2 Indonesia

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I. Introduction

Indonesia is a republic form of government, the House of Representatives and the president is elected directly. Jakarta is the country's capital. The original name of Indonesia had been known since centuries. It derives from the latin worlds Indus (India) and Nesos (Islands). Indonesia is a country in Southeast Asia, located on the equator and located between the continents of Asia and Australia and between the Pacific and Indian Oceans. Because it lies between two continents and two oceans, it also known as the Archipelago Islands. It consists of 17,508 islands. Indonesia's history is heavily influenced by other nations. The Indonesian archipelago become an important trade region since at least the 7th century, when Srivijaya kingdom religion and trade relations with China and India. Hindu kingdoms and Buddhism has grown in the early centuries AD, followed by the traders who brought Islam, and various European powers fought one another to monopolize the spice trade of Maluku during the era of ocean exploration. After about 350 years of Dutch colonialism, Indonesia declared its independence at the end of World War II. Further Indonesia challenged by natural disasters, corruption, separatism, a democratization process, and periods of rapid economic change. From Sabang to Merauke, Indonesia consists of distinct ethnic, linguistic and religious groups. The Javanese are the largest ethnic group and most politically dominant. Indonesia's national motto, "Unity in Diversity" ("Different but remains one"), articulates the diversity that shapes the country. In addition to its large population and densely, Indonesia has a natural area that supports the level of biodiversity in the world's second largest.

I.1 Geography and Climate

Indonesia lies between latitudes 11°S and 6°N, and longitudes 95°E and 141°E. It consists of 17,508 islands, about 6,000 of which are inhabited. These are scattered over both sides of the equator. The largest are Java, Sumatra, Borneo (shared with Brunei and Malaysia), New Guinea (shared with Papua New Guinea), and Sulawesi. Indonesia shares land borders with Malaysia on Borneo, Papua New Guinea on the island of New Guinea, and East Timor on the island of Timor. Indonesia shares maritime borders across narrow straits with Singapore, Malaysia, the Philippines, and Palau to the north, and with Australia to the south. The capital, Jakarta, is on Java and is the nation's largest city, followed by Surabaya, Bandung, Medan, and Semarang.

Indonesia has special characteristics, in terms of the position, as well as its existence, so it has a specific climate characteristics. In Indonesia there are three types of climate affect climate in Indonesia, namely climatic season (monsoon) climate tropica (hot climate), and the marine climate.

a. Climate Season (Monsoon Climate)

This type of climate is strongly influenced by seasonal wind changes every period. Usually a period of change in the monsoons is 6 months. The climate consists of two types, namely the southwest monsoon (West Monsoon) and northeast monsoon. West monsoon winds blowing around October to April wet season so bring rain / wet. East monsoon winds blowing around April to October in nature resulting in dry areas of Indonesia have droughts / dry.

b. Climate Tropical / Tropical (Hot Climate)

Areas that are in the vicinity of the equator will automatically experience a tropical climate that is hot and has only two seasons, namely dry season and the rainy season. Generally the southeast Asia region has a tropical climate, while the countries of Europe and North America experienced a subtropical climate. The tropical climate of Indonesia is hot so hot that invites a lot of rainfall or rain Up Tropical.

c. Marine climate

Indonesia is an archipelago that has resulted in many areas of marine sea water evaporation into air humid and high rainfall.

I.2 Demography

According to the 2010 national census, the population of Indonesia is 237.6 million,with high population growth at 1.9%. 58% of the population lives on Java, the world's most populous island. Despite a fairly effective family planning program that has been in place since the 1960s, population is expected to grow to around 265 million by 2020 and 306 million by 2050.

There are around 300 distinct native ethnic groups in Indonesia, and 742 different languages and dialects. Most Indonesians are descended from Austronesian-speaking peoples whose languages can be traced to Proto-Austronesian (PAn), which possibly originated in Taiwan. Another major grouping are Melanesians, who inhabit eastern Indonesia. The largest ethnic group is the Javanese, who comprise 42% of the population, and are politically and culturally dominant. The Sundanese, ethnic Malays, and Madurese are the largest non-Javanese groups.

While religious freedom is stipulated in the Indonesian constitution, the government officially recognizes only six religions: Islam, Protestantism, Roman Catholicism, Hinduism, Buddhism, and Confucianism. Although it is not an Islamic state, Indonesia is the world's most populous Muslim-majority nation, with 86.1% of Indonesians being Muslim according to the 2000 census. The majority of Muslims in Indonesia are Sunni. 9% of the population was Christian, 3% Hindu, and 2% Buddhist or other. Most Indonesian Hindus are Balinese, and most Buddhists in modern-day Indonesia are ethnic Chinese. Though now minority religions, Hinduism and Buddhism remain defining influences in Indonesian culture. Islam was first adopted by Indonesians in northern Sumatra in the 13th century, through the influence of traders, and became the country's dominant religion by the 16th century. Roman Catholicism was brought to Indonesia by early Portuguese colonialists and missionaries, and the Protestant denominations are largely a result of Dutch Calvinist and Lutheran missionary efforts during the country's colonial period.

1.3 Cultural

Indonesia has about 300 ethnic groups, each with cultural identities developed over centuries, and influenced by Indian, Arabic, Chinese, and European sources. Traditional Javanese and Balinese dances, for example, contain aspects of Hindu culture and mythology, as do*wayang kulit* (shadow puppet) performances. Textiles such as batik, ikat, ulos and songket are created across Indonesia in styles that vary by region. The most dominant influences on Indonesian architecture have traditionally been Indian; however, Chinese, Arab, and European architectural influences have been significant. Indonesian cuisine varies by region and is based on Chinese, European, Middle Eastern, and Indian precedents. Rice is the main staple food and is served with side dishes of meat and vegetables. Spices (notably chili), coconut milk, fish and chicken are fundamental ingredients. Indonesian traditional music includes *gamelan* and *keroncong*. The Indonesian film industry's popularity peaked in the 1980s and dominated cinemas in Indonesia, although it declined significantly in the early 1990s. Between 2000 and 2005, the number of Indonesian films released each year has steadily increased.

The oldest evidence of writing in Indonesia is a series of Sanskrit inscriptions dated to the 5th century. Important figures in modern Indonesian literature include: Dutch author Multatuli, who criticized treatment of the Indonesians under Dutch colonial rule; Sumatrans Muhammad Yamin and Hamka, who were influential pre-independence nationalist writers and politicians; and proletarian writer Pramoedya Ananta Toer, Indonesia's most famous novelist. Many of Indonesia's peoples have strongly rooted oral traditions, which help to define and preserve their cultural identities.

II. Overview of Macroeconomic Activity and Fiscal Position

Based on Bank Indonesia report. In the midst of the ongoing global economic upheaval, Indonesia's economy remained strong and showed improved performance. Economic growth in 2011 continued to keep up with increasing trend and reached 6.5%, the highest over the last decade, coupled with low inflation rate – in term of Consumer Price Index – of 3.79%. The inflation rate is below the inflation target of 5%±1%, thereby helping to accelerate disinflation process towards the much lower long-term target, a level that is at par with the inflation level of Indonesia's trading partner countries. The high level of economic growth was contributed by the strength of export performance in the midst of the global economic downturn and increasing investments. The quality of economic growth also improved as reflected in the decline in the poverty and unemployment. On spatial terms, higher economic growth and declining inflation occurred in almost all regions in Indonesia. Compared to other neighboring countries, in the midst of slower economic growth in emerging market economies including the ASEAN countries, Indonesia's economy, in contrast, showed a notable growth. As for the inflation which over the last decade was among the highest in the region, the inflation rate was similar to those of other countries in the region.

The domestic economy's resilience was reflected in the increase in exports amidst global economic slowdown and strong domestic demand. A number of factors have contributed to Indonesia's strong exports. First, the diversification of export destinations to the emerging market Asia such as China and India whose economic growth were still relatively high supported by domestic demand that continued to be strong. Secondly, the characteristic of export commodities to those countries –dominated by energy and food commodities – that were not significantly affected by shrinking volume in global trade. From a domestic perspective, Indonesia's economic resilience was also supported by several factors. Firstly, strong consumption that was supported by improving purchasing power in line with the growth of per capita income, particularly the upper middle income segment of the population. Secondly, the increase in the number of people categorized within the productive age, as well as employments in formal sector. Thirdly, increasing source of economic growth within regions thereby resulting in ever more equitable economic growth. Fourth, strong consumption was responded by an increase of investment which will expand capacity of domestic economy. The economic resilience and improved economic outlook has enhanced foreign investors' confidence and accordingly drove FDI to play an increasingly important role.

II.1 Macroeconomic Activity

II.1.1 International Environment

The Performance Of Indonesia's Balance Of Payments

Indonesia's BoP maintained its strong performance in 2011 despite lingering uncertainty in regard to global economic conditions. It recorded an overall surplus of 11.9 billion US dollar, contributed by surplus in the current account amounting to 2.1 billion US dollar and surplus in the capital and financial account of about 14.0 billion US dollar. On a quarterly basis, the BoP showed positive performance in the first and second quarter of 2011, driven by strong performance of the trade balance, direct –investment, and portfolio investment. In the second half of 2011, however, the BoP was under pressure due to massive capital out flows from portfolio investments and increasing imports. Trade balance recorded a higher surplus in 2011 than in 2010. Moderating global demand, reflected either in global economic slowdown or slowing growth of world trade volume, had not significantly affected export performance yet.

Export growth in 2011 remained high, supported by diversification of export destination to Asian emerging countries, advantageous characteristic of the main export commodities which were natural resource based, competitive rupiah exchange rate compare to other currencies in the region, and fairly high global commodity prices. In line with economic growth in trading partner countries and developments in global commodity prices, export performed quite well, especially in the first half of 2011.

However, in the fourth of 2011, exports slightly declined due to weak global demand and decreasing commodity prices. This condition, accompanied with continued increases in imports on the back of the still firm domestic demand, caused the current account to record a deficit in quarter IV of 2011. Global economic turmoil directly influenced the dynamics of the capital and financial account, in particular the portfolio investments. In tandem with the development of global liquidity, the portfolio investments (on the liabilities side) recorded a fairly significant surplus in the first half of 2011. Nonetheless, uncertainty regarding the resolution of European public debt crisis along with slowing US economy put strong pressure on portfolio investments, such that a deficit was recorded in the third quarter of 2011. It mainly owed to massive capital outflows from the redemption of foreign investments in domestic shares and government debt securities. In the last quarter of 2011, foreign capital returned to domestic financial market driven by growing positive market perceptions. With such dynamics in play, the portfolio investments in the whole 2011 posted a surplus, even though it was lower than the surplus in 2010, thus reducing the surplus in the capital and financial account.

Unlike the global economy whose prospect were still clouded by uncertainty, stable domestic economic conditions and increasingly conducive investment climate brought about an increasing role of FDI in the structure of foreign capital inflows. The high resilience and improving prospects of the Indonesia's economy helped bolster investor confidence. This increased the direct investment surplus, far exceeding the portfolio investment surplus. Besides, it was able to serve as cushion to support Indonesia's BoP amid decline in the portfolio investment surplus due to heightened global economic uncertainty. In line with robust BoP in 2011, various external vulnerability indicators showed an improvement. The foreign exchange reserves at the end of 2011 rose to 110.1 billion US dollar or equivalent to 6.4 months of payments of imports and government external debt. Meanwhile, the ratio of external debt to GDP and the ratio of external debt to exports also declined.

