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Real Estate

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Contents

SSEK Legal Consultants is one of the largest independent law firms in Indonesia and one of the most highly regarded in the country. It was established in 1992 and has its office in Jakarta. The firm's key practice areas are banking and finance, construction, hotels and tourism, insurance, project finance and land procurement. There are ten members in its construction law, and hotels and tourism practices, with Denny Rahmansyah the supervising partner of the latter.

Authors

Denny Rahmansyah is the managing partner of the firm, with a wealth of experience in real estate and property, banking and finance, foreign investment, general commercial and corporate law, M&A, IT and telecommunications. He joined SSEK in 2001 and has been deeply involved in numerous major transactions related to cross-border M&A, cross-border debt restructurings, banking and finance companies, plantations, private power and infrastructure projects. Denny is also experienced in the fields of oil and gas, mining, anti-corruption and forestry. He received his LLM degree, majoring in international economic and business law, from the University of Groningen, the Netherlands, and is a member of the Association of Indonesian Legal Consultants and the Indonesian Advocates Association (Peradi). In 2007, Denny attended the 44th Academy of American and International Law in the USA, where he studied American law from an international perspective.

Saprita Tahir is an associate who specialises in land and property, foreign investment, M&A, general commercial and corporate law, and data protection. She earned a Master of Laws degree from King's College London in 2016. Saprita's projects have included assisting one of the biggest national property companies in Indonesia in several joint venture transactions with renowned international hotel operators; assisting several international property companies with their establishments in Indonesia; managing the corporate documents of PT Hero Supermarket Tbk, one of the largest retailers in Indonesia; assisting one of the biggest oil and gas service companies in the world with various corporate matters; and conducting several successful due diligences.

1. General

1.1 Main Sources of Law

The main sources of real estate law are as follows.

- Fundamental regulations on the Indonesian agrarian framework – Law No 5 of 1960 regarding Basic Agrarian Law (24 September 1960) (Indonesian Agrarian Law).
- Land title ownership – Government Regulation No 40 of 1996 regarding Right to Cultivate, Right to Build and Right to Use Land (17 June 1996) (GR 40/1996); Government Regulation No 24 of 1997 regarding Land Registration (8 July 1997) (GR 24/1997); and Government Regulation No 103 of 2015 regarding Ownership of Houses or Residential Units by Foreigners Domiciled in Indonesia (28 December 2015) (GR 103/2015).
- Spatial layout and zoning – Law No 26 of 2007 regarding Spatial Layout (26 April 2007) (Law 26/2007) and Minister of Public Works and Housing Regulation No 06/PRT/M/2007 of 2007 regarding General Guidelines for Building and Neighbourhood Spatial Layout (16 March 2007) (MPW Reg 06/2007).
- Land utilisation – Law No 1 of 2011 regarding Housing and Residential Area (12 January 2011) (the Indonesian Housing Law), Law No 20 of 2011 regarding Condominiums (10 November 2011) (Condominium Law) and Law No 2 of 2012 regarding Procurement of Land for Development in the Public Interest (14 January 2012) (Law 2/2012).
- Lease – Government Regulation No 44 of 1994 regarding House Occupancy by Non-owners (26 December 1994) (GR 44/1994) and Ministry of Finance Regulation No 57/PMK.06/2016 regarding Implementing Guidelines for the Lease of State-owned Goods (8 April 2016) (MOF Reg 57/2016).
- Government authority – Presidential Regulation No 10 of 2006 regarding the National Land Office (11 April 2006).
- Construction – Law No 2 of 2017 regarding Construction Service (12 January 2017) (Construction Law) and Government Regulation No 36 of 2005 regarding the Implementation of Law No 28 of 2002 regarding Building (10 September 2005) (GR 36/2005).
- Environmental – Law No 32 of 2009 regarding Environmental Protection and Management (3 October 2009) (Environmental Law) and Government Regulation No 82 of 2001 regarding the Management of Water Quality and Water Pollution Control (14 December 2001) (GR 82/2001).
- Security – Law No 4 of 1996 regarding Mortgages (9 April 1996) (Mortgage Law).

1.2 Main Market Trends and Deals

Main Trends

The Indonesian real estate market has experienced a slowdown since 2013. But in 2018, the sector began to regain its footing, not only because of strong economic growth, at about 5%, but also continued urbanisation and a growing middle class. According to the World Bank, 20% of Indonesia's population, or about 52 million out of a total population of 260 million, is middle class. Such a large and growing middle class has pushed domestic consumption.

However, the growth in Indonesia's real estate sector may not have been as robust as hoped, for a number of reasons. One major factor is the political uncertainty related to the presidential and legislative elections scheduled for April 2019, which has resulted in some hesitation among the upper-middle segment to invest in real estate. Many investors and occupiers, especially in the upper middle-class segment, seem to be taking a wait and see approach.

Interestingly, in the residential sector the focus of the market appears to be shifting from the middle-upper segment to the lower-middle segment for a number of reasons, including:

- property prices in the upper-middle segment remain high since the increases that occurred from 2010 to 2012; the introduction of a new luxury tax also turned investors away from buying real estate;
- the impending completion of major infrastructure projects, specifically related to transportation (eg, the Mass Rapid Transit (MRT) in Jakarta; the Light Rail Transit (LRT) in Palembang, South Sumatra; and numerous toll roads across Indonesia); and
- currency weakness.

Meanwhile, in the lower-middle segment, purchasing power increased with the help of President Joko 'Jokowi' Widodo's One Million Houses programme. Jokowi's regime has been rolling out policies intended to boost home ownership and close the affordable housing shortfall. In December 2018, it was announced that the One Million Houses programme had exceeded its target, with 1,132,621 units.

Numerous major developers are also developing residential complexes, housing units and apartments specifically designed to cater to a middle-class lifestyle with flexible payment schemes, smaller down payments and instalment payments over long periods.

Despite the increasing number of entrepreneurs, demand in the office market continues to flag. The upcoming elections are seen to be a major factor for this stagnancy, while many tech-oriented companies and start-ups seem to prefer co-working space to traditional office spaces.

With the conclusion of the elections in the first quarter of 2019 and the completion of major infrastructure projects, numerous sources indicate that real estate market trends will continue to move in a positive direction.

Significant Deals

Residential: Meikarta in Bekasi, West Java, developed by Lippo Group; Nuvasa Bay in Batam, near Singapore, developed by Sinar Mas Land; and Citra Maja Raya in Maja, Banten, on Java, developed by Ciputra Residence. Office buildings: Treasury Tower in the Sudirman Central Business District in Jakarta, developed by Agung Sedayu Group; Casa Domaine Tower 1 and 2 in the KH Mas Mansyur area of Jakarta, developed by three construction groups (Salim Group, Lyman Group and Kerry Group); and World Trade Center 3 in the Sudirman area of Jakarta, developed by Jakarta Land.

1.3 Proposals for Reform

The government of Indonesia (GOI) is in the process of formulating a draft law on land to supplement the existing Indonesian Agrarian Law (the Draft Land Law). The Draft Land Law is considered to be crucial considering that Indonesia only has a single basic regulation on land, namely the Indonesian Agrarian Law, which was issued in 1960.

