

A photograph of an industrial oil and gas facility. In the foreground, there are large, dark, curved pipes that frame the top and right sides of the image. Below the pipes, a person is walking on a metal staircase that leads up to a large white storage tank. In the background, several other white storage tanks with domed tops are visible against a clear blue sky. The foreground is filled with tall, green grass.

oil and gas in Indonesia

investment and taxation guide*

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PRICEWATERHOUSECOOPERS 

*DISCLAIMER

This publication has been prepared to assist those interested in oil and gas investment in Indonesia.

The information in this publication is based on current legislation, case law, accounting standards, generally accepted accounting practice, information produced by Governments and Government agencies in Indonesia, press articles and oil and gas statistics collected and collated from several referenced sources. The information has been updated as far as practical to June 2005. This document should be taken as a guide only and no specific action should be taken before consulting one of PricewaterhouseCoopers' specialists named in this document.

This publication is intended to provide a general overview of the oil and gas market in Indonesia and is not intended to provide advice. No liability is accepted for any reliance on any statement or representation where our specific advice is not sought.

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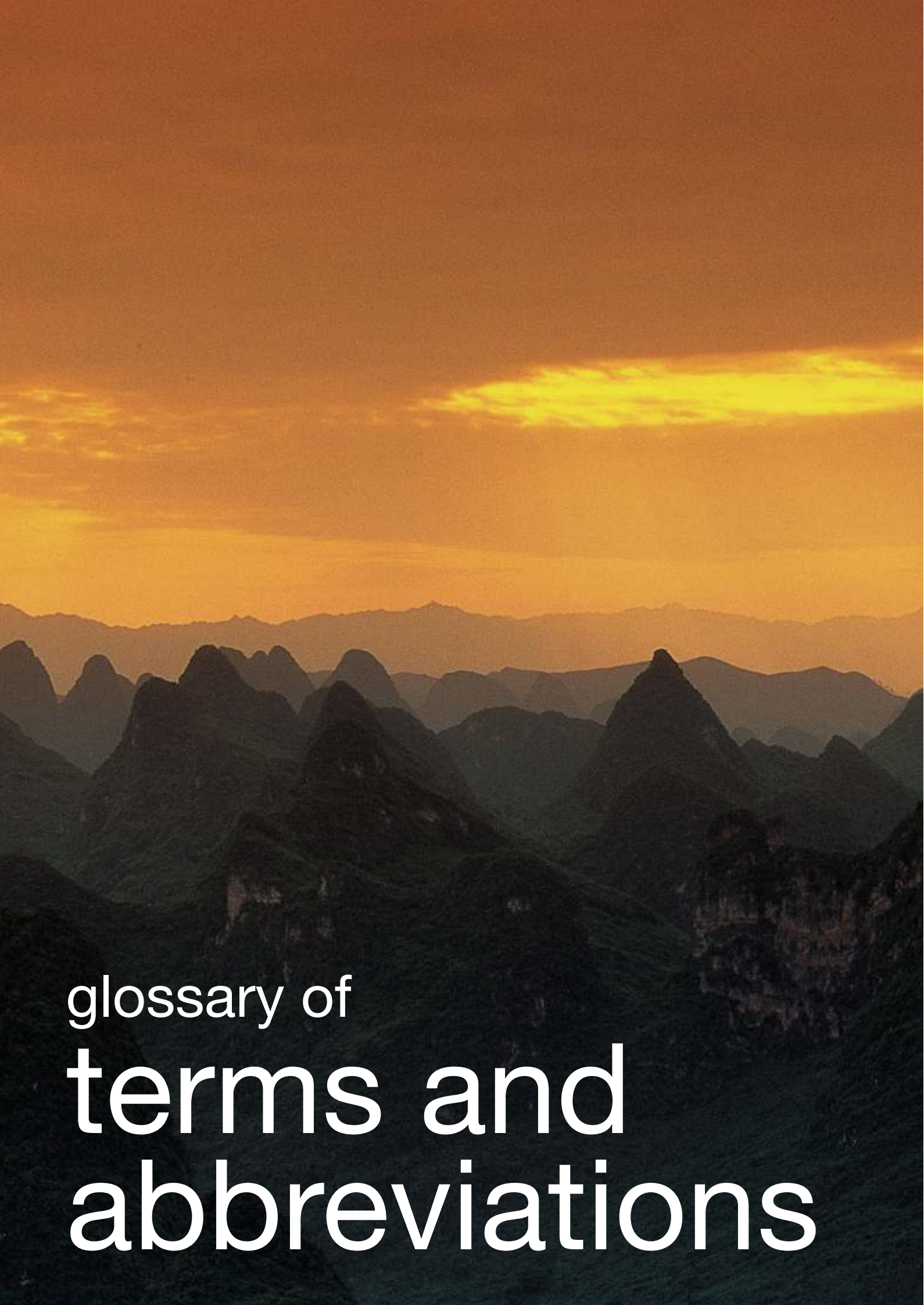
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glossary of
**terms and
abbreviations**

glossary of terms and abbreviations

Term	Definition
AFT	Automotive Fuel Tax
APBN	<i>Anggaran Penerimaan dan Belanja Negara</i> (State Budget)
APAs	Advance Pricing Agreements
API	<i>Asosiasi Panasbumi Indonesia</i> (Indonesian Geothermal Association)
APPI	Asian Petroleum Price Index
ASEAN	Association of South East Asian Nations
Bapepam	Capital Market Supervisory Board
BAPPENAS	National Development Planning Agency
BBC	Bare-Boat Charter
Bbl(s)	Barrels of oil
Bbl/d	Barrels of oil per day
BIK	Benefits in Kind
BKPM	<i>Badan Koordinasi Penanaman Modal</i> (Indonesia's Investment Coordinating Board)
Blue Book	Residence Registration and Amendments Book
BPHTB	<i>Bea Perolehan Hak atas Tanah dan Bangunan</i> (Rights for Use of Land and Building Transfer Duty)
BP Migas	<i>Badan Pelaksana Kegiatan Hulu Minyak dan Gas Bumi</i> (Oil and Gas Upstream Regulator and Implementing Agency)
BPH Migas	<i>Badan Pengatur Hilir Minyak dan Gas Bumi</i> (Oil and Gas Downstream Regulatory Agency)
BPK	<i>Badan Pemeriksa Keuangan</i> (State auditor that is independent to the Government)
BPKP	<i>Badan Pengawasan Keuangan dan Pembangunan</i> (Government auditing body)
BPPKA	<i>Badan Pengawasan Pengusahaan Kontraktor Asing</i> (Government auditing body)
BPR	Branch Profits Remittance
BUMN	State-Owned Companies
BUMD	Regionally Owned Business Enterprise established by the Regional Government
BVI	British Virgin Islands
Capex	Capital Expenditure
CEPT	Common Effective Preferential Tariff
CIT	Corporate Income Tax being Income Tax levied on companies
Contractor	The party (or parties) to a PSC/Cooperation/Service Contract (also referred to as "Contractor Group")
Cooperation Contract	A contract for the exploitation of oil and gas either based on a PSC (itself based on the principle of sharing the proceeds of production) or a service contract (which is based on the principle of granting compensation for the production activities)
DDB	Double Declining Balance method of depreciation
Decree No. 254	Decree No. 254 - Article 22 on import tax
Decree No. 267	Ministry of Finance Decree No. 267/1978 - Procedures for calculating and remitting company tax, interest, dividend and unpaid royalty tax by Contractors which operate PSCs with Pertamina
Decree No. 458	Ministry of Finance Decree No. 458/1984 - Procedures for calculating and remitting unpaid income tax by Contractors which entered into PSCs with Pertamina
DGFI	Directorate General of Financial Institutions
DGOG	Directorate General of Oil and Gas
DGoCE	Directorate General of Customs and Excise
DMO	Domestic Market Obligation
DPD	<i>Dewan Perwakilan Daerah</i> (regional senators)
DPR	<i>Dewan Perwakilan Rakyat</i> (House of Representatives)
DRM	<i>Daftar Rekanan Mampu</i> (vendors that are considered as qualified Contractors for joining the Government procurement bid)
ENI	Estimated Net Income
EOR	Enhanced Oil Recovery
FAS	Foreign Aid Status
FDC	Foreign-owned Drilling Company
FIFO	First In First Out
FPSO	Floating Production Storage and Offload (vessel)
FQR	Financial Quarterly Report
FSO	Floating Storage and Offload (vessel)
FTP	First Tranche Petroleum
GAAP	Generally Accepted Accounting Principles
General Tax Law	General Provisions and Taxation Procedures as per Law No. 6/1983 (as amended)

glossary of terms and abbreviations

Term	Definition
Government, the	Government of Indonesia
GR	Government Regulation
GR No. 35	GR No. 35/2004 – Upstream Business Activities
GR No. 36	GR No. 36/2004 – Downstream Business Activities
GTL	Gas to Liquids
HS	Harmonized System
IAS	International Accounting Standards
ICP	Indonesian Crude Price
IFRS	International Financial Reporting Standards
IGA	Indonesian Gas Association
IMTA	<i>Izin Mempekerjakan Tenaga Asing</i> (work permit for foreign workers)
INAGA	Indonesian Geothermal Association
Income Tax	Income Tax as levied under Income Tax Law No. 7/1983 (as amended)
IPA	Indonesian Petroleum Association
ITO	Indonesian Tax Office
IUP	<i>Izin Usaha Pertambangan Panas Bumi</i> (Geothermal Energy Business Permit)
Jamsostek	<i>Jaminan Sosial Tenaga Kerja</i> (Social Security Fund Foundation)
JO	Joint Operation
JOA	Joint Operation Agreement
JOB	Joint Operation Body
JOC	Joint Operation Contract
KAPETs	Integrated Economic Development Areas
Keppres 80	Presidential Decree No. 80/2003 - Guidelines on the procurement of goods and services
KIMS	<i>Kartu Ijin Masuk Sementara</i> (Temporary Entry Permit Card)
KITAS	<i>Kartu Ijin Tinggal Sementara</i> (Temporary Stay Permit Card)
KPP-PBB	Tax Office for Land and Building Tax
KRIS	Kost Reduction Indonesia Style
Law No. 8	Law No. 8/1971 - The Pertamina Law
Law No. 10	Law No. 10/1995 - Customs
Law No. 13	Law No. 13/2003 - The Manpower Law
Law No. 22	Oil & Gas Law No. 22/2001 - The (new) Oil and Gas Law
Law No. 25	Law No. 25/1999 on Inter-Government Fiscal Balance
Law No. 27	Law No. 27/2003 on Geothermal Energy
Law No. 44	Law No. 44/1960 - The (original) Oil & Gas Law
LIFO	Last In First Out
LNG	Liquefied Natural Gas
LPG	Liquefied Petroleum Gas
LST	Luxury Sales Goods Tax
MERP	Multiple Exit Re-entry
ML	Master List
mmbbls/d	Million Barrels per day
MMBTU	Million British Thermal Units
MMP	Ministry of Manpower
MoEMR	Ministry of Energy and Mineral Resources
MoF	Ministry of Finance
MoT	Ministry of Trade
MW	Mega Watt
New PSC	Contract signed with BP Migas after the enactment of Law No. 22
NJOP	Land and Building Tax
NPIK	Special Importer Identification Number
NPWP	<i>Nomor Pokok Wajib Pajak</i> (tax payer identification number)
Old PSC	Contract signed with Pertamina before the enactment of Law No. 22
OPEC	Organization of Petroleum Exporting Countries
Operator	The Contractor which manages the day-to-day operation of the physical asset and handles the financial aspects on behalf of the Contractor Group
Parties	BP Migas and foreign oil company or companies
PD	Presidential Decree
PD 22	Presidential Decree No. 22/1989 on the deferment of payment of VAT

glossary of terms and abbreviations

Term	Definition
PE	Permanent Establishment
PEB	Export Declaration
Pertamina	PT Pertamina (Persero)
Perusahaan Daerah	Local Government Enterprise
PIB	Import Declaration
PGN	<i>Perusahaan Gas Negara</i> (State Gas Company)
Platt's	Energy market data provider
PLN	<i>Perusahaan Listrik Negara</i> (State Electricity Company)
PMA	<i>Penanam Modal Asing</i> (Foreign Investment Company)
PMDN	<i>Penanam Modal Dalam Negeri</i> (Local Company)
PMK	<i>Peraturan Menteri Keuangan Republik Indonesia</i> (Ministry of Finance Regulation)
PoD	Plan of Development
PP	<i>Peraturan Pemerintah</i> (Government Regulation)
PPh	Income Tax Law
PP&E	Property, Plant and Equipment
PQR	Pertamina Quarterly Report (now FQR or Financial Quarterly Report)
PSAK	<i>Pernyataan Standar Akuntansi Keuangan</i> (Indonesian GAAP)
PSC	Production Sharing Contract
PSC Entity	A legal entity holding a working interest in a PSC
PT	<i>Perseroan Terbatas</i> (Limited Liability Company)
PTKP	Annual Non-Taxable Income
PwC	PricewaterhouseCoopers, refers to a network of member firms of PwC International Limited, each of which is a separate and independent legal entity
QQ Facility	Taxpayer making deliveries of taxable goods and/or services to VAT collectors through local agent can circumvent cascading VAT in the agent's hand via a QQ arrangement
Regulation No. 26	Ministry of Finance Regulation No. 26 regarding Customs Duty exemption for Geothermal activities
RIM	Energy market data provider
Ring Fencing	Concept of PSC costs being quarantined to a single PSC
RPTK	<i>Rencana Penggunaan Tenaga Kerja</i> (Annual Manpower Plan)
RPTKA	<i>Rencana Penggunaan Tenaga Kerja Asing</i> (Foreign Manpower Employment Plan)
S-318	DGoCE letter No. S-318/BL.3/2004 regarding import of goods needed for the oil and gas industry
SBI	Bank Indonesia Certificates
SE	<i>Surat Edaran</i>
SE-26	Circular Letter No. SE-26/PJ.53 on deferral of payment of VAT on exploration and drilling services of oil, gas and geothermal energy producers
SFAS	Statement of Financial Accounting Standards
SKPKB	Tax Underpayment Assessment
SKPKBT	Additional Tax Underpayment Assessment
SKPPS	<i>Surat Keterangan Pendaftaran Penduduk Sementara</i> (Temporary Resident Registration Certificate)
SKTT	<i>Surat Keterangan Tempat Tinggal</i> (Certificate of Domicile)
SLD	Straight Line Depreciation
SP	Company certification
SPE	Special Purpose Entity
SPOP	<i>Surat Pemberitahuan Objek Pajak</i> (Letter of Tax Objection)
Tabel Besar	BP Migas' guidelines for calculation of employee termination benefits
TAC	Technical Assistance Contract
TDR	<i>Tanda Daftar Rekanan</i> (Registered Vendor ID)
TSA	Technical Service from Abroad
Uniformity Principle	Concept of cost recovery equalling tax deductions as per MoF Letter No. S-443A of May 6, 1982
US	United States of America
US\$	United States Dollars (currency)
VAT	Value Added Tax as per the VAT Law No. 8/1983 (as amended)
VIE	Variable Interest Entity
VITAS	<i>Visa Ijin Tinggal Terbatas</i> (Limited Stay Visa)
WAP	Weighted Averaged Price
WHT	Withholding Tax as per Income Tax Law No. 7/1983 (as amended)
WOP	Write-off Proposal



about

PricewaterhouseCoopers

PricewaterhouseCoopers (“PwC”) is the world’s largest professional services organization. Drawing on the knowledge and skills of more than 125,000 people in 142 countries, we build relationships by providing services based on quality and integrity. “PricewaterhouseCoopers” refers to a network of member firms of PwC International Limited, each of which is a separate and independent legal entity. The people of PwC around the world are united by a commitment to quality and excellence. To that end, we have developed common methodologies, processes, knowledge bases, and technologies, and we continue to rework and refine them. Our firm comprises a worldwide group with a multidisciplinary skill base and deep expertise in financial and business affairs as well as a shared dedication to common values and ethics. We are organized to deliver consistent quality wherever our clients do business.

PwC is today the service provider of choice to many of the largest, most prestigious companies and Federal and State governments in the world. We command a significant market share in each industry segment that we provide services to, taking clients from ideas to action through the combination of:

People - individuals with knowledge, potential and distinctive capabilities that act as a valuable member of the client team. PwC recruits its professionals from world-class institutions and technology organizations and has been recognized as being in the top 100 global employers.

Knowledge - a source of power when shared across boundaries, within our organization and to our clients.

Worlds - providing content and meaning for what we do every day, helping our clients improve the worlds in which they operate.

PwC in Indonesia

PwC has operated in Indonesia since 1971. We have over 650 professional staff in Jakarta who are trained in providing assurance, advisory and tax services to Indonesian and international companies, and the Government of Indonesia (“the Government”).

PwC is the leading advisor to oil and gas companies in Indonesia. Our commitment to the oil and gas industry is unmatched and demonstrated by our active participation in industry associations around the world, and in Indonesia, and our thought leadership on the issues affecting the industry. Through our involvement with the Indonesian Petroleum Association (“IPA”), we help shape the industry as it progresses towards a truly world-class oil and gas center.

Our oil and gas team in Indonesia, comprising of over 100 dedicated professionals, brings together local knowledge and experience with international oil and gas expertise. Our strength in serving the oil and gas industry comes from our skills, our experience and our network of Partners and Managers who focus all of their time on understanding the oil and gas industry and working on solutions to oil and gas industry issues. Detailed oil and gas knowledge and experience ensures that we have the background and understanding of industry issues and can provide sharper, more sophisticated solutions.

about PricewaterhouseCoopers

In particular, we would like to highlight that PwC audits over 60% (in terms of production) of the oil and gas producers in Indonesia operating under Production Sharing Contract ("PSC") agreements, and also provides other professional services, such as taxation and advisory services, to the medium to large size oil and gas producers.

Our local presence and size enables PwC to be uniquely positioned to provide a genuinely local team with international experience, available here on the ground in Jakarta and supplemented by deeply experienced overseas experts.



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preface

Since the onset of the Asian financial crisis in 1997, all markets in Asia including the oil and gas market have undergone tremendous changes. In an attempt to stabilize and strengthen the markets, substantial reforms have been undertaken, stricter regulatory and supervisory measures have been implemented, and accounting standards have been improved. This handbook recognizes that reforms are continuing and that some of the information will become outdated as this proceeds.

Investors intending to invest in Indonesia will need to carry out further research and obtain updated information on investment and operational requirements. Investors should also consider the social, political and economic developments in the country, as they can be quite complex and all encompassing.

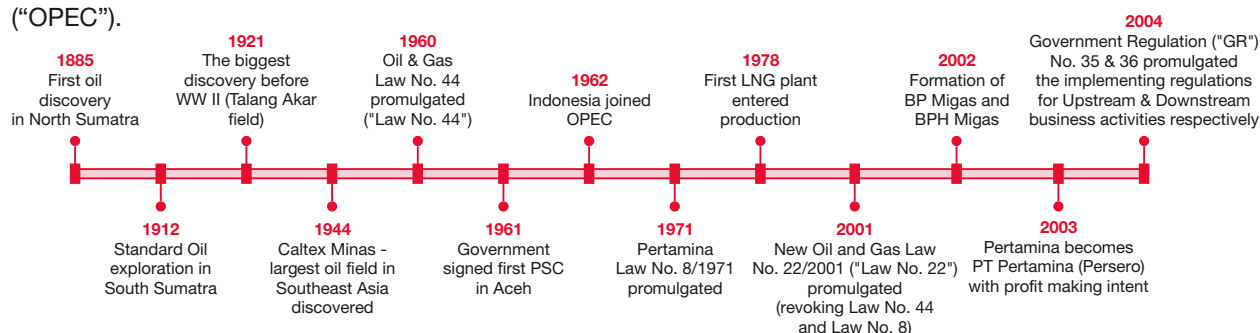
We recommend investors contact our specialist team should they need further advice. Please see the appendices for contact details.



Overview of Indonesia's oil and gas industry

Introduction

Indonesia continues to be a significant player in the international oil and gas industry after more than 100 years of activity in the sector. Despite stiff competition from emerging producers, Indonesia currently remains the world's largest exporter of liquefied natural gas ("LNG") and is ranked sixth in world gas production, with proven reserves of 98 trillion cubic feet, the eleventh largest in the world. Gas reserves are equivalent to three times Indonesia's oil reserves and can supply the country for fifty years at current production rates. Indonesia holds proven oil reserves of 4.3 billion barrels and ranks seventeenth among world oil producers, with approximately 1.8% of world production. Indonesia is the only Asian member of the Organization of Petroleum Exporting Countries ("OPEC").



Source: Migas and other secondary sources

Indonesia has a diversity of geological basins, which continue to offer sizeable oil and gas reserve potential. Of the estimated 60 oil basins, over 22 have been extensively explored. Most oil production and exploration is currently carried out in the basins of Western Indonesia. The bulk of Indonesia's oil reserves are located onshore and offshore of central Sumatra and Kalimantan. The Government has placed increased emphasis on developing oil reserves in Eastern Indonesia.

