

Indonesia: Navigating the Legal Landscape for Chinese Investors

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Indonesia – The Promise

President Joko Widodo (Jokowi) is trying to improve the ease of doing business in Indonesia and mitigate the challenges commonly faced when investing in Indonesia.



“What we need to do is improve ease of doing business in this country. Ministerial regulations should always refer to the objective. They should not scare investors away.” – President Jokowi in a cabinet meeting on July 24, 2017

Why Invest in Indonesia

Economic Growth

- Global economic growth will be driven by emerging markets and developing countries (with E7 economies including Indonesia)
- By 2030: Indonesia is predicted to be 5th largest economy in world

Large Population - Workforce

- Currently: 261 million
- By 2045: 309 Million
- Working Age: 52% by 2045

Rising Middle Class - Large Consumer Base

- Forecast to be 135 million by 2020
- Forecast to be 80% of the population by 2045

Abundance of Natural Resources

- Large reserves of minerals: bauxite, nickel, iron ore
- Large reserves of coal
- Large reserves of natural gas
- Plantation commodities
- Ocean resources

Sound Macroeconomic Policy

- Return of Sri Mulyani Indrawati as Minister of Finance
- Public debt management (28% of GDP)
- Budget deficit (3% of Government expenditures)

Jokowi and Foreign Investment

Jokowi's Economic Policy Package

- Deregulation, de-bureaucratization and enhanced law enforcement
- Objective is to increase Indonesia's industrial competitiveness

Deregulation:

Harmonizing regulations; revoking redundant and irrelevant regulations

De-bureaucratization:

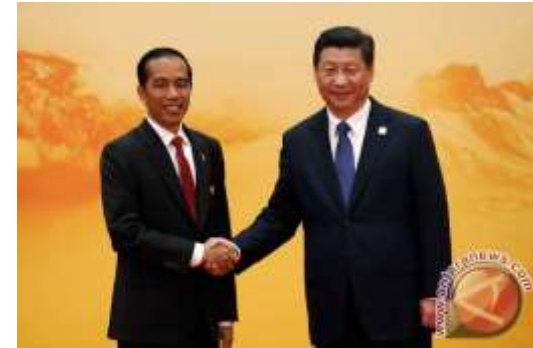
Simplification of licensing, fewer administrative requirements, electronic applications, one-stop integrated service, clear standards and procedures

Law enforcement and certainty of doing business:

Damage control channel, eradication of extortion, clear sanctions

Jokowi and Chinese Investment

- Jokowi actively seeks Chinese investment
- Favors infrastructure and manufacturing sectors
- Agreement to jointly develop infrastructure projects in North Sumatra, North Kalimantan and North Sulawesi
- “China Desk” with Mandarin-speaking officials in the Capital Investment Coordinating Board (“BKPM”)