The Draft Land Law is aimed at governing, among other things, land registration and certification priority rights over land, agrarian dispute settlement and agrarian reform. The last discussion held by the GOI on the Draft Land Law was in early October 2018. The timeline for the enactment is still unclear.

2. Sale and Purchase

2.1 Categories of Property Rights

Below are the types of titles that can be acquired and the parties who are permitted to acquire each of the specific titles:

- Right of Ownership (*Hak Milik,* or HM) – Indonesian individuals and specific Indonesian institutions;
- Right to Build (*Hak Guna Bangunan*, or HGB) – Indonesian individuals and Indonesian companies;
- Right to Cultivate (*Hak Guna Usaha*, or HGU) – Indonesian individuals and Indonesian companies;
- Right to Use (*Hak Pakai*) – Indonesian individuals, Indonesian companies, governmental institutions, religious and social agencies, diplomatic offices, international agencies, foreign representative offices and foreign citizens;
- Right to Manage (*Hak Pengelolaan*) – government institutions (including regional governments, State-owned business entities, regional government-owned business entities, PT Persero, authority bodies (*badan otorita*)and other government legal entities designated by the government);

- Right of Ownership over Stacked Units (*Hak Milik Atas Satuan Rumah Susun*, or HMSRS) – parties who are entitled to hold the land title on which the building is erected; and
- Lease (*Hak Sewa*) – Indonesian individuals, Indonesian companies and foreign parties.

In addition to these primary and secondary titles, in Indonesia (particularly in rural areas) there exist large areas of land that have not been registered and certificated under the Agrarian Law. The rights to this land are still governed by *adat* (customary) law. *Adat* rules vary significantly from one area to another.

This 'uncertificated land' can also be acquired. In this case, the buyer must apply for a registered title pursuant to the Agrarian Law and obtain a formal certificate of title. To obtain a land certificate, *adat* -based proprietary rights must be relinquished by the original owner to the State by signing a Right Relinquishment Deed, known in Indonesian as a Land Relinquishment Deed (*Akta Pelepasan Hak,* or APH), in favour of the buyer, as further explained in **2.3 Effecting Lawful and Proper Transfer of Title**.

2.2 Laws Applicable to Transfer of Title

The fundamental legal basis for transfer of title in Indonesia can be found in the Indonesian Agrarian Law and GR 24/1997. For the sale of apartment units, the Condominium Law provides further procedural guidelines.

Special laws for transfer of land title in Indonesia are more region-based than sector-specific. There may exist regulations issued by a regional government that apply to the transfer of title of land located in that specific region. For instance, the determination of the purchase price for any transfer of land in Bali shall be subject to the suggestion issued by the Regional Revenue Service Office (*Dinas Pendapatan Daerah*) in the relevant area where the land is located.

2.3 Effecting Lawful and Proper Transfer of Title

Land is legally acquired in Indonesia upon execution by the seller and buyer of a Sale Purchase Deed (*Akta Jual Beli,* or AJB) or an APH. An AJB is used if the buyer is to obtain certificated title to the land that is the same type as the seller's certificated title. An APH is used if the seller has certificated title to the land but such title is not the same type of title the buyer can or wants to acquire, or if the seller does not yet have certificated title to the land to be sold.

These deeds must be prepared by an authorised Land Deed Official (*Pejabat Pembuat Akta Tanah,* or PPAT) and executed in the Indonesian language before such PPAT. Upon execution of the PPAT deed, the PPAT is responsible, on behalf of the buyer, for arranging certification and registration of the buyer's title with the relevant office of the National Land Agency (*Badan Pertanahan Nasional*, or BPN).

Title insurance is not common in Indonesia.

2.4 Real Estate Due Diligence

Buyers normally engage local legal counsel to conduct real estate due diligence. The legal counsel will co-ordinate directly with the seller and, when necessary, the seller's PPAT to obtain the documents to be reviewed and collect the necessary information on the land and the seller. The due diligence would normally include the following.

- *Land ownership and land search* – to make sure the seller is the legal owner and has the legal right to transfer the land title. The documents that need to be reviewed in this case depend on whether the land is certificated. A land search is conducted to check the legal owner of the land and whether there is any security right or claim over the land.
- *Licences* – to identify whether the existing licences associated with the land are relevant for the purchaser. If so, the buyer will also need to check the validity of the relevant licences. It is also necessary to check whether there are any obligations imposed under the licence (eg, reporting obligations, restrictions).
- *Agreements* – the buyer will need to review all relevant agreements pertaining to the land (eg, lease agreement, financing or loan agreement making the land an encumbrance) and check any material provisions in the contract that could impede the contemplated transaction (eg, cross default, negative covenant).
- *Information on seller* – if the seller is an entity, the buyer will need to check the seller's articles of association, authorised representative and other corporate documents or licences relevant to the transaction. If the seller is an individual, the buyer will need to check the marital status of the seller and validity of any heir (if the obtainment is through inheritance).
- *Miscellaneous* – evidence of tax payment (eg, land and building tax, or PBB, and land acquisition tax and duty), research at the relevant government institution to confirm zoning and spatial layout, and the map of the land. Additionally, in certain cases, a site visit and interview with the relevant parties who know the status of the land and ownership might be necessary.

2.5 Typical Representations and Warranties

Indonesian law is silent as to the warranties that should be given in a real estate sale transaction, by both the seller and the buyer. Representations and warranties, as well as the buyer's remedies for the seller's misrepresentation, in a real estate sale transaction shall be freely agreed between the seller and the buyer.

Please note that Indonesian law recognises the principle of freedom of contract. This principle is codified in Article 1338 of the Indonesian Civil Code (ICC), which provides that par-

ties to a contract are free to include any provisions they wish, subject only to mandatory provisions of Indonesian law.

The typical seller's representations and warranties would provide, among others:

- the legality of the seller's ownership of the land;
- if the seller is an entity, the legality of its establishment, the obtainment of the necessary corporate approval to sell the land and confirmation that the sale of the land does not violate the seller's articles of association or any contract to which the seller is a party;
- settlement of all taxes imposed on or in respect of the land prior to the sale;
- confirmation that the land is free and clear from any security rights, claims or liens; and
- confirmation that there is no legal action or proceeding that has been served on the seller that restrains or prohibits the sale.

The representations and warranties of a buyer would normally be more lenient and typically provide, among others:

- if the buyer is an entity, the legality of its establishment, the obtainment of necessary corporate approval to purchase the land and confirmation that the sale of the land does not violate the buyer's articles of association or any contract to which the buyer is a party;
- confirmation that the buyer will provide the seller payment of the purchase price pursuant to the agreed terms and conditions; and
- confirmation that there is no legal action or proceeding that has been served on the buyer that restrains or prohibits the purchase.

2.6 Important Areas of Law for Investors

The most important areas of law for an investor to consider when purchasing real estate are as follows.