Table 1: Indonesia Balance of Payment

In million of US $

	2008	2009	2010	2011"
I. Current Account	126	10.628	5.144	2.070
A. Goods, net (Balance of Trade)	22.916	30.932	30.627	35.347
- Exports, fob	139.606	119.646	158.074	201.472
- Imports, fob	-116.690	-88.714	-127.447	-166.125
1. Non-Oil & Gas	15.130	25.560	27.395	35.276
- Exports, fob	107.885	99.030	129.416	163.193
- Imports, fob	-92.755	-73.470	-102.021	-127.917
2. Oil	-8.362	-4.016	-8.653	-16.310
- Exports, fob	15.387	10.790	15.691	20.283
- Imports, fob	-23.749	-14.806	-24.344	-36.593
3. Gas	16.147	9.388	11.886	16.381
- Exports, fob	16.333	9.826	12.968	17.996
- Imports, fob	-186	-438	-1.082	-1.615
B. Services, net	-12.998	-9.741	-9.324	-11.823
C. Income, net	-15.155	-15.140	-20.790	-25.667
D. Current Transfer, net	5.364	4.578	4.630	4.212
II. Capital & Financial Account	-1.832	4.852	26.620	14.018
A. Capital Account	294	96	50	1
B. Financial Account	-2.126	4.756	26.571	14.017
1. Direct Investment	3.419	2.628	11.106	10.437
Outward	-5.900	-2.249	-2.664	-7.722
Inward	9.318	4.877	13.771	18.160
2. Portfolio Investment	1.764	10.336	13.202	4.198
Asset	-1.294	-144	-2.511	-1.416
Liability	3.059	10.480	15.713	5.614
3. Other Investment	-7.309	-8.208	2.262	-618
Asset	-10.755	-12.002	-1.725	-7.341
Liability	3.446	3.794	3.987	6.723
III. Total (I+II)	-1.706	15.481	31.765	16.088

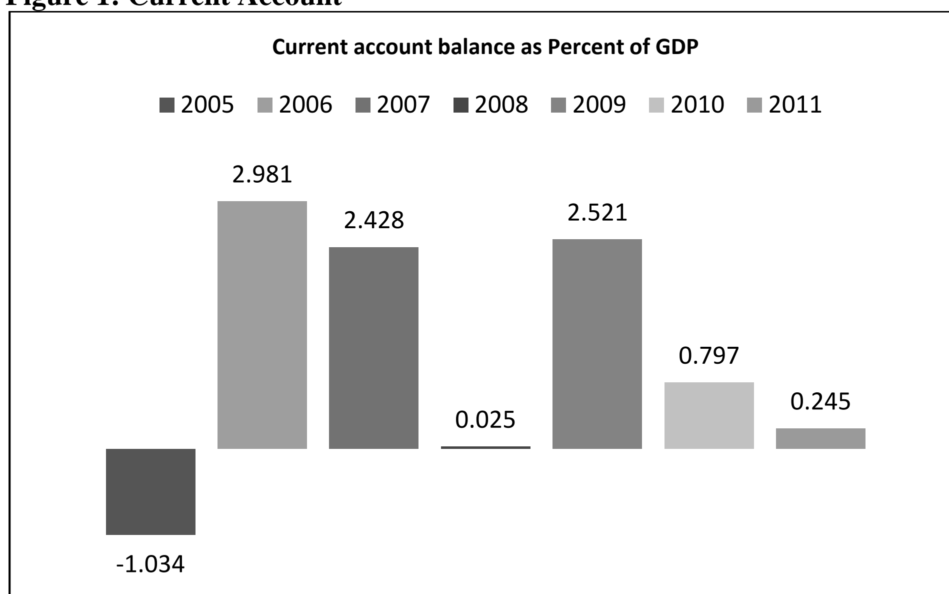
IV. Net Errors and Omissions	-238	-2.975	-1.480	-4.232
V. Overall Balance (III+IV)	-1.945	12.506	30.285	11.856
VI. Reserved and Related Items	1.945	-12.506	-30.285	-11.856
Memorandum :				
Reserve Asset Changes	51.639	66.105	96.207	110.123
(In months of imports and official foreign debt repayment)**	4,0	6,5	7,2	6,4

** very provisional figures
Source: Bank Indonesia.

Current Account

The current account recorded a surplus of 2.1 billon US dollar (0.2% of GDP), mainly owed to increasing surplus of the trade balance. The surplus of the trade balance was driven by a large increase in exports which surpassed the increase in imports stemming from increasing domestic economic activities. Nevertheless, the current account surplus was less than in the previous year since increasing imports also increased the services account deficit and increasing foreign investments also increased transfer payments of profits and investment returns which was reflected in increasing deficit of income account (Figure 1).

Figure 1: Current Account



Source : Bank Indonesia

The increase in the trade balance was driven by an increase in the non-oil and gas trade balance surplus. Non oil and gas exports, which grew at a faster pace than imports, significantly contributed to the increase in the non oil and gas trade balance. The gas trade balance surplus was supported by higher gas prices, in line with rising oil prices, while gas export volume experienced a decline. On the other hand, the oil trade balance deficit rose almost doubled from the previous year. The main factors behind the heightened pressure on the oil trade balance were the lower national crude oil production accompanied by ever-increasing fuel consumption amid rising oil prices.

Export

Exports of goods recorded fairly strong growth, supported by mining products and natural resource based products. The value of exports reached 201.5 billion US dollar, or grew at 27.5% from the previous year (Table 2). Commodities which showed the strongest growth were still mining products and natural resources based manufacture products such as coal and palm oil. However, the export growth of

agricultural products was quite low due to, among others, low levels of production caused by unfavourable weather conditions and policies on export duties, e.g. on cocoa to encourage domestic cocoa forward linkage industry. Improving exports performance was supported by higher non oil and gas export volumes, while oil and gas export volumes decreased. Increasing non oil and gas export volumes was in line with higher production and increasing production capacity in some sectors such as palm oil industry and textiles and textile product industry.

Table 2 : Export

Items	Value (million us$)		Share (%)		Growth (%)	
	2010	2011 "	2010	2011 "	2010	2011 "
Agriculture	4,991	5,157	3.2	2.6	14.8	3.3
Manufacturing[1]	101,740	127,269	64.4	63.2	32.9	25.1
Mining[1]	49,733	66,719	31.5	33.1	32.6	34.2
Others[1]	1,610	2,327	1.0	1.2	31.7	44.5
Total Export	158,074	201,472	100.0	100.0	32.1	27.5
- Non-oiland Gas	129,416	163,193	81.9	81.0	30.7	26.1
- Oil	15,691	20,283	9.9	10.1	45.4	29.3
- Gas	12,968	17,996	8.2	8.9	32.0	38.8

[1] : including oil and gas
" : provisional figures
Source : Bank Indonesia

At the same time, the oil and gas exports also increased despite of problems on the production side. In nominal terms, oil exports increased by 29.3% from 15.7 billion US dollar in 2010 to 20.3 billion US dollar in 2011. It was driven by higher oil prices. In term of volume, crude oil exports actually saw a decline from the previous year due to the declining national crude oil production from 0.945 million barrels per day in 2010 to around 0.902 million barrels per day in 2011. Declining oil production was caused by aging oil wells and lack of exploration of new wells. In addition, the decline of oil production was also attributable to other problems such as technical disturbances and unplanned shutdowns. The value of gas exports in 2011 increased to 18.0 billion US dollar from only 13.0 billion US dollar in the previous year. However, the volume of gas exports experienced a decline because of switching from export orientation – of which export contracts were expired – to domestic market regarding increasing domestic demand of gas. Oil and gas exports were mainly directed to several countries including Japan, South Korea, and Singapore.

The strong exports in the reporting year were also influenced by developments in the global commodity prices. The global commodity prices, especially crude oil, tended to increase as an impact of the geopolitical crisis in the Middle East which affected supply of crude oil).

Increasing oil price was also attributed to speculative trading, whereby oil was regarded as a safe haven asset during global financial market turmoil. Meanwhile, the price of non oil and gas commodities also rose quite rapidly, especially at the beginning of the year, despite later slowing in the second half of 2011. The non oil and gas commodities which saw price increases included rubber, palm oil and coal, amid strong global demand especially from Asian countries . The success to take advantage of increasing intra-Asian trade strengthened Indonesia's export growth. While demand from developed countries such as the US, European countries and Japan declined, market diversification helped to maintain Indonesia's strong export performance. Market diversification of exports was mainly to emerging market countries in Asia like China and India whose economies still grew at relatively high rate supported by strong domestic demand. Indonesia's exports also benefited from the characteristics of the export commodities to these countries which were mainly used for domestic consumption of these countries, like energy and food commodities, such that they were not significantly affected by slowing world trade volume. The export growth to these countries recorded an increase in 2011 (Table 3). With this development, the share of exports to these Asian countries continued to rise.

Table 3 Export by Country Origin (million US $)

	COUNTRY	2007	2008	2009	2010	2011	Trend (%) 2007-2011	Change (%) 10-Nov	Share (%) 2011
1	China	6.664,1	7.787,2	8.920,1	14.080,9	21.595,6	34,23	53,37	13,33
2	Japan	13.092,8	13.795,3	11.979,0	16.496,5	18.330,1	8,89	11,12	11,31
3	United States	11.311,3	12.531,1	10.470,1	13.326,5	15.684,2	7,41	17,69	9,68
4	India	4.885,0	7.060,9	7.351,4	9.851,2	13.279,0	26,28	34,80	8,20
5	Singapore	8.990,4	10.104,6	7.947,6	9.553,6	11.113,4	3,75	16,33	6,86
6	Malaysia	4.593,1	5.984,5	5.636,4	7.753,6	9.200,1	17,92	18,66	5,68
7	Korea, Republic Of	3.746,4	4.660,3	5.174,3	6.869,7	7.565,8	19,65	10,13	4,67
8	Thailand	2.646,9	3.214,5	2.598,4	4.054,4	5.242,5	17,34	29,31	3,24
9	Netherlands	2.749,5	3.881,2	2.902,9	3.682,1	5.076,3	12,45	37,86	3,13
10	Taiwan, Province Of China	2.337,8	2.901,2	2.875,5	3.252,3	4.205,1	13,75	29,30	2,60

Source: Ministry of Trade

Import

The import of goods in 2011 grew quite high, underpinned by stronger domestic demand for consumptions and investments. The value of imports in the reporting year grew by 31.4% (yoy) and reached 175.8 billion US dollar. The import growth of raw materials and capital goods accelerated, in line with increasing investment and production (Table 4).

Table 4. Import

Items[1]	Value (millions of US $)		Share (%)		Growth (%)	
	2010	2011**	2010	2011**	2010	2011**
Consumer Goods [2]	16,826	23,261	12.4	13.2	58.4	38.2
Raw materials /auxiliary materials [2]	92,098	119,785	68.1	67.9	45.6	30.1
Capital Goods [2]	24,983	32,361	18.5	18.3	28.7	29.5
Others [2]	1,417	948	1.0	0.5	175.4	-33.1
Total Import	135,323	176,355	100.0	100.0	44.3	30.3
Non-oil and gas	108,026	135,922	79.8	77.1	39.5	25.8
Oil	26,101	38,725	19.3	22.0	64.4	48.4
Gas	1,196	1,708	0.9	1.0	146.9	42.8

[1]Based on Broad Economic Category(BEC)
[2]IncludingOil and Gas
** Provisional figures
Source: Bank Indonesia

Import growth in raw materials was mainly driven by food and drink items, and supplies for manufacturing sector. Meanwhile, import growth of consumption goods was also fairly high, even though not as high as in the previous year, in line with the higher domestic consumptions. Imports, especially capital goods and raw materials, were still dominated by goods originating from Singapore, China and Japan.