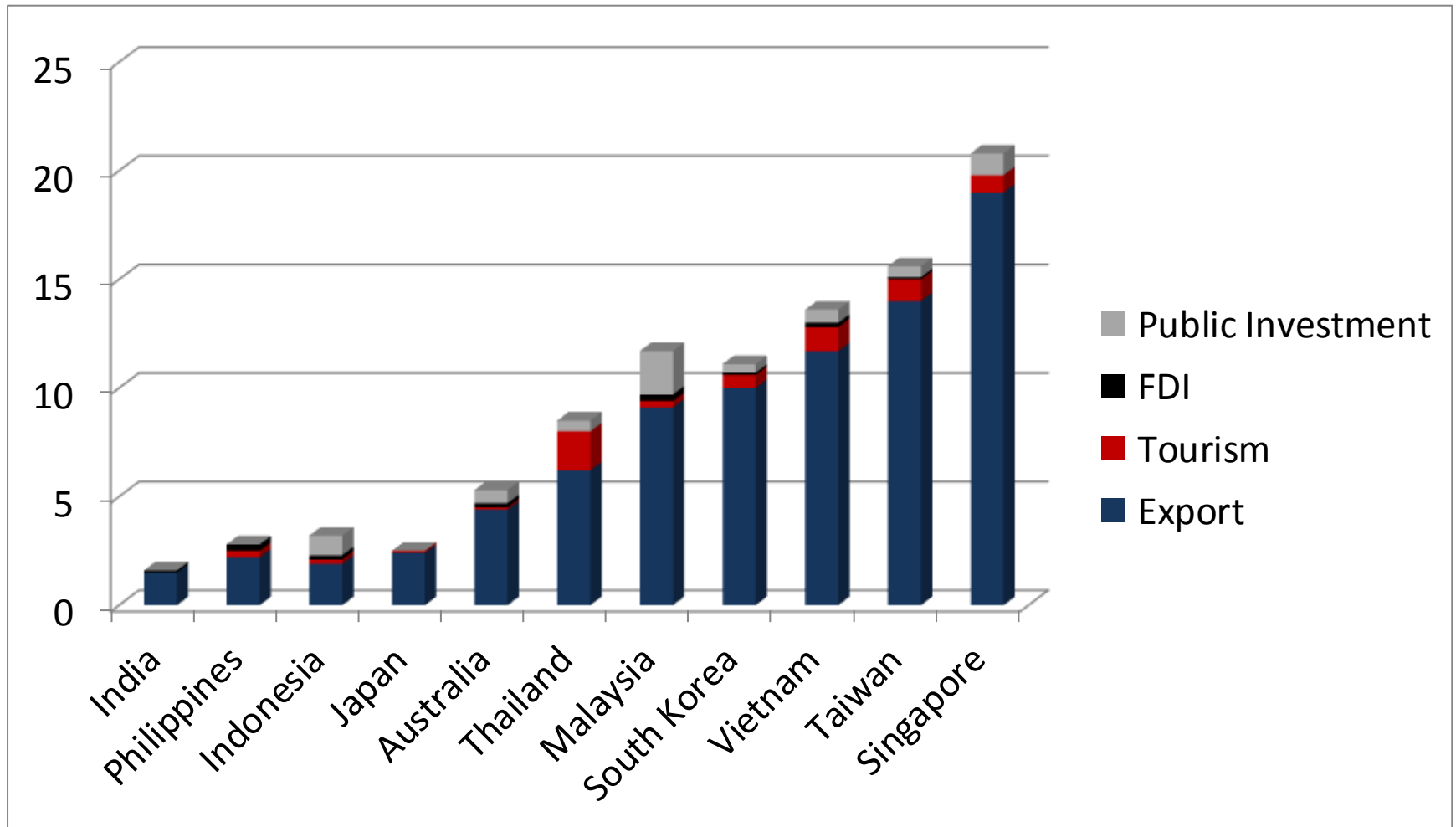


Chinese Investment in Indonesia

- China among the top 5 investors in Indonesia in 2017
- China's investment in 2017 included the following sectors: electricity, financing of ports and power plant construction, and nickel smelters



Chinese Investment in Asia (% of GDP)

