asia. It has the land border with Malaysia (in Borneo island), Papua New Guinea (in New Guinea island), and Timor Leste (in Timor island). It also has the sea border with Singapore, Philippines, and Australia. The national capital city is Jakarta in Java islands, which is also the largest city in Indonesia for the site of government, residential, as well as for business.

With the ethnic diversity from many islands on a wide area, it is quite difficult to name the region. The Dutch used to call as the Netherlands East Indies. On the other hand, young academic nationalist that had been a scholar in the Netherland, used the name Indonesia for nationalism reason. The name itself derives from *Indus* (the Latin), means India, and *Nesos* (the Greek), means island. George Samuel Windsor Earl and James Richardson Logan, both from the United Kingdom were the first scientists who used the name of Indonesia in their publication in 1850.

I.1 Geography, Climate, and Natural Resources

Indonesia is an archipelago country with 17,508 islands, located between two continents: Asia and Australia, and two oceans: Pasific and Hindia. It is spread out along the equator for about 6,400 km (3,977 mile). Indonesia has a land area of 1,919,440 square kilometer (741,050 sq mi), which is 16th largest in the world. The five major islands are: Sumatera (473.606 square km), Java (132.107 sq km), Kalimantan or Borneo (539.460 sq km), Sulawesi (189.216 sq km), and Papua or New Guinea (421.981 sq km).

The archipelago has a great effect from the movement of the Australian, Pacific, and Eurasian tectonic plate. It creates numerous volcanoes and frequent earthquakes. It includes Indonesia in the region called “Pacific Ring of Fire”. This is the reason why Indonesia becomes one of the most unstable geological are in the world. Furthermore, Indonesia has about 100 active volcanoes. Even though it is dangerous, many Indonesians live around the volcano. Volcanic ash supports the land fertility and attracts people to gather in a high density population in Java and Bali for agriculture. The famous devastating eruptions in the past were Krakatoa and Tambora. The recent eruption is Mount Merapi in the border of Central Java and Jogjakarta on early November 2010.

Another effect of the tectonic plate movement is tsunami. On 26 December 2004, the most deadliest tsunami in history swept in Northern Sumatra. It began with 9.1 Magnitude earthquake then soon followed by sudden waves as high as 30 meters. The most affected region was not only Sumatra, but also Thailand, Sri Lanka, India, and Maldives. It was estimated that about 230,000 people died, with around 170,000 of Indonesians. Indonesia is still suffering from tsunami. The recent tsunami pounded several of Mentawai Islands in West Sumatra and kills at least 100 people on October 26, 2010.

Indonesia has a tropical climate due to its position in equator, with two monsoonal seasons: wet and dry seasons. From June to September, the East Monsoon brings dry weather from Northern Australia. On the opposite, the West Monsoon brings wet air from the mainland of Asia from December to March. Occasional heavy rain occurs during the transitional months between two seasons. Average annual rainfall varies from 1,780 mm to 3,175 mm in the lowlands. The mountainous areas receive more rainfall up to 6,100 mm. The temperatures vary little along the year from 21ºC to 30ºC, but it can be much cooler on the highland areas. Humidity is generally high at average 80%.

Indonesia has a lot of oil and natural gas deposits scattered within the country. Some of them has already been explored and become a major part of export. Some natural resources were found in specific area such as coal in Borneo, nickel in Sulawesi, and copper in Papua. High valuable resource such as gold was found in Papua and Nusa Tenggara. Indonesia uses coal and geothermal to generate electricity. Mountainous areas with rivers provide the suitable place to build dam for hydropower electricity.

On the bio-natural resources, Indonesia is the perfect place to grow. The main agricultural product is rice, which is become the staple food. The recent development is on the high growth of palm oil plantation. Indonesia is the biggest palm oil producer in the world. The sea provides high quality of fish, especially in deep sea such as Banda. Some coastal areas are also well known with shrimp production, majorly for export.

I.2 Demography

The Indonesian population is 237 million people in 2010. It is designated Indonesia as the fourth most populous country in the world after China, India, and US. Dramatically, around 130 million people live in Java Island, make it as the most populous island in the world. Furthermore, the population is concentrated in the Java's big cities such as Jakarta, Surabaya, Bandung, Semarang, and Jogjakarta.

Two major groups of population can be found in Indonesia. Malay ethnicity occupy in the western regions, while the Papuans settle in the eastern regions. Furthermore, some specific ethnic groups are also recognized in certain region and have a specific language such as the Javanese from Central or East Java, the Sundanese from West Java, the Batak from North Sumatra, the Dayak from Borneo, the Bugis from Sulawesi, and the Balinese from Bali Island. There are also minority ethnicities of Chinese, Arabic, and Indians.

The ethnicity diversity appears in more than 300 local and regional languages, makes communication is difficult between them. On the daily conversation, many Indonesians speak their ethnic language as their mother tongue. Bahasa Indonesia, known as Bahasa, which is a standardized dialect of Malay become the official language. It is taught at all schools and most Indonesians are proficient in using it for communication. The Bahasa is used in all formal communications in Indonesia due to its simplicity.

Islam is the major religion in Indonesia which is 85.2% of the population. It is designating Indonesia as the largest Moslem country in the world. The remaining population consists of Protestants (8.9%); Catholics (3%); Hindus (1.8%); Buddhists (0.8%) and Confucianism (0.3%). While majority regions are Moslem, some specific areas have its own dominated religion, such as Protestants in Papua and North Sulawesi, Catholics in East Nusa Tenggara, and Hindu in Bali.

I.3 Cultural

Indonesian cultural art has a great influence from other culture such as the Hindu mythology and culture. It can be found in Javanese and Balinese art such as dance and craft. Some of dances also reflected Islamic values, especially ones come from Aceh region in Northern Sumatra. The Wayang Kulit, shadow puppet made from goat skin, is another famous cultural item. It contains Hindus mythological characters and stories. The Dayak and Papuan have their own cultural reflected Animism. Batik cloth, an art of fabric painting by wax, has been acknowledged as a world heritage.

I.4 History

The Island of Java and Sumatra has become the center of South East Asian on the history. The Buddhist Kingdom of Sriwijaya in Sumatra was established in 7^{th} Century and kept its influences seven centuries later. Some Buddhist and Hindu dynasties also raised and declined in Java between 8^{th} and 10^{th} century. They created large religious monuments such as Buddhist's Borobudur and Hindu's Prambanan. The greatest of all is Majapahit in Eastern Java in the late of 13^{th} century. During its peak in 14^{th} century, Majapahit gains most areas that known as modern Indonesia and advanced to regions as far as modern Malaysia, Singapore, and Brunei.

It soon vanished when Muslim traders brought Islam to South East Asia. Indonesians are gradually adopted Islam. Some Islamic kingdoms were raised such as Malaka in Malay Peninsula, Samudra Pasai in Northern Sumatra, and Demak in Java. The reign of Islamic kingdom was not too long due to the arrival of Portuguese, which was soon followed by the Dutch. The early purpose is to monopolize the sources of nutmeg, once one of the world most valuable commodities. The Dutch then colonize to what was to become Indonesia's present boundaries for more than three and a half centuries.

The long time colonization of Dutch was ended during World War II. The Japanese occupied South East Asia including Indonesia. Soon after the surrender of Japan to the Allied Forces, Indonesia tried to establish its own nation. On 17 August 1945, Soekarno and Hatta declared Indonesian's independence and were appointed as the president and vice president. It was still a long way on the independence war with the Dutch. It lasted in 1949 when the Dutch recognized the sovereignty of Indonesia.

I.5 Political Situation

Indonesia is a republic which adopting presidential system. The president appoints a council of minister. Before 2004, the president is elected by the People's Consultative Assembly (MPR). By the presidential general election of 2004, people directly elected a pair of the president and vice president. The president may serve in two-term of five year administration.

Some historical events happened during the presidential reigns. Soekarno is wellknown for his foreign affairs role as a founder of Non-Aligned Movement. Even his good in such role, the economic development after Independence War to the middle of 1960s was so left behind. An attempt of bloody coup in 1965 was blame for the responsibility of Communist Party which was later prohibited. General Soeharto maneuvered over Soekarno and formally appointed as President in 1968. Soeharto stepped down in 1998, which began by Asian Financial crisis that hardly hit Indonesia. It was not only an economic crisis but also political crisis.

Habibie stepped up as a president in 1998, and successfully led Indonesia to the multi-party general election. As a note, general election usually followed by only three parties in Soeharto's era. Habibie era was also identical with the separation of East Timor province to be independence country called Timor Leste. The winner party of 1999 general election was the Struggling Indonesian Democratic Party, so they got a lot of seats in parliament. Unfortunately, the president was not from this party due to coalition among other parties to raise Abdurrahman Wahid (Gus Dur) as 4^{th} president. Wahid administration was only up to 2002, followed by the breaking of coalition and he pushed to step down by the parliament, so that Megawati stepped up as a President.

This moment inspired politicians and followed by amendment on the Constitution that the President is elected directly by the people through Presidential Election. Other amendment was that President may serve only in two five-year terms, inspired by bad effects of long power in Soekarno and Soeharto era that accumulated so many problems during their administration. Susilo Bambang Yudhoyono elected as President in 2004 election. Even though his party (The Democratic Party) was not the winner, but his power was legitimate due to the direct election. After all, he can manage his campaign and won at 2009 election, including led his party to be the winner. In addition, Yudhoyono is a retired General and has a long career in military. On the other hand, he is also well educated by gaining his Master in US and Doctor in Indonesia. Furthermore, Yudhoyono received the Honorary Degree of Doctor from Keio University in 2006.

II. Overview of Macroeconomic Activity and Fiscal Position

The Indonesian economic has been integrated to the world economic so it heavily affected by its turmoil. To discuss the country's macroeconomic activity related to the world economic and the country's fiscal position, this chapter is drawn the data and some parts of the report from Bank Indonesia (Central Bank), Ministry of Finance, and Central Bureau of Statistic.

The major challenges for the Indonesian economy during 2009 was the under pressure of the condition of global economy. The bad condition was emerged mainly at the beginning of the year. It was a continuation effect from the peak of the global economic crisis in the fourth quarter of 2008. The impact was not also in the financial sector, but also in the domestic real sector. In the first quarter of 2009, the economic growth showed a declining trend. It mainly caused by the large scale of reducing activities in exports of goods and services. This trend lowered the confidence of economic agents in the financial sector and final sector.

Some policies were taken by the authorities to overcome these challenges. In monetary policy, Bank Indonesia adopted an easy monetary policy stance. It was also combined with other policies. It was including a measure to curb excess volatility in the foreign exchange market. In fiscal policy, the Government of Indonesia with the approval of the parliament implemented a substantial fiscal stimulus. The policy involved tax relief and measures to maintain public purchasing power. In addition, the Government has lowered prices for subsidized gasoline and automotive diesel in the beginning of the year.