Key Indicators - Indonesia's oil and gas industry

Indicator	1998	1999	2000	2001	2002	2003	2004
Reserves							
Oil (Million Barrels)							
Proven	9,692	9,826	9,613	9,753	9,746	8,800	8,300
Possible	5,100	5,203	5,123	5,095	4,722	4,700	4,300
Gas (TCF)							
Proven	4,592	4,623	4,490	4,659	5,025	4,100	4,000
Possible	137	158	170	167	177	178	188
Proven	77	92	94	91	91	91	98
Possible	60	66	76	76	86	87	90
Production							
Crude & condensate (1000 barrels)	568,156	547,610	517,547	489,306	456,944	369,757	347,159
Natural Gas (BCF)	2,979	3,068	2,901	2,807	3,036	3,155	3,030
LPG (1000 MT)	2,344	2,264	2,088	2,188	2,099	1,922	1,722
LNG (100MT)	26,974	28,956	26,990	23,883	26,215	26,077	23,011
New contracts signed	22	4	5	10	1	15	11*
No. of exploration wells drilled	145	89	82	80	73	36	68
Oil and gas discoveries	21	19	34	17	12	22	21

Sources: Petroleum Report Indonesia: 2002 - 2003 US Embassy, Jakarta
Directorate General of Oil & Gas, Ministry of Energy and Mineral Resources

(*) 11 blocks were tendered in 2004. Blocks tendered in 2005 are 27; of which 9 were awarded up to the date of writing this publication.

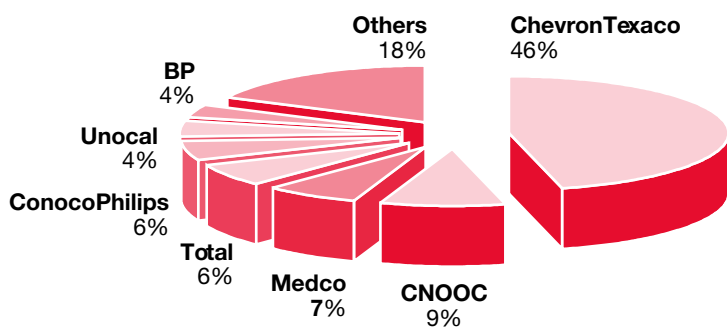
overview of Indonesia's oil and gas industry

Indonesia's crude oil production has declined over the last five years, due to the natural maturation of producing oil fields combined with a slower reserve replacement rate and decreased exploration/investment. The Government hopes oil Contractors will aggressively increase exploration activities to identify new reserves. With few significant oil discoveries in western Indonesia in the last ten years, the Government hopes eastern Indonesia's frontier and deep-sea areas may contain sizeable oil reserves.

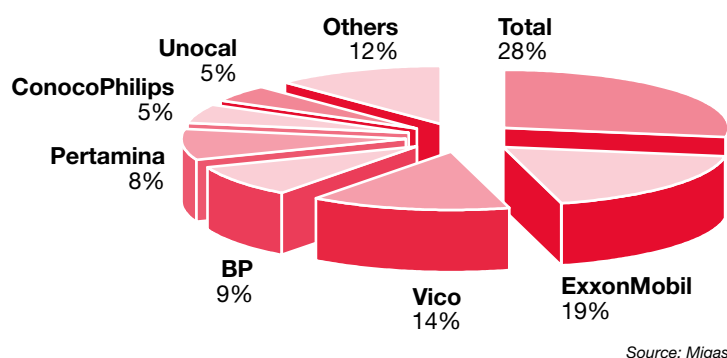
Reserve replacement and increasing production have become critical concerns for the Government, as increased consumption resulted in Indonesia becoming a net oil importer for the first time in early 2004. Combined with continued high oil prices in 2004-2005, this situation resulted in the Government continuing to reduce the costly fuel subsidy in early 2005, due to its excessive burden on the country's budget.

Most oil and gas production is currently carried out by foreign Contractors under PSC arrangements. Major players are:

Crude and Condensate Production, 2004



Gross Natural Gas Production, 2004



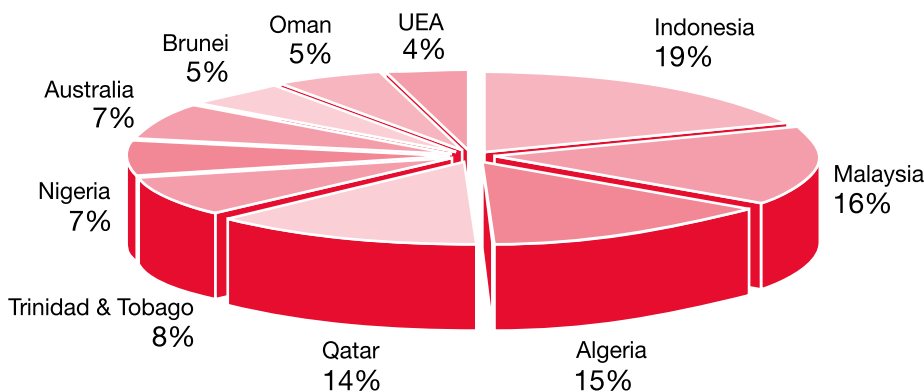
(*) At the time of writing this publication Unocal was subject to take-over by Chevron Texaco

As Indonesia's oil production has decreased in recent years, the country has attempted to shift towards using its natural gas (and to a lesser extent, geothermal) resources for power generation. Indonesia's natural gas industry is changing, affected by more competitive LNG markets, new pipeline exports, and increasing domestic gas demand. This is particularly so as fuel subsidies are gradually reduced, making natural gas a more competitive source for energy generation. Also, emerging LNG producers in Qatar, Australia, Algeria and Malaysia now challenge Indonesia's leadership in the LNG market. Indonesia currently supplies around 19% of the world's LNG.

overview of Indonesia's oil and gas industry

A majority of Indonesia's natural gas is produced for the manufacture of LNG, which is currently exported mainly to Japan, Korea and Taiwan. Production from Indonesia's two existing LNG facilities, Arun in Aceh and Bontang in East Kalimantan, have positioned Indonesia as the world's largest exporter of LNG. However, in recent years declining production, as a result of maturing gas fields in these areas, has threatened this position. New LNG projects are currently under consideration, with the Tangguh LNG project in Papua in advanced planning and development stages, and the possibility of a fourth LNG facility to be supplied by the Donggi gas fields in Central Sulawesi. These new projects are likely to result in the broadening of Indonesia's LNG customer base to China and the west coast of the United States.

World's Top Ten LNG Exporters for 2004



Source: BP Statistical Review of World Energy June 2005

Contribution to the Economy

The value of investment in the industry has decreased over recent years, impacted by uncertainty over changes in the regulatory environment affecting the industry, as well as political and security concerns. However, as some of these uncertainties begin to reduce, investment in the industry is slowly increasing. The Government has revamped procedures and improved some terms and conditions (e.g. production sharing splits) for exploration and production contracts to increase their attractiveness. Previously, oil and gas concessions were only awarded through an official tender. The Government now also accepts proposals for blocks through a direct bidding process. Production sharing splits have been improved as well.

Investors have shown a high interest in the blocks offered by the Government as indicated by the number of oil and gas Cooperation Contracts signed and the increased investment expenditures in the last few years. Currently, over 185 contracts are in place with independent operators, including over 157 PSCs for the exploration, development and production of oil and gas reserves.

Total Investment (in million US\$)

Type of Operation	1997	1998	1999	2000	2001	2002	2003	2004
Exploration/Development	1,841	2,068	1,311	1,011	1,158	1,557	1,409	1,744
Production Cost	2,435	2,303	2,250	2,442	2,615	3,374	3,458	3,204
Others	497	457	488	478	429	507	438	610
Total	4,773	4,828	4,049	3,931	4,202	5,438	5,305	5,558

Source: MIGAS, BP MIGAS and Directorate General of Oil and Gas
(as quoted in Petroleum Report Indonesia: 2002 - 2004 US Embassy, Jakarta)

overview of Indonesia's oil and gas industry

Since 2001, there has been a declining contribution from the upstream oil and gas industry to the Government revenues, in absolute and relative measures, despite above average international oil prices.

The upstream oil and gas industry has a long history of being a main contributor to the country's state budget. Nevertheless, for the past four years, since 2001 the contribution has been declining in nominal terms as well as a percentage of total Government revenue. The nominal contribution declined from approximately Rp 90 trillion (inclusive of the tax revenues from the upstream oil and gas industry – approximately US\$9.5 billion) in 2001 to barely Rp 54 trillion (approximately US\$5.6 billion) in 2004. Parallel with this, during the same period its share of total Government revenue declined from more than 30% to 15%. The relative contribution decline in 2004 was even more dramatic if compared to 1990 when the contributions from the upstream oil and gas industry represented more than 40% of total Government revenues.

The continuing decline of the upstream oil and gas industry's contributions to the Government revenues is certainly not favorable for Government which is in need of new funds for its routine as well as non routine budget expenditures. Arguably the Government has been pushing to broaden the country's economic base to not be so dependent on the petroleum sector but the dramatic decline can not be attributed to this macroeconomic policy alone. The continuing decline was experienced despite above average international oil prices in the last few years; hence, the decline can be largely attributed to Indonesia's declining oil and gas production.

Oil and Gas Contribution to Domestic Revenues

Year	Domestic Revenue	Oil/Gas Revenues	% of Contribution
	(Rp Trillion)		
1998/1999	156	41	26.28%
1999/2000	201	45	22.39%
2000	187	58	31.01%
2001	277	90	32.49%
2002	301	74	24.58%
2003	336	71	21.13%
2004	343	54	15.74%

Source : Ministry of Finance (MoF)

Oil and Gas Contribution to Foreign Trade

Year	Export Oil/Gas	Total Export	% of Contribution
	(\$ Million)		
1992	10,671	33,967	31.42%
1993	9,746	36,823	26.47%
1994	9,694	40,053	24.20%
1995	10,464	45,418	23.04%
1996	11,722	49,815	23.53%
1997	11,623	53,444	21.75%
1998	7,872	48,848	16.12%
1999	9,792	48,665	20.12%
2000	14,367	62,124	23.13%
2001	12,636	56,321	22.44%
2002	12,107	57,002	21.24%
2003	13,651	62,527	21.83%
2004	15,588	69,714	22.36%

Source : Ministry of Finance (MoF)

With respect to the downstream petroleum sector, most petroleum products refined in Indonesia are for domestic consumption. Key areas of consumption are transportation (47%), industry (21%), household (20%) and electricity power generation (11%). Indonesia currently has nine oil refineries, all owned and operated by PT Pertamina (Persero) ("Pertamina"), the state-owned oil and gas company or the Government, with a combined

overview of Indonesia's oil and gas industry

installed capacity of 1.06 million barrels per day ("mmbbls/d"). Although these refineries operate at 90% plus of their combined capacity, the limited capacity means that Indonesia imports significant amounts of refined products to meet demand, and must arrange for overseas crude processing when its larger refineries are shut-down for major maintenance. Law No. 22, once fully implemented, will permit foreign investors to produce, import and distribute oil-based fuels and lubricants and thus end Pertamina's monopoly in the downstream sector.

Domestic Fuel Consumption (Million Liters)

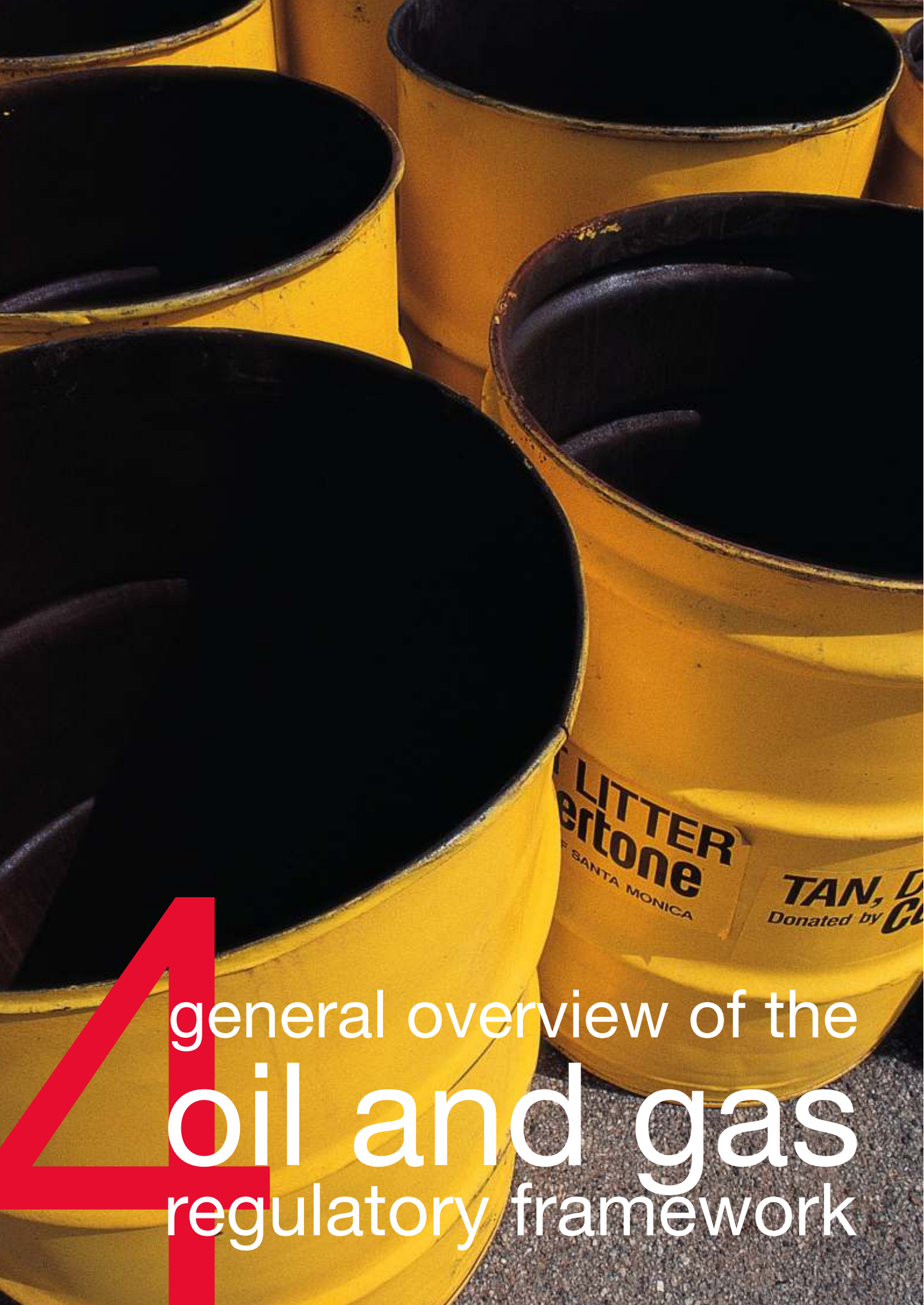
Products	2000	2001	2002	2003	2004
Automotive Diesel Oil	21,734.7	23,013.7	24,212.9	24,064.5	26,487.8
Gasoline	12,421.8	13,056.7	13,732.4	14,647.5	16,418.0
Kerosene	12,455.2	12,227.9	11,678.4	11,753.1	11,846.1
Fuel Oil	6,013.1	6,121.0	6,260.3	6,215.6	5,754.6
Industrial Diesel Oil	1,451.2	1,420.0	1,360.3	1,183.5	1,093.4
Avtur	744.1	-	552.9	1,929.4	-
Avgas	4.6	-	-	3.6	-
Total	54,824.7	55,839.3	57,797.2	57,797.2	61,599.9

Source: Petroleum Report Indonesia

Oil Refinery Production (1000 b/d)

Refinery	Installed Capacity	Recent Crude Processed Statistics
Pangkalan Brandan	5.0	2.7
Dumai	120.0	119.7
Sungai Pakning	50.0	49.1
Musi	135.2	121.2
Cilacap	348.0	318.0
Balikpapan	260.0	260.5
Balongan	125.0	122.6
Kasim	10.0	6.0
Cepu	3.8	2.5
Total	1,057.0	1,002.3

Source: MIGAS



4

general overview of the
oil and gas
regulatory framework

Overview

The basic premise underlying the oil and gas industry in Indonesia is established in the Constitution of the Republic of Indonesia promulgated in 1945. Article 33 states that, "All the natural wealth on land and in the waters is under the jurisdiction of the State and should be used for the greatest benefit and welfare of the people".

On October 23, 2001 the House of Representatives ("DPR") passed Law No. 22 and it came into effect from November 23, 2001, the date of signing by President Megawati Sukarnoputri.

Law No. 22 replaces:

- a) Law No. 44;
- b) the Law on Domestic Market Obligation ("DMO") No. 15 of 1962; and
- c) the so-called "Pertamina Law No. 8".

These laws had provided the legislative framework for the Indonesian oil industry for the past thirty years. Law No. 22 consists of 14 Chapters and 67 Sections. A brief summary of the Chapters of Law No. 22 is set out below.

Summary of Law No. 22

Chapter	Notes
1) General Article 1 only	<ul style="list-style-type: none"> - list of definitions; and - exploitation includes certain transportation, storage and processing activities.
2) Principles & Objectives Articles 2-3	<ul style="list-style-type: none"> - outline of the management of Oil & Gas business activities.
3) Control & Undertaking Articles 4-10	<ul style="list-style-type: none"> - the Government is holder of all mining authority; - division of activities into upstream & downstream sectors; - upstream via a "Cooperation Contract", controlled by BP Migas; and - downstream via a "business licence", controlled by BPH Migas.
4) Upstream Activities Articles 11-22	<ul style="list-style-type: none"> - provisions to be covered in a Cooperation Contract outlined; - increased emphasis on taxation and environmental matters; - Minister to control tender approval after consultation at regional government level; and - maximum 25% DMO.
5) Downstream Activities Articles 23-30	<ul style="list-style-type: none"> - 4 types of licences; - format of licences outlined; - continued guarantee of domestic supply; and - promotion of natural gas.
6) State Revenues Articles 31-32	<ul style="list-style-type: none"> - outline of upstream taxes. Potential for significant expansion beyond Income Tax; and - outline of downstream taxes.

general overview of the oil and gas regulatory framework

Summary of Law No. 22 (continued)

Chapter	Notes
7) Land Title Articles 33-37	- potential rights for compulsory acquisitions.
8) Development and Supervision Articles 38-43	- the Government is responsible for overall management.
9) Implementing/ Regulatory Bodies Articles 44-49	<ul style="list-style-type: none"> - Ministry of Energy and Mineral Resources (“MoEMR”) to control tendering/initial field developments; - BP Migas to control subsequent activities; - head of BP Migas to be appointed by the President of Indonesia; - business licences for downstream issued by the Government; - BPH Migas appointed by the President of Indonesia; and - BPH Migas to ensure supply of domestic market once promotion of Natural Gas.
10) Investigation Article 50	- creation of a Civil Servant Investigator.
11) Criminal Provisions Articles 51-58	- covers misuse of data and illegal upstream and downstream activities.
12) Transitional Articles 59-64	<ul style="list-style-type: none"> - BP Migas to be established within one year from enactment of Law No. 22; - BPH Migas to be established within two years from enactment of Law No. 22; and - Pertamina to discontinue support for supply of domestic fuel market within four years from enactment of Law No. 22.

Law No. 22 created an over-arching statutory framework for a fundamental restructuring of the oil and gas industry. Unlike its predecessor laws, Law No. 22 differentiates between upstream and downstream activities and requires a legal separation of upstream and downstream activities in order to achieve cost transparency between both segments. Although Law No. 22 requires that the upstream and downstream businesses be undertaken by separate legal entities, there are no ownership restrictions with respect to such entities. Law No. 22 requires that upstream and downstream activities be regulated by separate State regulatory bodies and prioritizes natural gas usage for domestic needs.

Law No. 22 also authorized the establishment of an implementing agency called “Badan Pelaksana Kegiatan Hulu Minyak dan Gas Bumi” (“BP Migas”) for upstream activities and a regulatory agency called “Badan Pengatur Hilir Minyak dan Gas Bumi” (“BPH Migas”) for downstream activities to assume state oil and gas company Pertamina’s regulatory roles. BP Migas took over Pertamina’s upstream regulatory functions and management of oil and gas Contractors. BPH Migas is charged with assuring sufficient natural gas and domestic fuel supplies and the safe operation of refining, storage, transportation, and distribution of petroleum products.