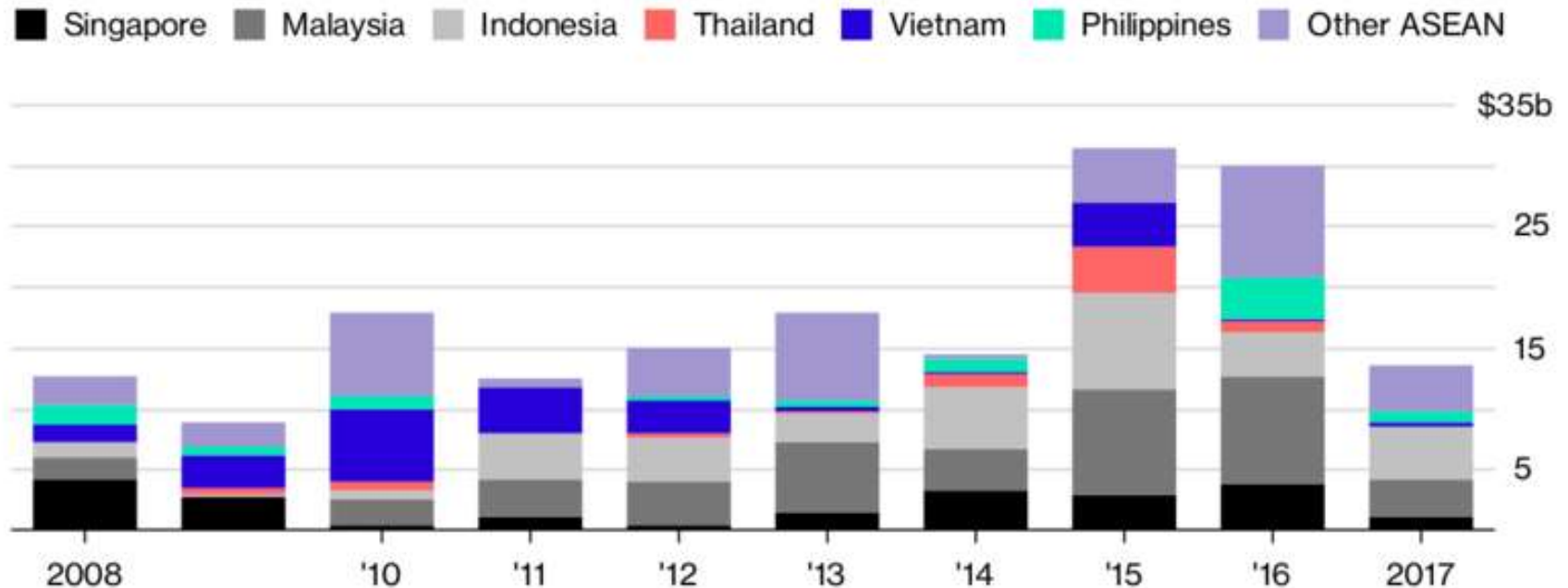


Source: Bloomberg, August 2016

Chinese Investment in Indonesia

Asean Countries

Value of China's investment and construction contracts in Southeast Asian countries



Note: 2017 includes data from first half of year only

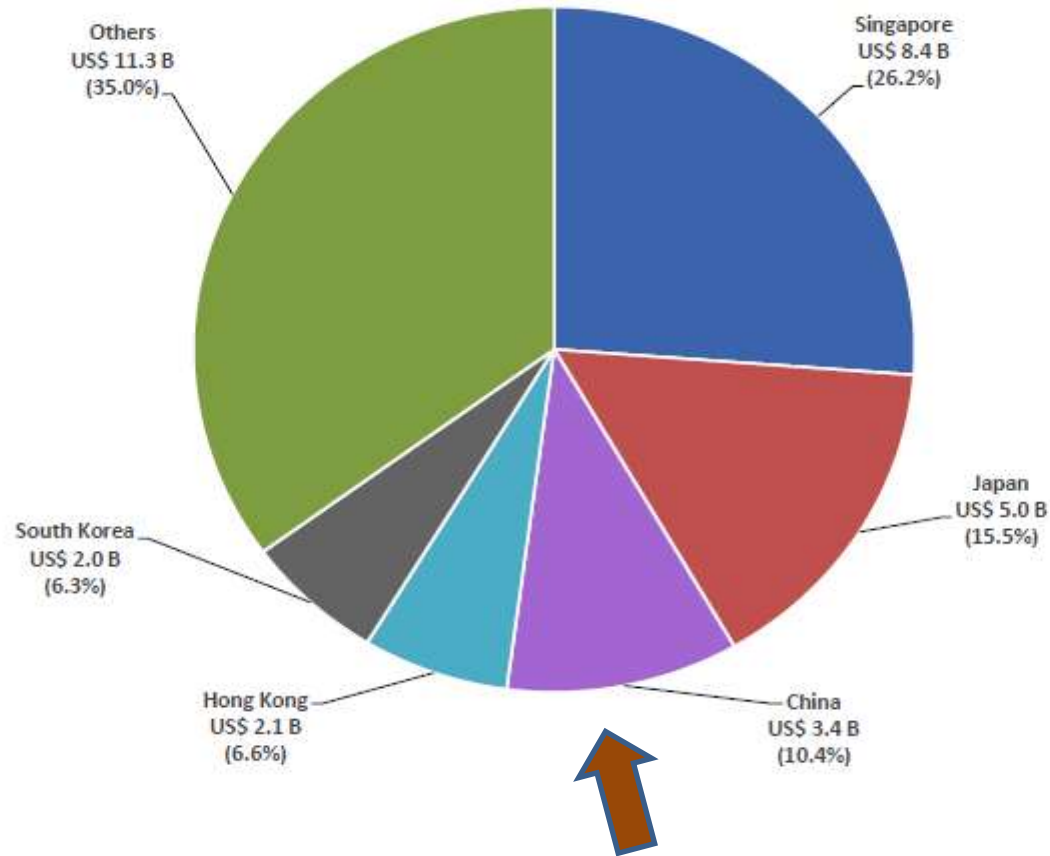
Source: Australia & New Zealand Banking Group Research