An initial improvement on financial system and macroeconomic stability was gained in the second quarter of 2009. It also maintained steady improvement for the rest of 2009. As a result, the Indonesian economy passed the challenging year in a good way. Economic grew 4.5% in 2009. Even though it was lower than 2008, it was still the third highest growth in the world after China and India. The inflation showed a modest result at 2.78%. This was the lowest level in the past decade.

Macroeconomic Activity

International Environment

Trade Balance

The effect of global economic contraction was shadowing the export in 2009 by pushing it down for both oil and natural gas exports and non-oil and gas exports. The negative growth of total export in 2009 was 14.4% compared to 2008. The oil and gas exports slipped to 20.45 billion US dollars in 2009 (Table 1). This was a huge drop of percentage at 35.5% from 2008. The falling down of world oil prices was the main reasons for this reduction.

On the other hand, the non-oil and gas export was down by 8.2% compared to 2008. This was not only as a result of contraction in global economic activity, but also the fall of prices for Indonesia's non-oil and gas export commodities. While both of agriculture and manufacturing products were down in 2009, the mining sector soared up a positive growth at 45.0%. The strong demand for resource-based exports was partly driving by the back of coal exports.

Table 1: Major Commodities Export and Import

(millions of US$)

Commodities		2008		2009	
		Value (millions of US$)	Growth (%)	Value (millions of US$)	Growth (%)
1)	Exports				
	Non Oil and Gas	107,885	15.8	99,063	(8.2)
	Agriculture	4,667	24.6	4,358	(6.6)
	Mining	13,695	10.2	19,859	45.0
	Manufacturing	89,523	16.2	74,846	(16.4)
	Oil and Gas	31,720	27.4	20,450	(35.5)
2)	Imports				
	Non Oil and Gas	100,933	40.4	72,203	(22.2)
	Consumptions Goods	9,061	25.1	6,162	(32.0)
	Raw Materials	70,425	39.5	51,151	(27.4)
	Capital Goods	20,763	53.8	20,550	(1.0)
	Oil and Gas	23,935	24.6	12,113	(49.39)

Source: Bank Indonesia and BPS-Statistics Indonesia

On the import side, a total of 27.7% of negative growth resulted in 84.3 billion US Dollars in 2009, a steeper drop compared to 14.4% of total exports. The oil and gas imports reached 12.1 billion US Dollars in 2009, a huge drop of 49.39% compared to 2008 (Table 1). The falling of world oil prices was not the only reason for this drop. Other reasons were the flagging domestic demand and the positive impact of the government-sponsored kerosene to gas conversion program.

The imports of non-oil and gas in 2009 reached 72.2 billion US Dollars or negative growth of 22.2%. This is mainly influenced by a steep drop in imports of consumer goods and raw materials, which were contracted 32.0% and 27.4% respectively. The tumbling of domestic demand was driven the sharp drop in non-oil and gas imports.

Current Account Balance

The global economic turmoil has a strong impact on the domestic economy which was reflected in the current account balance. In 2009, the current account reached a 10.6 billion US Dollars surplus, the same level of year 2006 and 2007. This was a huge rising compared to only 126 million US Dollars in 2008 (Table 2). It was a good point for Indonesia to keep an increased in current account surplus while the global growth was slowing down. This condition was driven mainly by strong exports. The demand for resource-based and particularly mining products was a key factor in the export performance. Exports were also supported by the demand for manufacturer goods in the end of 2009 in response to the economic recovery.

In contrast, imports slowed significantly due to falling domestic demand as the impact of flagging domestic economic growth. Another reduced demand occurred in raw materials for export-oriented manufactured goods. This kind of production normally has high imported content.

The capital and financial account posted a 3.673 billion US dollar surplus in 2009. This is a good result for Indonesia, even though there was a heavy capital outflows in the beginning of 2009. Bank Indonesia and Government policies in restoring the market confidence was starting in second quarter of 2009. The policies encouraged renewed inflows of short-term capital starting. Furthermore, it generated the positive outcome in the capital and financial account.

Table 2: Indonesia Balance of Payment

millions of US$

	Description	2006	2007	2008	2009
1)	Current Account	10,836	10,492	126	10,582
	Goods, net (Balance of Trade)	29,660	32,754	22,916	35,197
	Non Oil and Gas	22,875	27,048	15,130	26,860
	Oil and Gas	6,785	5,671	7,785	8,338
	Service, net	(9,874)	(11,841)	(12,998)	(14,155)
	Income, net	(13,790)	(15,525)	(15,155)	(15,331)
	Current Transfer, net	4,863	5,104	5,364	4,871
2)	Capital and Financial Account	3,025	3,591	(1,876)	3,673
	Capital Account	350	546	294	96
	Financial Account	2,675	3,045	(2,170)	3,577
	Direct Investment	2,188	2,253	3,419	2,313
	Portfolio Investment	4,277	5,566	1,721	10,103
	Other Investment	(3,790)	(4,775)	(7,309)	(8,838)
3)	Total (1 + 2)	13,885	14,083	(1,750)	14,255
4)	Net Errors and Omissions	644	(1,368)	(195)	(1,746)
5)	Overall Balance (3 + 4)	14,510	12,715	(1,945)	12,506
6)	Reserved and Related Items	(14,510)	(12,715)	1,945	(12,506)
	Reserve Assets Changes	(6,902)	(12,715)	1,945	(12,506)
	IMF Purchases	(7,608)	0	0	0
Memorandum :					
	International Reserve	42,586	56,920	51,639	66,105
	(In months of imports and official foreign debt repayment)	4.6	5.8	4.0	6.5

1) (-) surplus; (+) deficit

Source: Bank Indonesia and BPS-Statistics Indonesia

An overall 12.5 billion US Dollars balance of payment surplus was generated in 2009. This number is well ahead the 1.9 billion US Dollars balance of payment deficit in 2008. At the end of December 2009, the international reserves position touched 66.1 billion US Dollars, which was equivalent to 6.5 months of imports and servicing of official external debt. The conservative IMF calculation of about 3-4 months of imports or the peer nation average at 5.0 months of imports as benchmark showed that Indonesian reserves were at a good condition.

Exchange Rate

The Rupiah was under considerable pressure during first quarter of 2009 due to the uncertainty and risk perceptions on the foreign exchange market. The rupiah touched a low level at Rp 12,065 to the US Dollar in early March 2009. The Central Bank responded to this adverse development with a measured policy for stabilizing the exchange rate. The policy was to ensure an adequate level of liquidity in the domestic foreign exchange market. This policy was success to curbed expectations of further depreciation during the uncertainty. The current account surplus was also another fundamental factor that kept the Rupiah from steeper decline. The external condition of the positive sentiment on the global financial market eased downward pressure on the Rupiah starting from the end of March 2009.

An appreciating trend of the Rupiah was started since second quarter of 2009. The secure condition of domestic fundamental combined with the optimism over global economic recovery supported this trend. The continued surplus in the current account was also supported the strengthening of the Rupiah. Finally, the Rupiah closed at Rp 9,400 in the end of 2009. It had been appreciated 18.4% since the end of March 2009. As a whole year measurement, the Rupiah closed 2009 at level of 15.7% higher than end of 2008 (Figure 1).

Figure 1. Exchange Rate on Transactions (Rupiah per US Dollar)

Source: Bank Indonesia

Foreign Direct Investment (FDI)

The FDI in Indonesia is fluctuated between 2004 and 2009 (Table 3). There was a significant improvement from 2004 to 2005, which accounted at 8.3 billion US Dollars in 2005 or almost quadruple. The number then slashed down around half in 2006, then slightly increasing in 2007. From year 2007 to 2009 showed a declining trend in FDI.

The dominant economic sectors of FDI were manufacturing; mining and quarrying; and transportation, storage, and communication. Financial intermediation was also dominant. However, it lasted in 2008 due to the world financial crisis. While financial crashed down, Indonesia was still lucky to have a good rising in transportation, storage, and communication sector.

Tables 3. FDI in Indonesia by Economic Sector

million of US$

Sector	2004	2005	2006	2007	2008	2009
Agriculture, Hunting, and Forestry	141	2	225	285	198	(52)
Fishing	-	9	4	19	(33)	10
Mining and Quarrying	99	1,226	322	1,905	1,998	1,302
Manufacturing	834	5,265	1,691	2,412	847	1,573
Electricity, Gas, and Water Supply	-	163	(1)	(-61)	(27)	53
Construction	(18)	130	85	196	25	7
Wholesale and Retail Trade; Repair of Motor Vehicles; and Personal and Household Goods	(214)	60	375	214	748	73
Hotel and Restaurants	-	-	7	(10)	(2)	-
Transportation, Storage, and Communication	228	384	592	598	(26)	1,799
Financial Intermediation	233	780	1,028	1,388	1,554	149
Real Estate, Renting, and Business Activities	(18)	17	(14)	(4)	32	(25)
Others	609	301	599	37	9	(11)
TOTAL	1,895	8,336	4,914	6,928	5,325	4,876

Source: Bank Indonesia and BPS-Statistics Indonesia

Table 3 shows the FDI in Indonesia by country of origin between 2004 and 2009. Japan always has a special place in FDI in Indonesia due to the history and long relationship between two countries. Even though there was a negative flow in 2004, Japan took share at around 20% in the following year. ASEAN and Australia as the neighboring countries were also took a big share in the FDI. Malaysia and Australia showed a fluctuated trend, while Singapore showed an increasing point and relatively stable at around 1 billion US Dollar between 2006 and 2009. Singapore has also the biggest FDI in Indonesia in 2009.

The trend of FDI in Indonesia to be more regionalized in the recent year showed clearly in the table 4. FDI from USA and EU in 2004 were 41.28% and 18.51% respectively, or accumulated up to 60%. It then dropped to only 3.26% (USA) and 6.13% (EU) or less than 10% in sum up in 2009. Asia including Japan took share at around 74% of FDI in 2009. More details, ASEAN 28.32%, Japan 18.37%, and the rest were other Asian countries.