Imports of oil and gas experienced an increase due to low domestic production of oil and gas amid increasing consumptions. Imports of fuel and LPG increased in line with rapid growth of the domestic economy. Besides increasing volumes, oil and gas imports were also attributable to the fairly significant increases in prices. Crude oil was imported particularly from the Middle East, which included certain types of oil such as ALC (Arab Light Crude), with the remainder from Brunei Darussalam, China and Malaysia. Meanwhile, the increase of oil product imports, especially fuel, could not be avoided as a consequent of decreasing domestic crude oil production amidst continuously rising fuel consumption.

Capital and Financial Account

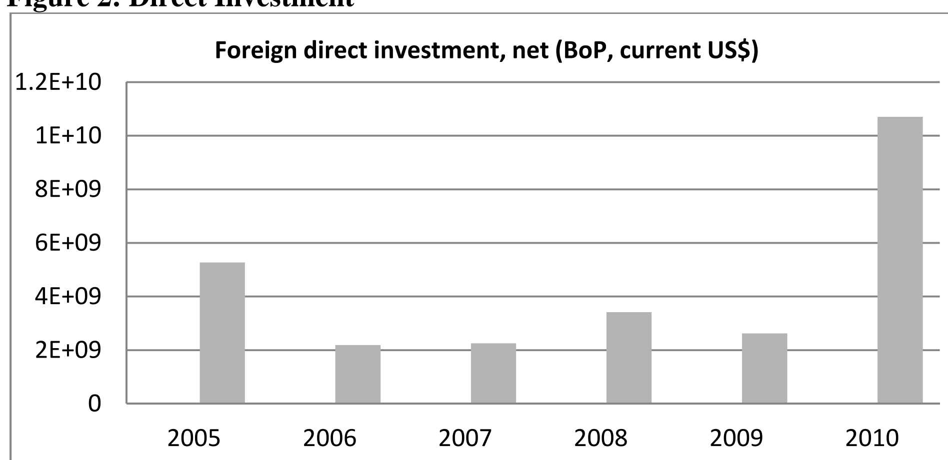
The capital and financial account in 2011 recorded a surplus of 14.0 billion US dollar, mainly supported by direct investments. The surplus, however, was lower than surplus in the previous year (26.6 billion US dollar) due to smaller surplus on portfolio investments. With larger surplus in direct investment compared to portfolio investment, the structure of the capital and financial account improved

this year. This meant that capital inflows was more stable, and thereby was able to support strong BoP performance

Direct Investment

Improving resilience and prospective Indonesia's economic outlook raised foreign investor confidence, and finally increased the share of direct investment in the capital inflow structure. The surplus of FDI rose to 18.2 billion US dollar in 2011, and boosted share of FDI to total capital inflows which was far greater than in the previous year. On the other hand, Indonesia's direct investment abroad rose to 7.7 billion US dollar in 2011. With this development, net inflows of direct investment in the reporting year was at 10.4 billion US dollar (Figure 2)

Figure 2: Direct Investment



Source: www.indexmundi.com.

Based on country of origin, most of the FDI were from Japan and other ASEAN countries , in particular Singapore. FDI share of Japan's reached 25.9% of the total FDI in the reporting period, or amounting to 4.7 billion US dollar. The share of FDI from ASEAN countries reached 45.5%, or equal to 8.3 billion US dollar.

Portfolio Investment

Foreign portfolio investment experienced a sharp decline in the second half of the year as the impact of global economic turmoil. Foreign portfolio net inflows (on the liabilities side) fell from 15.7 billion US dollar in 2010 to 5.6 billion US dollar in 2011. In the mean time, Indonesian portfolio investment overseas (on the assets side) also declined from 2.5 billon US dollar to 1.4 billion US dollar. Accordingly, the overall portfolio investment recorded a surplus of 4.2 billion US dollar, lower than the surplus in the previous year of 13.2 billion US dollar. The foreign portfolio investment surplus (on the liabilities side) accumulated in the first half of 2011, shrank in the second half due to raising negative market sentiment in the global financial markets.

The sharp decline in foreign portfolio investment was originated from redemption of SBI and rupiah denominated Government Bonds (SBN Rupiah) owned by foreign investors.

Other Investments

Other investment posted a deficit due to an increase of private sector deposits in banks overseas. The deficit of other investment in 2011 was around 0.6 billion US dollar after recording a surplus of 2.3 billion US dollar in the previous year. The deficit was mainly driven by increasing private sector deposits in overseas banks as non-oil and gas exports increased. On the other hand, loan disbursement by private sector also increased as financing requirement to support domestic economic activities increased. It, to

some extent, could compensate increasing Indonesian deposits in overseas banks, and prevented an even higher deficit of other investments.

Foreign Debt

In line with the robust BoP performance in 2011, various indicators of external vulnerability showed an improvement. From the solvency aspect, the ratio of external debt to GDP and the ratio of external debt to exports declined to 26.5% and 96.8%, respectively. In the mean time, the debt service ratio was relatively stable at around 22.5%. On the liquidity aspect, the ratio of forex reserves to short-term external debt rose to 2.4. Meanwhile, the ratio of foreign exchange reserves to imports was still considered safe as it covered 6.7 months of imports.

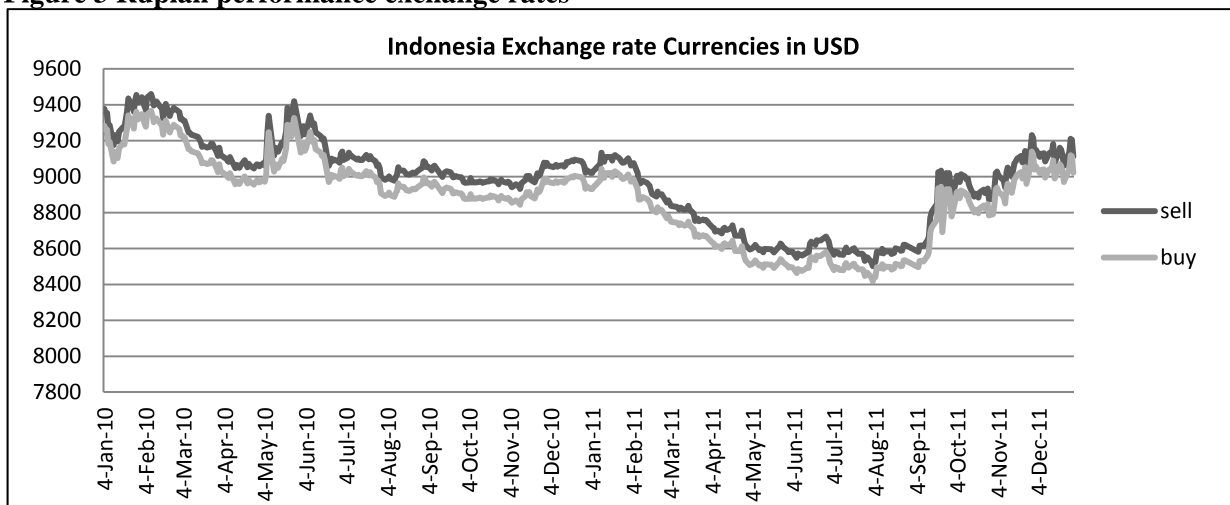
Exchange Rate

On average, the rupiah exchange rate tended to strengthen during 2011 in line with other regional currencies' movements. From domestic side, the exchange rate appreciation was supported by solid economic fundamentals, relatively stable risk indicators, and a high return on rupiah based assets, which impressed investor appetite to invest in domestic financial markets. Meanwhile, on the external side, rupiah exchange rate performance was affected by capital flows fluctuations, which was influenced by the dynamics of the global economy and policies. During semester I 2011, monetary easing in advanced countries led to an excess of global liquidity, which coupled with the widening interest rate differential between developed and developing countries led to a deluge of capital flows into the Asian region, including Indonesia. Such circumstances ensured the continuation of rupiah appreciation that had occurred in 2010. Notwithstanding, increased uncertainty in quarter III 2011 stemming from the debt crisis in Europe and recovery problems in the US triggered negative sentiment and capital outflows from Indonesia. Since this period the rupiah exchange rate had tended to weaken accompanied by increased volatility.

Exchange Rate Performance

In 2011, rupiah exchange rate appreciation was marked by a number of corrections associated with rising inflation expectations at the beginning of the year as well as increasing global economic risk that persisted until yearend. The rupiah appreciated in 2011, on average, by 3.56% from Rp9,080 per US dollar to Rp8,768. However, the rising of global economic uncertainty undermined the sustainability of rupiah appreciation that had occurred up until the end of semester I 2011. At yearend, the rupiah closed down by 0.64% at Rp9,068 per US dollar compared to Rp9,010 at the end of 2010 (Figure 3).

Figure 3 Rupiah performance exchange rates



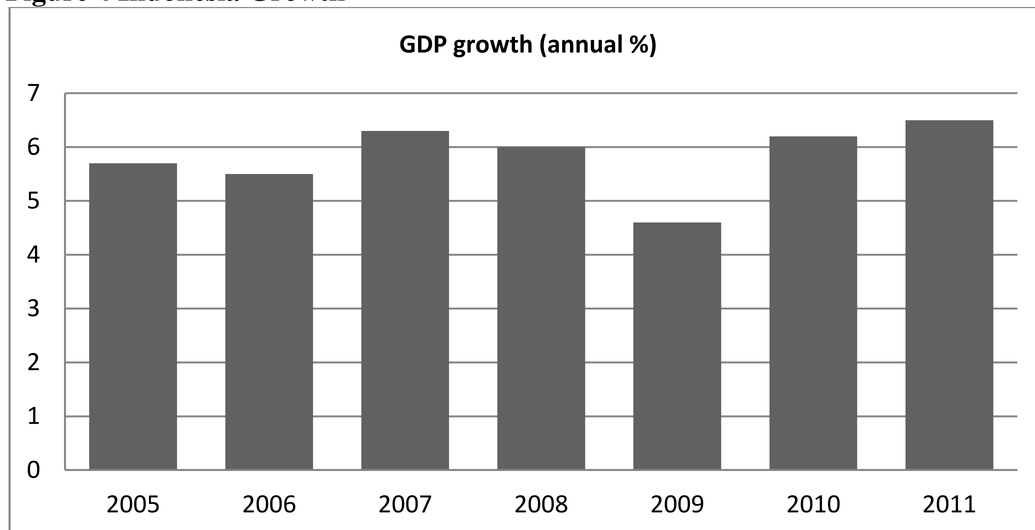
Source: Bank Indonesia.

II.1.2 Domestic Environment

Economic Growth

Indonesia's economy in 2011 grew strongly at 6.5%, improved over the previous year and reached the highest growth experienced within the last decade. On the demand side, the growth was primarily supported by an increase in consumption and investment performance, while on the supply side the primary contributor was supported by manufacturing and trade sectors performance. The growth was accompanied by an improvement in the quality of growth as reflected by increasing in investments contribution and continuing high exports contribution, declining unemployment and poverty, and rising economic growth contribution from outside of Java. The high economic growth in the midst of a weakening global economy was supported by both high growth in the domestic economy and also continued high growth of exports. The performance of the domestic economy, especially with regard to consumption, was supported by the large capacity of the domestic economy, which come from a rise in purchasing power, the growth of the middle and upper class, a high proportion of productive age population, and rising employment in the formal sector. These conditions encouraged domestic and foreign business optimism, thus enhanced investment. Meanwhile, Indonesia's strong export performance as supported by its ability to take advantage of intra-regional trade, particularly with countries whose economies were reoriented to focus on their domestic economies. In the midst of an uncertain global economic recovery, Indonesia's economy strengthened. Indonesia's Gross Domestic Product (GDP) grew from 6.2% in 2010 to 6.5% in 2011. This was the highest rate of growth since the 1997 crisis. Stable macroeconomic conditions such as low inflation, relatively stable exchange rate volatility, and stable political and security conditions in the country contributed to high economic growth.