Bloomberg

Chinese Investment in Indonesia

January – December 2017: Sector, Location, Country of Origin, and Region

Investment Realization in January – December 2017: *Based on Country of Origin*



B= Billion

The Investment Coordinating Board of the Republic of Indonesia

Rise of Chinese Investors in Indonesia

- ❑ One Belt One Road initiative by Chinese Government
- ❑ Investments in various sectors such as e-commerce, power, mining, mineral processing, real estate, ports and other infrastructure
- ❑ Key investments include:
 - China Hongqiao Group - First alumina smelter in Indonesia
 - China Shenhua Group - Several major IPP projects such as Jawa-7 and Sumsel-1
 - China Fortune Land Development - Indonesian township development project
 - Country Garden - Hotel and other property developments
 - Alibaba - Lazada Group
 - Didi Chuxing - Grab
 - China Construction Bank - Bank Windu
 - Xiaomi - Joint venture for manufacturing of smartphones

Establishing a Business and Legal Presence in Indonesia

- Foreign Direct Investment must be in the form of a locally incorporated company (PT PMA)
- Foreign Investment Licensing is administered by the BKPM
- Minimum amount of investment is generally IDR 10 billion for each business field (certain business fields require higher investment, e.g. industry)
- Minimum issued and paid-up share capital is Rp 2.5 billion (equivalent to approximately USD 200,000)
- Permitted ratio of Equity Capital to Indicative Loan (1:3 – 1:6)

Negative Investment List

- ❑ In principle, all business fields are open for PMA, unless otherwise stipulated in the Negative List

- ❑ The Negative List stipulates business fields that are:
 - completely closed for PMA; and
 - open for PMA with certain requirements, such as shareholding percentage, partnership with local business enterprises, special license, etc.

- ❑ PR 44/2016 increased maximum foreign shareholding for PPP, Pharmaceuticals, Venture Capital Financing, Port Facilities and Energy

Negative Investment List: Maximum Foreign Shareholding

Business Activity	Foreign Ownership Restriction
Electricity generation (capacity more than 10MW), transmission and distribution	100% for foreign shareholding with a PPP arrangement during the concession period Otherwise, maximum 95%
Oil and gas construction services:	
a. Platform	Maximum 75%
b. Spherical tanks	Maximum 49%
c. Conduit installation on the sea	Maximum 49%
Operation and Maintenance (O&M) of geothermal facilities	Maximum 90%
Construction of electricity-generating installation and O&M of electricity installation	Maximum 95%
Geothermal drilling services	Maximum 95%

Negative Investment List: Maximum Foreign Shareholding

Business Activity	Foreign Ownership Restriction
Insurance	Maximum 80%
Venture capital	Maximum 85%
Leasing	Maximum 85%
Pharmaceuticals	Maximum 85%
Mining services	100% opened for foreign investment
Manufacturing	100% opened for foreign investment
Plantation (minimum area 25 hectares)	Maximum 95%
Smelter	100% opened for foreign investment