Tables 4. FDI in Indonesia by Country of Origin

million of US$

Country	2004	2005	2006	2007	2008	2009
Japan	(30)	1,543	1,057	1,125	604	896
North America	(567)	3,426	(544)	(1,108)	605	174
USA	(523)	3,441	(549)	1,093	630	159
Canada	(44)	(14)	4	15	(25)	15
Europe	1,565	1,582	2,016	2,621	1,183	674
Europe Union	1,546	1,543	1,995	2,409	1,142	299
France	65	280	213	383	240	257
Germany	89	436	425	335	273	(88)
Netherlands	1,239	673	1,340	1,750	464	(645)
UK	199	50	31	(52)	157	402
Other EU	(46)	103	(15)	(7)	8	372
Other Europe	19	30	21	212	41	376
Asia	815	1,586	1,964	1,288	2,215	2,693
China	295	299	124	117	313	358
India	(1)	1	1	(345)	1	6
ANIEs	281	329	492	443	47	155
South Korea	228	239	317	251	11	80
Hong Kong	66	52	118	115	32	59
Taiwan	(14)	38	57	77	4	16
ASEAN	204	884	1,354	1,108	1,866	1,381
Malaysia	120	142	277	232	934	313
Singapore	83	741	1,076	837	896	1,016
Thailand	1	1	2	38	35	51
Other ASEAN	-	-	(2)	1	1	1
Other Asia	36	72	(7)	(35)	(12)	793
Australasia	96	56	366	309	196	262
Australia	96	56	366	309	196	262
Central And South America	11	120	35	42	1	-
Others	6	184	252	436	568	177
TOTAL	**1,895**	**8,336**	**4,914**	**6,928**	**5,325**	**4,876**

Source: BPS-Statistics Indonesia

Borrowing from Abroad

The external debt position of Indonesia in 2009 was at 172.9 billion US Dollars, an increasing of 11.5% compared to year 2008 (Table 5). Both official and private external debt were increasing at 6.7% and 7.5%, respectively. Government debt showed an increasing trend between 2006 and 2009 in bilateral debt. The same trends also showed in government bonds issues. On the private sector, external borrowing was dominated by corporation. It reached 61 billion US Dollars in 2009 or 12.6% of increasing compared to 2008.

Tables 5. Indonesia's Foreign Debt

million of US$

	2006	2007	2008	2009
Government and Central Bank	75,820	80,615	86,600	99,265
Government	73,055	76,920	85,136	90,853
Bilateral	31,833	32,141	35,751	33,715
Multilateral	18,837	19,055	20,337	21,529
Exports credit facility	11,220	10,983	10,553	9,508
Commercial	62	58	45	268
Leasing	70	16	2	0
Securities/Bonds	4,945	6,370	10,446	14,343
Domestic Securities owned by non-Resident	6,089	8,298	8,001	11,489
Central Bank	2,765	3,695	1,465	8,412
Private	56,813	60,565	68,480	73,606
Banks	8,459	9,934	11,583	9,530
Non-Banks	48,354	50,631	56,897	64,075
Financial Institution	2,017	2,114	3,891	3,066
Non Financial Institution	46,337	48,517	53,005	61,009
Total	132,633	141,180	155,080	172,871

Source: Bank Indonesia and BPS-Statistics Indonesia

Domestic Environment

Economic Growth Rate (GDP)

Indonesia's economic growth between 2005 and 2009 shows a downward trend after reached a peak of 6.35% in 2007 (Table 6). The global economic pushed down the 2009 growth to a level of 4.55%. The lowest level in 2009 was in the second quarter, and then it slowly climbed up in the end of the year. However, the growth exceeded the forecast at the beginning of the year at 4.0%. Furthermore, economic growth in 2009 was also better than other nations.

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

Items	2005	2006	2007	2008	2009				2009
					I	II	III	IV	
Total Consumption	4.3	3.9	4.87	5.94	7.28	6.27	5.44	5.91	6.21
Private Consumption	4.0	3.2	5.01	5.34	5.95	4.80	4.75	3.96	4.85
Government Consumption	6.6	9.6	3.89	10.43	19.25	16.97	10.32	16.97	15.72
Investment	12.4	1.3	1.93	12.42	(0.92)	3.01	4.35	4.49	2.77
Domestic Demand	6.3	3.2	4.11	7.60	5.05	5.40	5.15	5.55	5.29
Net Exports	12.0	12.8	6.46	7.61	5.34	9.38	25.24	10.63	12.37
Exports of Goods and Service	16.6	9.4	8.54	9.53	(18.73)	(15.52)	(7.79)	3.67	(9.70)
Imports of Goods and Service	17.8	8.6	9.06	10.00	(24.42)	(21.04)	(14.67)	1.62	(14.97)
GDP	5.7	5.5	6.35	6.01	4.53	4.08	4.16	5.43	4.55

Source: Bank Indonesia and BPS-Statistics Indonesia

The contraction in world economic growth affected much. This condition reflected in the negative growth of export in 2009. In addition to the tumbling exports, the high level of bank interest rates also took part in the slowdown of domestic economy. As a chain reaction, both factors contributed to slow investment growth. With the export and investment went down, the growth in 2009 was mainly supported by domestic consumption.

A large contribution of consumption in economic growth in 2009 was reflected in the GDP components distribution by sector (Table 7). The non-tradable sectors took a big share such as electricity, gas and water utilities, construction, the transport and communications sector and services. The transportation and communication sector grew by 15.53% and then followed by the electricity, gas and water utilities sector at 13.78%. In contrast to the non-tradable sectors, tradable sector such as manufacturing was hurt much by world crisis.

The transportation and communication sector growth always more 12% between 2005 and 2009. It is due to the ongoing market penetration, especially in the communications. The raising on the electricity, gas and water utilities sector was driven by the government decision in the energy saving program. The government decided to be a year ahead of completion of the kerosene to LPG conversion program. It was completed in 2009 rather than in the original plan of 2010.

The manufacturing sector grew only to 2.1% in 2009. Even though it gained recovery in the last quarter of 2009, but the growing from the first to third quarter at around 1.5% affected a lot to the whole year. The growth was also below the average of 4% in the recent years. On the contrary, the mining sector performed well by 4.37%, the highest point since 2005. This was as a result of expanding coal exports.

Table 7. GDP Growth and GDP Components Distribution on Sector

Items	2005	2006	2007	2008	2009				2009
					I	II	III	IV	
Agriculture	2.7	3.4	3.47	4.83	5.91	2.95	3.29	4.61	4.13
Mining and Quarrying	3.2	1.7	1.93	0.68	2.61	3.37	6.20	5.22	4.37
Manufacturing	4.6	4.6	4.67	3.66	1.50	1.53	1.28	4.16	2.11
Electricity, Gas, Water Supply	6.3	5.8	10.33	10.92	11.25	15.29	14.47	13.99	13.78
Construction	7.5	8.3	8.53	7.51	6.25	6.09	7.73	8.03	7.05
Trade, Hotel and Restaurant	8.3	6.4	8.93	6.87	0.63	(0.02)	(0.23)	4.17	1.14
Transportation and Communication	12.8	14.2	14.04	16.57	16.78	17.03	16.45	12.22	15.53
Finance Rental and Business	6.7	5.5	7.99	8.24	6.26	5.33	4.90	3.77	5.05
Service	5.2	6.2	6.44	6.23	6.70	7.19	6.04	5.69	6.40
GDP	5.7	5.5	6.35	6.01	4.53	4.08	4.16	5.43	4.55

Source: Bank Indonesia and BPS-Statistics Indonesia

Inflation

Inflationary pressure was generally minimal in 2009. All inflation components and categories of goods were declining. The result was the low CPI inflation in 2009. CPI inflation decreased sharply from 11.06% in 2008 to 2.78% in 2009 (Table 8). The same condition happened to the core inflation. It slashed around half in 2009 to the level of 4.28% compare to year 2008. On the other side, volatile foods decreased significantly from 16.48% in 2008 to 3.95% in 2009. Furthermore, administered price experienced a deflation. The decreased was quite large from 15.99% in 2008 to minus 3.26% in 2009. This was a result of Bank Indonesia policies in restoring market confidence in order to make a room for appreciation in the Rupiah.

The low inflation expectation could be explained also by lower administered prices and volatile foods inflation. In this case, the government policy made two important measures. First measure was to lower the subsidy for fuel prices in the early 2009. This gave positive influence and made the administered prices inflation fell below the historical trend. Second measure in the securing supply and distribution of vital food staples and energy pushed modest volatile foods inflation also below the historical trend.

Table 8. Core and Non-Core Inflation and Its Contribution

Percent (yoy)

Year	Core		Volatile Foods		Administered Prices		CPI
	Inflation	Contribution	Inflation	Contribution	Inflation	Contribution	Inflation
2005	9.75	5.66	15.51	2.79	41.71	9.59	17.11
2006	6.03	3.50	15.57	2.75	1.84	0.42	6.60
2007	6.29	3.48	11.41	2.75	3.30	0.37	6.59
2008	8.29	5.48	16.48	2.59	15.99	2.99	11.06
2009	4.28	2.74	3.95	0.67	(3.26)	(0.62)	2.78

Source: Bank Indonesia and BPS-Statistics Indonesia

The contribution of inflation by category of goods showed a decreasing in all categories in 2009 (Table 9). The biggest declining was food stuff which accounted for 12.47% decreasing from 2008 to 2009. This was the result of security of food supplies, especially in rice. Furthermore, the declining of food commodity prices in 2009 also gave a positive impact. From the level of inflation in 2009, the transportation, communication and financial service showed a deflation at 3.67%. The biggest share was supported by transportation subsector. The 18% cut in subsidized fuel prices and the reductions in urban and intercity transport fares were the measures taken by the government. The policy on energy had another impact in pushed down the inflation to only 1.83% in 2009 in housing, water supply, electricity, gas, and fuel sector. The achievement was due to the acceleration of kerosene to LPG program.

Table 9. Inflation and its Contribution by Categories

Categories	Weight (100%)	Based on 2007 = 100 (% yoy)		
	2007=100	2007	2008	2009
Food Stuff	19.57	10.74	16.35	3.88
Propared Food, Beverages, Cigarette and Tobacco	16.55	5.70	12.53	7.81
Housing, Water Supply, Electricity, Gas and Fuel	25.41	4.85	10.92	1.83
Clothing	7.09	7.53	7.33	6.00
Medical Care	4.44	3.52	7.96	3.89
Education, Recreation and Sport	7.81	6.94	6.66	3.89
Transportation, Communication and Financial Service	19.12	0.46	7.49	(3.67)
CPI Inflation	**100.0**	**5.61**	**11.06**	**2.78**

Source: Bank Indonesia and BPS-Statistics Indonesia

Money Supply

Monetary policy transmission was indicated to work through liquidity channel during a recovery from crisis period. This was as a result of Bank Indonesia’s effort in managing liquidity and the assumption of a stable money multiplier of narrow economic liquidity (M1). The M1 dropped almost half from 103 trillion Rupiah in 2008 to 48 trillion Rupiah in 2009 (Table 10).

Table 10. Changes in Money Supply and Its Affecting Factors

billion of Rp

Items	2005	2006	2007	2008	2009
Money Supply					
Broad Money (M2)	168,886	179,730	267,169	246,176	234,665
Narrow Money (M1)	25,194	75,873	103,042	103,042	48,821
Currency	15,051	26,693	32,140	32,420	17,004
Demand Deposits	10,231	36,294	61,740	61,740	32,633
Quasi Money	144,082	114,333	166,071	166,071	185,618
Affecting Factors					
Net Foreign Assets	48,313	102,467	102,942	50,439	115,389
Net Claims on Central Government	(4,633)	(5,049)	1,703	(49,052)	42,154
Net Claims on Business Sector	136,705	117,736	223,411	241,102	130,654
Claims on Official Entities	(225)	155	78	39	34
Claims on Private Enterprises	127,256	104,515	198,049	222,191	94,620
Net Other Items	2,473	(9,445)	(46,351)	(26,866)	(53,532)

Source: BPS-Statistics Indonesia

Employment

There was a significant improvement in the unemployment rate in Indonesia. The increasing number of labor was not automatically increased the unemployment rate. It means, there was a respond from the job market to get the worker quite fast. The unemployment rate in Indonesia showed a downward trend between February 2007 and August 2009 (Table 11). The number fell from 9.8% in February 2007 to 7.9% in August 2009. The Micro, Small, and Medium Enterprises (MSMEs) played an important role in absorbing new entrants of workforce during the economic slowdown.