- *Investment* – prior to the purchase of real estate, it is important for an investor to identify all the statutory obligations and limitations pertaining to its investment. For example, foreign investors will need to identify any foreign ownership restriction for their business activity in Indonesia.
- *Tax* – investors need to identify the taxes that can be imposed on them, as well as the procedure and timing to pay those taxes before purchasing real estate. Investors should engage a local tax consultant/adviser for this matter.
- *Condition of land* – it is also important for investors to identify whether the condition of the real estate that will be purchased is suitable and able to facilitate all its business needs. In this case, investors will need to check, among other things:
  (a) the size of the land;
  (i) the legality and completeness of the documents pertaining to the land;
  (ii) the permitted zoning and uses of the land;
  (iii) which direction the land faces;
  (iv) the location of the land;
  (v) the safety of the surrounding area; and
  (vi) the level of density and flatness of the land.

2.7 Soil Pollution or Environmental Contamination

If soil pollution or environmental contamination is already present when the buyer becomes the legal owner of the land, it is possible the buyer will be responsible for such pollution or contamination, unless the buyer can prove that it did not cause the pollution or contamination. Upon the transfer of title, the buyer assumes the rights and liability of the land, including any environmental liability.

Article 88 of the Environmental Law provides that each person whose action, business and/or activity uses hazardous and toxic material (B3), produces and/or manages B3 waste, and/or causes serious threats to the environment shall be absolutely responsible for the damages suffered and no evidence of breach elements shall be required.

The sanctions under the Environmental Law are divided into three categories.

- *Administrative liability* – the Environmental Law provides that a regent/mayor can force a company to restore the environment or appoint a third party to conduct recovery of the environment at the expense of such company, due to environmental pollution and/or damage caused by said company, using the funds of such company (Article 82). The Environmental Law also provides that a minister/governor/regent/mayor can impose administrative sanctions in the form of (i) a written warning, (ii) government coercive measures, (iii) a suspension of an environmental permit or (iv) environmental permit revocation. Other than the above, there are different kinds of administrative liabilities that may apply in this regard depending on the circumstances, such as (i) if the company disposes of wastewater in the water or water source, the company has an obligation to prevent and mitigate water pollution (Article 37 of GR 82/2001), and if it fails to do so, the regent/mayor may impose administrative sanctions on the company in the form of written warnings that can lead to the temporary suspension and revocation of its licences; and (ii) administrative liabilities governed under regional regulations related to the management of water quality and water pollution, as well as the management of underground water. The Environmental Law also provides that any person can file an administrative lawsuit with the State Administrative Court requesting that the authorities revoke the licence of a company causing environmental pollution.

- *Criminal liability* – there are different types of circumstances that may lead to the imposition of criminal sanctions, including (i) a formal offence (*delik formal)* occurs (ie, the company is reported to have caused water quality to fall below its proper level as well as caused damage to the environment); and (ii) the company has negligently caused water quality to fall below its proper level as well as caused damage to the environment, and whether the action has caused injury and/or danger to human health.
- *Civil liability* – the Environmental Law stipulates that any person responsible for a business/activity that pollutes or damages the environment or causes loss to a third party shall be liable to pay compensation and/or take remedial actions.

Under the Environmental Law, any environmental disputes may be settled through courts or outside the courts, provided that the parties to the dispute voluntarily agree to the settlement. Under the Environmental Law, lawsuits through the courts may only be submitted if a party or the parties to the dispute declare that out-of-court settlement has failed. A lawsuit can be submitted by a party that suffered a loss due to such environmental pollution or damage, an environmental NGO or the government.

2.8 Permitted Uses of Real Estate Under Zoning or Planning Law

As explained in **2.4 Real Estate Due Diligence**, in addition to reviewing the licences held by the seller pertaining to the land, the buyer may, during the due diligence, conduct research at the relevant spatial layout office (ie, subject to the location of the land) to confirm the zoning and spatial layout of the area where the land is located. The buyer would then be able to identify the permitted uses of the land.

In the process of investigating a possible location for a project, a company should contact the Local City Planning Office (*Dinas Tata Kota*) and the Land Office to obtain official information pertaining to the land (*Fatwa Tata Guna Tanah,* or Fatwa).

If the buyer's intended use of the land is not in accordance with the requirements of the applicable spatial layout, the buyer may file an application with the relevant government political subdivision (ie, the regency, municipal or provincial government) to amend the spatial layout to permit the use of the land for the buyer's intended purpose. It is at the regional government's discretion to decide whether to accept this application.

It is possible to enter into specific development agreements with the relevant public authorities to facilitate a project, as long as the project is necessary for the public interest and the relevant public authorities agree to the project.

2.9 Condemnation, Expropriation or Compulsory Purchase

Expropriation usually occurs on the basis of land procurement for the public interest. Law 2/2012 defines public interest generally as the interest of the nation, state and society that shall be implemented by the government for the maximum benefit of the people, but there is no single definition of what constitutes 'public interest'. The reasons behind nationalisation or expropriation are subjective, depending on the expropriating government. This firm's research on expropriation cases has found that legitimate public interest objectives can include protection of public health, safety and the environment, and penalty for crimes.

There are two legal bases to protect foreign investors in Indonesia: the Investment Law and the ASEAN Comprehensive Investment Agreement, dated 26 February 2009 (ACIA).

Article 7 of the Investment Law stipulates that the GOI will not nationalise or take ownership of investors' assets, except by law. In the event that the GOI does so, the GOI will provide compensation based on fair market value. If the GOI and the investor cannot agree on fair market value, the dispute shall be settled by arbitration.

Similarly, the GOI and the Republic of Philippines are parties to the ACIA. This multilateral investment treaty protects Association of Southeast Asian Nations (ASEAN) investors and their investments. Specifically, the ACIA provides protection from various measures that may be taken by host countries, including protection from expropriation and fair market value compensation, as regulated in Article 14 of the ACIA.

In addition, in the event of a dispute, the Investment Law and the ACIA have dispute settlement mechanisms that allow an investor to file a direct claim against the host country. Section B of the ACIA stipulates dispute settlement processes that include conciliation, consultation and ultimately arbitration. Article 33 of the ACIA liberalises the choice of forums available to investors to resolve any dispute with a country, including ICSID. In Indonesia, an international arbitration decision can be executed based on Law No 30 of 1999 regarding Arbitration and Alternative Dispute Settlement (12 August 1999).

2.10 Taxes Applicable to a Transaction

Sale of Real Estate Through an Asset Deal

This transaction involves the sale and purchase of a property owned by a company or individual. In this type of transaction, other than the purchase price of the land, the buyer must also pay various expenses, which normally include the following.