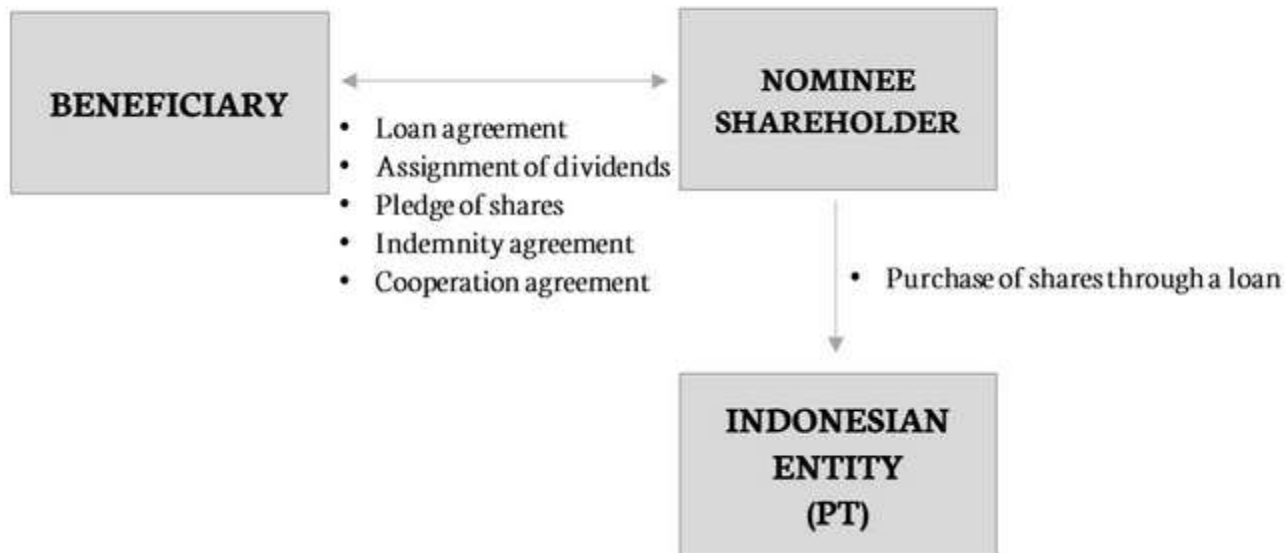
Establishing a Business and Legal Presence in Indonesia

Other Options for Establishing a Business Presence (Non FDI)

No.	Type of Business Presence	Remarks
1	<p>Representative Offices</p> <p>BKPM Representative Office (KPPA) if the Principal engages in the provision of services</p> <p>Foreign Trade Representative Office (KP3A) if the Principal engages in the trade of goods</p>	<p>KPPA is a precursor to establish a PT PMA</p> <p>KPPA and KP3A are merely the liaisons of the Principal and are not permitted to generate income in Indonesia</p>
2	<p>Construction Services Business Entity (BUJKA)</p>	<p>BUJKA License from Ministry of Public Works (MOPW)</p>

Nominee Structure

- A nominee shareholder is a person or a company that is the registered holder of shares of a company on behalf of the real owner. However, the ownership is simply ostensible and the nominee shareholder is essentially a name on the documents.
- Nominee structure is prohibited under Indonesian Investment Law, thus enforceability is questionable. Nonetheless it is commonly used.



Beneficial Ownership

- Presidential Regulation No. 13 of 2018 regarding the Implementation of the Principle on Recognizing Beneficial Ownership of Corporations in the Framework of the Prevention and Eradication of Money Laundering and Criminal Acts of Terrorism Financing (March 5, 2018) (“Regulation”)
 - ✓ Implementation of global standards for anti-money laundering and combating the financing of terrorism
 - ✓ Corporations must disclose their beneficial owner
 - ✓ The government plans to establish a database of beneficial owners of all Indonesian companies
 - ✓ Increases risk of exposure of nominee structure
 - ✓ Possible tax consequences

Land Ownership

Primary Titles

- Right of Ownership of Freehold Title (*Hak Milik*)
- Right to Cultivate (*Hak Guna Usaha* or “HGU”)
- Right to Build (*Hak Guna Bangunan* or “HGB”)
- Right to Use (*Hak Pakai*)
- Right to Manage (*Hak Pengelolaan* or “HPL”)