Table 11. Economic Growth and Open Unemployment

Type of activity	2007		2008		2009	
	Feb	Aug	Feb	Aug	Feb	Aug
Population 15+	162.4	164.1	165.6	166.6	168.3	169.3
Labor Force	108.1	109.9	111.5	112.0	113.7	113.8
Employed	97.6	99.9	102.1	102.6	104.5	104.9
Unemployed	10.6	10.0	9.4	9.4	9.3	9.0
Non-Labor Force	54.2	54.2	54.1	54.7	54.5	55.5
Labor Force Participation Rate (%)	66.6	67.0	67.3	67.2	67.6	67.2
Unemployment Rate (%)	9.8	9.1	8.5	8.4	8.1	7.9
Underemployment	30.2	30.4	30.6	31.1	31.4	31.6

Source: Bank Indonesia and BPS-Statistics Indonesia

Fiscal Position

The realization of the 2009 budget was under the target. It occurred both on the revenues and expenditures sides even though the government was trying to cut the budget through the revised budget. On the revenue side, the realization was 99.5%, while on the expenditure side, it accounted lower on 95% (Table 12). The revised budget of 2009 was set to prepare for the low revenue compare to year 2008. On the other hand, there was an increasing in the expenditure in 2009. As a whole, the 2009 budget reached a 1.6% deficit; lower than the deficit target at 2.4%.

Table 12. Summary of Government Finance and Operation

trillion of Rp

Items	2008	2009			
		Budget (Law No.41-2008)	Revised Budget	Realization	% Budget-r
A. Government Revenue and Grants	981.6	985.7	871.0	866.8	99.5
I. Tax Revenues	658.7	725.8	652.0	641.2	98.3
1. Domestic Taxes	622.4	697.3	631.9	622.5	98.5
2. International Trade Taxes	36.3	28.5	20.0	18.7	93.2
II. Non Tax Revenues	320.6	258.9	218.0	224.5	103.0
1. National Resources Revenues	224.5	173.5	138.7	137.9	99.4
2. Profit Transfer from SOEs	29.1	30.8	28.6	26.0	90.8
3. Bank Indonesia Surplus	3.7	5.4	5.9	5.8	98.8
4. Other Non-Tax Revenues	63.3	49.2	44.9	54.8	122.2
III. Grants	2.3	0.9	1.0	1.1	110.6
B. Government Expenditures	985.7	1.037,1	1.008,8	954.0	95.3
I. Central Government Expenditures	693.4	716.4	691.5	654.4	93.3
II. Regional Expenditures	292.4	320.7	309.3	308.6	99.8
C. Primary Balance	84.3	50.3	(20.3)	6.6	
Budget Surplus / Deficit	(4.1)	(51.3)	(129.8)	(87.2)	
Surplus / Deficit (percent of GDP)	(0.1)	(1.0)	(2.4)	(1.6)	
Financing	84.1	51.3	129.8	125.3	96.5
I. Domestic Financing	102.5	60.8	142.6	142.7	100.1
1. Banks	16.2	16.6	56.6	55.6	98.2
2. Non-Banks	86.3	44.2	86.0	87.1	101.3
II. Foreign Financing (nett)	(18.4)	(9.4)	(12.7)	(17.4)	136.7
Surplus / Deficit of Financing	80.0			38.1	

Aside of the realization, the 2009 budget had adequately supported the objectives. The possibility for this reason was due to the differences of assumptions used. There are two examples for this case. First one was the saving of 14% on the fuel subsidy. The assumption price of fuel was higher than the predicted of Mid Oil Platts Singapore (MOPS) price. Second one was 14.4% saving on the debt interest payments. This was as a result of appreciation in the Rupiah beyond than assumed level. Furthermore, it pushed the draw down on foreign borrowings below the targeted budget.

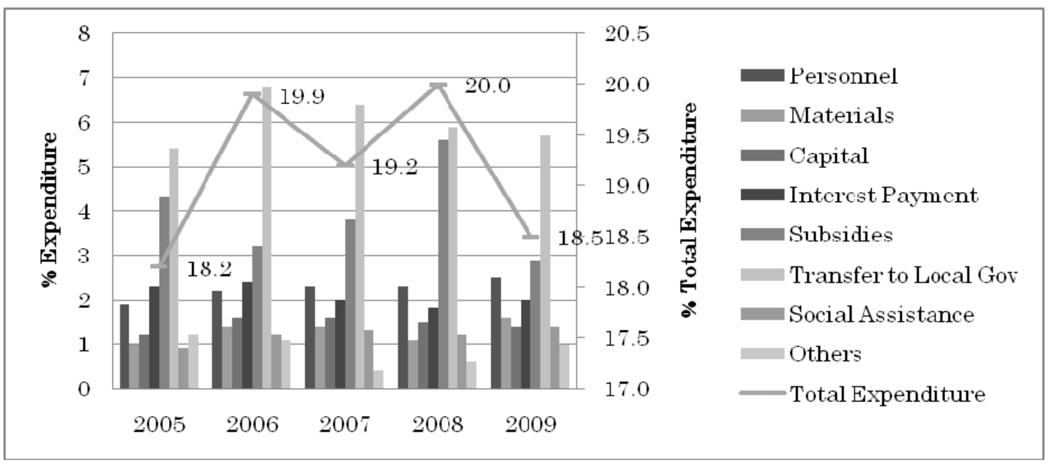
Government Expenditure

The trend of government expenditure as a percentage of GDP fluctuated between 2005 and 2009. The level of 18.5% in 2009 was almost the same as in 2005 (Figure 2). The personnel expenditure was increasing gradually from 1.9% in 2005 to 2.5% in 2009. This was in line with the policy to increase the salary of civil servants and retirements, including 13th salary and bonus. Another significant factor was due to the central government reform that was on progress in some ministries.

On the other hand, subsidies and interest payment fluctuated across the years. In 2009, the subsidies on gas and oil consumptions could be pushed down because of the falling of world oil prices. On the interest payment, it mostly depends on the exchange rate of the Rupiah, which showed a steady and upward trend to US Dollar.

The central government expenditures had cut the budget but it did not help on the realization. Even though the budget in 2008 at 693.4 trillion Rupiah pushed a little down to 691.5 trillion Rupiah, the realization was only 93.3%. In contrast, the local government achieved 99.8% in realization. Furthermore, the local government budget also increased from 292.4 trillion Rupiah in 2008 to 309.3 trillion Rupiah in 2009 (Table 12).

Figure 2. Trend of Expenditure as Percentage of GDP



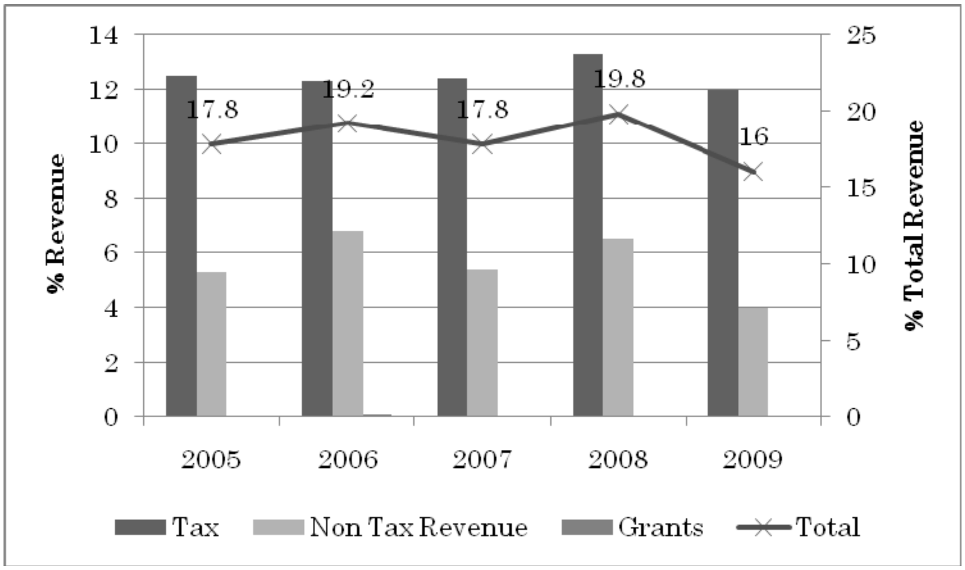
Source: Ministry of Finance

Government Revenue

The tax revenues did not achieve target in 2009 (98.3%). The domestic taxes reached 98.5% while international trade taxes only accounted 93.2% from the target (Table 12). The budget was still breathable by the support of non tax revenues that achieved over target at 103.0% in 2009. It mainly supported by other non-tax revenues at significant level (122.0%) compared to budget or more than 10 trillion Rupiah. The national resources revenues and Surplus of Bank Indonesia also did not meet the estimation. The lowest achievement was the profit transfer from the State Owned Enterprises (SOEs) at 90.8%. It could be explained by the great impact of world economic slowdown to Indonesian SOEs.

Total revenues as percentage of GDP also fluctuated between 2005 and 2009. The peak was in 2008 at level 19.8% (Figure 3). It then suddenly plunged to 16.0% in 2009, the bottom level across five year period. Tax revenues and non-tax revenues decreased to 1.3% and 1.5% of GDP compare to 2008, respectively. The bad economic situation in 2008 greatly affected tax revenues. It can be explained that the tax return for year 2008 was collected and filed in 2009.

Figure 3. Total Revenue as Percentage of GDP



Source: Ministry of Finance

Analyzing by the tax revenues categories, the domestic taxes saved the budget from economic turmoil. The domestic taxes increased slightly from 2008 to 2009 (Table 13). In contrast, the international taxes fell sharply from 36.3% in 2008 to 20.0% in 2009. The biggest fall was in export duties which gained only 1.4 trillion rupiah in 2009, far from 13.6 trillion rupiah in 2008. It can be quickly explained due to the negative impact of world economic slowdown. In detail for domestic taxes, the income tax, Duty on Acquisition of Land and Building, Excises, and Other taxes decreased from 2008 to 2009. On the other hand, the VAT and the Land and Building Tax decreased.