Figure 4 Indonesia Growth



Source: World Data Bank

On the demand side, economic growth came primarily from strong household consumption and from high investment growth. Stable purchasing power, which was in line with low inflation and rising incomes, was the factor that drove strong household consumption. Under these conditions, household consumption grew 4.7%, higher than the 4.4% average. Meanwhile, stable macroeconomic fundamental was sufficiently strong enough to support the more conducive business climate and to increase business optimism, thus driving investment performance. Under these favorable conditions, investment growth increased to 8.8%, outpacing its historical average of 7.4%. In addition to household consumption and investment, exports that continued to perform well despite the weakening global economy, also

contributed to the development of Indonesia's economic. Strong export performance that was supported by the successful diversification of export destinations, particularly to emerging market countries in Asia, enabled export to grow 13.6%, well above historical levels of 7.5%

On the production side, the tradable sector showed an improvement in growth, while the non- tradable sector remained stable with high rates of growth.1 In 2011, the tradable sector grew 4.5%, a fairly significant increase compared with 4.0% in the previous year. Meanwhile, the non- tradable sector achieved high growth at 8.2%, approximately the same as in 2010. In line with its accelerating growth, the contribution of the tradable sector to economic growth also expanded, although non-tradable remained to dominate.

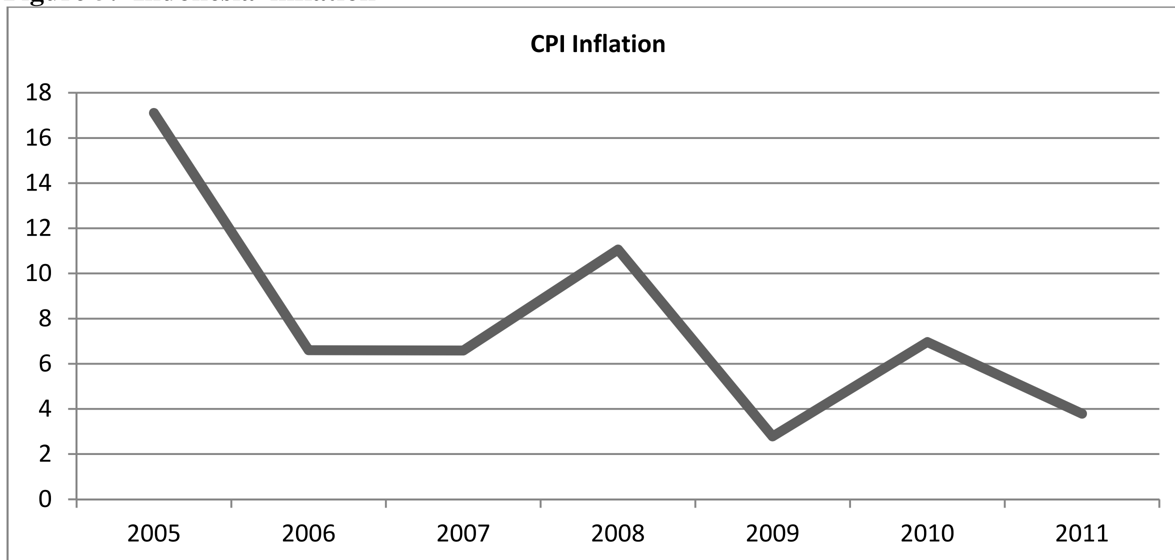
Inflation

Indonesia's inflation dropped to 3,79% in 2011 amid solid economic growth of 6,5%. The level was much lower than that in the previous year of 6,96% and below its target of 5% ± 1%. Inflation declined in almost all regions in Indonesia and moved toward the level in neighbouring countries. The policies taken on by the Government and Bank Indonesia contributed to the low level of the inflation. Core inflation was stable at a relatively low level of 4.3% due to adequate economic capacity, stronger rupiah and well-anchored inflationary expectations. Meanwhile, volatile food inflation, which peaked at 17.74% last year, fell sharply to just 3.37%, as a result of adequate supplies and food price stabilization efforts by the Government. Administered prices inflation was also kept minimal at 2,78% by the absence of policies in strategic commodities such as subsidized fuel prices and electricity tariff .

Inflation Performance

The declining trend of headline inflation persisted in 2011. Despite some significant negative shocks from foodstuff s prices and fuel prices over the decade, headline inflation has shown some resilience as indicated by its declining trend (Figure 9).

Figure 5: Indonesia inflation



Source : BPS- Statistic Indonesia.

The continuing trend in 2011, though mostly happened in food components, took place in almost all categories, except for the clothing, health and education components. Based on this development, the declining trend of inflation is expected to carry on in the future.

In the beginning of 2011 inflationary pressures were high but then they subsided until the end of the year. Contributing to the inflationary pressures at the start of the year were the high inflationary

expectations, pressures on domestic foodstuff s prices due to limited supply and disturbances to distribution, and harsh weather conditions. From external front, crude oil prices and agricultural commodities prices were also rising. Following the level in the end of 2010, headline inflation remained high in the first quarter of 2011, approaching 7%, which occurred in volatile food and core components. Inflation expectations for 2011 were also high at round 6.5%-6.8%.2 The high inflationary expectations were among others affected by the Government's plan to ration the consumption of subsidized fuel – which had started since 2010 - and the uptrend in global commodity prices, including energy prices.

Inflation by Group Commodities

The lower contribution to CPI inflation took place in nearly all components, except clothing and education The clothing component – especially jewellery - contributed significantly to CPI inflation - notably in the period of August to September, due to the stuttering global economic recovery. As such, the additional impact from gold price shock during the religious festivities of Ramadhan and Ied Fitr pushed up CPI inflation in August 2011 to 0.93% (mtm), higher than its August level in the past ten years. Meanwhile, in the education component, tuition fees increased at elementary school up to higher education in accordance with new academic year (at the beginning of the third quarter of 2011). The increase of inflation in the education component in 2011 was higher than that in the same period in the last four years. At the higher education level, high inflation particularly took place in Sulawesi and Sumatera. Meanwhile, for Senior High School and below, high inflation occurred in Sumatera and Java.

Employment

Employment condition continued to improve with the decreasing unemployment rate. In line with the improving economic growth, open unemployment rates dropped from 7.1% in 2010 to 6.6% in 2011 (Table 5). This decline was equally distributed across all regions In addition, the quality of labor force also improved as reflected in increased employment within the formal sector and greater numbers of workers with higher education background than primary school. Improvement in the formal sector was supported by more sustainable economic structure with improvement in the manufacturing sector, as a sector that absorbs many formally employed and highly educated workers. However, several issues remained, namely the still high level of unemployment rate in Jakarta and West Java that was above the national rate, as well as the slight decline in full-time workers during the year.

Table 5 Labor Force and Unemployment

Million people unless oted otherwise

No	Main Activities	2009	2010	2011
1	Productive age population (15+)	169.3	172.1	171.7
	-Labor force participation rate (percent)	67.2	67.7	68.3
2	Labor Force	113.8	116.5	117.4
	-Full time worker(percent)	64.4	64.3	64.0
	-Part time worker (percent)	14.2	15.5	17.9
	-Under employment (percent)	13.5	13.1	11.5
	-Open unemployment (percent)	7.9	7.1	6.6

Source: BPS-Statistics Indonesia.

II.1.3 Fiscal Position

In 2011, in order to support the achievement of national development goals, fiscal policy is more expansionary taken by the target deficit of 1.8 percent of GDP. On the deficit, the state revenue targeted to reach Rp1.104, 9 trillion and expenditures of Rp1.229, 6 trillion. This strategy is to create a balance between fiscal consolidation and fiscal stimulus, which is to create a fiscal stimulus by increasing the development budget, while keeping the budget deficit at a controlled level. This strategy expect - national oriented development goal which increasing national welfare through the four main pillars of national development that is pro-poor, pro-growth, pro-job, pro-environment

Table 6 Budget Summary 2011

(in Billions Rupiah)

				2011	
				Proposed Budget	Budget
A.	Revenues and Grants			1,086,369.6	1,104,902.0
	I.	Domestic Revenues		1,082,630.1	1,101,162.5
		1.0	Tax Revenues	839,540.3	850,255.5
			a. Domestic Tax Revenue	816,422.3	827,246.2
			b. International Trade Tax	23,118.0	23,009.3
		2.0	Non Tax Revenues	243,089.7	250,907.0
	II.	Grants		3,739.5	3,739.5
B.	Expenditures			1,202,046.2	1,229,558.5
	I.	Central Government Expenditures		823,627.0	836,578.2
		1.0	Line Ministry	410,409.2	432,779.3
		2.0	Non-Line Ministry	413,217.9	403,798.9
	II.	Transfer to Regions		378,419.2	392,980.3
		1.0	Balanced Funds	329,099.3	334,324.0
		2.0	Special Autonomy and Adjustment Funds	49,319.9	58,656.3
	III.	Suspend		0.0	0.0
C.	Primary Balance			726.2	(9,447.3)
D.	Surplus/Deficit (A - B)			(115,676.6)	(124,656.5)
E.	Financing			115,676.6	124,656.5
	I.	Domestic Financing		118,672.6	125,266.0
	II.	Foreign Financing		(2,995.9)	(609.5)
	Surplus / (Deficit) Financing			0.0	0.0

Source : Ministry of Finance.

Till the first quarter of 2011, the implementation of the budget is still appropriate with expectations. Although Indonesian economy having pressure from high oil prices on the international market and the price of food commodities, but fiscal situation remains under control at a safe level.

Government Revenue

Entering the year 2010, Indonesian economic condition was estimated to reach 5.8 percent growth, slightly higher than the achievement in 2009 that only reached up to 4.5 percent. Based on such estimation, and supported by the ICP price estimation that reached USD80 per barrel, the domestic revenues was targeted to be Rp990.5 trillion in APBN-P 2010 that would consist of tax revenues amounting to Rp743.3 trillion and PNBP Rp247.2 trillion. Such amount was 16.9 percent higher than the realization in the previous year. The progress of domestic revenues in 2005–2009 is shown in Table 7.