Secondary Titles

- Right to Lease (*Hak Sewa*)
- Right to Share Cropping (*Hak Usaha Bagi Hasil*)
- Right of Land Pledge (*Hak Gadai Tanah*)
- Right of Lodging (*Hak Menumpang*)

Customary Land (Tanah Adat)

- uncertified land
- governed by *adat* or customary law



Land Ownership

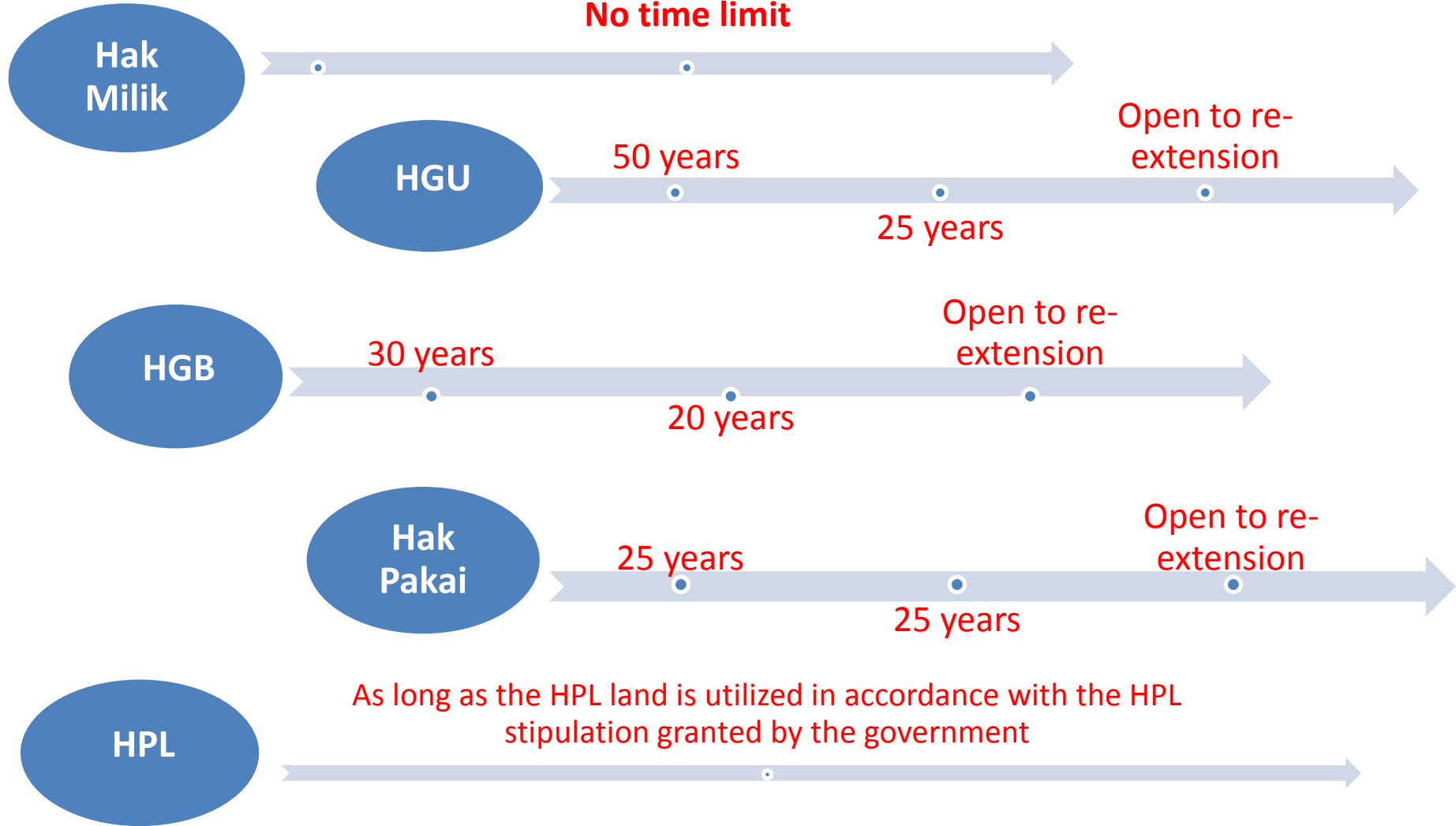
Land titles that can be held by a Foreign Investment Company