Table 13. Development of Tax Revenue Component

in trillion of Rp

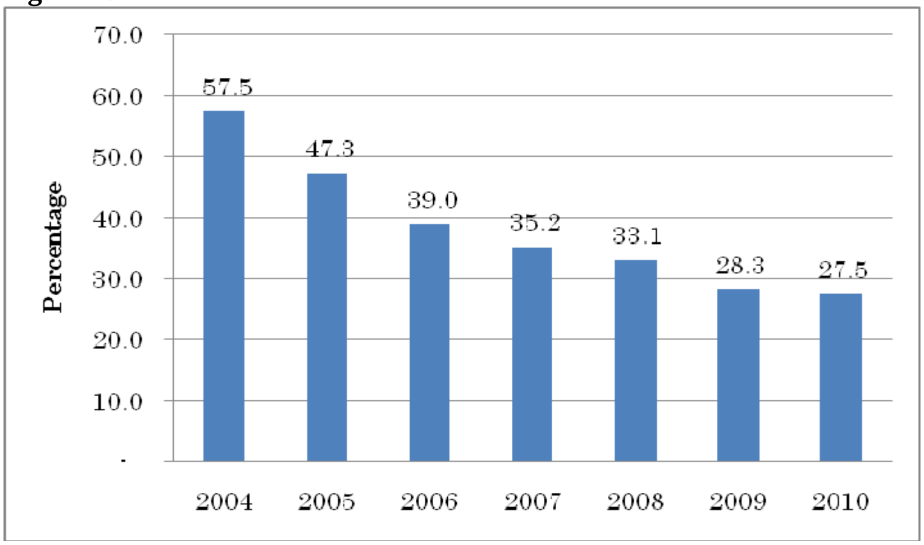
Description	2005 (Audited)	2006 (Audited)	2007 (Audited)	2008 (Audited)	2009
Domestic Taxes	331.8	396.0	470.1	622.4	632.1
Income Tax	175.5	208.8	238.4	327.5	340.4
Value Added Tax	101.3	123.0	154.5	209.6	203.1
Land and Building Tax	16.2	20.9	23.7	25.4	23.9
Duty on Acquisition of Land and Building	3.4	3.2	6.0	5.6	7.0
Excises	33.3	37.8	44.7	51.3	54.5
Other Taxes	2.1	2.3	2.7	3.0	3.3
International Taxes	15.2	13.2	20.9	36.3	20.0
Import Duties	14.9	12.1	16.7	22.8	18.6
Export Duties	0.3	1.1	4.2	13.6	1.4

Source: Ministry of Finance

Public Borrowing

The budget deficit financing strategy for 2009 was established to avoid pressure on the fiscal sustainability. The strategy was not only the prioritizing of domestic market issuances of government securities, but also utilizing foreign currency government securities as a supplementary instrument and activating of the buyback and debt switching. The government bought government securities for total 8.52 trillion Rupiah under the buyback strategy. The debt switching, which was to do in order to extend debt maturity and reduce refinancing risk, the government held debt switching auction accounted 2.93 trillion Rupiah. The downward trend of official debt to GDP ratio was achieved due to this financing strategy. For year 2009, this strategy achieved a decrease of 4.8% on the debt to GDP ratio compared to year 2008 (Figure 4).

Figure 4. Trend of Debt to GDP Ratio



Source: Ministry of Finance

The government took another several measures in public borrowing management. To avoid the crowding out effect on domestic financial markets, the government set a limit of the increasing of net domestic debt up to only 1% in one year. The government also focused on the new debt on the basis of Rupiah which came from domestic market. The purpose of this measure was due to avoid an unpredictable of exchange rate shock and to strengthen the debt position.

III. Tax Structure: Institutions and the Reality

III.1 Overview of the Role of Taxation in Indonesia

The legal basis of Indonesian Taxation is Article 23A of 1945 Indonesian Constitution. Based on this article, taxes and other compulsory levies required for the needs of the state are to be regulated by law. Furthermore, definition of tax is based on the Law Number 28 Year 2007 on General Tax Provisions and Procedures Law. The Article 1 of this law defines that tax is a compulsory contribution to the state owed by individual or entity that are enforceable under the Act, by not getting benefits directly and used for purposes of state for maximum benefit and prosperity of the people.

The outline of taxation in Indonesia consists of two big parts, central tax and local tax. Central tax is administered by central government through the Directorate General of Taxes (DGT). Each of central government taxes is based on its law. According to this outline, there are five central government taxes: Income Tax, Value Added Tax (VAT), Land and Building Tax, The Duty on Acquisition of Land and Building, and Stamp Duty. These taxes will be discussed in detail on this chapter.

The local tax is based only to one law on Local Tax and Retribution (Law Number 28 Year 2009). Even though only one law, but there are many local tax administered by local government, both for the province and the district. The province administered five taxes: Vehicle Tax; Duty on Acquisition of Vehicle; Fuel Tax; Surface Water Tax; and Cigarette Tax. The district administered five taxes: Hotel Tax; Restaurant Tax; Entertainment Tax; Advertising Tax; Street Lighting Tax; Non Metal Mineral and Stone Tax; Parking Tax; Ground Water Tax; and Swallow Bird's Nest Tax. The district also administered newly transferred tax from central government such as the Land and Building Tax (for Rural and Urban Area) and Duty on Acquisition of Land and Building.

There is a changing trend on the revenue side of the state budget. In the past, the non tax revenue especially from oil, gas and other mineral resources exports had been dominated the state budget. However, due to the declining of oil lift and the increasing of domestic demand, this trend has been changed. In 2009, the shares of state budget revenue were 74% from tax revenues and 26% from non tax revenues. In details, the tax revenue collected by central government took share of 65.8%, while the revenue from oil and gas only took share of 14.8%.

III.2 A Brief History of Taxation in Indonesia

The major reform on the Indonesia taxation was in 1984. It was the time of the changing of the taxation system from official assessment to self assessment. It means taxpayers are trusted to do the tax obligations by their self. Taxpayer must register to tax office and has a Taxpayer Identification Number (TIN / NPWP). Taxpayer also must calculate all income, amount of tax owed, tax credits, pay the amount of tax have to be paid, fill the tax return, and submit to tax office.

In 1983, three laws on taxation were approved by the parliament. The laws were the General Tax Provisions and Procedures Law, the Income Tax Law, and The Value Added Tax and Sales Tax on Luxury Good Law. All of the laws were enacted in 1984. The rally on taxation law was continuing in the 1985, when the other two laws were approved. The laws were The Land and Building Tax Law and The Stamp Duty Law. Furthermore, a new tax law on the Duty on Acquisition of Land and Building was introduced in 1997.

There were some tax law amendments in 1994 and in 2000. In the recent year, there was a rally of amendment on taxation laws. First, The Law Number 28 Year 2007 is the third amendment of the General Tax Provisions and Procedures Law. It was signed on 17 July 2007 and enacted on 1 January 2008. Second, The Law Number 36 Year 2008 is the fourth amendment of the Income Tax Law. It was signed on 23 September 2008 and enacted on 1 January 2009. Third, The Law Number 42 Year 2009 is the third amendment of the Value Added Tax and Sales Tax on Luxury Good Law. It was signed on 15 October 2009 and enacted on 1 April 2010.

III.3 Tax Administration in Indonesia

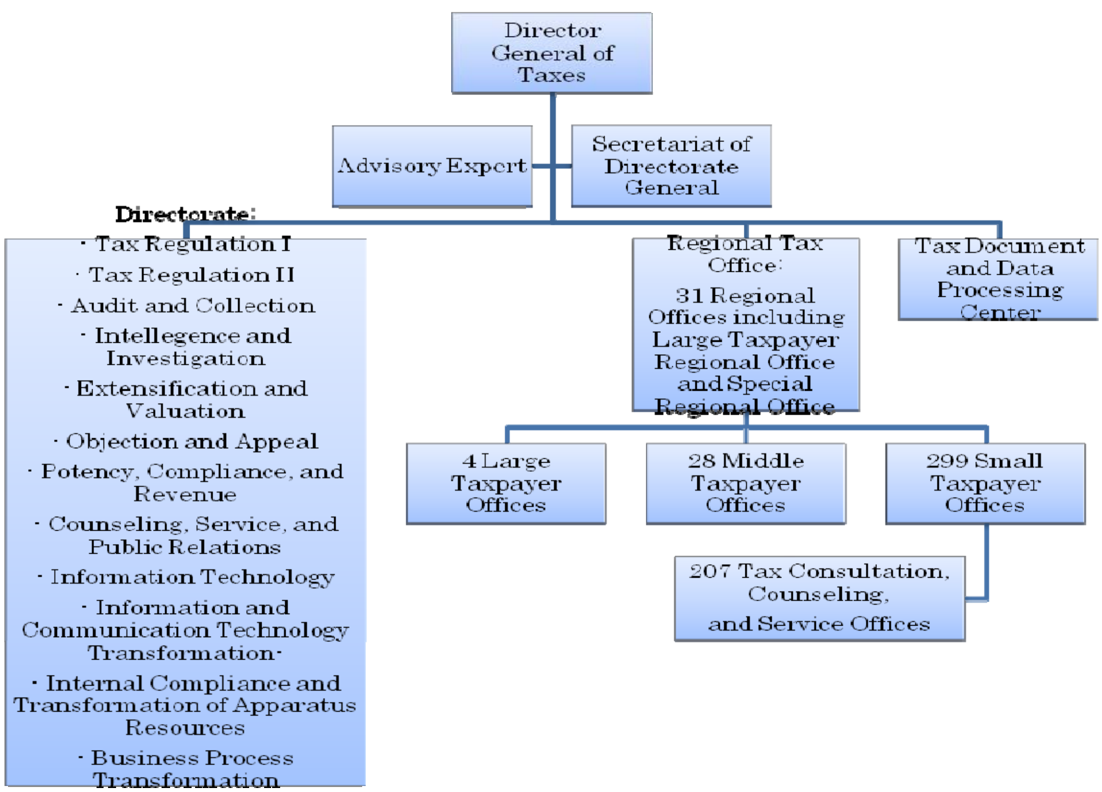
Indonesian tax authority which is responsible in collecting revenue for the Indonesian Government is The Directorate General of Taxes (DGT). Its vision is being a government institution that held a modern tax administration system is effective, efficient, and trustworthy people with integrity and high professionalism. The mission is collecting tax revenue based on the state taxation laws that could bring financial independence Budget of the State through the tax administration system that effectively and efficiently.

The independence Budget of the State means that the budget is not depending on the other countries' help. To achieve this purpose, the role of the society as tax payer is strongly needed. In response, DGT must provide the best quality of service in accordance with good governance principle. To gain the public trust, DGT established the organizational value for the tax official: integrity, professionalism, innovative, and teamwork.

III.3.1 Organization Structure

The Directorate General of Taxes is a directorate general under the Ministry of Finance. DGT is led by a Director General, supported by a Secretariat of DGT and advisory experts. In the head quarter, there are 12 Directorates and 1 Large Office of Data and Document Processing. For the supervision on the regional jurisdiction, there are 31 Regional Tax Offices. The tax offices under The Regional Tax Office consist of: 4 Large Taxpayer Offices (LTO), 28 Medium Taxpayer Offices (MTO), 299 Small Taxpayer Offices (STO), and 207 Tax Consultation, Counseling, and Service Offices (Figure 5). Furthermore, DGT is one of the biggest central government agencies in Indonesia with staff at around 32,000.