Table 7 Domestic Revenues, 2005 – 2010

(Trillion Rupiah)

Description	2005Real.	2006Real.	2007Real.	2008Real.	2009Real.	APBN-P2010
Domestic Revenue	493.9	636.2	7 06.1	979.3	847 .1	990.5
Tax Revenue	347 .0	409.2	491.0	658.7	61 9.9	7 43.3
a. Domestic Tax	331.8	396.0	470.1	622.4	601.3	7 20.8
i.. Income Tax	17 5.5	208.8	238.4	327 .5	317 .6	362.2
1) Oil and Gas	35.1	43.2	44.0	7 7 .0	50.0	55.4
2) Non-Oil and Gas	140.4	165.6	194.4	250.5	267 .6	306.8
ii. Value Added Tax	101.3	123.0	154.5	209.6	193.1	263.0
iii. Building and Land Tax	16.2	20.9	23.7	25.4	24.3	25.3
iv. Duties on Land and Building Transfer	3.4	3.2	6.0	5.6	6.5	7 .2
v. Excise	33.3	37.8	44.7	51 .3	56.7	59.3
vi. Other Taxes	2.1	2.3	2.7	3.0	3.1	3.8
b. International Trade Tax	15.2	13.2	20.9	36.3	18.7	22.6
Import Duties	14.9	12.1	16.7	22.8	18.1	17 .1
Export Duties	0.3	1.1	4.2	13.6	0.6	5.5
2. Non-Tax Revenue	146.9	227 .0	215.1	320.6	227 .2	247 .2
a. Natural Resources Revenue	110.5	167.5	132.9	224.5	139.0	164.7
i. Oil and Gas	103.8	158.1	124.8	211.6	125.8	151.7
ii. Non-Oil and Gas	6.7	9.4	8.1	12.8	13.2	13.0
b. Dividend from BUMN	12.8	23.0	23.2	29.1	26.0	29.5
c. Other non-tax revenue	23.6	36.5	56.9	63.3	53.8	43.5
d. BLU revenue	0.0	0.0	2.1	3.7	8.4	9.5

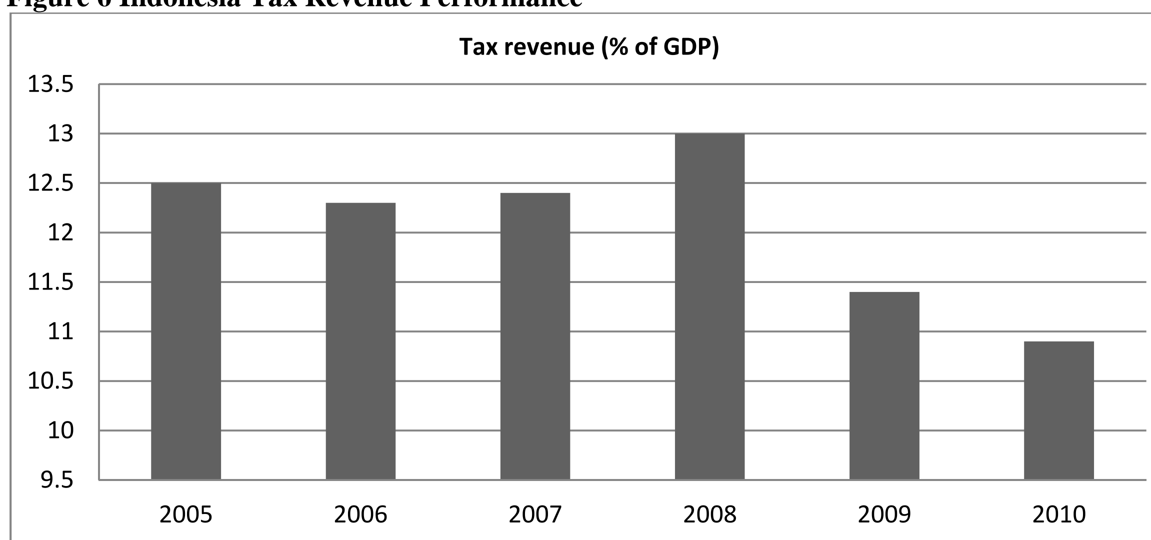
Source: Ministry of Finance

Tax Revenues

The average growth of tax revenues in 2005–2009 was 15.6 percent. Several main factors that supported the increase of tax revenues were the realization of stable macro economic fundamental condition and implementation of tax, customs and excise modernization policy. Based on sources, the tax revenues was categorized into domestic tax revenues and international trade tax. The domestic tax revenues consisted of income tax (PPh), value added tax (PPN) and sales tax on luxury goods (PPnBM), customs and other taxes, while international trade tax consisted of export duties and import duties. In the period of 2005–2009, the domestic tax revenues had grown with an average of 16.0 percent, while the international trade tax had 5.2 percent average growth.

Furthermore, the tax revenues was able to provide dominant contribution to domestic revenues. In 2005, the contribution from tax revenues was 70.3 percent, to 64.3 percent in 2006, to 69.5 percent in 2007, to 67.3 percent in 2008 and later to 73.2 percent in 2009. The increasing contribution from tax revenues reflected the role of tax revenues to become very strategic as the source of development funding. Meanwhile, based on its contribution to GDP, further mentioned as tax ratio, the tax revenues was able to contribute between 11 and 13 percent during the period of 2005–2009. The progress of tax ratio during the period of 2005–2009 is detailed in Figure 6.

Figure 6 Indonesia Tax Revenue Performance



Source: World Data Bank.

Non-Tax Revenues (PNBP)

The Law Number 20 Year 1997 regarding Non-Tax Revenues (PNBP) defined the PNBP as Central Government's revenues that derived not from taxation. In the above Law, the PNBP was categorized into: (1) revenues from Government's funding management; (2) natural resources (SDA) exploitation revenues; (3) revenues from separable asset management result; (4) revenues from Government services; (5) revenues based on court verdict and from administration fines; (6) revenues from grants that was Government's prerogative; (7) other revenues that were regulated in separate Law. In APBN structure, the PNBP is grouped into: (1) SDA revenues; (2) Dividend from State Owned Enterprises (BUMN); (3) other PNBP; and (4) public Service Agency (BLU) revenues. The SDA revenues consists of oil and gas SDA and non-oil and gas SDA revenues.

In APBN-P 2010, the PNBP was targeted to be Rp247.2 trillion. In comparison with 2009 realization, such target was increased by Rp20.0 trillion or 8.8 percent higher. With the above target, the PNBP was estimated to contribute 25.0 percent to the projected domestic revenues. Based on composition, the highest increase would come from oil and gas SDA revenues that increased by 20.7 percent in comparison with the 2009 realization. **Table 8** shows the progress of total PNBP and its revenues components during 2005–2010.

Table 8.Non-Tax Revenues, 2005 – 2010

(Trillion Rupiah)

Description	2005	2006	2007	2008	2009	APBN-P2010
I. SDA Revenue	1 10.5	167 .5	132.9	224.5	139.0	164.7
a. Oil and Gas SDA Revenue	103.8	158.1	124.8	211 .6	125.8	151 .7
b. Non-Oil and Gas SDA Revenue	6.7	9.4	8.1	12.8	13.2	13.0
II. Dividends from BUMN	12.8	21 .5	23.2	29.1	26.0	29.5
III. Other PNBP	23.6	38.0	56.9	63.3	53.8	43.5
IV. BLU Revenue	-	-	2.1	3.7	8.4	9.5
PNBP	146.9	227 .0	21 5.1	320.6	227 .2	247 .2

Source MInistry of Finance.

Government Expenditure

Based on the expenditure economic classification, the government expenditure budget consisted of personnel expenditure, material expenditure, capital expenditure, interest payment, subsidy, grant expenditure, social assistance, and other expenditures. From the total of central government expenditure

budget in RAPBN 2011 that amounted to Rp823.6 trillions; about 21.9 percent of them would be allocated for personnel expenditure, 16.0 percent for material expenditure, 14.8 percent for capital expenditure, 14.1 percent for interest payment, 22.4 percent for subsidy, 0.1 percent for grant expenditure, 7.5 percent for social assistance, and 3.2 percent for other expenditures. The above composition showed that the central government expenditure was still dominated by nondiscretionary spending that consisted of personnel expenditure, interest payment, subsidy and part of material expenditure. The budget that would be used for discretionary spending such as capital expenditure, grant expenditure, social assistance, part of material expenditure and other expenditures was still limited. The composition of central government expenditure budget in 2011 by economic classification is detailed in Table 9

Table 9. Central Government Expenditure

in Billions Rupiah

Item	2006	2007	2008	2009	2010	2011	
	Audited	Audited	Audited	Audited	Revised Budget	Proposed Budget	Budget
1. Personnel Expenditure	**73,252.3**	**90,425.0**	**112,829.9**	**127,669.7**	**162,659.0**	**180,624.1**	**180,824.9**
a. Salary and Allowances	43,067.9	50,343.5	67,760.7	70,653.7	81,064.9	91,170.6	89,726.2
b. Honorarium and Vacation	6,426.2	11,531.7	7,765.9	8,496.0	27,267.7	28,146.0	29,791.2
c. Social Contributions	23,758.3	28,549.8	37,303.3	48,520.0	54,326.4	61,307.6	61,307.6
2. Material Expenditures	**47,181.9**	**54,511.4**	**55,963.5**	**80,667.9**	**112,594.0**	**131,533.4**	**137,849.7**
3. Capital Expenditures	**54,951.9**	**64,288.7**	**72,772.5**	**75,870.8**	**95,024.6**	**121,658.7**	**135,854.2**
4. Interest Payment	**79,082.6**	**79,806.4**	**88,429.8**	**93,782.1**	**105,650.2**	**116,402.8**	**115,209.2**
a. Interest of Domestic Debt	54,908.3	54,079.4	59,887.0	63,755.9	71,857.6	80,396.0	79,396.0
b. Interest of Foreign Debt	24,174.3	25,727.0	28,542.8	30,026.2	33,792.6	36,006.8	35,813.2
5. Subsidy	**107,431.8**	**150,214.4**	**275,291.5**	**138,082.2**	**201,263.0**	**184,816.8**	**187,624.3**
a. Energy	94,605.4	116,865.9	223,013.2	94,585.9	143,997.1	133,806.7	136,614.2
b. Non Energy	12,826.4	33,348.6	52,278.2	43,496.3	57,265.9	51,010.0	51,010.1
6. Grant Expenditures	**-**	**-**	**-**	**-**	**243.2**	**771.3**	**771.3**
7. Social Assistance	**40,708.6**	**49,756.3**	**57,740.8**	**73,813.6**	**71,172.8**	**61,525.9**	**63,183.5**
a. Natural Disaster Rescue	-	-	-	-	3,792.8	4,000.0	4,000.0
b. Ministry/institution Assistance	40,708.6	49,756.3	57,740.8	73,813.6	67,380.0	57,525.9	59,183.5
8. Other Expenditures	**37,423.1**	**15,621.2**	**30,328.1**	**38,926.2**	**32,926.7**	**26,293.9**	**15,261.0**
a. Policy Measures	-	-	-	-	6,000.0	4,940.2	4,174.9
b. Other Expenditure	37,423.1	15,621.2	30,328.1	38,926.2	26,926.7	21,353.8	11,086.1
Total	**440,032.1**	**504,623.3**	**693,356.0**	**628,812.4**	**781,533.6**	**823,627.0**	**836,578.2**

Source : Ministry of Finance

III. Tax structure : Institutions and The Reality

III.1 The Role of Taxation

Taxation in Indonesia divided into central tax and local tax.

a. 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 (Sector Forestry and Mining), The Duty on Acquisition of Land and Building, and Stamp Duty.
b. The local tax is based only to one law on Local Tax and Retribution (Law Number 28 Year 2009). 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.