- Honoraria for PPAT for the AJB and/or APH, including honoraria for witnesses (maximum 1% of the purchase price).
- Fee for the land measurement and registration (P2T) team, based on the following formula stipulated in Government Regulation No 13 of 2010 regarding Tariffs on Non-Tax Revenues Effective within the BPN (GR 13/2010): for a land area up to 10 hectares, Tu = [(L x HSBKu) / 500] + IDR100,000, where Tu = land mapping and measurement tariff, L = area of land in square metres and HSBKu = Special Cost Unit Price for the mapping applicable in the current year; for a land area from 10 hectares up to 1,000 hectares, Tu = [(L x HSBKu) / 4,000] + IDR14,000,000; and for a land area above 1,000 hectares, Tu = [(L x HSBKu) / 10,000] + IDR134,000,000.
- Fee for Land Investigation Committee (Committee A) based on the following formula in GR13/2010: Tpa = [(L x HSBKpa) / 500] + IDR350,000, where Tpa = land mapping and measurement tariff for Committee A, L = area of land in square metres and HSBKpa = Special Cost Unit Price for the mapping applicable in the current year for Committee A.
- Contribution to the State for the HGB or *Hak Pakai* title (not applicable for the purchase of existing HGB from a company) based on the following formulae in GR 13/2010: for the extension and renewal of HGB or *Hak Pakai* that is executed at once, X = (2% x Land Value) + IDR100,000; and for the transfer of land title (including *Hak Pakai* or HGB title), X = (1% x Land Value) + IDR100,000.
- Payment by the purchaser of the Purchase Duty for the Acquisition of Land and Buildings (*Bea Perolehan Hak Atas Tanah dan Bangunan*, or BPHTB) of 5% of the taxable tax object acquisition value (*Nilai Perolehan Obyek Pajak Kena Pajak,* or NPOPKP).
- Value added tax (VAT) of 10% of the purchase price (if the seller is a taxable entrepreneur).
- Payment by the seller of income tax of 2.5% of the total gross amount of the transfer of rights over the land.
- Fees for the registration and issuance of land book and certificate, including the issuance of the decision on the granting of HGB or *Hak Pakai* title by the BPN of IDR50,000 per title.
- Stamp duty for each document or agreement to be signed, which is currently IDR6,000.

Other than the payment of income tax by the seller, the costs and fees related to a sale and purchase of land transaction are normally covered by the buyer. In special cases, in which the seller agrees to do so, the honoraria of the PPAT may be borne jointly by the seller and the buyer.

There are several goods that are exempted from the imposition of VAT. Those most relevant to real estate are as follows:

- basic apartment units with a size of 21 sq m up to 36 sq m;
- electricity, except household electricity exceeding 6,600 volt-amperes;
- low-cost houses, low-cost flats less than 21 sq m in size, low-cost accommodation for workers and student accommodation within a certain threshold;
- services rendered for the construction of low-cost accommodations and places of worship; and
- rental of low-cost houses and low-cost apartment units less than 21 sq m in size.

Further, the following parties are exempted from the imposition of BPHTB:

- diplomatic representatives or consulate officers;
- the State for the implementation of the government and/or for the public interest;
- international organisations' representatives determined by the Ministry of Finance;
- a private person or entity due to title conversion and other legal actions that do not involve a change of titleholder;
- a private person or entity for the purpose of charity; or
- a private person or entity for the purpose of religion worship.

There is also an income tax exemption for the seller for:

- a transaction with a value of less than IDR60 million;
- a grant transaction not for commercial purposes;
- a transfer due to inheritance;
- the transfer of land in conjunction with a merger, consolidation, or expansion of business, with the price of the transaction determined by the Ministry of Finance based on the book value; and
- the transfer of land for the purpose of implementing a build-operate transfer or for the utilisation of State-owned land or buildings.

There is also a tax exemption if the seller is a private person or entity that is not categorised as an Indonesian taxpayer.

Please note that for the sale of real estate through an asset deal, the buyer will inherit only those liabilities of the seller related to the land.

Sale of Real Estate Through a Share Deal

In this transaction, the sale will not directly involve any sale of a property, but rather a sale of shares of a company owning a property. The tax implications are not as complicated as an asset deal. However, the buyer will inherit the entire liability of the company in which the shares are acquired. The typical taxes imposed in a share deal transaction are as follows.

- VAT of 10% of purchase price.

- Final tax of 10% applies to income from the sale of shares at the Indonesia Stock Exchange (IDX). If the seller is a founding shareholder, the rate is 0.6%. This will be collected automatically by the IDX.
- 5% tax is applicable to the sale of shares by a foreign shareholder, unless it is exempted under a relevant tax treaty.
- Foreign companies and individuals are subject to a 20% withholding tax on dividends from real estate companies, subject to a relevant tax treaty.
- Honoraria for PPAT for the AJB of shares if the sale of shares triggers change of control.
- Stamp duty for each document or agreement that will be signed, which is currently IDR6,000.

2.11 Legal Restrictions on Foreign Investors

Foreign individuals and entities are given very little room under current laws and regulations to own real estate in Indonesia. Since its promulgation in 1960, the Indonesian Agrarian Law has only allowed a foreigner 'domiciled in Indonesia' to hold a *Hak Pakai* (Right to Use) land title among other forms of land title. GR 103/2015 and its implementing regulation further state that only foreigners with a 'stay permit in Indonesia' may hold a housing unit with a *Hak Pakai* land title.

The Indonesian Housing Law provides that in addition to a *Hak Pakai* land title, foreigners may only occupy housing units through a lease. A lease arrangement does not cause a transfer of ownership, but merely the transfer of 'possession rights' over the leased property and only for a certain period, which must take into account the period of the underlying land title where the property is built.

3. Real Estate Finance

3.1 Financing Acquisitions of Commercial Real Estate

The most common financing methods for the acquisition of commercial real estate include:

- *Internal funding* – many companies in Indonesia, especially engaged in real estate development, acquire commercial real estate by using their own capital funds (eg, paid-up capital or retained earnings).
- *Loan from third party* – it is also common for commercial real estate companies in Indonesia to secure funding from third parties, including international lenders, to acquire property.
- *Joint venture financing* – this is applicable when the entity that acquires the commercial real estate is a joint venture company and is using its own capital funds.
- *Listing on the IDX* – there are numerous real estate companies in Indonesia that obtained funding by going public and listing part of their shares on the IDX.

3.2 Typical Security Created by Commercial Investors

In Indonesia, the most common form of security interest over real estate is a mortgage (*Hak Tanggungan*). A mortgage is used to secure land with certain land titles (ie, HM, HGB, HGU, *Hak Pakai* over State land and HMSRS over HM or HGB or *Hak Pakai* land) and all the fixtures attached to it.

3.3 Restrictions on Granting Security over Real Estate to Foreign Lenders

There is neither a prohibition on granting security over real estate to foreign lenders nor restrictions on repayments being made to foreign lenders under a security document or loan agreement. The elucidation of Article 10 (1) of the Indonesian Mortgage Law expressly provides that the underlying agreement of a mortgage (eg, the loan agreement) can be signed overseas and the associated parties can also be a foreign individual or entity, as long as the loan is used for a development within the territory of the Republic of Indonesia.

A *Hak Pakai* over State land that is not transferrable (eg, *Hak Pakai* of the government, *Hak Pakai* of a social or religious agency and *Hak Pakai* of the representative of a foreign country), whose validity is not governed and is granted for as long as the land is utilised for specific purposes, cannot be granted a mortgage.