Figure 5. Organization Chart of Directorate General of Taxes



Source: Directorate General of Taxes

III.3.2 Tax Administration Reform

DGT had already finished the first phase of tax administration reform. It started in 2002 with the establishment of Large Taxpayer Office. The tax reform is an improvement of the tax administration in accordance with the good governance, which is transparent and accountable. It also involves the utilizing of reliable information system or called as the Modernized Administration Taxation System (SAPM). The completion of the first phase was marked with the implementation of the Modernized Administration Taxation System in all of the vertical units of DGT in December 2008. The strategy adopted was not only giving an excellent service to taxpayer, but also intensive monitoring to taxpayer.

As a continuation of the tax reform, DGT enters the second phase of reform in 2009. It addresses an upgrade and integration of the core tax systems, improvement of the human resource regime, and strengthening of the oversight and management functions. This is called a Program for Indonesian Tax Administration Reform (PINTAR), to be financed by the World Bank with assistance from other development partners. The main purposes of PINTAR are to increase taxpayer compliance by increasing the efficiency and effectiveness of the DGT and to improve good governance in tax administration by strengthening transparency and accountability mechanisms. This project is expected to be fully completed in the end of 2015.

III.4 Corporate Income Tax

A company will be considered taxable in Indonesia if it has a presence and conducts business in that country. Company is required to register at the relevant DGT's office for their location/status on or shortly after establishment. Company must file annual returns to compute the income tax payable. The income to be reported includes all overseas income as Indonesian tax law adopts the worldwide income basis. Tax paid offshore in relation to foreign source income can be credited in the same tax year subject to certain limitations.

(1) Tax Rates

A single flat rate of 25 percent applies from 2010. Public company 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 an effective tax rate of 20 percent in 2010. 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. Small enterprises, i.e. corporate taxpayers with an annual turnover of not more than Rp 50 billion, are entitled to a tax discount of 50 percent of the standard rate for taxable income of up to Rp 4.8 billion.

(2) 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.

(3) 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.

(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.

Income or profits received by an investment fund company as long as all income or profits are distributed to shareholders.

(5) Capital Gains Tax

Capital gains or losses may come from sales of a company’s assets. It is calculated as the difference between the sales proceeds and the tax written down value of the assets concerned. Capital gains are assessable while a capital loss is tax-deductible only if the asset concerned is used in the running of the business, i.e. for obtaining, collecting, and securing assessable income. The exemptions are for transactions in stock on the Indonesian stock market and on private property. The gain or loss is ignored and tax is instead charged on the transaction value. The tax rate is 0.1% of transaction value of stock, except for founder shares sold by founder 0.5% of transaction value. For Land and building, tax rate is 5 % of transfer value – final tax for individuals and foundations non-final tax for corporations.

(6) 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.

(7) 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.

Additionally, 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.

(8) 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.

(9) 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).

(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.5 Individual Income Tax

Individual taxpayer has an obligation to calculate, settle, and report income tax. The extent of the Indonesian income tax liability depends upon the individual's residence status in Indonesia. Resident individuals are taxed on their worldwide income, regardless of where such income arises or for whom work or services are performed. For Indonesian-source income, there is an extensive framework of withholding taxes so that income tax is often collected by deduction at source, for example in relation to employment income, interest, dividends, royalties, rent and income from sales of property, and listed shares. 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.

Resident individual taxpayer who receive or earn annual income exceeding the income threshold must register with the tax office and file annual income tax returns. The tax return should state the individual's income, including compensation from employment, investment income, capital gains, overseas income, and other income. Tax return also provides a summary of the individual's assets and liabilities.

A family is generally regarded as a single tax reporting unit with only a single Tax Identification Number in the name of the head of the family (typically the husband). His wife and his dependant children's income must be reported on the same tax return in his name. A married woman has two options. She can choose to have her own tax identification number and report her own income tax return separately from her husband. Otherwise, she can merge her income to her husband's tax return.

(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

(3) Tax Residence

Indonesian tax law distinguishes between resident and nonresident taxpayers. Residents are defined as individual if he/she fulfills any of the following conditions:

a. resides in Indonesia;
b. present in Indonesia for 183 days or more in any continuous 12-month period;
c. present and 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.6 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
On gross amount for the following payments:	
Dividends;	15 %
Interest, including premiums, discounts, and loan guarantee fees;	15 %
Royalties;	15 %
Prizes and awards.	15 %
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.7 Value Added Tax and Sales Tax on Luxury Goods

Both Entity and individual, in whatever form, which in the course of its operations, produces, imports or exports taxable goods, conducts trading activities or renders taxable services, is required to register as a Taxable Entrepreneur with the DGT. However, only a resident or a PE can obtain a VAT registration. Registration by non-residents is not allowed.

(1) Taxable Goods and Services

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;
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. Export of taxable goods (tangible and intangible) by an enterprise;
g. Export of taxable services 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 taxable goods on consignment;
h. Deliveries of taxable goods by a taxable entrepreneur in the framework of *syariah-based* financing, whereby the deliveries are deemed to take place directly from the taxable entrepreneur to the party in need of the taxable goods.

Indonesia VAT law introduces a negative list of goods and services. It means all goods and services, unless otherwise stated, constitute taxable goods or taxable services. The negative list of goods and services are categorized as non-taxable as follows:

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; 2) Basic commodities needed by society – rice, salt, corn, sago, soy beans, fresh meat, fresh vegetables and fresh fruit; 3) Food and drink served in hotels, restaurants and the like, either consumed in the vicinity or taken away, including food and drink by caterers; 4) Money, gold bars and securities.	1) Medical health services; 2) Social services such as orphanages and funeral services; 3) Mail services with stamps; 4) Financial services; 5) Insurance services; 6) Religious services; 7) Educational services; 8) Art and entertainment services; 9) Broadcasting services not for advertising purposes; 10) Public transportation on land and water and international air transport 11) Medical health services; 12) Religious services and Educational Services 13) Public transportation on land and water and i.e. international air transport; 14) Manpower services; 15) Hotel services; 16) Parking area services; 17) Public services provided by the government.

(2) 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:

(3) 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.

(4) 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 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 the end of tax year 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.

(5) 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.

A tax invoice must be issued at:

a. The time of delivery of taxable goods and services;
b. The time a payment is received if the payment is received prior to the delivery of taxable goods or services;
c. The time a term-payment is received in the case of delivery of a part of the work phase;
d. Such other time as maybe stipulated by MoF decree.

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

(6) VAT Refunds

Refund application can be made at the end of a book year. The DGT has to decide on a VAT refund application within 12 months after receipt of the complete set of the application on the basis of a VAT audit. If no decision is made within 12 months, the application is considered to have been approved. Monthly refunds are possible for certain taxpayers such as exporters of goods or services suppliers to the VAT collectors in the pre-production stage and suppliers of goods and services for which VAT is not collected.

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.

(7) Sales Tax on Luxury Goods (STLG)

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:

a. passenger vehicles;
b. alcoholic beverages;
c. certain food and non-alcoholic beverage products;
d. household appliances and electronic goods;
e. cosmetics;
f. 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.8 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. To be the beneficial owner, the following criteria should be satisfied:

a. For individuals, that they are not receiving income as an agent or nominee
b. An institution that is explicitly named in the tax treaty or one that has been agreed to by the Competent Authority in Indonesia and its treaty country partner
c. An offshore company which earns income through a custodian from share or bond transactions made on the Indonesian Stock Exchange (except interest and dividends), that is not an agent or nominee.
d. A company whose shares are listed on the stock exchange and traded regularly.
e. A bank, or
f. Any other company which meets specific requirements:

1. the establishment of the company in the tax treaty partner country and the way he transaction is structured or undertaken are not merely done to enjoy tax treaty benefits, the business activities are managed by the company's own management which has sufficient authority to carry out transactions;
2. The company has employee(s);
3. The company has activities or an active business;
4. Income derived from Indonesia is taxable in the recipient's country.
5. The company does not use more than 50% of its total income to fulfill its obligations to other parties, such as interest, royalty, or other payments.

The withholding tax rates applicable under tax treaties are summarized below:

Table 23. Tax Treaties

Country	Dividends: Portfolio	Dividends: Substantial Holdings	Interest	Royalties	Branch Profit Tax
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 [3 4]	15%	15%	15% / 0%	15%	20%
India	15%	10%	10% / 0%	15%	10%
Iran [7]	7%	7%	10% / 0%	12%	7%
Italy	15%	10%	10% / 0%	15% / 10%	12%
Japan	15%	10%	10% / 0%	10%	10%
Jordan [3]	10%	10%	10% / 0%	10%	20%
North Korea	10%	10%	10% / 0%	10%	10%
South Korea [2]	15%	10%	10% / 0%	15%	10%
Kuwait [4]	10%	10%	5% / 0%	20%	10% / 0%
Luxembourg [1]	15%	10%	10% / 0%	12.50%	10%
Malaysia [5]	15%	15%	15% / 0%	15%	12.50%
Mexico	10%	10%	10% / 0%	10%	10%
Mongolia	10%	10%	10% / 0%	10%	10%
Netherlands	10%	10%	10% / 0%	10%	10%
New Zealand [3]	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 [7]	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]	15%	10%	10% / 0%	10%	20%
Spain	15%	10%	10% / 0%	10%	10%
Sri Lanka [3]	15%	15%	15% / 0%	15%	20%
Sudan	10%	10%	15% / 0%	10%	10%
Sweden	15%	10%	10% / 0%	15% / 10%	15%
Switzerland [1 6]	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. 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
4. Tax only applies if the profits are remitted

5. 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.
6. Subject to ratification, the tax on royalties may be reduced to 10 percent.
7. 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

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 taxpayer 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 measure is established in order to curb tax evasion by resident taxpayers through offshore investments. 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.9 Stamp Duty

Stamp duty is nominal and payable as a fixed amount of either Rp 6,000 or Rp 3,000 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 Rp 6,000 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 Rp 1 million, and Rp 3,000 when the value is between Rp 250,000 and Rp1 million. Values below Rp 250,000 are not subject to stamp duty. For cheque, the rate is Rp 3,000 regardless of the monetary value stated.

III.10 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.

III.11 Duty on the Acquisition of Land and Building Rights (DAL&BR)

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.12 Tax Incentives

(1) Taxation on Merger and Acquisition

Gains resulting from restructuring which involves transfer of assets are assessable and based on market value. It includes business mergers, consolidations, or business splits. On the other hand, losses are generally claimable as a deduction from income. However, a tax-neutral merger or consolidation, under which assets are transferred at book value, can be conducted but subject to the approval of Director General of Taxes. The merger or consolidation plan in question must pass a business-purpose test in order to get this approval. Furthermore, the approval is also available for business splits which constitute part of an Initial Public Offering (IPO) plan.