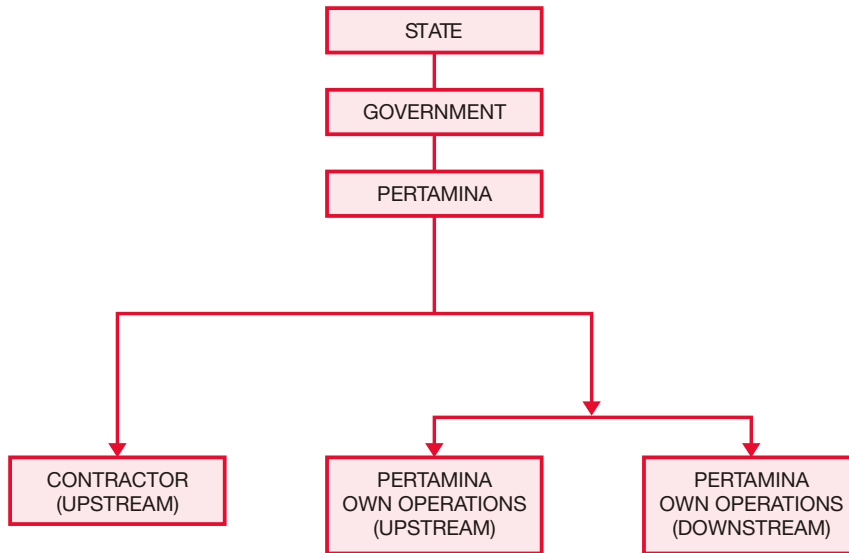
Stated goals of Law No. 22 are to ensure the “effective implementation and control” of upstream and downstream activities. Downstream includes the additional, and arguably contradictory, goal of promoting competitive activity, while guaranteeing domestic fuel supplies.

An overview of institutional framework is set out here in.

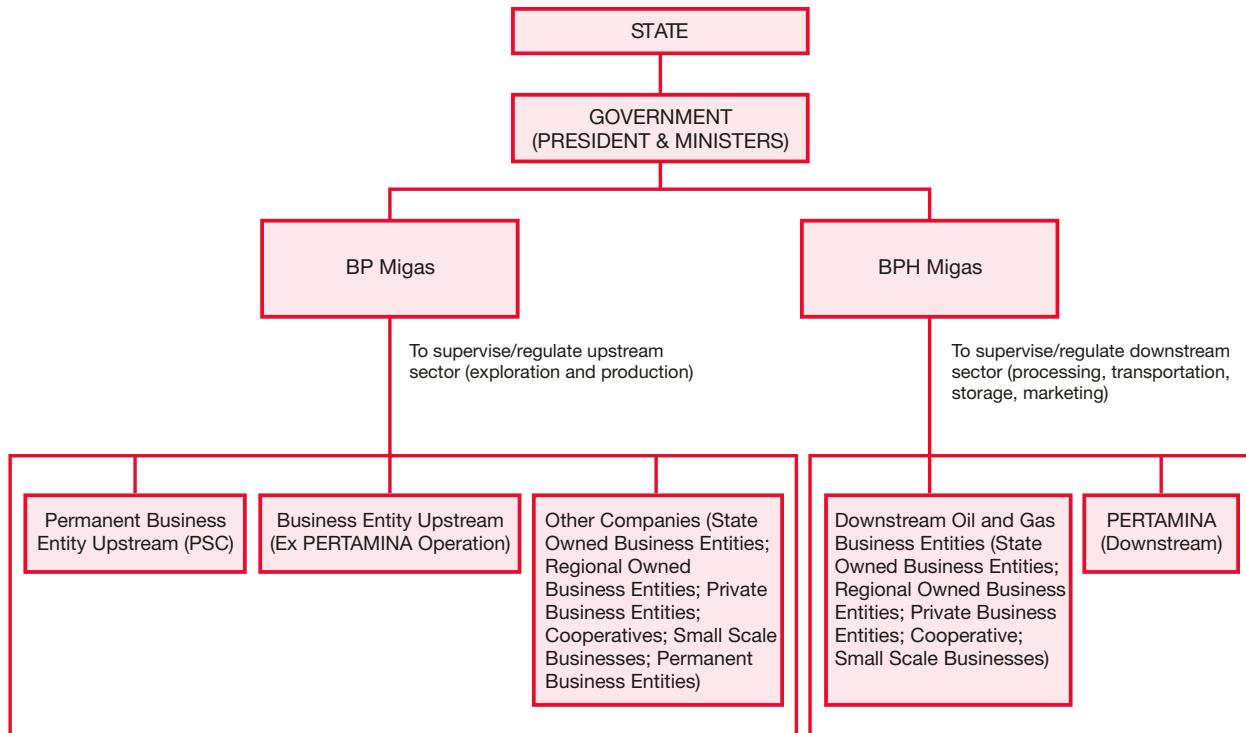
general overview of the oil and gas regulatory framework

Institutional Framework

INDONESIA'S OIL AND GAS BUSINESS UNDER LAW No. 8 (HISTORICAL)



INDONESIA'S OIL AND GAS BUSINESS UNDER LAW No. 22 (CURRENT)



general overview of the oil and gas regulatory framework

Overall management of Law No. 22 is the responsibility of the Government with most of the responsibility delegated to two “regulating agencies” (see table below). “Business activities” are formally broken into upstream and downstream categories as follows:

Upstream (BP Migas)	Downstream (BPH Migas)
Exploration Exploitation	Processing Transportation Storage Trading

Two implementing regulations: i.e. GR No. 35/ (upstream) and GR No. 36 (downstream), have been passed since Law No. 22 was promulgated. These are aimed at implementing the upstream and downstream provisions of Law No. 22 and have been summarized later in this guide.

Fiscal Decentralization Law

One of the key areas in which energy and politics intersect in Indonesia is the distribution of oil and gas revenues between the Central Government in Jakarta and Regional Governments in areas that produce oil and gas. Law No. 22/1999 on Regional Autonomy and Law No. 25/1999 on Inter-Government Fiscal Balance came into force on January 1, 2001. The income from oil and gas will now be allocated also to Regional Governments to realize Law No. 25 of 1999, whereas so far it has always been shared between the Contractors and the Central Government.

Since the enacting of the above laws on regional autonomy and fiscal balance, there has been continuous debate over the appropriate allocation of oil and gas revenues between the Central Government and Regional Governments. The issuance by the MoF of Decree No. 237/KMK.06/2003 dated June 3, 2003 on the “Stipulation of Estimated Financial Portions of Regions in Revenues for Petroleum and Natural Gas in Fiscal Year 2003” may bring some further clarity to the situation.

This decree forms part of the framework required by a number of Government Regulations (“GRs”) issued between 1999 and 2003 with respect to the basis for allocating the Government share of the revenues derived from the exploitation of natural resources.

The general basis for calculating the revenue sharing is derived from earlier regulations and is based on an allocation of the Government’s net income (i.e. gross sales based on realized liftings less cost recovery). For oil revenues, the sharing is 85% to the Central Government and 15% to the regency, with the regency share representing 3% to the province, 6% to the oil producing regency and 6% to other regencies in the province. For natural gas revenues, the sharing is 70% to the Central Government and 30% to the region, with the region’s share representing 6% to the province, 12% to the gas producing regency and 12% to other regencies in the province.

Contractual Arrangements

Participation in upstream activities can only be possible pursuant to contractual engagements with the holder of the relevant (Oil and Gas) Mining Authority. This authority will now be exclusively held by the Government as opposed to Pertamina. The contracts are now termed “Cooperation Contracts” and the engaging party will also be the Government (via BP Migas - please see our further comments on this matter later in this publication under the Chapter V, Sections A and B) rather than Pertamina. The Contractor can still be either a foreign or Indonesian incorporated company.

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As mentioned, upstream activities can take place only pursuant to a Cooperation Contract entered into with BP Migas. However, Law No. 22 provides that a Cooperation Contract must cover certain provisions, including:

- “State Revenue” terms;
- expenditure commitments;
- term and extension conditions (thirty years + twenty years);
- domestic supply obligations; and
- post-mining obligations, health and safety matters and environment management.

As described above, Contractors may enter into Cooperation or Service Contracts. However, to date, all Cooperation Contracts formalized are similar in form and content to the historical PSC format.

There are historically two categories of agreements and contracts for Indonesia’s petroleum industry. The first category refers to the bundle of rights and obligations granted to an investor to invest in cooperation with the Government in oil and gas exploration and exploitation. These types of contracts are the PSC, Technical Assistance Contract (“TAC”), and the Enhanced Oil Recovery (“EOR”) contract, defined as follows:

PSC:

- A Cooperation Contract for oil and gas exploration between BP Migas and a private investor (which can include foreign or domestic companies, as well as Pertamina);
- BP Migas is the supervisor or manager of the PSC;
- Investors are participating interest holders and Contractors;
- The Government take is under a production sharing arrangement whereby the Government and the Contractors take a split of the production measured in revenue based on PSC-agreed percentages;
- Operating costs are recovered from production through Contractor cost oil formulas as defined by the PSC;
- The Contractor has the right to take and separately dispose of its share of oil and gas; and
- Title of the hydrocarbons passes to the Contractor at the export or delivery point.

TAC:

- Variation of a Cooperation Contract, or PSC;
- Typically used for established producing areas and therefore covers exploitation only;
- Pertamina is the supervisor or manager of the TAC;
- Operating costs are recovered from production;
- The Contractor does not typically share in all production;
- The TAC can cover both exploitation and exploration if it occurs in an area where the Government has encouraged exploration; and
- Per Law No. 22, existing TACs will not be extended.

EOR:

- Variation of a Cooperation Contract, or PSC;
- Used for established producing fields with the intent of applying advanced technology to increase the recovery of hydrocarbons in the reservoirs;
- Pertamina is usually a participant, along with investors;
- Collectively they investors are the Contractors;
- Pertamina is the supervisor and manager of the EOR;
- Operating costs are recovered from production and typically capped at a percentage. In some cases, the incremental oil lifted from an EOR operation may be shared on a production sharing basis; and
- In many cases, the EOR may also include provisions concerning how the parties will conduct petroleum operations.

The participants in the PSC, TAC or EOR generally also enter into separate agreements on how they conduct the petroleum operations. These are known as Joint Operation Agreements (“JOAs”) and Joint Operation Bodies (“JOBs”), defined as follows:

general overview of the oil and gas regulatory framework

JOA:

- A separate agreement in addition to the Cooperation Contract;
- Governs the relations of the participating interest holders, defining their rights and obligations, and describing the procedures the Contractors will abide by; and
- The JOA typically includes: 1) the scope of operations; 2) designation, rights and obligations of the Operator; 3) establishment of an Operating Committee; 4) production disposition; 5) relinquishment, withdrawal and assignment; 6) confidentiality; 7) force majeure; and 8) dispute resolution and choice of law.

JOB:

- Typically part of the JOA;
- Governs the operations on behalf of the participating interest holders by establishing a non-legal entity, the JOB, to conduct petroleum operations;
- Representatives of the participating interest parties appoint representatives to the JOB;
- The JOB prepares an operating work program and budgets and carries out operations pursuant to the JOB agreement and the Cooperation Contract; and
- Participating interest holders remain the Contractor.

Upstream Stakeholders

MoEMR

All energy activities dealing with oil and gas fall under the MoEMR, which is charged with creating and implementing Indonesia's energy policy and awarding contracts. The MoEMR is divided into several directorates, with the Directorate General of Oil and Gas ("DGOG") responsible for all aspects of the petroleum industry, including its development, employee training and promulgating regulations. Refer to appendices for an organization chart and summary of roles and responsibilities.

BP Migas

BP Migas controls upstream activities on behalf of the Government through co-operation contracts with entities undertaking exploration and exploitation of oil and natural gas in Indonesia. Under the new regime, all of Pertamina's rights and obligations arising from existing PSCs were transferred to BP Migas, which replaced Pertamina as the Government party for all production sharing arrangements.

BP Migas is a non-profit state legal entity, and acts on behalf of the Government as party to co-operation contracts with business entities, but at the same time also acts as a regulator, which controls all oil and gas business operations. Please see our further comments on this matter in Section V which provides a summary of BP Migas' main duties.

BPH Migas

Among BPH Migas' responsibilities are regulating and determining the supply and distribution of oil-based fuel; regulating the transmission and distribution of natural gas; allocating fuel to meet national oil fuel reserves; the use of oil and gas transportation and storage facilities; setting tariffs for gas pipeline use; setting the price of natural gas for household and small consumers; making recommendations on pipeline levies; and setting the price of pipeline rights. Please see our further comments on this matter in Section VI which provides a summary of BPH Migas' main duties.

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House of Representatives/DPR and Regional Governments

The House of Representatives, or DPR, is responsible for the following main activities:

1. Legislation - to prepare, study/research and complete draft laws;
2. Control - to control the implementation of laws, including the state budget (“APBN”) and regulations, to discuss and follow up results from BPK, to control Government policy, and to discuss and follow up and advise from the senate (“DPD”); and
3. Budgeting - to discuss and provide any suggestions to Government in relation to APBN.

Regional Governments are involved in the approval of Plan of Development (“PoD”) through issuance of local permits and land rights.

PT. Pertamina

In June 2003, Pertamina was officially transformed from a state oil and gas enterprise governed by its own law into a state-owned limited liability company PT Pertamina (Persero). It is intended that Pertamina will be treated in the same manner as other oil and gas companies in Indonesia. This transformation is part of efforts to establish a new competitive and efficient entity, which is expected to increase economic activity and the welfare of the people. Pertamina has authority from the Government to supply fuel oil for domestic consumption, with compensation to be provided by the Government.

Pertamina contributes significantly to Indonesia’s petroleum output. It ranks 9th in crude oil production and was Indonesia’s 5th largest producer of natural gas in 2002. Pertamina executives have expressed their resolve to enhance Pertamina’s position in the upstream sector and to position the company for petroleum sector deregulation.

PT. Perusahaan Gas Negara

The origin of PGN was a Dutch-based gas company called Firma L.I. Eindhoven & Co. In 1958, the firm was nationalized and became Perusahaan Negara Gas, later changing its name to PT. Perusahaan Gas Negara (“PGN”) effective May 13, 1965. In 2003, PGN became a publicly listed company and begun trading on the Jakarta and Surabaya Stock Exchanges.

PGN’s responsibility is to implement and support the Government’s economic and national development programs, particularly in developing uses of natural gas for the benefit of the public as well as in the supply of a sufficient volume and quality of gas for public consumption. To achieve these objectives, the company is to carry out planning, construction and development of transmission lines and the distribution of natural gas in accordance with policies set out by the Government; planning, construction and development of the transmission and distribution of processed gas; or other businesses which support the foregoing activities in accordance with prevailing laws and regulations.

The IPA

The IPA was established in 1971 in response to growing foreign interest in the Indonesian oil and gas sector. Contractors and the Government meet frequently to discuss matters such as production ventures and energy economics. The IPA’s objective is to use public information to promote the exploration, production, refining and marketing aspects of Indonesia’s petroleum industry. More detailed information about the IPA is outlined in the appendices.

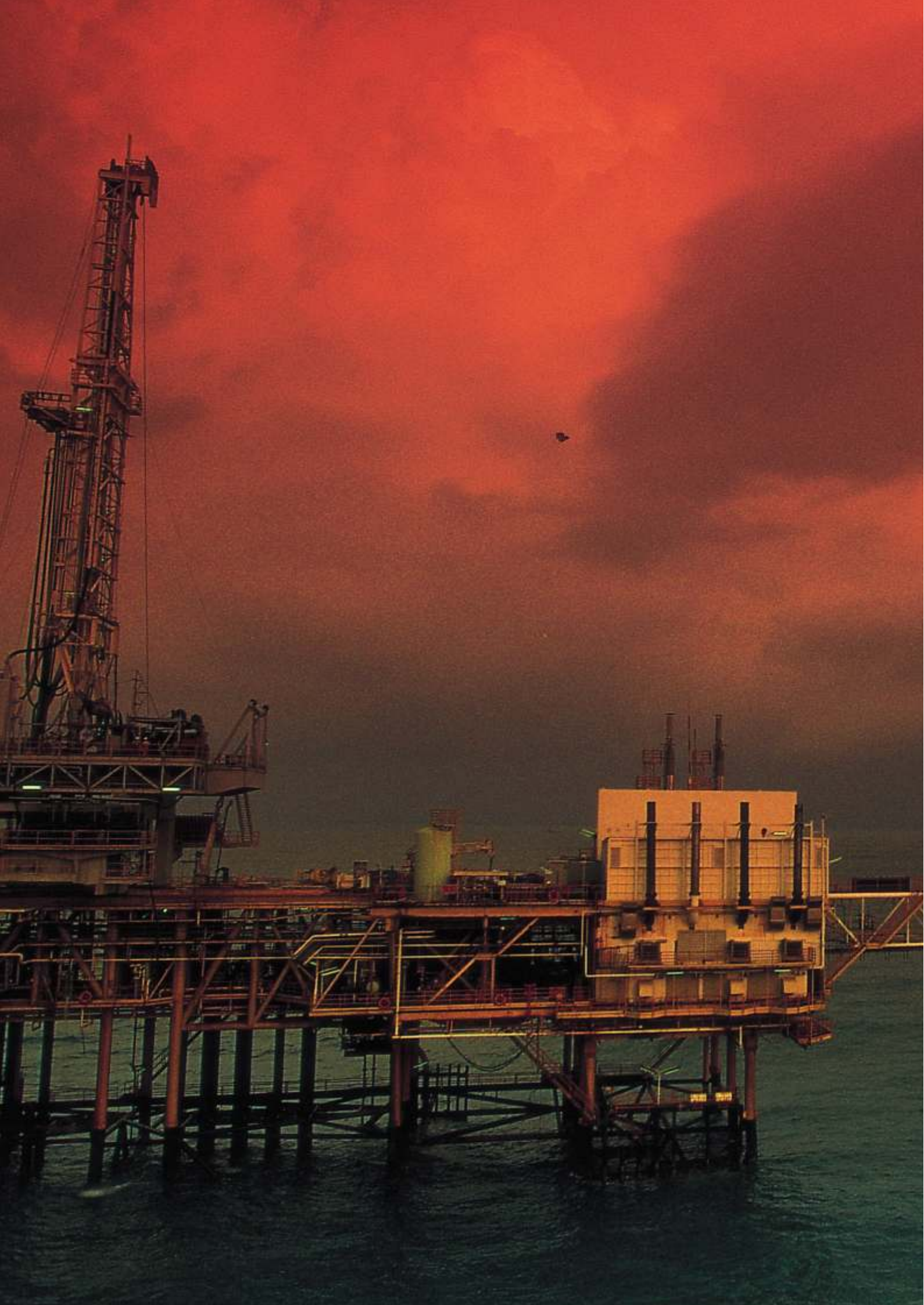
general overview of the oil and gas regulatory framework

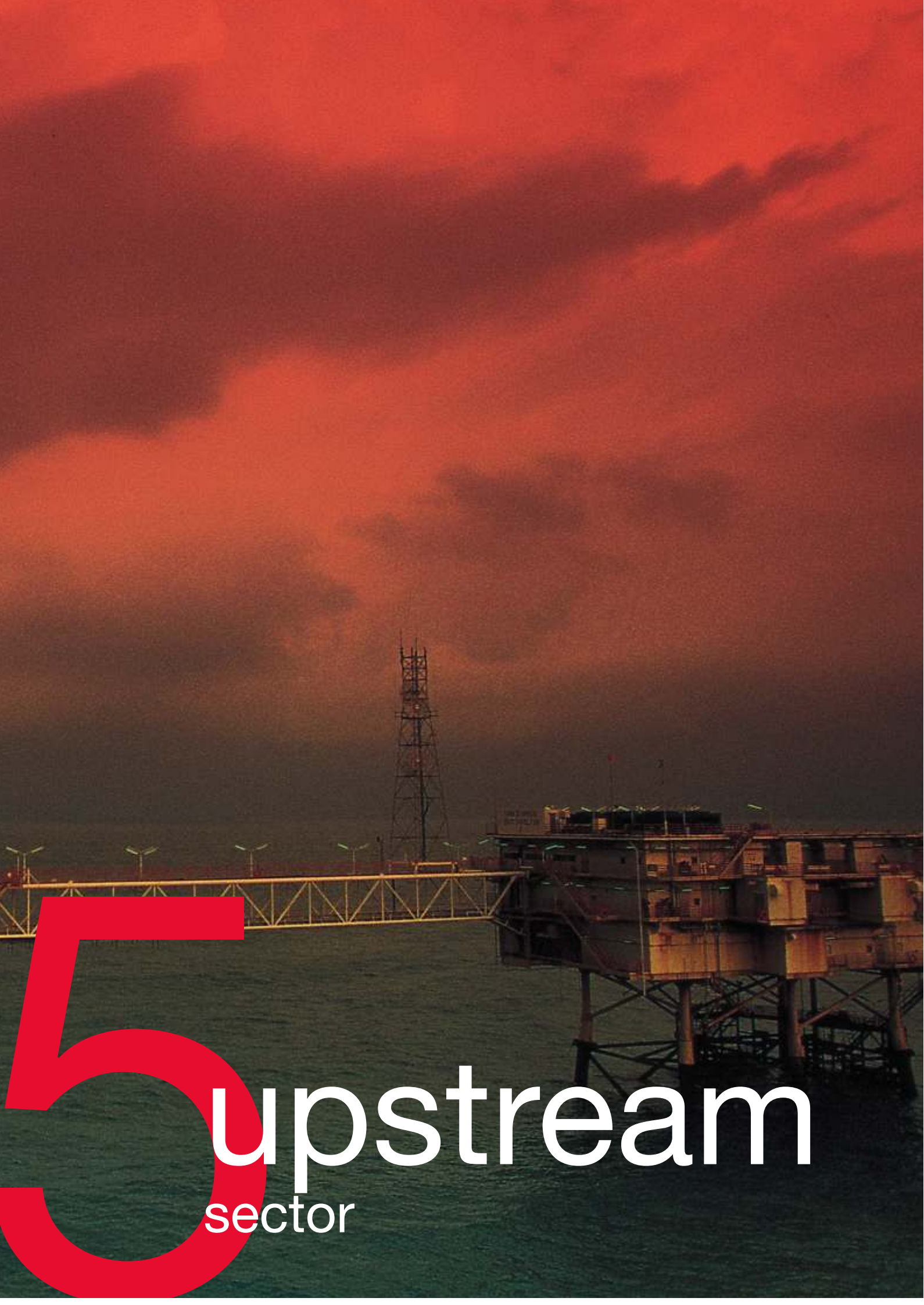
The IGA

The Indonesian Gas Association (“IGA”) was established in 1980 under the sponsorship of Pertamina and key gas producers, Mobil and Huffco. The main objective of the IGA is to provide a forum to discuss matters relating to natural gas and to advance knowledge, research and development in the areas of gas technology. The IGA also aims to promote the development of infrastructure and cooperation among producing, transporting, consuming and regulatory segments of the gas industry. More detailed information about the IGA is presented in the appendices.