Taxpayer rights

Based on the law, the taxpayer rights as follows:

a. To obtain TIN and or taxable person for VAT purpose Identification number after registering and reporting his business.
b. On a request, to extend the period to file annual tax return.
c. To receive a proof of receipt for a tax return filed directly to the DGT.
d. To amend the tax return.
e. On a request, the right to install or postpone the tax payment.
f. To request for correction of a notice of tax assessment.
g. 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.
h. To appoint a proxy by a power of attorney to exercise rights and fulfill tax obligations.
i. To obtain secrecy guarantee through official secrecy provisions.
j. 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.
k. To file a request for deduction or cancellation of incorrect tax assessment.
l. 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.
m. To file a request for appeals to the tax court against decision on objection which is still considered in appropriated.
n. To file additional reasons or written explanations before a decision on objection is issued.
o. The right to file an objection on a notice of tax assessment.
p. The right to extend the period to file an objection due to circumstances beyond his control.
q. The right to obtain written information on matters which constitute the basis for imposition of tax in order to file a objection.
r. 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.
s. 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.

t. 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.

Taxpayer obligations

Taxpayer must fulfill the obligations as follows:

a. To register and/or report his business.
b. 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.
c. 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.
d. In case a taxpayer is an entity, the tax return must be signed by any member of the management or board of directors.
e. In case a tax return is completed and signed by other than the taxpayer, a power attorney must be attached.
f. 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.
g. 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.
h. To pay or remit tax payable at state treasury or any other place of payment stipulated by Minister of Finance.
i. 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.
j. 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.
k. 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.
l. To store books, records and documents used as a basis of bookkeeping or recording for 10 years in Indonesia.
m. Keep book and record or recording in good faith, which reflects the facts or the real business activity.
n. Secure approval from DGT on changing in the method of bookkeeping and or accounting year.

III. 2 Tax Administration

Directorate General of Taxes as tax authority in Indonesia having a vision to be a institution that held a modern tax administration system effectively, efficiently, and trustworthy people with integrity and high professionalism. Moreover 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. 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.

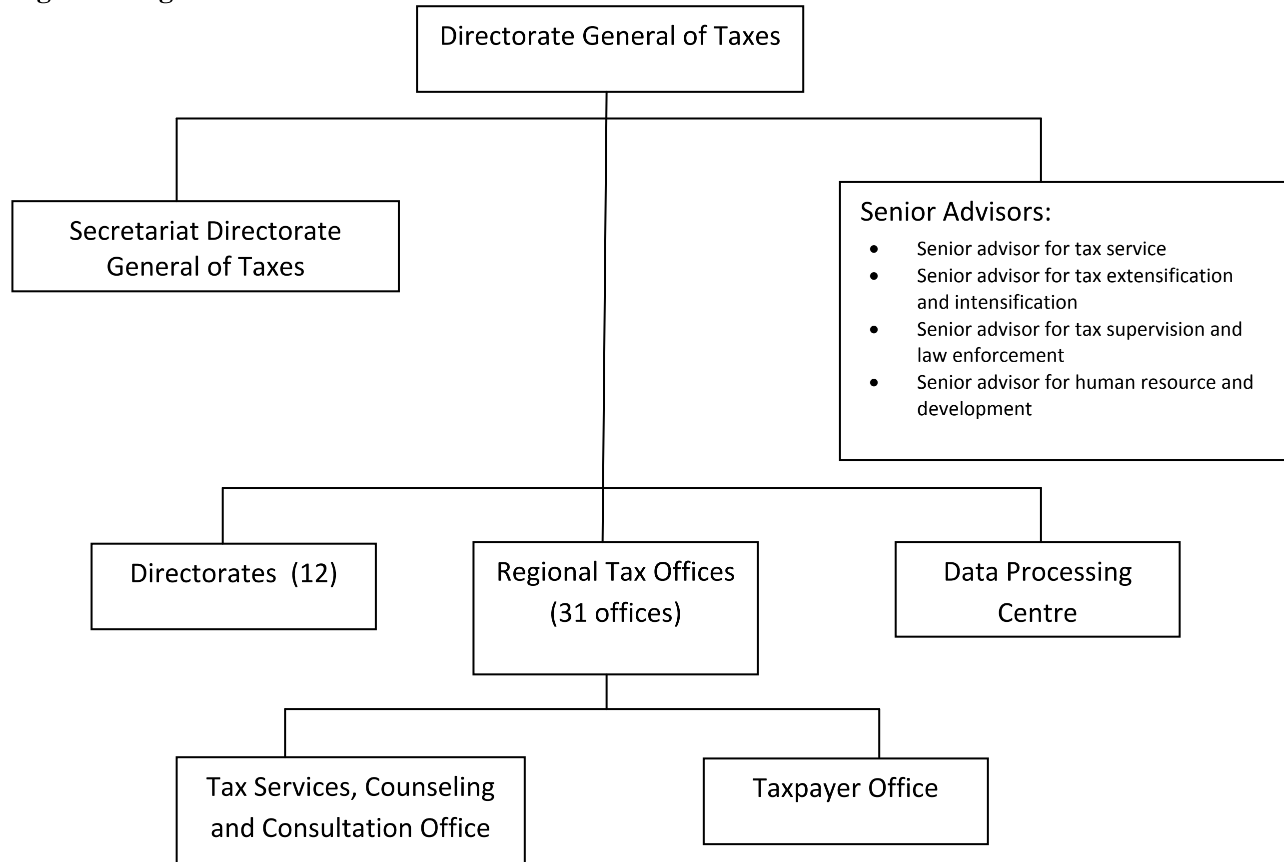
Indonesia government cooperate with donor country implementing tax administration reform that was carried out through tax modernization program that lasted from 2002 to 2008. The result of such modernization was among others the construction of 331 modern tax offices (KPP). Further, the tax reform program was continued with tax reform program II that was aimed to increase human resources management and informatics and communication technology. The main program of these activities was wrapped up in Project for Indonesia Tax Administration Reform (PINTAR), which was aimed to increase

voluntary tax compliance, and to implement good governance through transparency and accountability increment of Directorate General of Taxes.

III.3.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 7 Organization Structure



However with only 32000 staff it less than the ideal organization compare to OECD countries, DGT only have 34 % auditor compare with average 60 % in advanced countries.

III.4 Individual Income Tax

Overview of Individual 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.

a) **Tax Rates**

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

b) **Main Personal Relief**

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

Table 10: 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

Source Directorate General of Taxes.

c) 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:

i. resides in Indonesia;
ii. present in Indonesia for 183 days or more in any continuous 12-month period;
iii. 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.

d) Taxable Income

Table11 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

Source : Directorate General Of Taxes.

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:

i. Compensation or payments received or earned in connection with work or services.
ii. Lottery, prizes, and awards.
iii. Gross profits from individual business activities.
iv. Gains from the sale or transfer of assets.
v. Refunds of tax payments already deducted as expenses.
vi. Interest.
vii. Dividends, in whatever name or form, paid by a corporation, payments of dividends by an insurance company to policy holders.

e) Tax-Exempt Income

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

i. Benefits in-kind:
   Unless these amounts are taken as a deduction in determining the taxable income of the employers,
   Unless the employer is tax exempt or is subject to tax on a final tax or deemed profit basis
ii. Income tax borne by the employer (unless grossed-up)
iii. 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
iv. Inheritances
v. Payments from an insurance company because of accident, illness, or death of the insured, and payments of scholarship insurance
vi. Proceeds from disposal of certain domestic mutual fund/investment funds

f) 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.

g) 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:

Table12 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.	

Source : Directorate General Of Taxes

III.5 Corporate Income Tax

Overview of 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.

a) 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.

b) 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.

c) 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:

i. Gross profits from business;
ii. Gains upon the sale or transfer of property (realized capital gains);
iii. Interest, dividends, and royalties (subject to certain exceptions);
iv. Rents;
v. Income from debt forgiveness and;
vi. 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

d) Exempt Income

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

i. Gifts or donations that are not related to the business or profession of the parties involved;
ii. Dividends received by a resident company from another resident company, provided:
The dividend is sourced from retained earnings, 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.
iii. 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.
iv. Income or profits received by an investment fund company as long as all income or profits are distributed to shareholders.

e) 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.

f) Dividend

Tax is withheld from dividends as follows:

i. 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: the dividends are paid out of retained earnings; 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.
ii. Non-resident recipients: 20 percent (lower for treaty countries) final withholding tax is due on dividends paid to a non-resident recipient.

g) Deductions

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

i. 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;
ii. Promotional and sales costs;
iii. Bad debts, provided strict conditions are fulfilled;

iv. 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;
v. "Zakat" donations if paid to an approved body by a Moslem individual or Moslem-owned business;
vi. Losses from the sale or transfer of assets;
vii. Foreign exchange losses;
viii. Costs of research and development performed in Indonesia;
ix. Scholarships, apprenticeships and training costs;
x. 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;
xi. 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);
xii. Goodwill ("Muhibah") can be capitalized and amortized;
xiii. Office refreshments;
xiv. Prior year losses;
xv. 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:

i. 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;
ii. Private expenses;
iii. Non-business gifts and aid, except Islamic alms ("Zakat");
iv. 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;
v. Income tax payments;
vi. Tax penalties;
vii. Profit distributions;
viii. 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;
ix. Expenses relating to income which is taxed at a final rate, e.g., interest on loans relating to time deposits;
x. 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;
xi. Salaries or compensation received by partnership or firm as members where their participation is not divided into shares.

h) 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.

i) 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:

i. 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.
ii. 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.
iii. 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.
iv. 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.
v. 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:

i. 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:

    Category 1 - 4 years;
    Category 2 - 8 years;
    Category 3 - 16 years;
    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).
ii. 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:

    Category 1 – 50 percent declining-balance; 25 percent straight-line
    Category 2 – 25percent declining-balance; 12.5percent straight-line
    Category 3 - 12.5 percent declining-balance; 6.25 percent straight-line
    Category 4 – 10 percent declining-balance; 5 percent straight-line
iii. 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.

iv. 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.

v. 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.

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).

j) 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.

i. 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.

ii. 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.

iii. 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.

iv. 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.

v. 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.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.

a) 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.

b) Article 22 - Imports

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

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

c) Article 4 (2) – Final Income Tax

i. 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:

Table13 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	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	2.5%

d) 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:

Table14 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%

e) 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:

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

Table 15 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 for by the non-residents holding of Indonesian of a conduit company companys hares/where PE serves as an intermediary	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.

ii. 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.

a) 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:

i. Deliveries of taxable goods in the Customs Area by an enterprise;
ii. Importation of taxable goods;
iii. Deliveries of taxable services in the Customs Area;
iv. Use or consumption of taxable intangible goods originating from outside the Customs Area in the Customs Area;
v. Use or consumption of taxable services originating from outside the Customs Area in the Customs Area;
vi. Export of taxable goods (tangible and intangible) by an enterprise;
vii. Export of taxable services by an enterprise.