With the enactment of the Foreign Investment Risk Review Modernization Act of 2018 (FIRRMA), it is possible that a party seeking funding from a US citizen or entity for a real estate investment in Indonesia will be subject to review by the Committee on Foreign Investment in the United States (CFIUS). Some parties are of the opinion that FIRRMA has expanded the authority of CFIUS beyond the appropriate boundaries.

3.4 Taxes or Fees Relating to the Granting and Enforcement of Security

The typical fees that need to be paid on the granting and enforcement of a mortgage are as follows.

- Fee for certificates and land verifications (as explained in **3.5 Legal Requirements Before an Entity Can Give Valid Security**), which is normally IDR1,000,000 per certificate. However, the fees differ from one region to another.
- Fee for the notary for preparing the APHT, which will differ from one notary to another. The location of the land will also impact the notary's fee.
- Non-Tax State Revenue (*Penerimaan Negara Bukan Pajak*, or PNBP), which amount is subject to the value of the mortgage. For instance, for a mortgage of less than IDR250 million, the PNBP shall be IDR200,000 per certificate; and for a mortgage of IDR250 million to IDR1 billion, the PNBP shall be IDR500,000 per certificate.

The foregoing fees are solely for illustrative purposes. The actual fees will differ from region to region.
- Fee for encumbrance of mortgage by banks, which differs from one bank to another.

3.5 Legal Requirements Before an Entity Can Give Valid Security

The following are the steps that need to be taken to put a valid mortgage security over real estate in Indonesia.

- *Land search* – the granting of a mortgage shall be initiated by conducting a land search at the appropriate BPN office where the land is located, by submitting the required documents; eg, the original land certificate, the building construction permit (IMB), the function worthiness certificate (SLF) for the building and the land, and a receipt of payment of PBB. The Local Land Office, upon receiving the 'original' land certificate, will provide a Land Registration Statement Letter (*Surat Keterangan Pendaftaran Tanah,* or SKPT) that confirms the owner of the land.
- *Execution of deed of granting of security rights (Akta Pemberian Hak Tanggungan, or APHT)* – the execution of an APHT uses a specific form determined by law. It is signed by the mortgage grantor and mortgage grantee before an authorised PPAT, along with the submission of the required documents (eg, the original and executed agreement between the mortgage grantor and mortgage grantee to determine the secured amount to be incorporated in the APHT, the original land certificate(s), the IMB, the SLF and the evidence of payment of property tax upon the relevant land, including the PBB).
- *Registration of an APHT by the Local PPAT at the pertinent Land Office* – the Local PPAT must meet the pertinent Local Land Office official to file and register the executed APHT and other necessary documents (eg, the original land certificate(s), a copy of the underlying loan agreement, the application letter, and the POA from the mortgage grantee and the mortgage grantor to the PPAT to conduct PPAT registration).

3.6 Formalities When a Borrower is in Default

An entitlement to execute a mortgage equals an event where a mortgage grantor (debtor) fails to fulfil the obligation stipulated under the loan agreement, which further generates the rights held by the mortgage holder (creditor) to execute the land or property being mortgaged agreed under the APHT.

Principally, a mortgage is enforceable without the need for the creditor first to submit any claims to the court or to wait for any final and binding court decision on the basis that the Security Rights Certificate (*Sertifikat Hak Tanggungan*) has naturally been conferred with executorial status written into the initial part of the certificate. This is in line with the nature of a mortgage, including that it is easy and certain to be executed.

Essentially, the Indonesian Mortgage Law provides two alternative mortgage execution methods: through a public auction or a private sale. It is possible for the debtor to challenge a mortgage execution by way of public auction, whereas the consent of both parties is required for the private sale method.

The execution of a mortgage by a public auction must be carried out based on a court order. Please note that the court order is not a court decision on whether the debtor was in an act of default, but is merely a stipulation issued by the court converting the rights held by the mortgage holder into a real action allowing the mortgage holder to auction the mortgaged land publicly.

However, the mortgage holder will normally have a much stronger position than the mortgage grantor in the event that the latter breaches the agreement. The mortgage holder may directly request the court to issue a court order so long as the mortgage holder can show that the mortgage grantor has failed to repay its debt that is due.

3.7 Subordinating Existing Debt to Newly Created Debt

It is possible to subordinate secured debt to newly created debt; for instance, by way of signing a novation deed. The determination on what method to use for the subordination shall be agreed by the relevant parties based on the freedom of contract principle as explained in **2.5 Typical Representations and Warranties**, while the restrictions should follow sector-specific regulations, if any.

3.8 Lenders' Liability Under Environmental Laws

A lender is not liable under environmental laws even if it holds or has enforced security over the relevant real estate.

3.9 Effects of Borrower Becoming Insolvent

A mortgage gives priority rights to the security holder during the insolvency and, theoretically speaking, gives the security holder the right to enforce the secured assets by way of private sale or through an auction as if the borrower is in default, as explained in **3.6 Formalities When a Borrower is in Default**.

3.10 Consequences of LIBOR Index Expiry

It is seemingly uncommon to apply the London Interbank Offered Rate (LIBOR) to Indonesian contracts. However, if the parties to a contract agree to apply LIBOR, it is advisable that the contract includes clauses that stipulate the determination of changing interest rates and allow the bank to substitute a new number to replace LIBOR based on its calculations.

4. Planning and Zoning

4.1 Legislative and Governmental Controls Applicable to Strategic Planning and Zoning

Article 14 of the Indonesian Agrarian Law requires every regional government to plan the use of land. To implement this requirement, Indonesia enacted Law 26/2007. The spatial layout scheme consists of the national spatial layout plan, provincial spatial layout plans and regency/municipal spatial layout plans.

Pursuant to Articles 26(3), (4), (5) and (7) of Law 26/2007, a spatial layout plan for a regency or municipality must be stipulated by a regional regulation, issued by the relevant regent or mayor. The regional spatial layout plan for a regency or municipality must be the basis for the issuance of location development permits and land administration.

Other ministries such as the Ministry of Forestry also prepare special layout plans but their plans are more likely to affect land in rural areas rather than in developed areas/industrial estates. In rural areas, these plans will need to be reviewed and the local offices of the Ministry of Forestry, Ministry of Energy and Mineral Resources, Ministry of Agriculture and other relevant ministries will need to be approached to research the permissible uses of, and existing rights in respect of, a given parcel of land.

4.2 Legislative and Governmental Controls Applicable to Design, Appearance and Method of Construction

Building construction in Indonesia must adhere to technical requirements as imposed by the government. GR 36/2005 imposes an 'intensity requirement' for the construction of a building, whereby a building must be constructed not exceeding certain maximum density and height limits that are stipulated by the relevant regional government.