INAGA

The Indonesian Geothermal Association (“INAGA”) is an organization for professionals involved in geothermal businesses in Indonesia. The organization currently has about 400 members from various disciplines. More detailed information about the INAGA is presented in the appendices.





5

upstream

sector

A. Regulatory Framework

Guidance and Supervision of Upstream Business Activities

Guidance of upstream business activities is the responsibility of the Government. The MoEMR is responsible for ensuring the implementation of upstream business activities in accordance with the relevant laws and regulations. Upstream business activities are executed and controlled through Cooperation Contracts between BP Migas and business entities/Permanent Establishments (“PEs”). BP Migas exercises supervision and control over execution of the Cooperation Contracts. BP Migas is responsible for coordinating relationships between the Contractors and the Government.

In summary, BP Migas has the following main duties:

- to provide opinions to the MoEMR regarding its policies on matters of preparation and offers of work areas and Cooperation Contracts;
- to conduct the signing of Cooperation Contracts;
- to evaluate plans for development of fields that are to produce for the first time in a given work area and to submit the evaluation to the MoEMR to obtain approval;
- to grant approval for field development plans;
- to grant approval for work plans and budgets;
- to conduct monitoring of, and reporting to the MoEMR on, the implementation of Cooperation Contracts; and
- to appoint sellers of the State’s share of crude oil and/or natural gas that can provide the greatest possible advantage to the Government.

The MoEMR and the Head of BP Migas may further stipulate the provisions regarding the scope of implementation and supervision of upstream business activities. If necessary, the MoEMR and the Head of BP Migas may jointly regulate the scope of supervision of upstream business activities.

Upstream Oil & Gas Business Activities

We have set out below a summary of the upstream regulations as provided for in GR No. 35 which is aimed at implementing the upstream provisions of Law No. 22.

Work Areas

- Work areas are formalized upon approval of the MoEMR in consultation with BP Migas and relevant Local Government officials;
- Work areas can be offered to business entities and PEs either through tenders or through direct offers;
- Pertamina can request to operate an open work area that has not been tendered or offered, and the MoEMR may approve such request;
- A business unit or PE can only hold one work area (i.e. the “ring-fencing” principle); and

upstream sector

- Work areas should be returned (in stages or in full) and commitments fulfilled in accordance with terms agreed in the Cooperation Contract.

General Surveys and Oil and Gas Data

- General surveys (geological, geophysical) are to be conducted by a business entity at its own expense and risk in open areas within Indonesia with specific permission from the MoEMR;
- General surveys and exploration data are the property of the State and controlled by the Government. Any utilization, transmission, surrender and/or transfer of data inside or outside of Indonesia requires specific permission from the MoEMR; and
- Data resulting from exploration and exploitation activities must be surrendered to the MoEMR (through BP Migas) within three months of its collection, processing and interpretation.

Execution of Upstream Business Activities Cooperation Contracts

Upstream business activities can be conducted by business entities and/or PEs on the basis of Cooperation Contracts entered into with BP Migas. These contracts must contain at a minimum the following terms and conditions:

- Ownership of oil and gas natural resources to remain with the Government until the point of delivery;
- Ultimate management control of operations to remain with BP Migas; and
- All capital and risks to be borne by the Contractor.

The basic provisions of a Cooperation Contract need to be in accordance with prevailing laws and regulations and after consideration of the level of risk and greatest possible benefit to the Government. The form and the basic provisions of a Cooperation Contract require approval of the MoEMR and the Head of BP Migas.

Cooperation Contracts are required to contain clauses covering the basic provisions, such as state revenues, work areas and their return, obligation to incur funds, transfer of ownership of the proceeds of oil and gas production, time periods and conditions for extension of contracts, resolution of disputes, obligation to supply crude oil and/or natural gas for domestic needs, ending of contracts, obligations following mining operations, occupational safety and health, management of the natural environment, transfer of rights and responsibilities, reporting requirements, field development plans, priority on use of domestic goods and services, development of local communities and guarantees of the rights of traditional communities, and priority on the use of Indonesian manpower.

The Term of a Cooperation Contract

The term of a Cooperation Contract is thirty years from the date of approval and the Contractor must start the activity within six months from the date of signing of the Cooperation Contract. The terms start with an exploration period of six years which may be extended up to ten years. If there are no commercially viable discoveries in the exploration period, the Cooperation Contract terminates. The original thirty year term can be extended for a twenty year period for which specific approval from the MoEMR is required. A request for extension can be submitted no earlier than ten years and no later than two years before the Cooperation Contract expires. If the Contractor has been bound in a natural gas sale/purchase contract, the Contractor may request extension of the Cooperation Contract before the above-stipulated time limits.

Amendments to a Cooperation Contract

A Contractor may propose to the MoEMR amendments to the terms and conditions of a Cooperation Contract. These may be approved, or rejected, based on the considered opinions of BP Migas and their benefits to the Government.

Expenditure and Other Activity Commitments

A Contractor is required to carry out definite work programs with the estimated total expenditure laid out in the Cooperation Contract during the first three years of the exploration period. Under-expenditure can be made up only with the MoEMR's consent. Inability to carry out the required obligation may lead to termination of the Cooperation Contract. If a Contractor finishes a Cooperation Contract without meeting work program commitments, under-expenditure may need to be paid to the Government.

Participating Interest

A Contractor can surrender or transfer part or all of its participating interest to a non-affiliate with prior approval of the MoEMR and BP Migas. If such a surrender or transfer is to a non-affiliated company, or non-working partner, the MoEMR may require the Contractor to first offer it to a national company. The permission of the MoEMR is also required before disclosure of work area data to another party that may be necessary for effecting such surrender or transfer. Transfer of a Contractor's majority participating interest to a non-affiliate is not allowed during the first three years of the exploration period.

The Contractor is required to offer a participating interest to a regionally owned business entity ("BUMD") upon first commercial discovery of a work area, which the local company must accept within 60 days from the offer date. If the offer is not availed by a regionally owned company within the stipulated period, the Contractor is required to offer such interest to a national company. The offer is declared closed if the national company does not accept the offer within a period of 60 days from the date of receiving the offer.

Jurisdiction and Reporting

Cooperation Contracts are required to be subject to Indonesian law. Contractors are obligated to report their discoveries and the results of certification of oil and/or gas reserves to the MoEMR/BP Migas. Contractors are also required to perform their activities in line with good industry and engineering practices.

Reservoir Extension and Unitization

A reservoir extension into another Contractor's work area, an open area, or the territory/continental shelf of another country must be reported to the MoEMR/ BP Migas. Unitization arrangements must be formalized when a reservoir extends into another Contractor's work area. If the reservoir extends into an open area, a unitization must be formalized when such open area becomes a work area. However, if such open area does not become a work area within a period of five years, a proportionate extension of a contract's work area can be requested. All unitizations must be approved by the MoEMR.

For a reservoir that extends into boundaries of another country, the MoEMR may pass a resolution based on the continental shelf agreement with the other country, and on considerations of optimum benefit to the Government.

Upstream vs. Downstream Activities

The activities of field processing, transportation, storage, and sale of own production, by a Contractor within the domain of an overall upstream development/project are classified as upstream business activities. These should not be aimed at obtaining a profit. Use of such facilities by a third party on a proportional operating cost sharing basis is allowed provided there is excess capacity, approval of BP Migas has been obtained, and that such activities are not aimed at making a profit. However, if such facilities are used jointly with another party, with an objective of making a profit, these represent downstream activities and require establishment of a separate business entity under a downstream business permit.

Utilization of Crude Oil and Natural Gas to Fulfill Domestic Needs

The Contractor is responsible for participating in meeting the demand for crude oil and/or natural gas for domestic needs. Under GR No. 35 the Contractor's share in meeting domestic needs was set at a maximum of 25% of Contractor's share of production of crude oil and/or natural gas. Subsequently, a Supreme Court decision eliminated this maximum percentage and required a floor percentage for DMO.

State Revenues

Contractors are required to pay state revenues in the form of taxes and non-tax revenues. The taxes consist of state taxes, import duties and tariffs, regional taxes and other levies. For most PSCs import duties and tariffs, regional taxes and other levies are assumed and/or discharged by the Government. The non-tax revenues consist of the state's share in the form of fixed fees and exploration and exploitation fees and bonuses.

Procedures for Settlement of Use of Land under Rights of State Land

Upstream rights do not include land surface rights. If land is necessary for a project, a Contractor is required to obtain a right to use such land and obtain relevant land registration and other documents. Consideration for land is based upon the prevailing market value.

A Contractor holding a right of way for a transmission pipeline must permit other Contractors to use its oil and gas transmission pipeline on a technical and economic consideration basis, and after consideration of safety and security matters. A Contractor that plans to use a right of way can directly negotiate with the Contractor/other party that holds the right of way, and if agreement between parties cannot be reached, the MoEMR/BP Migas can be approached for settlement.

Please see our further comments on this matter in Chapter VIII, Section C.

Occupational Safety and Health, Environmental Management, and Community Development

Contractors are required to comply with relevant laws and regulations on occupational safety and health, management of the natural environment and development of local communities.

Contractors are required to provide funds for undertaking any community development programs. Community development activities should be conducted in consultation with the Local Government with priorities to

communities within proximity of the work areas. A Contractor's contribution to community development can be in kind, in the form of physical facilities and infrastructure, or through empowerment of local enterprises and workforce. Expenditures for community development are usually cost recoverable.

Use of Domestic Goods, Services, Technology, and Engineering and Design Capabilities

All goods and equipment purchased by Contractors become the property/assets of the Government. Any import of goods and equipment requires appropriate approvals from the MoEMR, the MoF, and other minister(s) whose area of duties includes trade affairs. Goods and equipment, services, technology, and engineering and design capabilities can be imported only if they are not available domestically. Such imports must meet requirements of quality/grade, efficiency of operating costs, guaranteed delivery time and after sales service.

Management of goods and equipment rests with BP Migas. Any excess supply of goods and equipment must be transferred to other Contractors within Indonesia with appropriate approvals of BP Migas, the MoEMR and the MoF.

BP Migas is required to surrender excess goods and equipment to the MoF, if the equipment cannot be used by another Contractor. Any other use of such goods and equipment, including donation, sale, exchange, use for capital participation by the State, destruction or rental, requires approval of the MoF on the recommendation of BP Migas/ MoEMR.

All goods and equipment used for upstream activities must be surrendered to the Government upon termination of the Cooperation Contract.

Please see our further comments on this matter in Section B of this Chapter.

Manpower

Contractors should give preference to Indonesians for meeting a work area's manpower needs. Contractors may use foreign manpower for positions requiring expertise that cannot be met by Indonesian personnel. The governing manpower laws and regulations should apply to employees of a Contractor. Contractors are required to carry out development, education and training programs for Indonesian workers.

Transitional Provisions

PSCs and other contracts related to the PSCs between Pertamina and other parties which pre-date Law No. 22 were transferred to BP Migas and remain in force until the end of the contracts concerned. The transfer of contracts did not alter the provisions of such contracts.

Contracts between Pertamina and other parties in the form of a JOA/JOB were also transferred to BP Migas and remain in force until the end of the contracts concerned. Rights and responsibilities (i.e. participating interest) in JOAs and JOBs were transferred from Pertamina to PT Pertamina (Persero). When JOA/JOB contract term expires, the MoEMR shall determine a policy on the forms and provisions in relation to such contracts, if extended.

Contracts between Pertamina and other parties in the form of TAC and EOR were transferred to PT Pertamina (Persero) and remain in force until the end of the contracts concerned. When the TAC and EOR contract term expires, the contract areas will continue to be part of the work areas of Pertamina.

Pertamina is required to enter into Cooperation Contracts with BP Migas to continue exploration and exploitation on their existing concession areas. Pertamina is also required to establish subsidiaries and enter into Cooperation Contracts with BP Migas for each of its work areas, with a Cooperation Contract period of thirty years, which may be extended in accordance with prevailing laws and regulations. The MoEMR shall determine the forms and provisions of Cooperation Contracts for Pertamina and its subsidiaries.

B. General Overview of a PSC and Commercial Terms

PSCs have been the most common type of Cooperation Contracts in Indonesia's upstream sector. There have been four generations of PSCs, although there have not been many variations to each model. Briefly, the second and third generation PSCs issued after 1976 removed the earlier cost recovery cap of 40% of revenues and confirmed an after tax equity split of 85/15 for BP Migas and the Contractor, respectively. The third generation model of the late 1980's introduced the concept of First Tranche Petroleum ("FTP") and offered incentives for frontier, marginal and deep-sea areas. To stimulate investment in remote and frontier areas (the Eastern Provinces), the Government introduced a 65/35 after-tax split on oil in 1994 for contracts in the region (fourth generation model).

Since July 16, 2002, all the Cooperation Contracts have been signed by BP Migas instead of Pertamina. With the passage of Law No. 22, upstream business activities are to be implemented by way of Cooperation Contracts. Cooperation Contracts may be in the form of the PSC or other contract such as a Service Contract. Key differences between the current PSCs signed by BP Migas, and those of Pertamina are as follows:

- Rather than a fixed production sharing, the production sharing percentage can now be negotiated between the Contractor and BP Migas;
- PSC now provide for a natural gas DMO;
- BP Migas shall be entitled to FTP of ten percent (10%) of the Petroleum production which will not to be shared with the Contractor;
- BP Migas and Contractor agree that all of the profit sharing percentages appearing in the contract have been determined on the assumption that Contractor is subject to dividend tax on after tax profits under Article 26 (4) of the Indonesian Income Tax Law and is not sheltered or reduced by any tax treaty;
- Certain pre-signing costs (e.g. seismic purchase) may be cost recoverable; and
- Transfer of (original) PSC interest for non-affiliate is only allowable subject to:
 - BP Migas' approval;
 - retention of the majority interest and operators ability; and
 - after three years of signing.

Terms of PSC

The general concept of the PSC is that the Contractors bear all risks and costs of exploration until commencement of commercial production. If production does not proceed, these costs are unrecoverable; if production does proceed, the Contractors receive a share of production to meet cost recovery, an investment credit and an after tax equity interest of the remaining production.

The PSC is a legal agreement between the Contractor, often a foreign oil company, and BP Migas ("the parties") with the following features:

1. Exploration expenses are recoverable only from commercial production;
2. The Contractor is entitled to cost recovery for all allowable current costs, including production costs, amortized exploration costs and capital expenditures;
3. The Contractor pays a signature bonus at the time the contract is signed, an education bonus and a crude oil production bonus later during the term of the contract. The crude oil production bonus is determined on a cumulative quantity basis. These bonuses are not cost-recoverable from future production. However, they may be tax deductible in the calculation of Corporate Income Tax ("CIT");
4. The Contractor agrees to a work program with a minimum amount of exploration expenditure for a certain number of years;
5. All equipment, machinery, inventories, materials and supplies purchased by the Contractor and brought to Indonesia become the property of BP Migas when landed in Indonesia. The Contractor has a right to use and retain the custody and control of these items during the performance of the operation. Although the Contractor has access to exploration, exploitation and geological and geophysical data, the data remains the property of BP Migas;
6. The entitlement of both parties under the crude oil allocation is a shared profit from production less deduction for recovery of the Contractor's operating costs. Each party must file and pay its tax obligation separately;
7. The Contractor bears all risks of exploration;
8. Historically, parties were entitled to FTP of 15% (for fields in Eastern Indonesia and some in Western Indonesia pursuant to the 1993 incentive package) or 20% (for other fields). This is calculated before considering any investment credit and cost recovery. Recent contracts do not provide for a sharing of FTP between the Contractor group and the Government. The entire FTP (now 10%) accrues to the Government;
9. The Contractor is required to sell and supply a share of its crude oil production to meet the DMO. The quantity and price of the oil to be sold is stipulated in the agreement. New contracts require a gas DMO as referred to in GR No. 35;
10. After commercial production, the Contractor may be entitled to recover an investment credit ranging from 17% to 55% of capital investment costs incurred in developing crude oil production facilities; and
11. The Contractor is required to surrender the contract area per a schedule specified in the PSC. This is known as the "exclusion of areas".

PSC Commercial Arrangements

Basic cost-recovery principles are stipulated in the PSC and usually cover the following:

1. Current-year capital and non-capital costs;
2. Prior years' unrecovered capital and non-capital costs;
3. Depreciation charges;
4. Bonus payments;
5. Unrecovered natural gas or crude oil production;
6. Inventory costs;
7. Recovery of interest costs on loans at rates not exceeding prevailing market rates;
8. Home-office overheads charged to the operation; and
9. Recovery of premiums on insurance and receipts from insurance claims.

Other relevant principles are not stated in the PSC but have been developed over time through BP Migas (formerly Pertamina) regulations or in part by Indonesian Tax Office ("ITO") regulations.

The PSC Contractors obtain an after-tax equity share of 15% (more for frontier areas, for gas and under new contracts) after cost recovery and investment credits. However, a DMO must be met out of this "equity" oil or

upstream sector

gas. A foreign oil company having interests in several Indonesian PSCs typically earns a return of less than 15% of the equity oil because there is no cost recovery or tax deductibility for unsuccessful PSCs and because of the DMO requirement. FTP arrangements have enabled the Government to share production before the Contractor has fully recovered its costs.

Pertamina/the Government added a new clause to its PSC in 1995 in which site restoration becomes the responsibility of the Operator. PSC Contractors must include in their budgets provisions for clearing, cleaning and restoring the site upon completion of work. Those funds set aside for abandonment and site restoration are cost recoverable and tax deductible when spent or funded. Unused funds will be transferred to BP Migas.

The PSC outlines the accounting to be applied by the Contractor. Under this clause of the contract, operating, non-capital and capital costs are defined together with the related accounting method to be used for such costs, which differs from Generally Accepted Accounting Principles ("GAAP").

Although GAAP in Indonesia has a specific accounting standard ("PSAK" No. 29) for oil and gas, which is similar to US Statement of Financial Accounting Standard ("SFAS") 19: Financial Accounting and Reporting for Oil and Gas Producing Companies, most companies do not prepare Indonesian GAAP statements. They prepare PSC statements that are adjusted in the respective parent company's home office to conform with GAAP.

Relinquishments

The PSC also sets out the requirements for areas to be relinquished during the exploration period. Specific details are set out in the contract on the dimensions of areas to be relinquished, but the parties must consult BP Migas and the areas must be large enough to enable others to conduct petroleum operations there.

Pre-PSC Costs

The recipient of a PSC will typically incur expenditures before the PSC is signed. These pre-PSC expenditures may not be transferred to the PSC, and become non-recoverable costs for purposes of cost recovery and tax deductibility. Generally, these costs are recorded in the company's head office as leasehold costs along with any signing bonus paid to obtain the PSC.

In new Cooperation Contracts, it is understood that seismic or data costs acquired prior to signing may be cost recoverable.

Equity Share between the Government and Contractor

Sharing of Production - Oil

Crude production in excess of amounts received for FTP, cost recovery and investment credit is allocated to the Government and to the Contractor before the impact of tax, adjusted by the domestic supply obligation.

Since the concept of the PSC involves the sharing of output, in practical terms the oil to be shared between the Government and Contractor is made up of:

- cost oil;
- investment credit; and
- equity oil.

Cost Oil

The Contractor can recover certain defined costs of production in terms of oil or gas produced. Expenses allowable for cost recovery purposes are:

- a) Current-year operating costs, including costs in exploring other sites in the PSC area, intangible drilling costs on exploratory and development wells and costs of inventory when landed in Indonesia (as distinct from when used). The Contractor can also recover a proportion of the head office overheads, typically capped at 2% of total costs, and provided the costs are applied consistently, disclosed in quarterly reports and approved by BP Migas;
- b) Depreciation of capital costs at rates of 50%, 25%, 12.5% and 10% on the declining balance method for assets put into use or ready for use for at least one day in the year. Title of the capital goods passes to the Government on landing in Indonesia, but the Contractor can claim depreciation on those capital items; and
- c) Un-recouped operating and depreciation costs from previous years. If there is not enough production to recoup costs these may be carried forward to the following year with no time limit.

The main elements of non-recoverable Contractors' costs are bonuses paid to the Government and certain financing costs. However bonuses may be tax deductible as noted earlier.