(2) 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 comprised of following certain industries: Food Industries; Garment and textile; Pulp and paper; Industrial chemical materials; Pharmaceutical Industries; Rubber and products made from rubber; Iron and Steel, Machines and equipment; Electronics; Land transportation vehicles; Ship building and reparation; Cement (in Papua, Sulawesi, and Nusa Tenggara); Products and packaging made from plastic (outside Java); Geothermal exploitation; Oil refining; and Mini natural gas refining.

(3) 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.

(4) 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.

If a qualifying project is only partially funded by a foreign loan or a foreign grant, the tax facilities are determined proportionate to the amount of loan or grant.

III.13 Fiscal Exit Tax

Individual resident taxpayers must pay a Fiscal Exit Tax upon each departure by from Indonesia. Trip by air and by sea must pay Rp 2.5 million and Rp 1 million, respectively. Furthermore, trip by land is exempted from this tax. Fiscal Exit Tax applies to resident individual without TIN until the end of 2010. 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.

III.14 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.15 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) 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.

(7) Products of a Tax Audits

The legal products of a tax audit consist mainly of tax assessment letters and Tax Collection Letters (TCLs), which must be based on the closing conference document. A TCL typically serves as a legal instrument to collect administrative tax sanctions not covered in a tax assessment letter. In some other situations, it may also be used by the DGT to collect tax due in a particular tax period (month) within the current year and the interest penalty thereon.

III.16 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.17 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.

III.18 Taxpayer rights

Based on the law, the taxpayer rights can be compiling as follows:

1. To obtain TIN and or taxable person for VAT purpose Identification number after registering and reporting his business.
2. On a request, to extend the period to file annual tax return.
3. To receive a proof of receipt for a tax return filed directly to the DGT.
4. To amend the tax return.
5. On a request, the right to install or postpone the tax payment.
6. To request for correction of a notice of tax assessment.
7. The right for a refund of a tax overpayment within a maximum period of one month since the request is received due to the issuance of a notice of tax overpayment assessment.
8. To appoint a proxy by a power of attorney to exercise rights and fulfill tax obligations.
9. To obtain secrecy guarantee through official secrecy provisions.
10. To file a request for deduction or annulment of administrative penalties in the form of interest, fine and surcharge due to taxpayer’s disregard or other than his intentional faults.
11. To file a request for deduction or cancellation of incorrect tax assessment.

12. To refuse a tax auditor who doesn't possess an auditor identity card, is not provided with an audit order or doesn't show them to the audited taxpayer.
13. To file a request for appeals to the tax court against decision on objection which is still considered in appropriated.
14. To file additional reasons or written explanations before a decision on objection is issued.
15. The right to file an objection on a notice of tax assessment.
16. The right to extend the period to file an objection due to circumstances beyond his control.
17. The right to obtain written information on matters which constitute the basis for imposition of tax in order to file a objection.
18. The right to obtain a decision on objection no latter 12 months since the date the objection is received by DGT. If after the time limit has elapsed, there is no decision issued, the objection shall be considered to be granted.
19. The right for a statue of limitation in a law suit of tax crime , that is a period of 10 years after the date a tax is payable or after the end of a taxable period, a fraction of a taxable period or a taxable year.
20. The right for termination of tax crime investigation when the taxpayer has paid in full the unpaid or underpaid tax or the tax which should have not been refunded, added with administrative penalty in the form of fine of 4 times of the amount of the unpaid or underpaid tax or the tax which should have not been refunded.

III.19 Taxpayer obligations

On the other hand, taxpayer must fulfill the obligations as follows:

1. To register and/or report his business.
2. To obtain and fill out his annual tax return correctly, completely and clearly and sign and file it to the DGT before the due date.
3. To submit a statement estimating the amount of a tax payable for a taxable year and proof of settlement of the tax payable in the case that the taxpayer files a request to extend the period to file annual tax return.
4. In case a taxpayer is an entity, the tax return must be signed by any member of the management or board of directors.
5. In case a tax return is completed and signed by other than the taxpayer, a power attorney must be attached.
6. For a taxpayer who maintains bookkeeping, his annual tax return must be accompanied with financial statement in the form of balance sheet and income statement and other information.
7. To pay an administrative penalty of 2% interest per month o the amount of tax under paid if the taxpayer voluntary amends his tax return resulting an increase in the amount of tax payable.
8. To pay or remit tax payable at state treasury or any other place of payment stipulated by Minister of Finance.
9. To pay any underpaid tax as stated in annual tax return at the latest of the 25th of the third month after the end of a taxable year.
10. Taxpayer conducting business activities or independent personal services in Indonesia is obliged to keep book and record pursuant to the provisions of the tax laws.
11. Individual taxpayer who according to the provisions of the tax laws is permitted to calculate net income by using the calculation norm is obliged to maintain records.
12. To store books, records and documents used as a basis of bookkeeping or recording for 10 years in Indonesia.
13. Keep book and record or recording in good faith, which reflects the facts or the real business activity.
14. Secure approval from DGT on changing in the method of bookkeeping and or accounting year.

IV. Country-Specific Fiscal Issues

The global economic turmoil in recent year needs the government to react carefully in 2009. The government took some fiscal policies in order not only to promote economic recovery but also to enhance competitiveness.

IV.1 Fiscal Policy to Promote Economic Recovery

The fiscal policy aims to promote economic recovery by providing tax incentives to various sectors and businesses. Furthermore, the policy is not only to promote private consumption but also investment spending. On general taxation, the government provides some incentives. More details in categories, in could be divided to Income Tax, VAT, and custom incentives.

On the Income Tax incentives, there is a reduction on income tax rate for corporations. The rate is 28% in tax year 2009 and then it decreases to 25% in tax year 2010. Furthermore, there is additional advantage for listed companies. They have additional 5% reduction of income tax rate. The requirement is at least 40% of the share must be on the public ownership. In addition, as already explained in the previous chapter, the government also provides income tax facilities for businesses in specific industries or areas.

On the VAT, a further step was taken. The primary agriculture products are free from VAT. This measure is to reduce the burden of VAT especially for the poor. Another expectation is to promote growth in the agricultural sector. On the other sector, to be in line with the advance of technology, the government evaluates some products that recently become more in mass productions and it leads to cheaper price. By this price, the product is no longer luxurious. The measure is elimination of many luxury tax items.

On the custom, the government provides tax and custom Incentive for special areas in accordance with law on tax and custom. Furthermore, there is elimination of non tax revenue for export and import documentation. This measure is in order to lower the cost of administration, not only for tax official but also for taxpayer.

Related to the energy incentives, the government provides incentive for geothermal energy through income tax and VAT. This is due to promote the exploration of geothermal exploration in Indonesia. There are many sources of geothermal energy due to the volcanic activities, but much of valuable energy resources are still untapped. For the main energy, the government gives tax incentive on imports (both income tax and VAT on imports) for the oil and gas exploration sector. This is to support all the activities in oil and gas in order to improve the lifting of oil and gas. For the alternative energy, the government also provides incentive for green energy through for VAT and subsidy.

The incentive for industry, especially the custom incentives is also provided. Some selected industries get this incentive. In addition, there is incentive for imported capital goods. This measure is to support the establishment of new factory. Furthermore, it is also support the revitalization of industry to modernize its production line.

IV.2 Fiscal Policy to Enhance Competitiveness

The rapid growth of development among the neighboring country made the competition become though. To be more competitive, it must be started by strengthen domestic industries. The Indonesian government continues to support the development of infrastructure and enhance the social welfare through the effective fiscal policy and incentives for specific sectors.

The infrastructure development is the first priority in order to enhance competitiveness. The lack supply of electricity must be overcome. The 10,000 Mega Watt of electricity is established but it is not running well. The government makes a guarantee for the acceleration of this program. Another problem in infrastructure is the toll road building. Only certain areas in the major city has toll road. Furthermore, there is no interconnection of toll road among big cities, even in Java Island. Only Jakarta and Bandung had been connected. The major problem is land clearing. The additional fund for land clearing for toll road building was provided to support this program.

Other infrastructure developments are in the water sector and housing. On the water sector, the government guarantees not only obligation for State Water Company but also provides subsidy on interest for clean water. Another scheme for interest credit for State Water Company is also provided. On the housing sector, the government gives subsidy and VAT for people's housing. This is applied only for low income housing.

IV.3 Issues related to Taxation

The government took several measures in taxation. The rally for amendment of Tax Laws finally had completed. Began with the amendment of the General Provision of Tax Laws, and then followed by the Income Tax Law, and ended by the VAT Laws. Furthermore, as a government body which has responsibility in taxation, DGT also kept in pace with the new situation.

IV.3.1 The Amended VAT Law Come in Force

The parliamentary had approved the amended VAL Law on September 16, 2009. The law itself came in force on April 1, 2010. The time span was given order to provide enough time for preparation of the implementation of new law. There are several important points related to the amended laws:

a. Taxable events:
   - An export of Intangible goods and services in is charged at 0% (zero percent). This measure is taken in order to neutralize the imposition of VAT and to increase the competitiveness of service activities carried out by Indonesian firm outside the Customs Area.
   - Farm products taken directly from the source are still taxable. It will use the mechanism of crediting Input Tax (Input Tax deemed).

b. Non-taxable goods and services:
   - The type of goods and services that are not subject to VAT, which was originally regulated by Government Regulation Act, then mentioned directly on the VAT Tax Law in order to provide legal certainty.
   - Products of mining taken directly from the source, including the coal, are not subject to VAT. This is to ensure the availability of raw materials in the domestic energy.
   - Fresh meat, eggs, unprocessed milk dairy, fresh vegetables and fresh fruits are set as the primary goods and not subject to VAT. This is in order to fulfill the nutrition requirements standard at an affordable price.