In the calculation of the maximum density and height limits, the following are terms commonly used, as well as the respective statutory definitions, which can be found in MPW Reg 06/2007:

- KDB (*Koefisien Dasar Bangunan,* or Building Base Coefficient) – the comparative percentage between the area of a building's base floor that may be constructed and the whole area of the possessed land;
- KLB (*Koefisien Lantai Bangunan*, or Building Floor Coefficient) – the comparative percentage between the amount of the areas of all the floors that may be constructed and the whole area of the possessed land;
- KDH (*Koefisien Dasar Hijau,* or Green Base Coefficient) – the comparative percentage between the open space outside the building that is purposed for green area and the whole area of the possessed land; and
- KTB (*Koefisien Tapak Basemen*, or Basement Floor Coefficient) – the comparative percentage between the area of the basement floor and the whole area of the possessed land.

The specific guidelines for each region shall be based on the relevant regional regulations.

4.3 Regulatory Authorities

The authorities that are responsible for regulating the development and designated use of individual parcels of real estate are the specific regional governments (see **4.1 Legislative and Governmental Controls**).

4.4 Obtaining Entitlements to Develop a New Project

Licences that must be obtained prior to the commencement of a real estate development project include a Location Permit (*Izin Lokasi*), a Land Utilisation Permit (*Izin Peruntukan Penggunaan Tanah*), IMB, SLF and Environmental Permit (*Izin Lingkungan*).

If it is completing a major refurbishment, a company will need to check whether the licences issued to construct the existing building are still valid and relevant for the refurbishment. If the licences are no longer valid and relevant, the company will need to renew the existing licences or apply for new licences, depending on the regional regulation and applied policies.

Technical approvals and recommendations will also need to be obtained from the relevant government institutions. These licences, approvals and recommendations are generally obtained from the regional government. There may be small differences in the licences, approvals and/or recommendations required from region to region, due to differences in the provisions of the relevant regional government regulations and adopted policies.

4.5 Right of Appeal Against an Authority's Decision

If an intended use of the land is not in accordance with the requirements of the applicable spatial layout plan, the company may file an application with the relevant government political subdivision (ie, the regency, municipal or provincial government) to amend the spatial layout plan to permit the use of the land for the company's intended purpose. However, this application may not be accepted.

4.6 Agreements with Local or Governmental Authorities

This depends on the nature, capacity and purpose of the project. For a small-scale project with a purpose not related to the public interest, it is not necessary to enter into agreements with local or governmental authorities or agencies to facilitate a development project, unless the regional govern-

ment requires so. For a bigger project with a purpose that is heavily related to the public interest, it might be necessary/possible to enter into agreements with regional governments, although this is at the discretion of the regional government.

4.7 Enforcement of Restrictions on Development and Designated Use

This depends entirely on the applicable regional government regulations and adopted policies.

5. Investment Vehicles

5.1 Types of Entities Available to Investors to Hold Real Estate Assets

For domestic investors, Indonesian law recognises various corporate vehicles, including those with (i) non-legal entity status, such as a (a) *maatschap* (civil partnership), (b) firm and (c) *comanditer venootschape* (limited partnership, or CV); or (ii) legal entity status, such as a limited liability company (*perseroan terbatas,* or PT) or co-operative.

Small to medium-sized business players usually use a CV or PT as their corporate vehicle, while large-scale businesses will use a PT.

For foreign investors, as generally required under Law No 25 of 2007 regarding Capital Investment (26 April 2007) (the Investment Law), direct investment in Indonesia is implemented through the establishment of a limited liability company (usually referred to as a PT PMA, with PMA standing for *Penanaman Modal Asing,* or foreign capital investment) or other forms allowed under relevant Indonesian laws and regulations.

All the foregoing corporate vehicles are able to acquire real estate, with certain limitations. PT or PT PMA are the preferred entities and more commonly used to acquire real estate and invest in the sector, depending on whether the investors are entirely domestic or consist of foreign investor(s).

5.2 Main Features of the Constitution of Each Type of Entity

In addition to the same characteristics as the other aforementioned entities (eg, have their own assets, have a specific purpose as a group, have their own interest), PT and PT PMA also have the following features:

- the capital consists of shares;
- the highest authority lies in the general meeting of shareholders;
- the owners of a PT or PT PMA are shareholders; and
- shareholders will obtain revenue in the form of dividends.

The following can be considered as the benefits of PT and PT PMA:

- shareholders are only liable for debt equivalent to the value of their shares;
- the continuity of a PT or PT PMA as a legal entity is more secure; and
- the owners (in this case the shareholders) can change subject to certain common procedures; it is not difficult to transfer ownership of shares to another party.

5.3 Minimum Capital Requirement

For a PMA company engaging in the development and management of property, there is a 4:1 debt-to-equity ratio requirement if the property development is not integrated in a building or one housing compound.

Other than the foregoing, there is currently no applicable minimum capital for a company that invests in the real estate sector. However, there are minimum capital requirements for a PT and PT PMA as explained below.

Indonesian law recognises three types of capital of any Indonesian company: authorised, issued and paid-up. Authorised capital may be up to four times greater than issued capital and all issued capital must be fully paid-up. The Company Law provides that the minimum authorised capital of a PT should be IDR50 million. The payment for shares may be in a monetary form or through an in-kind contribution to be valued by an independent appraisal company.

Notwithstanding the minimum capitalisation requirements of the Company Law, in practice, the Capital Investment Coordinating Board (*Badan Koordinasi Penanaman Modal*, or BKPM) and the Online Single Submission (OSS) system require that the total investment in the PT PMA be reasonably sufficient so that the intended business can achieve commerciality. A low level of investment might cause delay as it may not be considered as sufficient by the BKPM.

The BKPM policy on the total investment for a PT PMA is still applicable under the OSS regime. Article 6 (2) of BKPM Regulation No 6 of 2018 Regarding Guidelines and Procedures on Capital Investment Licensing and Facilities (20 July 2018) (BKPM Reg 6/2018) requires that the minimum total investment should be more than IDR10 billion (excluding land and building), which will be further divided into equity (issued and paid-up capital) and loan(s). Under Article 6 (3) (b), the minimum issued and paid-up capital shall be IDR2.5 billion, while the balance of the total investment, IDR7.5 billion, may be contributed by way of loan. In current practice, the OSS system requires the paid-up and issued capital of a PT PMA to be at least IDR2.5 billion, the minimum amount required in BPKM Reg 6/2018. Accordingly, the OSS system will reject any application with paid-up and issued capital of less than IDR2.5 billion.

BKPM Reg 6/2018 also requires the minimum total nominal value of shares that a shareholder needs to own in the PT PMA to be at least IDR10 million.

5.4 Applicable Governance Requirements

A PT or PT PMA must have, at all times, at least two shareholders. If for any reason it has only one shareholder for a period longer than six months, it will lose its limited liability status and the sole shareholder's liability will not be limited to the equity invested in the company (ie, it will be personally liable for the actions of the company)

For PT PMA, investors have to determine the business line of the PT PMA and review Indonesia's valid Negative Investment List to confirm whether the intended business line in the real estate sector is subject to any foreign ownership restriction.

It must have at least one director and one commissioner. A foreign national may serve as a director or commissioner.