Investment Credit

An investment credit is allowed on direct development and production capital costs incurred on a project-by-project basis as negotiated and approved by BP Migas.

In recognition of the delays in generating income inherent in the processes of exploration through to production, the PSCs offer a credit ranging from 17% to 55% of the capital cost of development, transport and production facilities. The second generation PSC allowed a rate of up to 20% for fields that became commercial after 1976. The investment credit must be taken in oil or gas in the first year of production, but can be carried forward subject to the FTP limitation.

In earlier PSCs, the investment credit was capped in cases where the share of total production taken by the Government did not exceed 49%. This condition has been eliminated in later generation PSCs.

Marginal Field Incentives

The MoEMR issued Regulation No. 008/2005 ("Regulation No. 008/2005") on the Marginal Oil Field incentive program on April 25, 2005. The regulation provides Contractors with the incentive of an additional cost recovery of 20%. It appears that the likely treatment of this incentive will be similar to an investment credit which is cost recoverable but taxable.

Oilfields entitled to the incentive must meet the following criteria:

- a) be located in the production working area; and
- b) have an estimated rate of return based on the terms and condition in the PSC and other prevailing incentive package regulations, of less than 15%.

Applications for the incentive can be submitted to BP Migas with a copy to the DGOG. Within thirty days after the application is received, BP Migas has to issue its written approval or rejection to the Contractors.

The Contractor must report to BP Migas its actual realization and year-to-date rate of return of the marginal oil field within thirty days after the year-end. If the rate of return is more than 30%, the incentive will be revoked. However, if the rate is below 15%, a similar incentive will be provided for the following year.

It is unclear what the BP Migas position will be if the rate of return is between 15% and 30%. It is also unclear whether the incentive will be calculated on a monthly or annual basis.

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Regulation No. 008/2005 stipulates that the Contractors also have to maintain separate bookkeeping for the marginal oil field. Further detailed operational regulations are expected to be issued by BP Migas.

Interest Recovery

Interest recovery is part of cost recovery. It is one of the incentives or allowance facilities on capital expenditures for certain projects as approved by BP Migas. Interest recovery is applicable until the capital costs of such projects have been fully depreciated. Certain conditions apply for the recovery of interest on loans.

Details of any financing plan and amounts must be included in each year's budget of operating costs for the approval of BP Migas.

Interest paid is subject to withholding tax ("WHT") with some relief possibly granted under various tax treaties. As a precaution, most PSC Contractors gross up the interest charged to reflect any WHT implications. Please refer to Section E of this Chapter where we have commented further on this matter.

Management and Head Office Overheads

The Contractor has exclusive authority to conduct the oil and gas operations in the area and is responsible to BP Migas for the conduct of those operations. In practice, BP Migas exercises considerable control through its obligation to approve the Contractor's annual work programs, budgets and manpower plans.

Some general and administrative costs (other than direct charges) related to head office overheads can be allocated to the PSC operation, based on a methodology approved by BP Migas. This overhead allocation methodology must be applied consistently and is subject to periodic review and audit by BP Migas. Some PSC arrangements cap this overhead at a flat 2% of total PSC operating costs. For producing PSCs, BP Migas will, often on an annual basis, travel abroad to audit head office costs. Again, please refer to Section E of this Chapter where we have commented further on this matter.

Equity Oil

Any oil that remains after investment credit and cost recovery is split between BP Migas and the Contractor. Second and third generation PSCs involve an after-tax split of 85/15 (65/35 for frontier regions) for BP Migas and the Contractor respectively. This is an after-tax allocation so that after taking account of taxation at the current rates the Contractor is entitled to lift:

Equity Oil Lifting Entitlement

	New Contracts (Post Law No. 22) %	1995 Eastern Province PSC %	1995 PSC %	1985 - 1994 PSC %	Old PSC %
Tax rate	44	44	44	48	56
Share of production after tax:					
Government	Negotiable	65	85	85	85
Contractor	Negotiable	35	15	15	15
Contractor's share of production before tax:	Depends on the negotiated share of production				
35/(100-44)		62.50			
15/(100-44)			26.79		
15/(100-48)				28.85	
15/(100-56)					34.09

Source: Migas

FTP

Under pre Law No. 22 contracts, Contractors and the Government were entitled to take a quantity of petroleum equal to 20% of the production of each year before any deduction for recovery of operating costs, to be split according to their respective equity shares as stated in the contracts.

Post Law No. 22 contracts, the Government is entitled to take the entire FTP, with no sharing with the Contractor group.

For later generation contracts only, the FTP of 20% or 15% of production might be considered to be a component of equity oil. Cost recovery and any investment credit in the current year are therefore limited to a maximum of 80 to 85 percent of production.

Although FTP is arguably considered equity oil, an industry issue exists over whether the Contractor's share of FTP is taxable particularly if the Contractor has carried-forward un-recovered costs.

DMO

According to the terms of the PSC, after commercial production commences, the Contractor should fulfill its obligation to supply the domestic market in Indonesia. The crude oil DMO for each year is calculated on the lesser of the following points:

- a) 25% of the Contractor's standard pre-tax share or its participating interest share of the total quantity of crude oil produced from the contract area ; or
- b) the results of multiplying the Contractor's standard share of crude oil produced from the contract area (either 62.50%, 26.79%, 28.85% or 34.09% - as described above) by a fraction which the numerator is the total quantity of crude oil to be supplied and the denominator is the entire Indonesian production of crude oil of all petroleum companies for the PSC area, multiplied by the Contractor's standard share.

In general practice, the Contractor is required to supply a maximum of 25% of total oil production from the contract area to the domestic market in Indonesia out of its equity share of production. It is understood that the oil DMO is satisfied from equity oil exclusive of FTP.

It is possible for the oil DMO to absorb the entire Contractor's share of equity oil. Conversely, if there is not enough production to satisfy the oil DMO, there is no carry-forward of any shortfall to future periods. Generally, for the first five years after the contract area commences commercial production, the Contractor is paid by BP Migas in full for its oil DMO but this is reduced to 10% of that price for subsequent years. The price used is the weighted average price ("WAP"). Earlier generations of PSCs provided a price of only US\$0.20 per barrel.

Historically there has been no DMO obligation associated with gas production. However, under the latest legislation and new PSCs, a DMO on gas production has been introduced. No specific regulation has been issued to explain how gas DMO would be determined.

Valuation of oil

To determine the sharing of production, and for tax purposes, oil is valued on the basis of a basket of average Indonesian Crude Prices ("ICP") published by Asian Petroleum Price Index ("APPI") (20%), RIM (40%) and Platt's (40%). The value is calculated monthly by BP Migas. Under a PSC, the Contractor receives oil or in-kind product for settlement of its costs and share of equity. This makes it necessary to determine a price to convert oil to US dollars in order to calculate cost recovery, taxes and other fiscal items such as under/over lifting. In the past, the ICP was determined monthly by BP Migas/Pertamina based on a moving average spot price of a basket of a number of internationally traded crudes. However, their values did not properly account for the significant fluctuations in the movements in oil prices and was considered deficient for this reason.

upstream sector

Monthly tax calculations are based on ICP and actual Contractor liftings. The actual year-end annual PSC Contractor entitlement (cost plus equity barrels) is based on the average ICP for the year. The average ICP during the respective year is known as Weighted Average Price or WAP.

Sharing of Production - Gas

The provisions for the sharing of gas production are similar to those for oil as explained above except for equity splits and DMO. When a PSC produces both oil and gas, production costs will be allocated against each according to the proportion of production in value terms in the year or another means of allocation as approved by BP Migas. The costs of each category that are not recouped can either be carried forward to the following year or relieved against the production of the other category in the same year only.

The main difference between oil and gas PSCs relates to the equity split. The majority of PSCs are based on an oil 85/15 after-tax split. For gas, the after-tax split is usually 70/30 for the Government and the Contractor respectively, although some older PSCs are based on an after-tax split of 65/35. After the 1995 incentive package, Eastern Province gas Contractors use an after-tax split of 60/40.

These provisions result in the following entitlements:

Equity Gas Lifting Entitlement

	New Contracts (Post Law No. 22) %	1995 Eastern Province PSC %	1995 PSC %	1985 - 1994 PSC %	Old PSC %
Tax rate	44	44	44	48	56
Share of production after tax:					
Government	Negotiable	60	70	70	70
Contractor	Negotiable	40	30	30	30
Contractor's share of production before tax:	Depends on the negotiated share of production				
40/(100-44)		71.43			
30/(100-44)			53.57		
30/(100-48)				57.69	
30/(100-56)					68.18

Source: Migas

If the natural gas production does not permit full recovery of natural gas costs, as outlined above, the excess costs shall be recovered from crude oil production in the contract area.

Likewise, if excess crude oil costs (crude oil costs less crude oil revenues) exist, this excess can be recovered from natural gas production.

Illustrative Calculation of Oil Entitlement

An illustration of how the share between the Government and Contractors is calculated is presented in the tables below.

ILLUSTRATIVE CALCULATION OF OIL ENTITLEMENT FOR OLD PSC

Assumptions:

Contractor's Share before tax = 34.0909%

Government's share before tax = 65.9091%

WAP Per Barrel = US\$20

Corporate & Dividend tax = 56%

DESCRIPTION	FORMULA USED	YEAR TO DATE	
		BBLs	US\$
LIFTINGS:			
- BP MIGAS	US\$ (A1) = BBLs x WAP	2,500	50,000
- CONTRACTORS	US\$ (A2) = BBLs x WAP	4,500	90,000
TOTAL LIFTINGS	(A)	7,000	140,000
LESS: FTP (20%)	(B) = 20% x (A)	1,400	28,000
TOTAL LIFTINGS AFTER FTP	(C) = (A) - (B)	5,600	112,000
LESS:			
- COST RECOVERY	COST IN BBLs = COST IN US\$: WAP	4,000	80,000
- INVESTMENT CREDIT	COST IN BBLs = COST IN US\$: WAP	100	2,000
TOTAL COST RECOVERY EQUITY TO BE SPLIT	(D)	4,100	82,000
	(E) = (C) - (D)	1,500	30,000
BP MIGAS' SHARE:			
- BP MIGAS' SHARE ON FTP	65.9091% x (B)	923	18,455
- BP MIGAS' SHARE ON EQUITY	65.9091% x (E)	989	19,773
- DMO	25% x 34.0909% x (A)	596	11,932
BP MIGAS' ENTITLEMENT:	(F)	2,508	50,160
OVER/(UNDER) BP MIGAS' LIFTING	(G) = (A1) - (F)	-8	-160
CONTRACTOR'S SHARE:			
- CONTRACTOR'S SHARE ON FTP	34.0909% x (B)	477	9,545
- CONTRACTOR'S SHARE ON EQUITY	34.0909% x (E)	511	10,227
LESS:			
- DMO	25% x 34.0909% x (A)	(596)	(11,932)
CONTRACTOR'S ENTITLEMENT:		392	7,840
ADD:			
- COST RECOVERY		4,000	80,000
- INVESTMENT CREDIT		100	2,000
TOTAL NET CONTRACTOR'S ENTITLEMENT	(H)	4,492	89,840
OVER/(UNDER) CONTRACTORS' LIFTING	(I) = (A2) - (H)	8	160

ILLUSTRATIVE CALCULATION OF CORPORATE AND DIVIDEND TAXES FOR CONTRACTOR'S OIL ENTITLEMENT IN OLD PSC

DESCRIPTION	US\$	
CONTRACTOR'S SHARE:		
- CONTRACTOR'S SHARE ON FTP		9,545
- CONTRACTOR'S SHARE ON EQUITY		10,227
- COST RECOVERY		80,000
- INVESTMENT CREDIT		2,000
LESS: DMO		(11,932)
		89,840
LESS: LIFTING PRICE VARIANCE		(8,983) **
CONTRACTOR'S NET ENTITLEMENT:		80,857
LESS: - COST RECOVERY		80,000
ADD:		
- ACTUAL PRICE RECEIVED FROM DMO		7,642 *
CONTRACTOR'S TAXABLE INCOME		8,498
LESS:		
- CORPORATE TAX (45%)		3,824
- DIVIDEND TAX (11%)		935
CORPORATE AND DIVIDEND TAX (56%)		4,759
CONTRACTOR'S NET INCOME		3,739
* DMO COMPRISED OF TWO ITEMS:	QUANTITY IN BARRELS	US\$
- OLD OIL (40% of total DMO in barrels)	239	478
- NEW OIL (60% of total DMO in barrels)	358	7,164
ACTUAL PRICE RECEIVED FROM DMO	597	7,642
** CALCULATION OF LIFTING PRICE VARIANCE:	US\$	
ENTITLEMENT BY USING WAP	89,840	
ENTITLEMENT BY USING ICP	80,857	
LIFTING PRICE VARIANCE	8,983	

Combined Effective Tax Rate :

= Corporate and Dividend Tax/
Contractor's Taxable Income
= 4,759/8,498
= 56%

PRICE OF DMO
10% FROM WAP
WAP

@ The entitlement is calculated by using the monthly ICP during the respective year

**ILLUSTRATIVE PRESENTATION OF OLD PSC IN BP MIGAS QUARTERLY REPORT
(FORMERLY KNOWN AS PERTAMINA QUARTERLY REPORT – PQR)**

DESCRIPTION	US\$
GROSS REVENUE/LIFTING	
LESS: FTP (20%)	140,000
GROSS REVENUE / LIFTING AFTER FTP	28,000
	112,000
COST RECOVERY:	
- COST RECOVERY	
- INVESTMENT CREDIT	80,000
TOTAL COST RECOVERY	2,000
	82,000
EQUITY TO BE SPLIT	
	30,000
BP MIGAS' SHARE:	
- BP MIGAS' SHARE ON FTP	
- BP MIGAS' SHARE ON EQUITY	18,455
- LIFTING PRICE VARIANCE	19,773
- GOVERNMENT TAX ENTITLEMENT	8,983
ADD: DMO	4,759
LESS: DOMESTIC MARKET ADJUSTMENT	11,932
TOTAL BP MIGAS' SHARE	(7,642)
	56,260
CONTRACTORS' SHARE:	
- CONTRACTOR'S SHARE ON FTP	9,545
- CONTRACTOR'S SHARE ON EQUITY	10,227
- LIFTING PRICE VARIANCE	(8,983)
LESS: DMO	(11,932)
ADD: DOMESTIC MARKET ADJUSTMENT	7,642
LESS: GOVERNMENT TAX ENTITLEMENT	(4,759)
ADD: TOTAL RECOVERABLES	82,000
TOTAL CONTRACTORS' SHARE	83,740

upstream sector

Domestic Gas Pricing

Currently, gas pricing in domestic supply contracts is reached through negotiations on a field-by-field basis among BP Migas, buyers and individual producers based on the economics of a particular gas field's development. Historically, all domestic gas had to be sold to Pertamina under a gas supply agreement. Pertamina then in turn sold the gas to the end-user (e.g. State Electricity Company ("PLN") and PGN). Prices were fixed for a designated supply for the duration of the contract.

Under Law No. 22, individual producers can sell directly to end users with contract terms and conditions negotiated directly between the producer and buyer (with assistance from BP Migas).

Take-or-pay arrangements have been negotiated in some circumstances. Although this concept has long been accepted, the Government, buyers and PSC Contractors have not fully determined the complete ramifications of such an arrangement from a tax, accounting (revenue recognition) and reporting perspective.

PSC Contractors and potential investors should also consider the credit risk inherent in any domestic gas sales arrangements when negotiating contract terms and conditions, and how they might protect themselves.

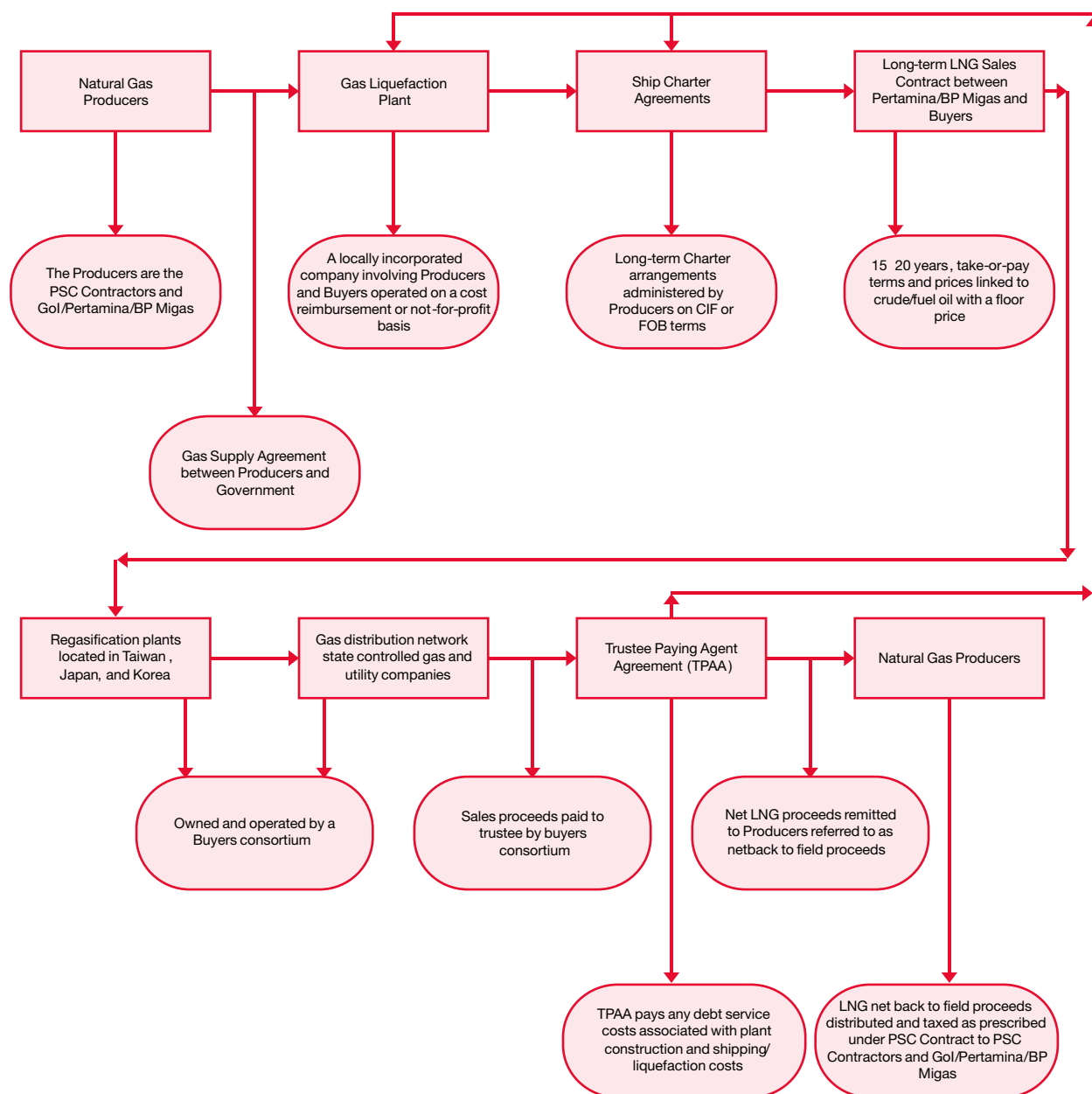
LNG Arrangements

Indonesia currently has two large LNG facilities, Arun located in North Sumatra and Bontang located in Northwest Kalimantan. A third LNG facility is under development in Papua.

Fully integrated LNG supply chain

Historically, Indonesia has utilized a traditional LNG integrated seller/buyer supply chain structure. The Arun and Bontang LNG supply chains are generally structured as follows:

LNG Integrated Seller/Buyer Supply Chain



For both Arun and Bontang locally incorporated special purpose O&M companies were established by the Producers and Buyers on a not-for-profit basis. A number of sales contracts were initially entered into with at least two or more buyer consortia under fixed long-term supply arrangements and minimum prices to augment risk for the Producers. The initial contracts were simple and carried CIF terms. During the late 1980's and early 1990's, the shipping arrangements were changed to allow buyers and/or others (e.g. Japanese companies) to participate in long-term shipping charters on a FOB basis. A trustee paying agent was established to service debt and other operating costs with net proceeds distributed to the Producers.

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In the 1990's as a number of long-term LNG sales contracts neared expiry, and in an effort to obtain contract extensions, the Government or its appointed agent Pertamina/BP Migas replaced its pricing mechanism in extended contracts with a crude pricing mechanism that softened LNG price increases during times of high oil prices and protected LNG price decreases during times of low oil prices.

The “net back to field” taxation concept

The Producers are subject to a maximum of fifty-six percent (56%) and a minimum of forty-four percent (44%) corporate income tax depending on the generation of the PSC contract. Therefore, it is more beneficial to the Government to allow the maximum amount of LNG proceeds to flow back or net back to the field.

As such, the MoF has supported a net back to field concept whereby tax (WHT or VAT) is minimized in order to maximize the profitable income to Producers operating under a fully integrated LNG supply chain. Accordingly, little or no WHT, or VAT is assessed on gas liquefaction activities, shipping, financing or trustee costs as any such tax would result in additional costs to the Producers reducing their taxable profit. The “net back to field” concept has been challenged by the Indonesian tax office on a number of occasions in the past twenty years but to no avail.