     Specific objects that have been subject to local taxes are exempt from the imposition of VAT due to avoidance of double taxation on a same object. This includes non metal mineral and stone, food and beverages served in hotels, restaurants, cafes and the like, hotel services, catering.
   - To provide equal treatment, financial services performed by anyone, including Islamic banking is not designated as a taxable service. Therefore, it is not subject to VAT.

c. Return of Taxable Services

   If a consigned taxable goods are not sold but are returned to their owner, the firm which received the consignment may use the provisions on return of Taxable Goods. This was not regulated in the previous laws. In order to be parallel with the treatment of return taxable goods, the amended of VAT law regulates on the return of taxable services which are returned in part or entirely.

d. Sales Tax on Luxury Goods

   The upper limit of the luxury sales tax rate increased from 75% to 200%. The highest tariff of 200% will be applied when it is absolutely necessary. It gives a space to the government in order to carry out its regulatory functions.

e. Input Tax Credit

   A taxable enterprise, who has not yet produced any goods, has a right to claim the VAT paid on purchases of capital goods. However, if within a certain time they failed to produce the goods, then VAT that has been credited and refunded must be paid back. Time limit for the Taxable enterprise is three years since the first time of the crediting input tax on tax return. In details, it applies to all business sectors.

f. VAT refund

Taxpayer may ask for a refund on the end of tax year or carry over the overpaid VAT to the following months if accumulated input tax for a particular month exceeds the accumulated output VAT. However, certain taxpayer who acts as exporter may ask for a refund on a monthly basis. The preliminary refund is given to an obedient taxpayer in order to help liquidity, provide better service, and to encourage voluntary taxpayer compliance.

g. Deemed input tax

A new regulation on the mechanism for determining the amount of input tax that can be credited to a particular taxpayer, either based on turnover and business activities, which aims to facilitate taxpayers in calculating its VAT liability.

h. Simplified of Centralized Reporting

There is no other requirement in applying for centralized reporting of VAT. Taxpayer just simply sends a written notification to the tax office. This is in order to reduce the administrative burden of taxpayer.

i. Time for issuing a Tax Invoice:

- Taxpayer who supplies taxable goods or renders taxable services shall be obliged to withhold VAT payable and give a Tax Invoice as a proof of tax withholding. It can be at the time of delivery or in the case of payment preceding the delivery, Tax Invoice was made at the time of payment. By this arrangement, taxpayer is no longer need to create sales invoice that different to the Tax Invoice.
- The due date of payment and filing the VAT return, which are previously no later than the 15th and 20th on the following months, respectively are extended. In order to assist taxpayer liquidity and to give a longer time for preparing tax return, the due date is extended by the end of the following month.

j. Tax facilities

To provide legal certainty for tax incentives, some measures are regulated especially for:

- representatives of foreign countries or international agencies
- import and delivery of taxable goods and services in the implementation of government projects financed by loans/grants/foreign aid.
- electricity and water
- national natural disaster management activities
- public air transport in certain areas
- raw material of silver craft

k. Restitution Foreign Tourists

There is a VAT refund on luggage carried outside the customs area by an individual foreign passport holder (Tourist) who meets certain requirements.

l. Joint Responsibility

The joint responsibility of VAT deleted during the amendment of the General Tax Provisions and Procedures Law because it is a material arrangement. It is then regulated in the VAT law due to a need to protect both the buyer and seller.

IV.3.2 Improvement in the Tax Administration

The DGT tends to simplify tax administration. There are several measures was taken in order not only to improve the service to taxpayer, but also to gain efficiency in office management. The improvement in electronic filing is managed by DGT itself, while on tax payment management is related to other agencies or external party.

IV.3.2.1 Improvement in electronic filing

Related to the filing of tax return matter, DGT applied some measures. DGT built software for tax filing. The software then released and can be downloaded easily via website. Otherwise, tax payer can also request for the software when they visit tax office. The software called e-SPT (electronic tax return). The e-SPT had been upgraded to the new version in order to improve its performance. Some advantages of e-SPT:

1. The submission of SPT can be performed quickly and safely, because the attachment in the form of CD / USB.
2. Taxation Data Organized well.
3. The Software organizes data with good corporate taxation and systematically.
4. The tax calculation is done quickly and accurately because it is computerized.
5. It is easier in preparing tax return.
6. Data submitted by WP always complete due to the numbering of the form by software.
7. It is avoid wasteful use of paper.
8. The reduction in clerical jobs on the data entry of tax return that usually takes considerable resources

IV.3.2.2 Simplification in the 2nd sheet of Tax Payment Slip administration

In the past, Tax Payment Slip administration was taking a lot of time to manage. It consists of 5 sheets: 1st for taxpayer archive, 2nd for tax office through bank or post office, 3rd for tax office to compliment the tax return, 4th for bank or post office archive, and 5th for withhold taxpayer (if available). The problem usually came up when taxpayer wanted to claim the refund or to do the overbooking of false payment. The tax official must make sure that taxpayer had already paid the tax. Even though the automated tax payment system had been established, but the old procedure needed to check all the tax payment through the 2nd sheet of slip. It was genuine because it comes directly from the bank or post office. However, both bank and post office were the different institution, so that DGT could not interfere. Furthermore, there were thousands of branches of bank and post office that accept tax payment. It usually takes a long time process to see the 2nd sheet of slip appear in the tax office. The result was clearly predicted. It took a long time to claim refund or to do the overbooking.

The new procedure is easier. There is no need to wait for the 2nd sheet of slip. It is due to the improvement in the integration of revenue payment administration. The key improvement on this program is the development of NTPN. It is a unique number that created by the Directorate General of Treasury and installed in the bank and post office computer. It is unique because there is no same number for each payment. If taxpayer pays tax, then the number is generated. The tax office gets the data of tax payment and can easily monitor the genuine of payment.

IV. 3.2.3 No monthly filing for tax payment of Article 25

In addition to the integration of revenue payment administration, the payment for Article 25 is easy to monitor. Article 25 is the monthly payment for taxpayer who has income tax payment for the last tax year. The common practice is by calculating the income tax payment then divided by twelve. It is actually an installment for the next tax year payment in order not to make a big burden in the tax return season.

The old practice needs taxpayers submitted the 3rd sheet of slip to tax office, monthly. This is also recorded as monthly tax return. It usually raises the compliance cost. Sometimes taxpayer has no other tax payment but Article 25 only. Even though taxpayer has nothing to with tax office at that time, taxpayer still has to go to tax office just only to submit 3rd sheet of slip. Otherwise, taxpayer gets the penalty for not filing monthly tax return.

The using of unique number made monitoring process for tax payment easier. Because of its genuinely, there is an administration burden if tax office keeps taxpayer filing monthly tax return. DGT decided to skip this process. As a result, taxpayer who had already paid tax does not need to submit (filing) monthly tax return. However, there is an exception. For taxpayer who has a null payment, taxpayer must file it to tax office. This measure is taken in order to monitor the presence of taxpayer. In general, taxpayer who has null payment usually has no activity or has a lost in the previous financial statement.

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

V.1 Macroeconomic activities

Overall, the Indonesian economic is predicted to grow higher in 2010. GDP growth is forecasted to reach the level of 5.5% - 6.0% projection. Alongside with more confidence in the economy, both export and investment are expected to keep rising. It will provide additional boost to encourage more consumption in support of higher levels of economic growth. On the inflation, it is estimated that the inflation rate will be established on target at range of 5.0% ±1% in 2010 and 2011. The sign of future inflation until the end of 2010 has been identified. It mainly comes from the seasonal uncertainties of administered price and volatile food.

The expectation of higher growth on export is related to the global economic recovery. In 2010, the global economy is predicted to step in an expansionary phase. On this phase, more demand from Indonesia’s major trading partner such as China, will boost the export. The high expectation on the rising price of world primary commodities will also support this growth. This situation will put the export as the main factor of economic growth in 2010. The good track on export will produce an overall increase in private incomes. This will lead the household consumption to remain strong also in 2010. The increasing on the private incomes is also a contribution from higher investment. Furthermore, this will support a stronger public purchasing power.

V.2. Fiscal Policy

The government will expand the continuity of the effective fiscal stimulus from 1.4% of GDP in 2009 to 1.6% of GDP in 2010. Furthermore, there is an attempt to reduce the debt to GDP ratio at the level of 27.8% in 2010, a slightly decreasing from the level of 28.3% in 2009. The provisional measurement of fiscal deficit is at 2.1% of GDP in 2010, an increasing from 1.6% of GDP fiscal deficit realization in 2009. The government also introduced a new feature of fiscal policy. It provides fiscal space to implement additional priority programs in 2010. The allocated budget is up to 2.5 billion US Dollar or equal to 0.4% of GDP.

V.3. Challenge on Tax Administration: Transfer of Administration of Land and Building Tax to Local Government

The Law Number 28 Year 2009 on Local Tax and Retribution has a significant impact on administration of Land and Building Tax. The authority for taxing of Land and Building Tax in the rural and urban sector is handed over to local government according to Article 77 to 85. The law will come in force on January 1, 2014. Furthermore, a full authority in all aspect of taxation for local government has given in Duty on Acquisition of Land and Building Right. It is based on Article 85 to 93. The law will be in force on January 1, 2011. The time gap is allocated to accommodate both central and local government in preparing for the transfer of authority.

Local governments have no experience in administrating in both taxes. Before the amendment, they have just received the shares from central government and fixed it to their local budgets. Now, they have to administrate the taxes. On the other hand, central government has established a system that currently not available in local government. It means a lot of work to do to build such kind of system. Some point of interest that may be a constraint in the transfer of authority. It could be identified the problem that may arise could be categorized into three aspects: Legal Aspect, Human Resources, and Information Technology. The local government must be prepared to handle it.

On the legal aspect, Tax and Land Building and its supporting laws have already been established in central government. As a lesson, Local Government must coordinate with Local Parliament to legislate the Local Regulation on the Land and Building Tax Administration. It should be based on legislation so that the tax collection could be implemented.

The head of local government is responsible to issue the result of land valuation. It is completely different with the centralized tax in which the land valuation is under jurisdiction of Minister of Finance. The main advantage is about the local knowledge. The local government must know in detail about the condition of his/her area better than central administration. It also minimized conflict that sometimes happen when people do some objections on the valuation result, especially when it is overvalued so that they must pay higher tax.

On the Human Resources, some specialists in land and building tax are crucially needed. Property Appraiser is a must in order to make a valuation on the tax object. While current number of this specialist in DGT is limited, it is still a big question how should the local government get this specialist. Another specialist such as Operator Console must take into account in order to maintain the computer system. Recruiting is a simple way, but it is still difficult to find such profession in Indonesia. There are other measures to get the staff, such as giving training to local government employee or just simply transferring central staff to local governments. The transferred employees would carry their competence with them, and automatically improving technical capacity among local governments. Which one is the best, the local government should start to think how to fulfill the needs of this specific job.

The last one is about Information Technology issue. The DGT has already built system to handle a huge number of tax objects. This system is very crucial in maintaining data, helping the valuation process, and administering task in Land and Building Tax. The local government may provide this system also in order to keep the pace. It is said may, because if there no such information technology, all the works are still can be done manually. Furthermore, if new technologies in property tax assessment, collection, and record keeping are used, it could minimize much of the current problem with the property tax. Now the choice is in the hand of local governments whether they use the information technology or not. A budget on information technology should be prepared if they want to use it.

It is also interesting to discuss on the flow of revenue and its effects. It has been described that almost all of the revenue from Land and Building Tax before the amendment was giving to the local government. Psychological thing that may arise is political consideration on the authority of taxing and hold the budget before dividing the tax money. A political power may be a little bit decreasing from central government.

Looking further on the recent revenue of land and building tax by sector, it is clear that central government still holds major authority of taxation. The mining, forestry, and estate count around 70% of the revenue. It means the central government still holds a strong position on the budget. Even though only the small authority based on revenue is given, the ending is the same that local government would have some spaces in budgeting by not too depend on the budget transfers from central government.

Transfer of administration of Land and Building Tax to local government is a part of fiscal decentralization in Indonesia. Local government should prepare on some point of interests during the transition period. The effectiveness of revenue collection is also in question. If local government does not prepare well, this transfer may only be a new administration burden. However, if local government can handle these problems, it should be good to enhance its comparative advantages.

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