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

i. Deliveries of a title to taxable goods according to an agreement;
ii. Transfers of taxable goods according to a leasing-with-option or finance-lease agreement;
iii. Deliveries of taxable goods to an intermediary trader or an auction official;
iv. Own-use and/or free gift of taxable goods;
v. Remaining taxable goods and certain assets originally not for sale at a company's dissolution;
vi. 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;
vii. Deliveries of taxable goods on consignment;
viii. 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 16 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; and funeral 2) Social services such as orphanages 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 international air port 11) Medical health services; 12) Religious services and Educational Services 13) Public transportation on land and water international air transport 14) Manpower services; 15) Hotel services; 16) Parking area services; 17) Public services provided by the government.

b) 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:

i. 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;
ii. 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);
iii. Auction price for deliveries of taxable goods to an intermediary trader of an auction officer;
iv. 10 percent of selling price for used cars;
v. 5 percent of the total service charges, provisions, and discounts for factoring services;
vi. Average selling price for video and audio recording products;
vii. 4 percent of total costs incurred or paid, exclusive of the acquisition price of land, for the self-construction of a building;
viii. Retail selling prices for deliveries or import of tobacco products;
ix. 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:

c) 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.

d) 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.

e) 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:

i. The name, address and tax ID number of the taxpayer delivering the taxable goods or services;
ii. The name, address and tax ID number of the purchaser;
iii. The type of goods or services, the quantity, the sales price or compensation and any discounts;
iv. The VAT that has been collected;
v. The sales tax on luxury goods that have been collected (if any);
vi. The code, serial number and date of issue of the invoice;
vii. 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:

i. The time of delivery of taxable goods and services;
ii. The time a payment is received if the payment is received prior to the delivery of taxable goods or services;
iii. The time a term-payment is received in the case of delivery of a part of the work phase;
iv. 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:

i. Import declarations (PIBs) together with tax payment slips or tax collection slips issued by Customs;
ii. Export declarations (PEBs);
iii. Instruction letters for the distribution of milled flour and sugar from the state organizer of staple distribution (Bulog or Dolog);
iv. Pertamina delivery invoices;
v. Telephone/telecommunications service bills, electricity bills, airway bills, or delivery bills issued for domestic air transportation services;
vi. Tax payment slips for the self-assessed VAT on the use or consumption of foreign taxable services or intangible goods;
vii. 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

f) 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:

i. Manufacturers who process at least 75 percent of their products using their own manufacturing facilities;
ii. Public companies (having their shares listed in Indonesian stock exchanges);
iii. 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.

g) 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:

i. passenger vehicles;
ii. alcoholic beverages;
iii. certain food and non-alcoholic beverage products;
iv. household appliances and electronic goods;
v. cosmetics;
vi. luxury homes and apartments.
vii. It is necessary to determine the applicability of the STGL on a case by case basis as the rules are complex and subject to change. There is an exemption from STGL 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 fo 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.

a) To be the beneficial owner, the following criteria should be satisfied:

i. For individuals, that they are not receiving income as an agent or nominee
ii. 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
iii. 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.
iv. A company whose shares are listed on the stock exchange and traded regularly.
v. A bank, or
vi. Any other company which meets specific requirements:

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;

The company has employee(s);

i) The company has activities or an active business;
ii) Income derived from Indonesia is taxable in the recipient's country.
iii) 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.

b) 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.

c) 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.

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

Table 17 Indonesia Tax Treaties

No	Country	Branch Profit Tax	Dividends		Interest and royalties	
			Portfolio	Substantial holdings	Interest	Royalties
1	Aljazair	10%	15%	15%	15%	15%
2	Australia	15%	15%	15%	10%	15%
3	Austria	12%	15%	10%[10]	10%	10%
4	Bangladesh	10%	15%	10%[10]	10%	10%
5	Belgium	15%	15%	15%	15%	10%
	Renegotiated	10%	15%	10%[11]	10%	10%
6	Brunei Darussalam	10%	15%	15%	15%	15%
7	Bulgaria	15%	15%	15%	10%	10%

8	Canada	15%	15%	15%	15%	15%
	Renegotiated	15%	15%	10% [12]	10%	10%
9	Chech Republic	12,50%	15%	10% [13]	12,50%	12,50%
10	China	10%	10%	10%	10%	10%
11	Denmark	15%	20%	10% [14]	10%	15%
12	Egypt	15%	15%	15%	15%	15%
13	Finland	15%	15%	10% [15]	10%	15%
14	France	10%	15%	10% [16]	15%	10%
15	German	10%	15%	10% [17]	10%	15%
16	Hungarian	n/a	15%	15%	15%	15%
17	India	10%	15%	10% [18]	10%	15%
18	Italia	12%	15%	10% [19]	10%	15%
19	Iran	7%	7%	7%	10%	12%
20	Japan	10%	15%	10% [20]	10%	10%
21	Jordanian	n/a	10%	10%	10%	10%
22	South Korea	10%	15%	10% [21]	10%	15%
23	North Korea	10%	10%	10%	10%	10%
24	Kuwait	10%	10%	10%	5%	20%
25	Luksemburg[23]	10%	15%	10% [22]	10%	12,50%
26	Malaysia	10%	15%	15%	10%	10%
	Renegotiated		10%	10%		
27	Mexico	10%	10%	10%	10%	10%
28	Mongolia	10%	10%	10%	10%	10%
29	Dutch	9%	15%	10%	10%	20%
	Renegotiated	9%	15%	10% [24]	10%	10%
	Renegotiated	10%				
30	New Zealand	n/a	15%	15%	10%	15%
31	Norwegian	15%	15%	15%	10%	15%
32	Pakistan	10%	15%	10% [25]	15%	15%
33	Filipina	20%	20%	15% [26]	15%	15%
34	Poland	10%	15%	10% [27]	10%	15%
35	Portugal	10%	10%	10%	10%	10%
36	Qatar	10%	10%	10% [10]	10%	5%
37	Rumania	12,50%	15%	12,5% [28]	12,50%	12,50%
38	Russia	12,50%	15%	15%	15%	15%
39	Saudi Arabia[8]	n/a	n/a	n/a	n/a	n/a
40	Seychelles	n/a	10%	10%	10%	10%
41	Singapore	15%	15%	10% [29]	10%	15%
42	Slovakia	10%	10%	10%	10%	15%
43	South Africa	10%	15%	10% [30]	10%	10%
44	Spain	10%	15%	10% [31]	10%	10%
45	Sri Lanka	Based on Domestic Law	15%	15%	15%	15%
46	Sudan	10%	10%	10%	15%	10%
47	Swedish	15%	15%	10% [32]	10%	15%
48	Swiss	10%	15%	10% [33]	10%	12,50%
49	Suriah	10%	10%	10%	10%	20%
50	Taiwan	5%	10%	10%	10%	10%
51	Thailand[34]	Based on Domestic Law	(RI)15% (Thai)25%	(RI) 15% (Thai) 15%	(RI) 15% (Thai)25%	10%
52	Tunisia	12%	12%	12%	12%	15%
53	Turkey	15%	15%	10% [35]	10%	10%
54	Uni Emirat Arab	5%	10%	10%	5%	5%
55	Ukraine	10%	15%	10% [36]	10%	10%
56	British	10%	15%	10%	10%	15%
	Renegotiated	10%	15%	10% [37]	10%	15%
57	USA	15%	15%	15%	15%	15%
	Renegotiated	10%	15%	10% [38]	10%	10%
58	Uzbekistan	10%	10%	10%	10%	10%
59	Venezuela	10%	15%	10% [39]	10%	20%
60	Vietnam	10%	15%	15%	15%	15%

Source : Directorate General Of Taxes

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:

a) 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.
b) Notary's deeds and their copies.
c) Deeds prepared by a designated land notary ("Pejabat Pembuat Akta Tanah").
d) All documents bearing a sum of money which:
    i. State the receipt of money;
    ii. State the recording or deposit of money in a bank;
    iii. Contain notification of a bank balance;
    iv. Contain the acknowledgement of debt wholly or partly paid or compensated;
    v. Are in the form of valuable documents such as drafts, promissory notes, or acceptances;
    vi. Are in the form of securities, in whatever name or form;
    vii. Are in the form of cheque.
e) Documents to be used as instruments of evidence before a court:
    i. Ordinary letters or internal papers
    ii. 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,
    iii. and deviate from their original purpose.

The Rp 6,000 rate is applicable to (a), (b), (c), and (e). For (d), 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

a) 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.

b) 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

a) 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.

b) 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:

i. 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).
ii. Accelerated depreciation or amortization of assets.
iii. Withholding tax on dividend paid or payable to offshore at 10 percent or at the rate of prevailing tax treaty, whichever is lower.
iv. 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.

c) Bonded Zones

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

i. 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.
ii. 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.
iii. 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.
iv. 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.

d) 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:

i. Exemption from import duty;
ii. No collection of VAT and STLG and
iii. Income tax is borne by the government for primary contractors, consultants and
iv. 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 Tax Assessments and Tax Audits

a) 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).

b) 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:

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

c) 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 business sector or specific tax payer which proposed by bottom-up risk analysis and top-down risk analysis

d) 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.

i. 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

ii. 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:

i) Issuing taxpayer identification number ex-officio;
ii) Terminating taxpayer identification number;
iii) Confirming or revoking taxable person for Value Added Tax (VAT) purposes;
iv) Taxpayer lodges objection;
v) Collecting material for determination of net deemed profit;
vi) Verifying data and or information;
vii) Determining whether taxpayer is located at remote area;
viii) Designating one or more places where VAT is payable;
ix) Audit in the framework of tax collection;
x) Determining the commencement of production or extending the time period of loss compensation relating to granting tax incentives; and or
xi) 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.

e) Closing conference

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

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

III.14 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.

a) 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.

b) 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:

i. Objection Decision Letters;
ii. Decision Letters on the Reduction or Cancellation of Administrative Sanctions;
iii. Decision Letters on the Reduction or Cancellation of a Tax Assessment;
iv. 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.

c) 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:

i. 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: The Decision has been based on a perjury, a deception, or false evidence from the part of the opposing party; A piece of important written evidence is found, which had it been considered previously would have led to a different Decision;

ii. For those pertaining to conditions below, the time limit is 3 months after the court decision: Some part of the claim has been ignored without reason; Something not demanded was granted;

iii. The Decision is patently inconsistent with prevailing tax regulations.

IV. Country Specific Fiscal Issues

In the fiscal year 2011, Directorate General of Taxes having two predominant project particularly to increasing the revenue and to improving the image of Directorate General Of Taxes as an institutions and as tax officers. To increasing the revenue, DGT introduces National Tax Census, and to getting better image, *Whistle Blowing System* already being implemented.

IV.1 National Tax Census

When the government will carry out the development will require funds, one of which comes from taxes. Taxes are compulsory contributions to be paid by all taxpayers without getting a direct reward that will be used for the greatest prosperity of the community. Every year, taxpayers must calculate and report the amount of tax to be paid by means or a form called Notice of Annual (SPT).While the means to remit the tax to the bank or post office used a form called the Tax Payment (SSP). Currently, only few Taxpayers who have filling return to the Tax Office, of tens of millions of Indonesian people who earn above the personal exemption (taxable income), only 8.5 million were reported her tax return for the tax year 2010. Even with the enterprise, from tens of millions of registered, only 466 thousand filling return. Recognizing the inadequate number of taxpayers, the government will implement the activities called **National Tax Census**. National Tax Census essentially for strengthening the fairness. It's not fair when there are some people who have paid taxes but there are many more that have not paid taxes.

a) **Overview of the National Tax Census (NTC)**
NTC is collecting data on the tax liability in order to broaden the tax base by attending subject to tax (individuals or entities) in all regions of Indonesia by the Directorate General of Taxes.

b) **Background of NTC**
National development can keep moving and the country's economy can continue to grow because of the state revenue. The greater the state revenue would be more and more public facilities that can be provided by the government. State revenues could be increased if there is expansion of the tax base. Expansion of the tax base can be realized if there is accurate data on potential tax. That is why the NES is necessary for justice and the welfare of the people manifested through the use of tax money.

c) **NTC Basic Law**
The legal bases are as follows:
   i. Law No. 6 of 1983 on General Provisions and Tax Procedures (CTP), as amended by Act No. 16 of 2009 ;
   ii. Law Number 12 of 1985 concerning Land and Building Tax as amended by Act No. 12 of 1994 ;
   iii. Minister of Finance Regulation No. 149/PMK.03/2011 dated 12 September 2011 concerning the National Tax Census.