Non integrated LNG supply chain

With increasing supplies of LNG and competition from Qatar, Oman, Malaysia and north-west Australia coupled with other LNG market dynamics occurring such as short-term contracts, swap sales, and liberalisation/deregulation allowing oil and gas companies to take equity positions in LNG shipping and regasification plants, Indonesia has had to reconsider its LNG supply chain structure previously utilized for Arun and Bontang.

The desire for gas producers to extract more value out of the downstream supply chain and gas buyers desire to participate further in the upstream part of the supply chain to extract value and obtain some security over supply has also caused Indonesia to reconsider its LNG supply chain structure.

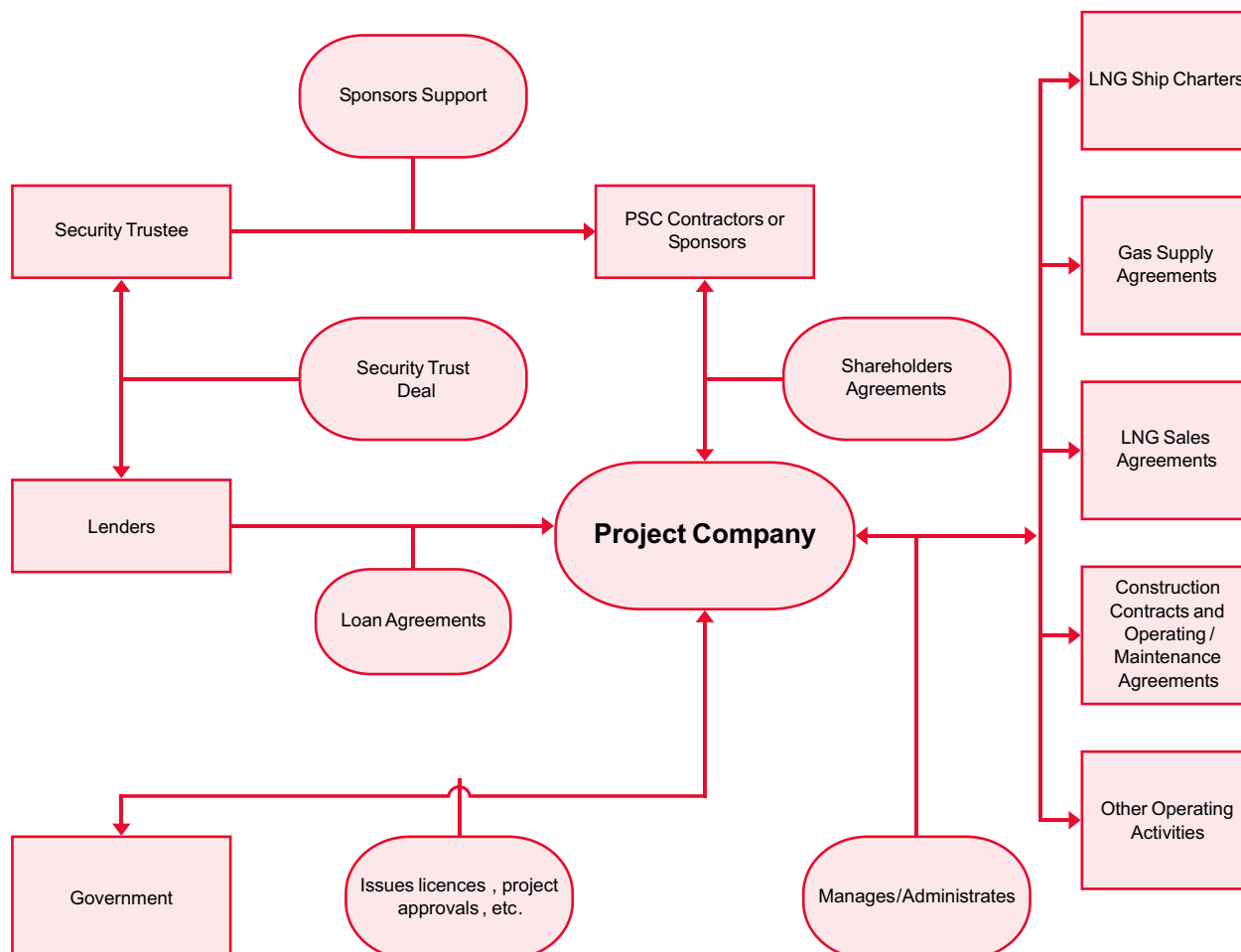
Concepts currently being considered by Producers which have created a change in the LNG seller/buyer supply chain structure include:

- PSC Contractors being allowed to be the appointed seller of LNG;
- Shorter LNG supply arrangements;
- The use of an offshore project company sponsored by a shareholder agreement which receives initial funds for development and manages/administers construction, operation maintenance, LNG ship charters, LNG sales etc.

Such concepts provide a high degree of flexibility to PSC Contractors or Producers allowing equity ownership in all aspects of the supply chain albeit complex arms – length contractual arrangements are required.

It is believed that the Tangguh LNG project has adopted some of these concepts resulting in the possible utilization of a non-integrated LNG seller/buyer supply chain. However it is not known to what extent, if at all. An example of a non-integrated LNG seller/buyer supply chain which incorporates some of these concepts is as follows:

Non-Integrated LNG Seller/Buyer Supply Chain



Taxation on non integrated LNG supply chain

As this structure is relatively new both in the industry globally and Indonesia, it is difficult to assess the Indonesian tax implications. Clearly, withholding tax, VAT, transfer pricing and permanent establishment issues will need to be considered in addition to tax treaty conditions in regard to the domicile of the project company and the various contracting arrangements it has with all parties.

Other PSC Conditions and Considerations

Tender for New Acreage (Awarding of Contracts)

In general the steps involved in the tendering of a Cooperation Contract are as follows:

- a) A company should register as a participant by obtaining the official bid information package from the DGOG at the MoEMR. The fee for the bid information package varies and is non-refundable;
- b) It is also mandatory that tender participants purchase an official government data package on the particular block to be tendered to support their technical evaluation and proposed exploration program in their tender. The fee for the data package will vary depending on the nature of the block;

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- c) A clarification forum is held for participants a few days prior to tender date;
- d) On the tender date, participants submit two identical copies of the completed bid documents;
- e) The bid documents consist of:
 - A completed application form;
 - A proposed work program and budget for six years exploration;
 - Geological and technical justification for supporting the exploration program;
 - Annual financial statements for the past three years certified by a certified public accountant;
 - A statement letter confirming the participant's ability to pay any required bonuses;
 - In the case of a bid by a consortium, copies of all agreements between and/or among the consortium members together with confirmation of which member of the consortium is the designated operator;
 - A statement agreeing to the terms of the draft PSC agreement which will be signed by the winning bidder;
 - A draft of the PSC agreement;
 - A copy of the payment receipt for the bid information document;
 - A copy of the proof of purchase of the official government data package; and
 - A copy of the participant's notarized articles of incorporation.
- f) The evaluation and grading of the tender bid document is carried out by the MoEMR Oil and Gas Technical Tender Team for New Acreage. Bids are evaluated on the basis of each bid's furtherance of Indonesia's national interests. Bid evaluations consider administrative compliance, financial and technical capability as well as the performance of bidders in previous Indonesian activities; and
- g) The winner of the tender is determined by the DGOG after recommendation from the Tender Team.

Expenditure requirements and bonuses

The Contractor is responsible for all financing requirements of the operation and bears the full risk if exploration is not successful. This financing is expected to be in foreign currency, usually US dollars. Any costs incurred by BP Migas are subject to a refund from the Contractor.

The PSC includes annual exploration expenditure requirements for both the initial six years and any four-year extension. Over-expenditures can be carried forward to the next year, but under-expenditures can only be made up with BP Migas's consent. While the overall annual commitment is established in the PSC, details must be approved by BP Migas in the form of annual work programs and related budgets.

The award of the PSC usually involves a tendering process with the amounts bid relating to bonuses payable to BP Migas. These bonuses are of two types:

- Signature Bonus – payable within one month of award of contract. These bonuses generally range between US\$1 – 15 million; and
- Production Bonus – payable if production volumes exceed a specified number of barrels per day, e.g. US\$10 million when production exceeds 50,000 bbl/d.

The amount of bonuses to be paid and the amount of committed expenditures stated in a PSC are usually negotiated and agreed to by both the Contractor and BP Migas before formally signing the PSC.

Tendering for goods and services for oil and gas Contractors

Procurement is regulated to give preference to Indonesian or domestic suppliers. For purchases in excess of defined values, detailed procedures must be complied with, including the calling of tenders and approval by BP Migas.

The Government sets the procurement guidelines for procurement of goods and services at government institutions including state owned enterprises through Presidential Decrees, with the latest being Presidential Decree No. 80/2003 (“Keppres 80”), which amends previous decrees on the same subject. With reference to Keppres 80 BP Migas, through its Decision Letter No. KPTS.21/BP00000/2004-SO, Guidance No. 007/PTK/VI/2004 on Management Framework for Supply Chain for Cooperation Contracts (“Pedoman Tata Kerja Pengelolaan Rantai Suplai Kontraktor Kontrak Kerja Sama”) was issued. In addition to setting guidance on procurement of goods and services, the decision letter also provides guidance on asset management, customs and project management.

In general, all purchases of goods and services are done by either tender or direct selection/direct appointment (with certain requirements) and only vendors with Registered Vendor ID’s (“Tanda Daftar Rekanan” or “TDR”) are considered qualified Contractors (“Daftar Rekanan Mampu” or “DRM”) able to bid. A Contractor can write its own tenders, but for the procurement of goods and services over certain amounts it must obtain approvals from BP Migas, as per the following circumstances:

- the planning for a package of procurement of goods and services above Rp20 billion or US\$2 million; and
- the determination of a winning/appointed supplier for a package of procurement above Rp50 billion or US\$5 million.

Changes in the scope or terms of contract which cause an increase in the contract value (from the initial contract value) with suppliers must also be approved by BP Migas, as follows:

- for contracts where the appointment of the supplier was through approval by BP Migas and where the overruns exceed 10% of initial contracts or above Rp50 billion or US\$5 million; and
- for contracts where the appointment of the supplier was made by the Contractors and where the cumulative amount of the initial contract plus overruns exceeds Rp50 billion or US\$5 million.

On a quarterly basis the Contractors are required to submit certain reports to BP Migas on their procurement activities. In addition, Contractors must submit to BP Migas a copy of contracts above Rp50 billion or US\$5 million, reports for project close out and finalization of contracts, asset management, customs and project management.

Tender awards are based on price, Indonesian content, technical advantage and reputation. Wholly foreign-owned Indonesian entities are allowed to participate and are considered to be a local Indonesian company. The tendering process requires domestic goods or services to be used if available and if they meet the technical requirements. In general, Indonesian-made equipment must be purchased if it meets the requirements, even at a higher cost. With this approach the Government would like to see an increased use of products made in Indonesia. Replacement parts and equipment can usually be ordered from the original supplier.

All equipment purchased by oil and gas Contractors is considered the property of the Government when it enters Indonesia. In the past, oil and gas equipment could enter duty free if it is used for operational purposes (However please see our further comments on this matter in Section D of this Chapter). Imported equipment used by service companies on a permanent basis is assessed for import duty unless waived by the Foreign Investment Coordinating Board (“BKPM.”). Import duties on oil and gas equipment range from 0% to 29%. The position for temporary imports of Sub-Contractors’ equipment is covered in Section D of this Chapter under import taxes.

Over/(under) lifting

Lifting variances will occur each year between the Contractor and the Government. These under/over lifts are settled in cash with the Government and can be considered to be sales/purchases of oil or gas respectively. The individual members of the PSC may in turn have under/over lifts between themselves, which will be settled according to joint venture agreements generally in cash or from production in the following year.

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Under existing BP Migas regulations and guidelines, any over/under lift portion between the Contractor and the Government should be settled in cash within thirty days. In practice though, such an amount is not settled until the year-end BP Migas Financial Quarterly Report is finalized in mid February or March of the subsequent year.

Inventory

Under the PSC, inventory is separated into two categories, capital and non-capital. Non-capital inventory is charged to cost recovery immediately upon landing in Indonesia. A contra account is usually maintained to track the physical movement and use of non-capital inventory.

All inventory items imported must pass through Batam Island under a PSC Master List ("ML") arrangement where it is inspected. A large number of PSC Contractors maintain warehouse facilities in Batam solely for materials-in-transit.

Under BP Migas guidelines, any excess or obsolete inventory must be circulated to other PSCs and receive BP Migas approval before any amounts (capital inventory) can be charged to cost recovery.

If inventory is transferred or sold to another PSC, the selling price must be at its carrying cost. Generally, the sale of inventory is not subject to VAT. If a PSC Contractor cannot dispose of the inventory, a Write-Off Proposal ("WOP") must be submitted to BP Migas for approval. Once approved, the inventory is usually charged to cost recovery (if not yet charged) and transferred to a BP Migas warehouse or facility.

Property, Plant and Equipment

Under the terms of the PSC, Property, Plant and Equipment ("PP&E") (including land rights) purchased under the PSC becomes the property of the Government when landed in Indonesia. The Company continues to have use of such property until it is approved for abandonment by BP Migas.

The net book value of such property, as reflected in the PSC basis financial statements, represents expenditures by the Company, which have not yet been cost recovered.

Tangible drilling costs of unsuccessful exploratory wells are charged to operating expenses as incurred. If commercial reserves are determined in the contract area and the exploratory wells subsequently become productive the associated tangible drilling costs are capitalized. Additionally, tangible costs of successful development wells are capitalized.

Depreciation is calculated at the beginning of the calendar year in which the asset is placed into service with a full year's depreciation allowed in the initial year. The method used to calculate each year's allowable recovery of PP&E or capital cost is determined under the PSCs term as either the declining balance depreciation method or double declining balance method. Calculation of each year's allowable recovery of PP&E should be based on the individual PP&E assets at the beginning of such year multiplied by the depreciation factors as stated in the PSC. In general, the property, plant and equipment is categorized, based on the useful lives, into three groups: group 1, group 2 and group 3.

The undepreciated balance of assets taken out of service will not be charged to recoverable costs but will continue to be depreciated based upon the useful lives described above, except where such assets have been subjected to unanticipated destruction.

Employee Costs and Benefits

As part of the PSC annual work plan and budget review, BP Migas reviews training programs/costs, salary and benefit costs and planned Indonesianization of expatriate positions. BP Migas controls the number of expatriate positions and these positions are reviewed annually. Manpower or organization charts for both nationals and

expatriates (RPTKs and RPTKAs) are to be submitted annually by Contractors for BP Migas review and approval. BP Migas controls the amount of national salaries and benefits which can be paid and cost recovered through salary caps. Due to these salary and benefit caps, PSC Operators are hindered in recruiting and retaining quality staff. In an effort to offset any inequity inherent in the salary caps, PSC Operators tend to offer generous employee benefits such as housing loan assistance, car loan assistance, and long-service allowances etc., which are cost recoverable if such schemes are approved by BP Migas.

PSC Operators, under the guidance of BP Migas, provide the future pension liability upon employee retirement or severance payment upon termination which ever is applicable, referred to as “Tabel Besar” or the “Big Table”. A Big Table scheme is a form of a defined benefit whereby an employee is given a certain number of months pay based on years of service.

Accordingly, some PSC Operators have established defined contribution pension plans, which are managed by a separate trustee-administrated pension fund that is an independent pension entity in which the PSC operator contributes a percentage of an employee’s salary and the employee may contribute additional percentages. Any pension contributions paid or funded to the pension entity or insurance company are charged as cost recoverable. Some PSC Operators also purchase annuity contracts from insurance companies to satisfy their pension obligations. Pension contribution accruals cannot be charged as cost recoverable until funded (i.e. paid).

Some PSC Operators have opted to manage their pension plans by funding the pension obligations with bank time deposits. The interest earned on the time deposits is reinvested and will be used to reduce future funding. All of these pension schemes require PSC Operators to prepare an actuarial assessment to evaluate the fair value of assets and the future pension liability whether it is fully funded or unfunded. Historically, any unfunded pension liability is maintained off balance sheet.

Site restoration and abandonment provision

As mentioned earlier, PSC Contractors that signed contracts after 1995 must include in their budgets provisions for clearing, cleaning and restoring sites upon completion of work. Those cash funds set aside in a non-refundable account for abandonment and site restoration are cost recoverable and tax deductible. Any unused funds will be transferred to BP Migas. Note that for PSCs that do not progress to development stage, any costs incurred are sunk costs and will not be recovered from BP Migas.

It has been suggested that any abandonment and site restoration costs and liabilities related to PSCs signed before 1995 remain the Government and BP Migas’s responsibility. However, consistent with PSCs signed since 1995, BP Migas or the Government may, at some point in the future, require the Contractor to contribute to the cost of restoration and abandonment activities.

C. Upstream Accounting

The table below shows some of the key standards and differences relating to upstream oil and gas companies under PSC accounting, US GAAP and International Financial Reporting Standards (“IFRS”).

ACCOUNTING IN UPSTREAM OIL AND GAS BUSINESS Comparison between PSC accounting and US GAAP and IFRS

Area	PSC	US GAAP*	IFRS
Amortization of capital costs	Accelerated depreciation	Units of production	Method not specifically determined: to be allocated on a systematic basis over useful life, reflecting consumption of asset's benefits
Non-capital/controllable stores	Expensed upon receipt	Expensed as consumed	Expensed as consumed
Obsolete stores or idle facilities	Written-off only when approved by BP Migas	Expensed/impaired when identified	Expensed/impaired when identified
Deferred taxes	Not provided	SFAS 109 treatment	IAS 12 treatment
Contingent liabilities	Recognized when settled or approved by BP Migas	SFAS 5 treatment	IAS 37 treatment
Severance and retirement benefits	Pay as you go basis	SFAS 87 treatment	IAS 19 (Revised) treatment
Pre-production costs cost	All costs capitalized pending recovery	A portion of costs capitalized	Capitalized as long as meeting IFRS asset recognition criteria
Abandonment	Recorded and recovered on cash basis	Provided for on a units of production basis; SFAS 143	Provision to be provided under IAS 37
Acquisition costs	Expense	Capitalize	Capitalized as long as meeting IFRS asset recognition criteria
Exploratory dry holes	Expense	Expense	Expense
Exploratory wells-successful: Tangible costs Intangible costs	Capitalize Expense	Capitalize Capitalize	Not specifically addressed. Capitalized as long as meeting IFRS asset recognition criteria
Development dry holes	Expense	Capitalize	Not specifically addressed. Capitalized as long as meeting IFRS asset recognition criteria

(*) Currently, Indonesian GAAP for oil and gas companies does not significantly differ from US GAAP.

ACCOUNTING IN UPSTREAM OIL AND GAS BUSINESS

Comparison between PSC accounting and US GAAP and IFRS (continued)

Area	PSC	US GAAP *	IFRS
Development wells-successful: Tangible costs Intangible costs	Capitalize Expense	Capitalize Capitalize	Not specifically addressed. Capitalized as long as meeting IFRS asset recognition criteria
Support equipment and facilities	Capitalize	Capitalize	Capitalize

(*) Currently, Indonesian GAAP for oil and gas companies does not significantly differ from US GAAP.

D. Taxation and Customs

Introduction

The purpose of this part is to set out the industry specific aspects of Indonesian taxation and customs law for upstream participants. This includes an analysis of some common industry issues. To the extent that an upstream player has taxation obligations common with ordinary taxpayers these obligations are not addressed (although, please refer to the appendices where we have reproduced our 2005 PwC Pocket Tax Guide). Similarly, for customs valuation rules please refer to the appendices.

Historical Perspective

“Net of Tax” to Gross of Tax

The modern regulatory era dealing with the framework of oil and gas activities in Indonesia began with the passage of Law No. 44 in 1960. Pursuant to Law No. 44, the right to mine Indonesian oil and gas resources was vested entirely in Indonesian State-owned Enterprises. Law No. 44 did, however, allow for State-owned Enterprises to appoint other parties as Contractors.

Pursuant to GR No. 27 of September 4, 1968, Pertamina was formed as a State Enterprise. Pursuant to Law No. 8/1971 of September 15, 1971, Pertamina was granted exclusive powers in regard to the appointment of private enterprises, including those which are foreign incorporated, as Contractors under oil and gas mining arrangements. This began the era of PSC and similar contractual engagements.

From the early 1960’s until the late 1970’s, PSC entities were entitled to take their share of production on a “net of tax” basis (i.e. with the payment of Indonesian Income Tax made on their behalf by the State/Pertamina).

In the late 1970’s this was changed to a “gross of tax” basis, to accommodate US foreign tax credit rules. This change led, for the first time, to a calculation of taxable income being necessary, and an actual payment of Income Tax by PSC entities. Notwithstanding this alteration, there was an understanding that a “net of tax” entitlement for PSC entities was to continue.