The PT or PT PMA will also need to obtain the customary permits and approvals required for the establishment of a company, such as a Business Identification Number (*Nomor Induk Berusaha*), a Taxpayer Registration Number (*Nomor Pokok Wajib Pajak*), a Company Registration Certificate (*Tanda Daftar Perusahaan*), a Certificate of Domicile (*Surat Keterangan Domisili Perusahaan*) and other regional/sectoral licences.

5.5 Annual Entity Maintenance and Accounting Compliance

This depends on the needs of the individual company. Investors will normally engage an accountant or financial adviser to analyse this issue.

6. Commercial Leases

6.1 Types of Arrangements Allowing the Use of Real Estate for a Limited Period of Time

The only type of arrangement that is relevant for this is a lease arrangement.

6.2 Types of Commercial Leases

Indonesian law is silent as to the types of commercial leases. However, there are numerous types of commercial leases available in practice, among others:

- *Net lease* – in addition to the monthly rent, the tenant will be required to pay some or all of the taxes, insurance and maintenance.
- *Percentage lease* – this arrangement typically requires the tenant to pay base rent, plus an additional percentage of monthly sales; this is commonly found in retail mall outlets or shopping centres.
- *Double net lease* – the tenant is required to pay rent, plus taxes, insurance and maintenance.
- *Full service lease* – the lessor is responsible for paying the most basic costs (eg, insurance, maintenance, service).

6.3 Regulation of Rents or Lease Terms

There are no express legal restrictions on the length of leaseholds in Indonesia. In principle, the lessor and the tenant may freely negotiate the terms of the lease.

Ideally speaking, a lease term shall be subject to the validity period of the underlying title, unless the underlying title is a *Hak Milik* title, which is valid for an indefinite period.

6.4 Typical Terms of a Lease

As explained in **6.3 Regulation of Rents or Lease Terms**, the typical and ideal term shall be subject to the validity period of the underlying title, unless the underlying title is a *Hak Milik* title.

Article 1551of the ICC provides that the lessor shall be bound to deliver the leased asset in a condition of proper maintenance. In this regard, the lessor shall, during the term of the lease, carry out all the repairs that are deemed necessary, with the exception of those that are the tenant's responsibility.

The most common term for rent payment is on an annual basis. However, the determination of rent payment frequency commonly depends on the needs and discretion of the lessor, which should be agreed by the lessee in the lease agreement.

Under Indonesian law, the tenant is protected should the lessor wish to sell or transfer the land to another party while the lease is still effective. Article 1576 of the ICC provides that leases as a matter of law survive the sale of property unless the lease agreement specifically states otherwise.

6.5 Rent Variation

This can be freely negotiated between the tenant and the lessor based on the freedom of contract principle. Normally, the lessor shall require a rent increase upon the expiry of the initial lease term and the parties will have to agree to extend the lease.

6.6 Determination of New Rent

This can be freely negotiated between the tenant and the lessor based on the freedom of contract principle. In some cases, this can be more at the discretion of the lessor. Normally, it will follow the market price of the property.

6.7 Payment of VAT

Rent is subject to VAT, which is payable by the tenant on each instalment of the rent. VAT is currently 10% of each instalment.

6.8 Costs Payable by Tenant at Start of Lease

This arrangement will differ from one lease to another, considering the freedom of contract principle. However, the costs will normally include:

- a security deposit;
- a monthly or annual parking charge;
- an initialsinking fund payment; and
- an initial payment of mandatory maintenance charges.

6.9 Payment of Maintenance and Repair

This can be freely negotiated between the tenant and the lessor based on the freedom of contract principle, although in most cases it is determined by the lessor. Usually, tenants will bear the costs.

6.10 Payment of Utilities and Telecommunications

This can be freely negotiated between the tenant and the lessor based on the freedom of contract principle, but in most cases it is determined by the lessor. Usually, tenants will bear the costs.

6.11 Insuring the Real Estate that is Subject to the Lease

In most cases, the lessor will pay for the cost of insuring real estate. However, there are special cases where the tenant is responsible for providing the insurance, especially in a long-term lease arrangement for a luxury residential property. The events that are typically covered by the policy are as follows:

- fire, lighting, explosion, airplane crash, smoke;
- riots;
- theft, burglary with violence; and
- third-party liabilities.

6.12 Restrictions on Use of Real Estate

This can be freely negotiated between the tenant and the lessor based on the freedom of contract principle, but in most cases it is determined by the lessor. Normally, if the property is a complex of condominiums or apartments or villas, the organiser of the complex will set forth tenants' rules that must be followed by the tenants.

6.13 Tenant's Ability to Alter and Improve Real Estate

This can be freely negotiated between the tenant and the lessor based on the freedom of contract principle, but in most cases it is determined by the lessor.

6.14 Specific Regulations

GR 44/1994 provides the very fundamental basis of house occupancy. It is stipulated that leasing a house requires an agreement between the landowner and the tenant that shall govern at least the rights and obligations of each party, the term of the lease and the amount of rent.

Additionally, the procedure to lease a state-owned land is stipulated in MOF Reg 57/2016.

There is, nonetheless, no basic specific regulation that provides comprehensive procedural guidelines for leases in Indonesia. The Draft Land Law is expected to provide such comprehensive guidelines when it is enacted.

6.15 Effect of Tenant's Insolvency

A lease agreement can include provisions for the tenant's insolvency based on the freedom of contract principle. Normally, the lessor may terminate the lease agreement if the tenant becomes bankrupt/insolvent, with certain conditions (eg, there must be evidence the tenant is bankrupt/insolvent and prior written notice must be provided).

6.16 Forms of Security to Protect Against Failure of Tenant to Meet Obligations

This can be freely negotiated between the tenant and the lessor based on the freedom of contract principle, but in most cases it is determined by the lessor. The most common form of security that a landlord will usually require is a security deposit, which is to ensure that the lessor is secured against any default by the tenant and for the cost of repairs to cover certain damage to the property caused by the tenant.

6.17 Right to Occupy After Termination or Expiration of a Lease

This is at the discretion of the lessor. Article 1573 of the ICC provides that if, following the termination of a lease concluded in writing, the tenant remains and is permitted to be in possession of the property, a new lease shall arise and the consequences thereof shall be regulated by the articles that are applicable to oral leases.

The lessor can freely add clauses to the lease to ensure the tenant leaves on the date originally agreed and the implications for a tenant violating such clauses.

6.18 Right to Terminate Lease

The events that typically give the landlord and the tenant the right to terminate the lease are of default (eg, the tenant does not provide payment of rent in a timely manner, the lessee fails to complete the construction of building or either party is guilt of a criminal offence), force majeure and lapse of validity.

6.19 Forced Eviction

This can be freely negotiated between the tenant and the lessor based on the freedom of contract principle, but in most cases it is determined by the lessor and agreed by the tenant.

6.20 Termination by Third Party

This firm is not aware of any commercial lease being terminated by any third party while the lease is ongoing, including the government or a municipal authority. Several leases on

state land have not been extended after the terms expired for the purpose of public interest.