d) **NTC goals**
NTC implemented in order to:
   i. Expansion of tax base
   ii. Increased tax revenue
   iii. The increase in total revenue in Annual Income Tax
   iv. Data Base Updates

e) **NTC Target**
Target NTC is for those who:
   i. Tax payer does not have Taxpayer Identification Number (TIN), hence TIN will be given
   ii. Tax payer not paying taxes yet, hence will be pay taxes
   iii. Tax payer not filling return yet , hence will fill return to the SPT
   iv. Having a tax debt, to pay off
   v. Not optimal to pay taxes, will be pay correctly

f) **Benefits of NTC**

i. Improving the public's active role in financing national development
ii. Realizing the role of the subject of tax fairness in financing national development
iii. Reduce dependence of foreign loan financing
iv. Achieve a better national development
v. Welfare of the whole people

IV. 2 Whistle Blowing System

TO prevent and early detection for violations that may occur in the Directorate General of Taxes (DGT), DGT has issued the law of Director General of Taxes number PER-22/PJ / 2011 dated August 19, 2011 through increased participation and civil society to be actively reporting violations (*Whistle blower*). Moreover to make whistle blowing system can be understood and implemented by all employees DGT leaders has conducted socialization to employees in the Head Office and the DGT Regional Office in Indonesia. Socialization is divided into several stages of the time and place of execution, namely:

a) In September, the socialization of whistle blowing system is held within socialization of Compliance Systems Development Year 2011 held at Medan (includes regional tax office Aceh, North Sumatra I, and North Sumatra II) and Surabaya.
b) In October, held at the Head Office (include Headquarters and all the Regional Office in Jakarta) and Makassar (includes Nusa Tenggara, South Sulawesi, North Sulawesi, Gorontalo, Papua and Maluku Regional Office).
c) In November, socialization held in Balikpapan (including the Regional Office of Kalimantan, and Padang
d) In the final stage in December, socialization held at the Central Office includes the Office of the Banten, West Java I DJP Regional Office, West Java II Regional Office, Central Java Regional Office I,II, and the Regional Office of Yogyakarta.

DGT became the first echelon level institutions that realize and can concretely realize *whistle blowing system* became a rule, which is not even covered is likely to be a reference to the unit / other government agencies and even private institutions.

The purpose of whistle blowing system mainly to avoid the betrayal of employees in various forms of possible violations, but *whistle blowing System* also intended to rebuild *public trust* towards the DGT and encourage all employees to change the culture of permissiveness into Corrective culture which means it will never tolerate any breach by way of complaints reported to the channel that has been provided. An understanding of *whistle blowing System* Directorate General of Taxes is expected to prevent and reduce abuses, establish a new culture of corrective DJP, DJP and improve employee compliance. This in turn is expected to support the achievement of optimal tax revenue.

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

V.1 Where We Stand

Based on Bank Indonesia and Ministry of Finance report it is declared that Indonesia's economic prospects in 2012 influenced by developments on a number of assumptions related with the global as well as the domestic economy.

a) The Global Environment

The global economy is expected to experience a slower growth. The global economy, which grew by 3.8% in 2011, is expected to slow to 3.3% in 2012. Developed countries are expected to experience slower growth in 2012 from 1.6% to 1.2%. The economic slowdown in the developed countries is primarily caused by continued weakening domestic demand, particularly in terms of consumption, as well as the existence of the deleveraging process. Developing countries are expected to continue to shore up the global economy with the growth of 5.4% in 2012, in spite of it being lower than the 6.2% growth achieved in 2011. International commodity prices are expected to be lower in 2012. The global economic slowdown is expected to result in a decline in commodity prices to 12.8% following an increase of 15.8% experienced in 2011. The decline in commodity prices is expected for non-oil and gas commodities, while a correction of the oil prices are expected to be largely limited. Global inflation is expected to be relatively low as a result of the declining trend in commodity prices. Inflation in the developed countries is expected to decline from 2.7% in 2011 to 1.6% in 2012, while inflation in the emerging markets will decline from 7.2% to 6.2%. Monetary policy in the developed countries will continue to ease, as a response to the global economic slowdown and declining commodity prices. Accordingly, central banks in the emerging markets will also implement accommodative monetary policies. Fiscal policy is expected to continue to be directed at providing stimulus for growth, which tends to decline. However, the room for fiscal stimulus in the developed countries will largely be limited to fiscal consolidation as part of efforts to reduce the level of fiscal deficit.

b) The Fiscal Policy

In accordance with the Government's 2012 Budget, fiscal policy seeks to provide impetus for the economy (fiscal stimulus) by maintaining economic stability and fiscal sustainability. This objective is expected to be accomplished through four main objectives, which includes enhancing economic growth (pro-growth), creating and enhancing employment opportunities (pro-job), and enhance public welfare while preserving the environment (pro-environment). The strategy for the 2012 fiscal policy seeks to balance fiscal consolidation and stimulus as reflected in the 2012 budget deficit projected to be as much as Rp123.9trillion or 1.5% of GDP.

V.2 Where We Go

In the medium term, Indonesia's economy is expected to grow higher and sustainably with a maintained macroeconomic stability. This optimism is supported by investment and domestic consumption growth that remain high as well as the continued recovery of the global economic conditions. Investment that grew relatively high in 2011 is expected to be even higher in future, including investment in a number of infrastructure projects, thereby boosting the economic capacity and productivity. Indonesia's economy in the medium term is expected to grow by around 6.6% - 7.4% in 2016, while inflation is expected to gradually decline towards 4.0% ± 1% in 2016.

a) The Global Environment

Following the slowdown experienced in 2012, global economic growth is expected to gradually expand in the medium term. In the developed countries, the fiscal consolidation process to reduce sovereign debts

to an acceptable level as well as the need to further strengthen domestic demand are expected to result in gradually implemented efforts to bring the level of economic growth to its longer term trend. With such conditions, economic growth in the developed countries is expected to reach a level of as much as 2.7% throughout the 2014-2016. As for the emerging countries, through the support of increased domestic demand, they are expected to achieve a strong growth of around 6.7% within the same period. In line with this, growth of the world trade volume in the medium term will moderately increase towards 7.4% in 2016. In line with the gradual economic recovery, international commodity prices for both oil and gas as well as non-oil and gas is forecasted to rise causing the global inflationary pressure to moderately increase in the medium term. In the medium term, inflation in the developed countries is expected to slowly increase close to a level prior to the crisis of around 1.7% in 2016. On the contrary, inflation in the emerging markets is expected to decline to around 4.2% within the same year.

b) The Fiscal Policy

In the medium term, efforts towards structural improvements to enhance the economic capacity and productivity, particularly through physical infrastructure improvements and quality of human capital, has become the key factors to achieve a sustainable economic growth. The continuing macroeconomic and the financial system stability to date has instilled a conducive environment for the national economy. Therefore, progress in implementing various structural policies in the years to come will strengthen the economy's foundation in achieving higher growth. In addition to enhancing economic capacity, structural enhancements will drive higher productivity (Total Factor Productivity–TFP) and efficiency thereby in turn increasing return on investment and the national economy's competitiveness.

Improvements on the structural side will provide opportunities to the economy in the medium term to remain on a higher growth path with sustained macroeconomic stability. Combination of fiscal and monetary policies is believed to be able to ensure that aggregate demand expansions will be sufficiently responded by aggregate supply hence higher economic growths will not disrupt macroeconomic and financial system stability. If this condition is achievable, Indonesia's economy in the medium term is expected to be able to grow by 6.6% - 7.4% in 2016. Meanwhile, inflation is expected to gradually decline toward its medium term target of 4.0% ± 1% in 2015-2016. Investment performance as the main factor that drives the economy in the medium term is expected to expand continuously. Investment growth is expected to reach 13.1% - 13.9% in 2016. Positive sentiment towards macro and micro risks of Indonesia's economy serves as the investment's pull factors2 that put Indonesia as one of the most preferred destinations for Foreign Direct Investment (FDI). In the meantime, the push factor that drive this investment growth are the foreign capital flows to the emerging countries in the midst of the excess global liquidity. Recent upgrades of Indonesia's sovereign rating to investment grade status will also boost FDI needed to expand investment and the economy.

Apart from the greater support of FDI, investment growth will also be driven by accumulated private savings in the medium term. Growth in public savings, which had previously declined as a result of the Asian financial crisis, has increased in line with the rise in public income. The demographic strength and rational consumption behavior positively contributed to the increase of private savings.

The demographic strength will be in the form of the increase of productive age population that is accompanied with the growth of the middle class income) in Indonesia thereby providing demographic dividend to the economy. Larger composition of the productive age population to the total population will also reduce the dependency ratio thereby the productive age population will be able to save more.

The growing number of the middle class income is the result of its steady growth over a decade following the Asian crisis of 1997/98. It also reflects improvements in people's income that ultimately supports growth in private savings. In addition to this, savings growth is also supported by the people's consumption behavior, which has become increasingly rational. Increase in income for those within the productive age category has driven people to increase their spending for long-term needs such as housing and education. This behavior, among others, is reflected in the private consumption to GDP ratio, which has actually declined during times when people's income tends to increase

Investment performance not only depends on improved macro and micro conditions but also on improved efficiency of the use of production factors. The efficiency is highly dependent on the infrastructure's competitiveness, which to date has been the main obstacle of Indonesia's economy. Infrastructure competitiveness aspects cover the physical infrastructure as well as the quality of human resources such as: lack of available transportation infrastructure and energy, low quality and level of inclusiveness of the education system, and the extent of the digital divide (technological gap). Development of physical infrastructure is expected to be achieved by implementing Master plan for Acceleration and Expansion of Indonesia Economic Development or MP3EI. One of the pillars of the MP3EI program is aimed at strengthening physical infrastructure, or referred to as Strengthening National Connectivity, by building roads, bridges, ports, airports, electricity power, as well as the development of information technology and communications. Realization of physical infrastructure development through the MP3EI is expected to improve significantly once the Draft Law for the Law Land Acquisition for Public Purposes Development is passed and made into Law

Aside from this, the other important pillar of the MP3EI, involving enhancing human resource quality as well as science and technology, is expected to be able to improve national productivity as a preparation towards a knowledge-based economy. Human resource development that focuses on the development of a higher educational system is expected to enhance Total Factor Productivity (TFP) while simultaneously reduce technological gaps. In addition to this, efforts to enhance TFP is also carried out through technological development thereby elevating economic capacity to a higher level

Meanwhile, the level of private consumption is expected to remain strong in the medium term. Increased domestic investment activities will improve economic capacity thereby positively impact price stability and in turn improve people's purchasing power. Larger economic capacity will also boost job creation and improve income thereby strengthening the accumulation of private savings. This cycle of income creation has been established in recent years, which is reflected in the income growth trend and savings ratio that continue to increase in the last ten years. This trend is expected to persist in the future thereby ensuring sustainable private consumption for the years to come. As a result, household consumption is expected to grow strong to reach around 4.8% - 5.6% in 2016.

On the external front, export growth can potentially return to its normal path in line with the global economic recovery. Also, substantial investment in export oriented business, including the industrial sector, and export diversification to other developing countries are expected to increase the volume of exports. Diversification of export destinations is clearly an evident in recent years with the gradual shift in export market share from the traditional countries such as the US, Japan, and the Euro zone to emerging countries such as China, India and the ASEAN region. Based on this development, exports growth is projected to return to the normal path at the range of 13.4-14.2% in 2016.

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