Uniformity Principle

As the change from a “net of tax”, to a “gross of tax” basis, was not meant to disturb the “desired” production sharing entitlements, it became necessary to adopt the so-called “uniformity principle” in relation to the calculation of taxable income. This principle, as outlined in MoF Letter No. S-443A of May 6, 1982, provides that the treatment of income and expenditure items for cost recovery and tax deductibility purposes should be identical (with limited exceptions, such as for Pertamina bonuses).

Uniformity therefore meant that the calculation of Income Tax for PSC entities differs to the calculation applying to other Indonesian taxpayers. Significant differences include:

- a) that the taxable value of oil and gas “liftings”, is to be referenced to a specific formula (currently ICP), as opposed to an actual sales amount;
- b) that the classifications for intangible and capital costs, are not necessarily consistent with the general Income Tax rules relating to capital spending;
- c) that the depreciation/amortization rates applying to these intangible and capital costs, are not necessarily consistent with the depreciation rates available under the general Income Tax rules;
- d) that there is a general denial of deductions for interest costs (except where specially approved), whereas interest is usually fully deductible under the general Income Tax rules;
- e) that there is an unlimited carry forward of prior year unrecovered costs, as opposed to a 5 year restriction under the general Income Tax rules; and
- f) that no tax deductions will arise until there is commercial production, as opposed to a deduction arising from the date of the spending being expensed or accrued under the general Income Tax rules.

Income Tax Rates

Various Eras

The introduction of the uniformity principle necessitated that the Income Tax rate should be “grand-fathered” to the rate applying at the time that the PSC (or extension) was entered into. This is because, as the production sharing entitlements are set out in the PSC, the entitlement is grossed-up to accommodate the Income Tax rate applying at the time. These rates then need to apply for the life of the PSC.

MoF Decree No. 267 of January 1, 1978, and MoF Decree No. 458 of May 21, 1984, provide “loose” implementing guidelines on the levying of Income Tax against PSC entities. Decrees No. 267 and No. 458 discuss taxable income in terms of a share in oil and gas production (or “liftings”). Deductions are discussed in terms of associated exploration, development and production costs.

Where the relevant entity holds an interest in a PSC signed before 1984, the Income Tax rate applying should be 45%. This rate was reduced to 35% in 1984, and then to 30% in 1995.

The general assumption, in the early years of PSC licensing, was that PSC entities would be foreign incorporated. On this basis, the after tax profits of a PSC entity were subject to a further tax on Branch Profits Remittances (“BPR”). This tax was due at the rate of 20%, giving rise to a total Income Tax exposure of (say) 56% for pre-1984 PSCs (i.e. 45% plus (55% x 20%)). In the relevant PSC this was shown as a (gross of tax) production share of 0.3409 for oil (i.e. 15%/1-.56%) and 0.6818 for gas (i.e. 30%/1-.56%).

In order to ensure a constant after tax take, this gross-of-tax share has altered over the years as Indonesia’s general Income Tax rate has been lowered. In addition, in recent PSC bidding rounds, the net-of-tax Contractor take has been increased to (up to) 25% for oil and 40% for gas. This has also led to a variation in the gross production sharing rates.

These calculations can be summarized as follows:

PSC Era	Income Tax - General	Income Tax - Branch Profits	Combined Tax Rate	Production Share (Oil)	After Tax	Production Share (Gas)	After Tax
Pre - 1984	45%	20%	56%	0.3409	15%	0.6818	30%
1984 - 1994	35%	20%	48%	0.2884	15%	0.5769	30%
Post 1994	30%	20%	44%	0.2678	15%	0.5357	30%
Latest PSCs	30%	20%	44%	0.4464	25%	0.7142	40%

BPR - Treaty Use

The Income Tax rate applying to BPRs can be reduced by a tax treaty. However, with the exception of a small number of treaties (most notably those with the Netherlands, the U.K., Malaysia, and Singapore – although there are others), the BPR reduction in a tax treaty does not apply to PSC activities.

Any reduction in the BPR tax rate will lead to an increase in a PSC entity's after-tax production share. Consequently the Indonesian tax authorities have historically disputed a PSC entity's entitlement to utilize treaty benefits. In the late 1990's this issue led to the cancellation of the Netherlands' treaty (although this has since been renegotiated), and the threatened cancellation of others, including that with the U.K. In 1999, the MoF issued an instruction that the Government's production share should be increased to compensate for any PSC entity utilizing treaty concessions.

Recent PSCs have sought to contractually negate the use of treaties by including provisions seeking to amend the production shares (i.e. as per the MoF instruction above). Typical PSC language is now as follows:

“BP MIGAS and CONTRACTOR agree that all of the percentages appearing in Section VI of this Contract (i.e. for production sharing) have been determined on the assumption that CONTRACTOR is subject to dividend tax on after-tax profits under Article 26(4) of the Indonesia Income Tax Law (i.e. tax on BPRs) and is not sheltered by any tax treaty to which the Government of the Republic of Indonesia has become a party to. In the event that, subsequently, any portion of CONTRACTOR's participating interest in this Contract becomes subject to a tax treaty, all of the percentages appearing in Section VI as applicable only to the portion of CONTRACTOR's participating interest in this Contract so affected by a tax treaty shall be revised in order to maintain the same net income after-tax for all CONTRACTOR's participating interest in this Contract”

Given that this provision has only appeared in recent PSCs (which are not yet in production) the actual operation is not yet clear.

Indonesian Entities – Special Issues

The “gross of tax” calculation included in the production share assumes a foreign incorporated PSC holder with a liability to Income Tax on BPRs, at the rate of 20%.

A PSC can however, be awarded to an Indonesian entity. In such a case, the production sharing formula will typically be unchanged and so assume a dividend (rather than BPR) withholding tax, also at the rate of 20%.

Where a PSC is held by an Indonesian entity with Indonesian shareholders, the taxation of dividends should follow the general taxation rules. Under these rules, for an Indonesian entity, dividend income is tax exempt where:

- the dividend originates from retained earnings;
- the recipient shareholding entity holds no less than 25% of the dividend paying entity's paid in capital;

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- c) the recipient shareholding entity carries on an “active” business (i.e. other than shareholding); and
- d) the dividend is received from an Indonesia resident entity.

It is not clear however, that any PSC related Income Tax reduction can be achieved in practice.

New Oil and Gas Law Election

In November 2001, Law No.8 was replaced with Law No. 22 (See Chapter IV for further discussion). While Law No. 22 introduced a number of changes, a large volume of implementing regulations are still to issue, and many of the changes remain unclear. For instance, GR No. 35, one of the main instruments in this area, was only released in October 2004.

In regard to Income Tax, Article 31(4) of Law No. 22 provides that:

- “The Cooperation Contract shall provide that the obligation to pay taxes referred to paragraph (2) letter a shall be made in accordance with:*
- a) the provisions of tax laws and regulations on tax prevailing at the time the Cooperation Contract is signed; or*
 - b) the provisions of prevailing laws and regulations on tax”.*

This “election” is repeated at Article 52 of GR No. 35, but without elaboration. It is expected that detailed guidance will issue in the future.

For any PSC signed since Law No. 22, it would seem that an Article 31(4) election is available. At the time of writing however, the exact nature of this election was not clear including whether the election could lock-in the uniformity principle. The typical PSC language also does not assist, as it merely defines the Indonesia Income Tax Law as the “Tax Code including all the appropriate regulations”.

Administration

Regulation

A PSC entity (where foreign incorporated) is required to set up a branch office in Indonesia. Under the Indonesian Income Tax law, this branch also gives rise to PE. This is the case for all foreign-incorporated PSC interest holders (i.e. operators and non-operators).

A PSC branch, as a PE, should register for tax by filing an appropriate registration application form including the following attachments:

- a) a letter from the branch’s “head office” declaring the intention to establish a branch in Indonesia, including information on the branch’s chief representative;
- b) a copy of all pages of the passport of the branch’s chief representative;
- c) a notification letter on the chief representative’s domicile (issued by a local government officer);
- d) a notification letter on the domicile/place of business of the branch (usually issued by a building management company in case of locating in a commercial office building);
- e) a copy of the PSC; and
- f) a letter of appointment of the chief representative from the head office.

Compliance

The registration obligation applies from the time of commencement of business activities. This therefore includes the exploration phase (i.e. there is no entitlement to defer registration until, say, commerciality is declared).

Ongoing tax obligations include:

- a) the filing of annual Income Tax returns (each interest holder);
- b) the filing of monthly reports on Income Tax due on monthly liftings, as well as the remittance of Income Tax payments (each interest holder-but obviously only after production);
- c) the filing of monthly returns for withholding obligations, including on employee salaries (operator only);
- d) the filing of monthly VAT reports (operator only); and
- e) the maintaining of books and records (in Indonesia) supporting the tax calculations (operator only).

Ring Fencing

Pursuant to MoF Regulation No. SE-75/1990, an entity may hold an interest in only one PSC (i.e. the “ring-fencing” principle). There are also no group or similar relief facilities available in Indonesia. This means that costs incurred in respect of one PSC cannot therefore be used to relieve the tax obligations of another.

US\$ Bookkeeping

Through the PSC itself, and separate MoF regulations, a PSC entity is automatically entitled to maintain its books, and calculate its Income Tax liability, in US dollars. VAT and WHT however, continue to be calculated in Rupiah.

Payment of Tax

The Income Tax payments of a PSC entity are effectively counted by the Government as oil revenue, rather than as an Income Tax receipt. The Income Tax is remitted to the Director General of Financial Institutions (“DGFI”), as opposed to the ITO.

A “Tax Certificate” evidencing the payment of Income Tax can generally be obtained by taxpayers (say for home country tax credit purposes).

Monthly Income Tax payments are due on each month’s liftings. At year-end, the actual lifting entitlement is determined, and the final Income Tax liability settled. Lifting variances are treated as sales or purchases of oil etc. Where Income Tax prepayments exceed the total liability for the year, the overpayment is carried forward rather than refunded.

Audits

In the past, PSC tax affairs were generally administered (including via audit) exclusively by BPPKA and BPKP (both being Government auditing bodies). In recent years, the ITO has however, re-asserted its general Income Tax law right to audit. ITO audits in the upstream sector have been occurring for the past 1-2 years.

The first ITO assessments arising from these audits are only now beginning to issue. Early indications are that the ITO has focused on WHT and VAT liabilities rather than Income Tax.

Employee Income Taxes

For PSC entities (where operator), the taxation arrangements for employees are largely identical to those for other employers. On this basis, there is an obligation for the Operator to withhold and remit Income Tax, and to file monthly returns, in accordance with either Article 21 or 26 of the Income Tax law. The Article (and so the tax rate) varies according to residency of the employee (see the appendices for details).

Industry tax issues in relation to employment activities include:

- a) the treatment of “rotators” or similar semi-permanent personnel. This mainly relates to ensuring that the correct tax rates are applied;
- b) the treatment of non-cash “benefits in kind”. The treatment can vary according to the era of the PSC, whether the personnel are working in designated “remote areas”, and whether the Operator wishes to claim cost recovery for the relevant benefit.

Withholding Taxes

For PSC entities (where operator) the WHT obligations are largely identical to those for other taxpayers. On this basis, there is an obligation for the Operator to withhold and remit Income Tax, and to file monthly WHT returns, in accordance with the various provisions of the Income Tax law (see the appendices for details).

For PSC entities the most common WHT obligations arise in regard to:

- a) land and building rental (i.e. Article 4(2)-a final tax);
- b) deemed Income Tax rates (i.e. Article 15, for international shipping at 1.2% and 2.64%);
- c) payments for the provision of services etc. by tax residents (Article 23-rates range from 1.5%-7.5%); and
- d) payments for the provision of services etc. by non-residents (Article 26-20% before treaty relief).

Industry concern exists in regard to whether a WHT liability should exist for:

- a) cost allocations between PSCs;
- b) reimbursements with no mark-up; and
- c) home office costs allocations.

VAT

General

The sale of hydrocarbons taken directly from source is currently exempt from VAT. PSC entities have therefore never constituted taxable firms for VAT purposes and have never been registered for VAT purposes (although see "VAT Collectors" later in this Section).

VAT charged to/suffered by PSC entities is therefore not available as an input credit. Instead, and depending upon a number of factors, the VAT has historically either been:

- a) deferred (typically for in-country supplies); or
- b) exempted (typically for imports); or
- c) reimbursed (by BP Migas).

In-Country Supplies - VAT Deferment

Pursuant to Presidential Decree No. 22/1989 ("PD 22") and its implementing regulations, VAT payments arising from oil, gas and geothermal exploration and drilling services were deferred until the time of Government Share (when the VAT was then reimbursed-see VAT Reimbursement). This arrangement effectively eliminated all but a small cash flow exposure on VAT charged in these scenarios.

In 1995 however, an amendment to the VAT Law sought to terminate all VAT deferrals with effect from December 31, 1999. The Indonesian tax authorities took the view that this amendment ended the deferment available to PSC entities. In January 2000, assessments for all VAT deferred up to this date were issued. Around 30 taxpayers appealed these assessments through the Indonesian Court system. The outcome of these cases has been mixed. Irrespective of this, a general consensus is probably that post-2000 VAT is not deferrable in any circumstance (although this continues to be an area of dispute).

New PSC entities should probably assume no entitlement to defer VAT payments. On this basis, the VAT charged on "in-country" goods and services will need to be paid, and will not be refunded unless production is achieved.

In recent press reports, the Government has indicated that it will provide a new VAT protection mechanism to assist the upstream sector during the exploration phase. At the time of writing however, no implementing regulations had issued and so no further detail was available.

Imports-VAT Exemption

See “Import Taxes” later in this Section.

VAT Reimbursement

PSCs issued prior to Law No. 22, typically provided that Pertamina (now BP Migas) is to:

“assume and discharge all other Indonesian taxes other than income tax including VAT, transfer tax, import and export duties on materials equipment and supplies brought into Indonesia by Contractor, its contractors and subcontractors.....”

The obligations of Pertamina (now BP Migas) hereunder shall be deemed to have been complied with by the delivery to Contractor within one hundred and twenty (120) days after the end of each Calendar Year, of documentary proof in accordance with the Indonesian fiscal laws that liability for the above mentioned taxes has been satisfied, except that with respect to any of such liabilities which Contractor may be obliged to pay directly, Pertamina (now BP Migas) shall reimburse it only out of its share of production hereunder within sixty (60) days after receipt of invoice therefore. Pertamina (now BP Migas) should be consulted prior to payment of such taxes by Contractor or by any other party on Contractor’s behalf”.

PSC protection from non-Income taxes has therefore historically fallen into two categories. Firstly, those taxes met directly by BP Migas (e.g. Land and Building Tax), and secondly those taxes met by the Contractor (e.g. VAT) which have then been reimbursed. Further, and depending upon the PSC era, the reimbursement shall be only from BP Migas’ share of production (i.e. there is no entitlement to reimbursement until the PSC goes into production and reaches Government share).

Reimbursement is, in practice, also subject to the PSC entity satisfying high standards of documentation (original VAT invoices, etc.). Where VAT is not reimbursed for a documentation related concern BP Migas has, on occasions, allowed VAT to be charged to cost recovery.

VAT borne by PSC entities during the exploration phase, who do not subsequently move into production, will never be reimbursed, and so the VAT will become an absolute cost.

VAT reimbursements are denominated in Rupiah at historical exchange rates, and so the reimbursement mechanism also carries an exchange risk. (The reimbursement mechanism was in fact strengthened with the issue of a new MoF Decree in July 2005).

VAT Collectors/QQ Facility

While PSC Contractors are not VAT firms, they do constitute “collectors” for VAT purposes (except for the period January 2004-2005). As a result, PSC entities remit the VAT that is charged on goods and services directly to the tax authorities (rather than to the suppliers). There is a monthly filing associated with the process. This remittance arrangement leaves suppliers to the upstream sector in a perpetual VAT refund position.

Due to BP Migas bidding rules, these suppliers are often Indonesian entities acting as “agents” for foreign oil service multinationals. Historically, the VAT cashflow disadvantage that the collector arrangements have created for local agents gave rise to the QQ system. This system effectively allowed the agent to pass the VAT cashflow burden onto the multinational oil service entity, by allowing the VAT invoice to by-pass the agent.

The QQ facility is however only available with written approval from the ITO. At the time of writing, it was not clear whether approvals were still being granted. It was also not clear whether taxpayers who had obtained approvals in prior years were able to continue to apply the QQ facility.

Import Taxes

As indicated, PSCs issued prior to Law No. 22, typically provided that Pertamina (now BP Migas) is to:

“assume and discharge all other Indonesian taxes (other than income tax) including VAT, transfer tax, import and export duties on materials equipment and supplies brought into Indonesia by Contractor, its contractors and subcontractors.....

The obligations of Pertamina (now BP Migas) hereunder shall be deemed to have been complied with by the delivery to Contractor within one hundred and twenty (120) days after the end of each Calendar Year, of documentary proof in accordance with the Indonesian fiscal laws that liability for the above mentioned taxes has been satisfied, except that with respect to any of such liabilities which Contractor may be obliged to pay directly, Pertamina (now BP Migas) shall reimburse it only out of its share of production hereunder within sixty (60) days after receipt of invoice therefore Pertamina (now BP Migas) should be consulted prior to payment of such taxes by Contractor or by any other party on Contractor’s behalf”.

The discharge of “import taxes” (which includes Import Duty, VAT and an Income Tax prepayment), has historically been accommodated via a ML. The ML arrangements effectively led to an outright exemption of all taxes due on the import of approved capital items. This covered both permanent (i.e. where title transfers to the State) and “temporary” (i.e. where title remains with the importer) imports.

However, under Law No. 22, BP Migas assumed Pertamina’s regulatory role including that in relation to MLs. Further, Law No. 22 now requires Contractors to pay import taxes, meaning that “protection” may again be available only via reimbursement or some more limited method.

There has been considerable uncertainty in this area over the past two years. At the time of writing, the form of import tax protection to be available in the industry was a major concern to investors.

Recent regulations have indicated a distinction is being drawn between PSCs signed under the 1971 Pertamina Law (“old PSCs”), and those signed under Law No. 22 (“new PSCs”). For old PSCs, a regulatory picture seems to have emerged that full ML protection will continue, at least on permanent imports.

For new PSCs, the MoF issued a Regulation in January 2005 to exempt Import Duty on goods permanently imported. This regulation will however be in force only up to July 15, 2006 and does not provide an exemption for the VAT and Income Tax prepayments also due on imports. The Regulation also does not explicitly cover temporary imports including those by subContractors. The current position in respect of temporary imports, for all eras of PSC, appears to follow the treatment of permanent imports.

Regional Taxes

Indonesia has commenced a program of passing certain taxing rights to Regional Governments. It is likely that a variety of new taxes will be levied on a regional basis, particularly in areas with a special autonomy status (Papua, Aceh, etc.). Investors should carry out separate reviews on all the potential regional taxes that could apply.

Technically speaking, PSC entities should be protected from these taxes via the language of their PSC (see above). However, as regional taxes are relatively new, the protection is somewhat untested.

Tax Dispute Process

Pursuant to the General Tax Law, taxpayers are entitled to object to the ITO against tax assessment letters.

Requirements include that the objection:

- a) be prepared for each assessment;
- b) be in Bahasa Indonesia;
- c) indicate the correct tax amounts;
- d) include all relevant arguments; and
- e) be filed within three months of the assessment date.

The ITO is required to decide on an objection within twelve months. Failure to decide within this timeframe means that the objection is deemed accepted. Note also that there is no requirement to have paid an assessment in order to “perfect” an objection (although filing an objection also does not defer the payment obligation and so interest penalties will continue to accrue).

Appeals

Taxpayers are entitled to appeal to the Tax Court against an unfavorable objection decision. Requirements include that the appeal letter:

- a) be prepared for each decision;
- b) be in Bahasa Indonesia;
- c) indicate all relevant arguments;
- d) be filed within three months of the objection decision date;
- e) attach a copy of the relevant objection decision; and
- f) include evidence that the underlying assessment is either fully or 50% paid (depending upon the law under which the appeal is heard).

Requests for Reconsideration

For Tax Court decisions delivered after April 12, 2002, taxpayers are entitled to file “reconsideration requests” with the Supreme Court. Again, a three month action period is in place, with the Supreme Court required to respond within six months. A limited number of such requests have so far been filed.

Interest Penalties/Compensation

Late payments of tax are subject to interest penalties, generally at the rate of 2% per month. Refunds of tax that were overpaid by taxpayers attracts a similar 2% interest compensation.

E. General Upstream Commercial and Tax Issues

When an investment is considered in a PSC, investors often find it useful to conduct a thorough review of the financial and taxation affairs of a particular PSC.

A summary of issues commonly identified in upstream sector, along with areas for consideration is presented in the table set out as follows.