7. Construction

7.1 Common Structures Used to Price Construction Projects

Under the Construction Law, a procurement arrangement is made through the execution of a construction work contract between the project owner/employer and the service provider/contractor. The Construction Law acknowledges the various types of construction work contracts that are typically used, including contracts based on:

- delivery system, including design-bid-build, design-build, engineering-procurement-construction, construction management and partnership contracts;
- service payment, including advance payment, progress payment, milestone and turnkey contracts; and
- work calculation system, including lump sum, unit pricing, combination of lump sum and unit pricing, cost reimbursable and target cost contracts.

In principle, the type of structure used to price construction projects will depend on the needs of the project owner/employer and the service provider/contractor, as well as the type of construction work.

7.2 Assigning Responsibility for the Design and Construction of a Project

The parties are free to agree the particular provisions governing the responsibilities and mechanism to appoint a subcontractor, subject to the express provisions under the Construction Law.

Under the Construction Law, subcontracting of work may only be done for 'specialised services'. These specialised services cover:

- technical and scientific consultation;
- technical testing and analysis;
- equipment lease; and
- specialised construction, covering work or construction in specific parts of the project.

The above implies that under the Construction Law, subcontracting may not be done for the entire project. The Construction Law further requires that the appointment of subcontractors obtains the approval of the employer.

7.3 Management of Construction Risk

The Construction Law requires that a construction agreement at minimum shall cover, among other things, guarantee over risks that arise and legal responsibilities to other parties in the implementation of the construction work or from building failure.

The following are risks that are typically allocated to the contractor:

- defects in the contractor's work;
- injury, loss of life, damage or loss to property to any party due to the contractor's work;
- physical condition of the location/work area; and
- faults or defects by appointed subcontractors.

In some contracts, the contractor may be released from bearing the above risks when it is caused by the employer's gross negligence or wilful misconduct. The freedom of contract principle as elaborated above allows the parties to agree mutually on the allocation of risks among them.

It is quite typical for the parties to put a limitation of liability clause in their contracts. The limitation of liability is usually set based on the contract value. In some instances, provisions in a contract stipulate that any liability arising from gross negligence or wilful misconduct will not be capped. However, the Indonesian courts can refuse to enforce a limitation of liability provision:

- for damages that result from gross negligence or wilful misconduct; an Indonesian court could consider such a limitation of liability contrary to public policy;
- if the party enforcing the limitation of liability did not negotiate or implement the contract in good faith; in its analysis, the court might consider the nature of the agreement, the parties, their expertise and their relationship, among other factors; and
- if the provision is inconsistent with the principle of fairness (*keadilan*), common practice (*kebiasaan*) and other laws and regulations, under Article 1339 of the ICC.

Warranties are also commonly included in a construction contract. Parties would be able to negotiate freely the scope and length of warranties provided by the contractor in relation to the work, equipment and materials.

7.4 Management of Schedule-related Risk

The parties would normally negotiate provisions in the event of delay and the provisions would normally include the following.

- *Cause of delay* – delays are most commonly caused by (i) the contractor's act or omission, (ii) the employer's act or omission and (iii) events outside the control of the parties (eg, force majeure events or change of law). Parties would set out possible causes and consequences for such delays.
- *Extension of time for completion* – in certain conditions of delay (eg, if the delay is caused by the employer's request

to suspend work), the contractor is entitled to an extension of time to continue its work without being subjected to delay damages or being held in default of the contract.
- *Step-in rights* – the employer will usually negotiate a provision allowing them to step in and take all necessary actions to cease the delay, at the contractor's cost.
- *Termination* – parties may also agree that certain degrees of delay by the contractor could result in the termination of the contract.

It is common to have a construction contract that provides that the owner is entitled to monetary compensation if there is a delay. Parties will negotiate on the amount and cap for delay damage. Delay damages also relate back to the cause of the delay. For example, the contractor should not be subject to delay damages if the delay was due to force majeure.

7.5 Additional Forms of Security to Guarantee a Contractor's Performance

To secure payment, it is common to require contractors to prepare bonds (eg, advance payment bond, performance bond and maintenance bond) and/or letters of credit issued by banks.

Parties will normally negotiate the form, amount and conditions in relation to performance security or bonds required to be obtained by the contractor in relation to the work.

7.6 Liens or Encumbrances in the Event of Non-payment

In addition to an encumbrance in the form of a mortgage, as discussed in **3.2 Typical Security Created by Commercial Investors**, it is common in Indonesia for a contractor to lien its property over collateral. For movable goods, the lien will normally be in the form of a fiduciary security or pledge (eg, materials supplied or vehicles in the project). If the construction contract allows the contractor to place a lien on the property, materials and/or supplies used in the project, the construction contract will usually include clauses that require the contractor to provide the owner a lien waiver upon the fulfilment of the payment obligation by the owner. The lien waiver can be in the form of a partial and/or final waiver. The construction contract will also normally include the form of letter that shall be used to waive the lien.

SSEK Legal Consultants

14th Floor, Mayapada Tower I
Jl. Jend. Sudirman Kav 28
Jakarta, Indonesia

Tel: +62 21 521 2038
Fax: +62 21 521 2039
Email: ssek@ssek.com
Web: www.ssek.com

In addition, materials and supplies that are not fixed to the land are covered under Article 1459 of the ICC, which provides that ownership of the goods will not be transferred if there is no handover from the seller (in this case, the contractor) to the buyer (in this case, the owner). As such, the contractor will have the right to hold back the handover of the goods until the contractor has been paid by the owner.

7.7 Requirements Before Use or Inhabitation

Upon completion of construction, an SLF is required to be obtained in some regions.

8. Tax

8.1 VAT

VAT is payable on any sale and purchase of real estate unless it is exempted (see **2.10 Taxes Applicable to a Transaction**).

8.2 Mitigation of Tax Liability

Parties will normally hire a tax consultant/adviser to mitigate tax liabilities.

8.3 Municipal Taxes

Each region may apply different regional taxes or retributions. Parties must enquire directly at regional tax offices for further details on taxes or retributions and exemptions.

8.4 Income Tax Withholding for Foreign Investors

As explained in **2.10 Taxes Applicable to a Transaction**, foreign companies and individuals are subject to a 20% withholding tax on dividends from real estate companies, subject to a relevant tax treaty.

Rental income for non-residents is taxed at a flat rate of 20% of gross income in Indonesia.

Income and capital gains earned by companies are taxed at a flat rate of 25% of net income, with several exemptions (eg, foreign diplomatic and consular personnel, SMEs and representatives of international organisations).

VAT is levied at a flat rate of 10% on gross rental income.

8.5 Tax Benefits

Depreciation and credit interest deduction are tax benefits from owning real estate. Investors may wait for capital gain from the future sale of property without having to input the tax income in their cash flow.

Leased property can be used to cut down taxes as a source of income.

A 50% reduction in the property tax rate is given to land and buildings used for non-profit activities, including social and educational activities, and healthcare services.