- **Right to Build (HGB):** can be attached to HPL land or Hak Milik land; can be acquired by way of sale and purchase or capital contribution (*inbreng*)
- **Right to Use (*Hak Pakai*):** can be attached to HPL land or Hak Milik land; can be acquired by way of sale and purchase or capital contribution (*inbreng*)
- **Right to Cultivate (*Hak Guna Usaha*):** solely for the purposes of agriculture, plantation, fishery and animal stock business; can be acquired by way of sale and purchase or capital contribution (*inbreng*)
- **Right to Lease (*Hak Sewa*):** no time limitation

Land titles that can be held by a Foreigner*

- **Right to Use (*Hak Pakai*):** can only be attached to State land, HPL land or Hak Milik land
- **Right to Lease (*Hak Sewa*)**

Validity Period of Land Titles



Land Ownership

Economic Policy Package

- Chairman of National Land Agency (BPN) Regulation No. 17 of 2015 regarding the Services and Regulation Standards of Agrarian, Spatial Layout and Land for Investment Activity (“Chairman of BPN Reg 17/2015”) simplifies the land licensing process and therefore shortens the time period.

Process	
Information on the availability of land	7 business days
Issuance of HGU	30 – 90 business days
Extension of HGU	20 – 50 business days
Issuance of HGB or <i>Hak Pakai</i>	20 – 50 business days
Extension of HGB or <i>Hak Pakai</i>	20 – 50 business days
Issuance of land certificate	5 business days
Settlement of complaint	5 business days

Land Ownership

Economic Policy Package

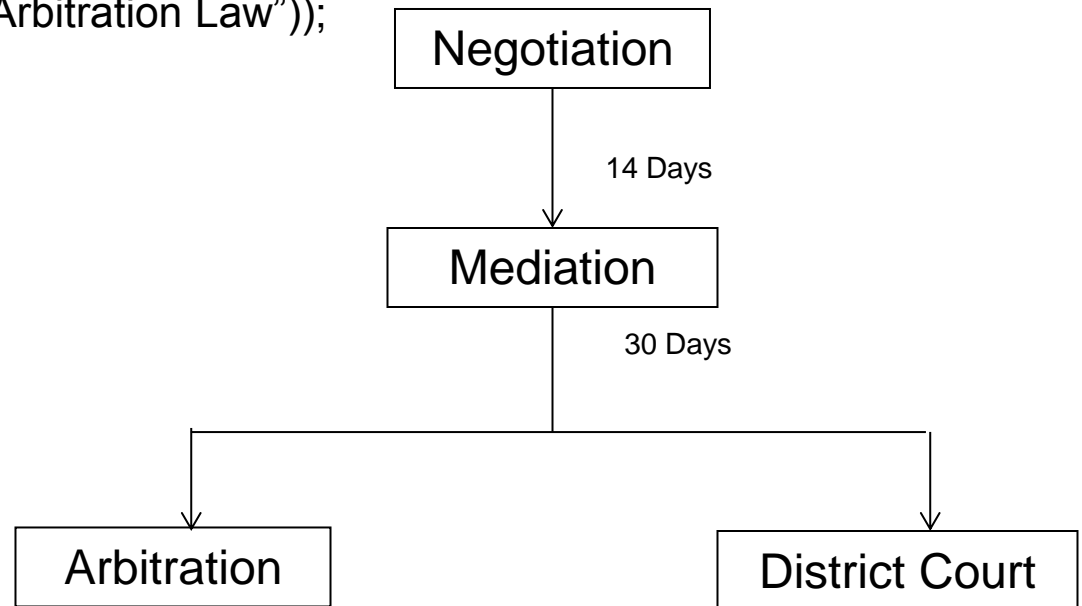
- ❑ Tax Treatment for Real Estate Investment Trust (REIT) in Minister of Finance Regulation No. 200/PMK.03/2015 (“MOF Reg 200/2015”)

- ❑ Before the promulgation of MOF Reg 200/2015:
 1. Dividend received by REIT from Special Purpose Company (SPC) is subject to Article 23(1)(a) Income Tax (15% rate);
 2. The transfer of real estate to REIT or SPC is subject to Article 4(2)(d) Income Tax (generally, 5% rate)

- ❑ Under MOF Reg 200/2015:
 1. Dividend received by REITs from SPC is not used for the calculation of REIT’s taxable income;
 2. Dividend received by REITs from SPC and the transfer of real estate to an SPC or REIT are exempt from Article 23(1)(a) and Article 4(2)(d) Income taxes;
 3. Capital gain on a transfer of real estate is still subject to income tax;
 4. REIT is considered as low-risk Taxable Entrepreneur (upon stipulation from Directorate General of Tax) and is entitled to preliminary refund of VAT overpayment.

Dispute Resolution

- ❑ **In Court Settlement** (Indonesian Civil Code Proceeding/H.I.R)
 - Via the appointed district court by the parties or the district court having jurisdiction of the defendant (Article 118 of H.I.R)
- ❑ **Out of Court Settlement** (Article 6 of Law Number 30 of 1999 on Arbitration and Alternative Dispute Resolution (“Arbitration Law”));
 - Negotiations
 - Mediation
 - Arbitration



Enforcement of Foreign Arbitral Awards

- ❑ Indonesia does not acknowledge foreign court judgments. Therefore, most parties prefer to resolve commercial disputes by way of arbitration.
- ❑ Indonesia adopted the framework for the enforcement of foreign arbitral awards in accordance with the 1958 United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the “New York Convention”)
- ❑ Required steps for the enforcement of foreign arbitral awards:
 - ✓ Registration of the foreign arbitral award to the registrar of the Central Jakarta District Court (“CJDC”). A registration by a representative of the party shall be accompanied by powers of attorney from the party and the tribunal.
 - ✓ Once the deed of registration has been issued by the registrar of the CJDC, submit an application to the Chairman of the CJDC for a “*fiat exequatur*” or enforcement order.
 - ✓ Once *fiat exequatur* or enforcement order has been issued by the Chairman of the CJDC, submit an application for *aanmaning/notification* to the parties.

Enforcement of Foreign Arbitral Awards

- Obstacles in enforcing foreign arbitral awards:

- ❖ **Ambiguity on the determination of international arbitral awards**

The determination of the category of the arbitral award shall be based on a territorial view of the seat of the arbitration; however, the application can be different in practice. (e.g. the case of PT Lirik Petroleum v. PT Pertamina (Persero) and PT Pertamina EP)

- ❖ **Delay**

Registration of international arbitral award in Indonesia may require documents that often take a substantial amount of time, such as the certification from the Indonesian diplomatic representative in the issuing country. Further, there is no time limit for the execution of *fiat exquatur* or enforcement order.

- ❖ **Lack of clarity on the definition of public order**

- ❖ **Parallel litigation**

The commencement of a parallel litigation or court proceedings often hinders the enforcement of an international arbitral award, causing the Court to be reluctant to enforce the said arbitral award. (e.g. Karaha Bodas Company LLC (KBC) v. Pertamina Case)

Tax Incentives

- News reports indicate the Government of Indonesia is planning to introduce **tax holiday** as a fiscal incentive to attract foreign investment.

- **Tax holiday** for upstream companies depending on the level of investment
 - Investors with certain minimum investment (between 500 billion IDR - 1 trillion IDR) may be exempt from corporate income tax obligation for 5 years.
 - Investors with minimum investment of 30 trillion IDR may be exempt from corporate income tax obligation for up to 20 years.
 - After such period, the Ministry of Finance may grant a 50% discount for the investor's income tax based on its discretion

- The Government is also planning to allow investors to apply for **tax allowance** in parallel with its application for business license (*Izin Usaha*)



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