Topics	Issues
Abandonment Costs	<ul style="list-style-type: none"> • BP Migas has included an abandonment clause in the PSC agreements signed since 1995, which provides that the PSC Contractors must include in their budgets provisions for clearing, cleaning and restoring the site upon completion of work. As those funds set aside for abandonment and site restoration are cost recoverable and tax deductible. Unused funds at the end of the contract will be transferred to BP Migas. • For PSCs which do not progress to development stage, any costs incurred are considered sunk costs.
DMO	<ul style="list-style-type: none"> • Historically, there was no DMO obligation associated with gas production. • GR No. 35 imposes a DMO obligation on a Contractor's share of natural gas.
Carry arrangements	<ul style="list-style-type: none"> • Terms of a PSC may require private participants to match BP Migas' sunk cost and further provide funds to finance BP Migas' participating share of all expenditures until commercial production commences. These are known as carry arrangements. • After commercial production commences, BP Migas will repay the funds provided up to the date of commercial production plus an uplift (similar to interest) of 50%, generally, which will be repaid from the Government's equity entitlement. • In a nutshell, the Contractor bears the risk when exploration turns out to be a dry hole, whilst the carry arrangements formally provide for a return/repayment from BP Migas only out of future production. Should the PSC turn out to be producing, the uplift provided to a Contractor in a carry arrangement could be considered taxable income for the Contractor.
Head office costs	<ul style="list-style-type: none"> • Pursuant to the relevant PSC, administrative costs of a "head office" can generally be allocated to a PSC operation for cost recovery purposes. The allocation should be based on a methodology approved by BP-Migas and applied consistently. The allocation is subject to review and audit by BP Migas. Most PSC arrangements cap this allocation at a flat 2% of annual operating costs. • Due to uniformity, a tax deduction has also been available. Allocations above the permitted cost recovery have not been tax deductible. • These allocations technically also create WHT and VAT liabilities (i.e. as cross-border "payments"). Pursuant to MoF Letter No. S-605 of November 29, 1998, the Government indicated that it would implement arrangements to "bear" these taxes on behalf of PSC entities. On this basis, many PSC entities have historically treated these allocations as exempt from WHT and VAT. • However, MoF Letter No. S-605 was arguably never fully implemented and so has never actually provided a technical tax exemption. The ITO is known to have focused on head office costs in tax audits. The potential for taxes to be assessed in this area remains a major industry concern.
Interest recovery	<ul style="list-style-type: none"> • A PSC entity is generally not allowed cost recovery for interest and associated financial costs. • Subject to specific approval, Contractors may be granted interest recovery facilities attached to specific projects. This facility should be pre-approved and included in the PoD.

Topics	Issues
Interest recovery (continued)	<ul style="list-style-type: none"> The interest recovery entitlement will generally reference the pool of approved but un-depreciated capital costs, at the end of an agreed “period” of time. This period might be monthly, quarterly or annually (as negotiated). The “loan” attracting the relevant interest is generally deemed to be equal to the capital spending on the project. Depreciation of the spending is treated as a repayment of the loan. Consequently, the “interest” in question may not be interest in a technical sense. BPKP and Pertamina have historically been of the view that oil/gas taken as interest recovery is deductible but also subject to tax (i.e. through an interest WHT obligation). Pertamina typically allowed a gross up for Indonesian WHT at the rate of 20%. Some PSC entities have been successful in reducing this rate via a tax treaty. This is even though the “interest” may not satisfy the relevant treaty definition.
Investment credits	<ul style="list-style-type: none"> An investment credit is provided to a PSC entity as an incentive for developing certain capital intensive facilities, including pipelines and terminal facilities. The credit entitles a PSC entity to take additional production without an associated cost. An investment credit has therefore traditionally been treated as taxable. More difficult questions have arisen in regard to the timing of investment credit claims. For instance, an investment credit should generally be claimed in the first year of production, and any balance should be carried forward (although there are sometimes restrictions on carry forward). Applicable to oil and/or gas, the facility is for specific pre-approved developments only.
Annuity/Royalty Obligations	<ul style="list-style-type: none"> Some contracts require that annuity/royalty payments be made to another party due to their ownership or other rights to certain seismic data, etc. Legal and other disputes may arise from unclear agreements or uncertain bases for calculating the obligation. As such, unknown financial obligations may emerge from the above issue. Cost recoverability/tax deductibility of these amounts cannot be assumed. WHT obligations may also arise.
Take or Pay	<ul style="list-style-type: none"> A gas supply agreement may include provisions for a minimum quantity of gas to be taken by buyers on a take-or-pay basis. If buyers take less than the committed quantity of gas under the agreement, they must still pay an amount (as agreed in the agreement) in relation to the shortfall. Take-or-pay liabilities may arise, if buyers have taken less than the committed quantity of gas under the agreements. The shortfall in the gas taken by buyers, if any, results in a take-or-pay liabilities positions for make-up gas to be delivered to buyers in the future.
Regional and National Participation	<ul style="list-style-type: none"> Under Law No. 22 after a PoD has been approved for a field that is producing for the first time within a given Work Area (i.e. a PSC) the Contractor is required to offer a 10% Working Interest to a BUMD. If the BUMD does not take up the offer, the Contractor is required to offer it to a national company.

Topics	Issues
Land rights	<ul style="list-style-type: none"> • Historically, BP Migas (formerly Pertamina) took a central role in acquiring surface rights for oil and gas development. • This, however, changed as new law requires the Contractor group to obtain relevant land rights in accordance with the applicable local land laws and regulations. • Entitlement to the contract area under the PSCs does not include any rights to land surface. • The process of obtaining appropriate land rights for the acreage may well be very time consuming and cumbersome. • Investors should consider whether any infrastructure on land acquired generates either (a) a liability for land and building duty on acquisition or (b) annual land and building tax liability.
“Net Back to Field” Arrangements	<ul style="list-style-type: none"> • Contractor calculations for transactions involving Trustee or similar arrangements (e.g. for piped gas/LNG, etc.) typically commence with a revenue figure which has been netted against certain post-lifting costs (e.g. trustee, shipping, pipeline transportation, etc.). Once again, this follows the uniformity principle which generally disallows cost recovery on spending past the point of the hydrocarbon lifting. • Net back to field costs are generally also treated as being outside of a PSC entity’s WHT and VAT obligations.
Sole risk operations	<ul style="list-style-type: none"> • Typically, all costs and liabilities of conducting an exclusive (“sole risk”) operation for drilling, completing and equipping the sole risk wells are borne by “the Sole Risk Party”. The Sole Risk Party indemnifies the Non-Sole Risk Parties from all costs and liabilities relating to the sole risk operation. • Should the sole risk operation result in commercial discovery, the Non-Sole Risk Parties have historically been given option to participate in the operation. If the Non-Sole Risk Parties agree to exercise their option to participate in the sole risk wells when the wells are declared commercial, the Non-Sole Risk Party pays to the Sole Risk Party a lump sum amount which typically can be paid either through “Cash Premium” or “In-Kind Premium” to cover for past costs incurred as well as reward for risk taken. • It is not clear whether these premiums should be treated as taxable liftings income or ordinary income.
Unitizations	<ul style="list-style-type: none"> • Unitization is a concept whereby the parties to two or more PSCs agree to jointly undertake the E&P operations on defined acreage (which typically overlaps between the respective PSCs), and share the risks and rewards from such activity in an agreed proportion. • Some typical issues to consider under a unitization arrangement include: <ul style="list-style-type: none"> - Re-determination of costs/revenues; - Maintenance of separate records; - Ring-fencing; - Audits; and - Impact on the overall economics of the PSCs.

Topics	Issues
Transfer of PSC interests	<p>General</p> <ul style="list-style-type: none"> • Historically, transfers of PSC interests have not been taxed. This has been irrespective of whether the transfer was: <ol style="list-style-type: none"> 1. via a direct transfer of a PSC interest (i.e. as an “asset sale”); 2. as a partial assignment such as a farm-out; or 3. via a sale in the shares of a PSC holding entity (i.e. as a “share sale”). • The ITO is however, now reviewing this area. Whilst the existing tax law could probably tax many transfers, proposed amendments to the law will specifically target PSC transfers. <p>Existing Tax Law</p> <ul style="list-style-type: none"> • An interest in an Indonesia PSC probably constitutes an intangible asset for Indonesian Income Tax purposes. Taxable income can include gains from the sale of intangible assets. As such, any gain made on an “asset sale” could technically be taxable. A tax treaty will typically not prohibit this. • One reason historically cited for there being no tax on transfers, is the operation of the uniformity principle. That is, Indonesia should only tax a seller on a PSC “gain” if the consideration in excess of unrecovered costs is cost recoverable (and so tax deductible) to the buyer. As this excess is not cost recoverable under uniformity, then the gain should not be taxed. • Where a transfer is via a share sale, then the Indonesian Income Tax will only apply if there is a “sale of assets in Indonesia” within the meaning of the Income Tax Law. Pursuant to MoF Decree No. 434 of August 24, 1999, these “assets” are currently restricted to shares in Indonesia incorporated companies. <p>Proposed Tax Law</p> <ul style="list-style-type: none"> • The proposed amendments to the Income Tax Law include the following: <ol style="list-style-type: none"> a) that tax “objects” will include profits resulting from the sale or transfer of PSC interest; and b) that the ITO will have the right to treat a sale of shares in a “tax haven” entity, as a sale of shares in an Indonesian entity (and so tax under Decree No. 434 as above). At this stage, there is no definition of a “tax haven” (although many PSC interests are held in BVI or entities from similar low tax jurisdictions). • The tax reforms are not expected to be in force until January 1, 2006 at the earliest. • Should these changes be enacted, this could provide advantages in not holding PSC interests in “tax haven” entities. However, as a tax levied on such a share sale would actually be a tax on the relevant shareholder, an alternative strategy might be for the shareholder to be resident in a treaty country which provided protection from such tax.



downstream

sector

A. Regulatory Framework

Introduction

Historically, the downstream oil and gas sector in Indonesia was part of Pertamina's exclusive operations. With the passage of Law No. 22, the Downstream Regulations set out in GR No. 36 and MoEMR Regulation No. 0007/2005 the sector is now opening to direct foreign investment in the areas of processing, transportation, storage and trading.

Law No. 22 generally envisions a downstream sector which:

- would eliminate Pertamina's monopoly position by November 2005;
- ensures that investors and participants are given equal regulatory and legal treatment;
- establishes a transparent pricing regime based on market prices;
- rationalizes and streamlines downstream administration; and
- allows local and private investors to enter the downstream sector in four areas: processing, transportation, storage and marketing.

Indonesia has already licenced (in principle) several new fuel retailers and is now moving toward greater transparency in its pricing of fuel. There is a likelihood of a further reduction of fuel subsidies in the near future, at least on certain products.

However, given the capital intensive nature of the downstream sector (pipelines, refineries, lubricant blending plants, etc.) it remains to be seen whether the current legal framework and the opportunities in the Indonesian market can attract new foreign investment into the sector.

We have set out below a summary of the downstream regulations as provided for in GR No. 36/2004 which is aimed at implementing the downstream provisions of Law No. 22.

Operation of Downstream Business

Downstream businesses can be operated in a fair and transparent manner by a corporate body (hereafter referred to as a "PT company") that has obtained a business licence issued by the MoEMR/the Government, with input from BPH Migas. As indicated BPH Migas is responsible for regulating, developing and supervising the operation of the downstream industry.

downstream sector

Regulatory and Development Areas under BPH Migas	Supervisory Areas under the MoEMR
<ul style="list-style-type: none"> ● Business licences ● Type, standard and quality of fuels ● Availability and distribution ● Exploitation of gas for domestic needs ● Strategic oil reserves ● National fuel oil reserves ● Master plan for a national gas transmission and distribution network ● Occupational safety, health, environment and community development ● Price formulation ● Utilization of local resources 	<ul style="list-style-type: none"> ● Business licences ● Type, standard and quality of fuels ● Occupational safety, health, environment and community development ● Employment ● Utilization of local resources ● Oil and gas technology ● Technical rules ● Utilization of measuring tools

Source: PP No. 36/2004

BPH Migas is also responsible for the supervision of fuel oil distribution and transportation of gas through pipelines operated by PT companies.

Supervision and Distribution of Fuel Oil	Transportation of Gas by Pipelines
<ul style="list-style-type: none"> ● Availability and distribution of fuel oil ● Availability of fuel oil in remote areas ● Allocation of fuel oil reserves ● Market share & trading volumes ● Settling of disputes 	<ul style="list-style-type: none"> ● Development of transmission segment and distribution network area ● Determination of tariff and prices ● Market share of transportation and distribution ● Settling of disputes

Source: PP No. 36/2004

Business Licences

Separate business licences are required in relation to the following downstream activities:

- processing (excluding field processing);
- transportation;
- storage; and
- trading (two types of business licences required - wholesale trading business licence; and trading business licence).

The MoEMR has the authority to grant business licences. To obtain a business licence, a PT Company must submit an application to the MoEMR, which should contain, at a minimum, the following:

- name of operator;
- line of business proposed;
- obligation to comply with operational procedures; and
- detailed plan and technical requirements relating to the business.

Processing

A PT company holding a processing business licence must submit to the MoEMR and BPH Migas operational reports, an annual plan, monthly realizations, and other reports.

Processing of gas into LNG, Liquefied Petroleum Gas (“LPG”), and Gas To Liquids (“GTL”) is to be classified as a downstream business activity as long as it is intended to realize a profit and is not secondary to an upstream development. The processing of oil, gas and/or processing output to produce lubricants and petrochemicals are to be stipulated and operated jointly by the MoEMR and the Ministry of Trade (“MoT”).

Transportation

Transportation of gas by pipelines via a transmission segment or a distribution network area is permitted only with specific approval of BPH Migas.

A PT company securing such approval is required to:

- prioritize use of transportation facilities owned by cooperatives, small enterprises and national private enterprises;
- submit operational reports to the MoEMR and BPH Migas each month;
- provide an opportunity to another party to share utilization of its pipelines and other facilities used for the transportation of gas; and
- comply with the Master Plan for a National Gas Transmission and Distribution Network.

BPH Migas has authority to:

- regulate, designate, and supervise tariffs after considering the economic considerations of the PT company, users and consumers; and
- grant permits for the transportation of gas by pipelines to a PT company based on the Master Plan for a National Gas Transmission and Distribution Network.

A PT company may increase the capacity of its facilities and means of transportation after obtaining special permission.

Storage

A PT company is required to:

- submit its operational reports to the MoEMR each quarter or as and when requested by the BPH Migas;
- provide an opportunity to another party to share in its storage facilities;
- share storage facilities in remote areas; and
- have a licence to store LNG.

A PT company can increase the capacity of its storage and related facilities after obtaining permission from BPH Migas.

Transportation or storage activities that are intended to make a profit, or used jointly with another party by collecting fees or lease rentals, are construed as downstream business activities and requires appropriate downstream business licence and permits.

downstream sector

Trading

A PT company must guarantee the following when operating a trading business:

- constant availability of fuels and processing output in its trade distribution network;
- constant availability of gas through pipelines in its trade distribution network;
- selling prices of fuels and processing output at a fair rate;
- availability of adequate trade facilities;
- the standard and quality of fuels and processing output as determined by the MoEMR;
- accuracy of the measurement system used; and
- utilization of qualified technology.

A PT company is required to:

- submit its operational reports to the MoEMR each month or at any time required by BPH Migas;
- maintain facilities and means of storage and security of supply from domestic and foreign sources;
- distribute fuels through a distributor, to small-scale users under the Company's authorized trademark;
- prioritize cooperatives, small enterprises and national private enterprises when appointing a distributor; and
- submit operational reports to the MoEMR and BPH Migas regarding appointment of distributors.

A PT company holding a wholesale trading licence can operate a trading business to serve certain consumers (large consumers). The MoEMR, along with BPH Migas, may be able to determine the minimum capacity limit of a storage facility or facilities of a PT company. The PT company may start its trading business after fulfilling the required minimum capacity.

A direct user who has a seaport or receiving terminal may import fuel oil, gas, other fuels, and process the output directly for its own use, but not for re-sale, after obtaining specific approval from the MoEMR.

A PT company operating an LPG trading business is required to:

- have facilities and means of storage and bottling of LPG;
- have a registered trademark; and
- be responsible for maintaining a high standard and quality of LPG, LPG bottling, and LPG facilities.

PT companies operating in the business of gas trading may include those having a gas distribution network facility and those who do not. The former shall operate after obtaining a licence to trade gas and special permission for a Distribution Network Area. The latter may only be implemented through a distribution network facility of a PT company that has obtained access to a Distribution Network Area and after obtaining a licence to trade gas.

The MoEMR has the authority to determine and set technical standards of gas, and also minimum technical standards for distribution and facilities.

Strategic Oil Reserve

A strategic oil reserve determined by the Government can be built up either through domestic production or imports. The Government may assign a PT company to contribute in building the strategic oil reserve.

The MoEMR shall determine the quantity, type, and location in relation to storage and exploitation of the strategic oil reserve. The quantity of strategic oil reserve will be oil need driven.

National Fuel Oil Reserve

The MoEMR is responsible to stipulate a policy on the quantity and type of national fuel oil reserve and may appoint a PT company to contribute in the building of such a reserve.

The national fuel oil reserve is to be stipulated by BPH Migas. BPH Migas is to supervise the national fuel oil reserve. The reserve can only be utilized when there is a scarcity of fuel oil, and when such a scarcity is solved the reserve must be returned to its original position.

Standard and Quality

The MoEMR determines the type, standard and quality of fuel oil, gas, other fuels, and processing output in the form of finished products that can be marketed domestically. The MoEMR will review the technology to be applied, the capacity of the producer, the consumer's financial condition and need, and the safety, health, and environmental standards in making such determination.

A PT company operating as a processing business must have an accredited laboratory to perform tests on the quality of the processing output. The corporate body operating in a storage business, which does blending to produce fuel oil, must provide a testing facility on the quality of blending output. In case the PT company is unable to provide a self-owned laboratory, it is allowed to utilize the facility of an accredited laboratory owned by another party.

Fuel oil, gas, and processing output in the form of finished products, which are imported or directly marketed domestically, must comply with the standard and quality as determined by the MoEMR. On fuels and processing output that will be exported, a producer at a consumers' may determine the standard and quality request. On fuels and processing output with special demand, the standard and quality determined must be reported to the MoEMR.

Availability and Distribution of Certain Types of Fuel Oil

To guarantee the availability and distribution of certain types of fuel oil, a trading business at the moment cannot operate in a fair and transparent market. The gradual implementation of a fair and transparent market will be stipulated in a separate Presidential Decree ("PD").

The MoEMR has the authority to designate areas of trading of certain types of fuel oil domestically. This may include trading areas of fuel oil where:

- the market mechanism has been effective;
- the market mechanism has not been effective; and
- the market is located in remote areas.

BPH Migas has the authority to:

- designate a trade distribution area for certain types of fuel oil for corporate bodies holding a trading business licence; and
- determine joint utilization of transportation and storage facilities, particularly in areas where the market mechanism has not been effective and in remote areas.

If necessary, the Government may determine the retail prices for certain types of fuel oil, based on input from BPH Migas according to a calculation of its economic value.

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A corporate body being holder of a wholesale trading business licence that operates in the trading of certain types of fuel oil to transportation users and trades kerosene for household and small enterprises, must give an opportunity to a distributor appointed through a selection process. The distributor includes cooperatives, small enterprises, and/or national private enterprises integrated with the corporate body based on an association contract. The distributor may only distribute trademarked fuel oil of the corporate body. The corporate body must submit a report to BPH Migas with a copy to the MoEMR regarding appointment of the distributor.

In the framework of supporting the fuel oil trading business, the use of transportation owned by cooperatives, small enterprises, and national private enterprises through a selection process, must be prioritized. The transportation business must be operated integrally with the corporate body pursuant to an association contract.

Prices of Fuel Oil and Gas

Prices of fuel oil and gas, except gas for household and small consumers, are to be determined based on fair and transparent competition. The prices of gas for household and small consumers are stipulated by BPH Migas according to the provision of gas and price policy determined by the Government. BPH Migas will supervise prices over fuel oil and gas.

Retail prices of fuel oil domestically should consist of the price at the level of the corporate body holding the wholesale trading business licence plus cost of distribution, retailer's margin, and tax.

Distribution of Fuel Oil to Remote Areas

The MoEMR shall issue a policy for remote areas based on location, market establishment, preparedness, and strategic value of the area. For the distribution of fuel oil to remote areas, the PT company may cooperate with regional enterprises, cooperatives, small enterprises, and national companies. Fuel oil that must be distributed to remote areas shall be in the form of gasoline, diesel fuel, and kerosene adjusted to the needs of the respective areas.

Occupation Safety and Health, Environmental Management, and Development of Local Community

PT companies must guarantee and comply with provisions regarding safety, health, environment, and development of local communities. This means participation in developing and utilizing locals through employment of a certain quantity and quality of manpower in accordance with the required competence. Development of the environment and local communities by the PT company shall be implemented in coordination with the Regional Government and prioritized around the area of operation.

Utilization of Local Goods, Services, and Engineering and Design Capacity and Employment of Workers

A PT company operating in a downstream business must prioritize the utilization of local goods, tools, services, technology, and engineering and design capacity.

In fulfilling the need for workers, a PT company must prioritize the employment of Indonesian workers according to the required standard of competence. A PT company may employ foreign workers in positions that cannot be fulfilled by Indonesian workers according to the required occupational competence.

To improve the capacity of Indonesian workers to be able to meet the standard of competence and occupational qualifications, PT companies must arrange development and training programs for Indonesian workers.

Development and Supervision

The MoEMR shall exercise supervision over the operation of processing, transportation, storage and trading businesses. BPH Migas will execute supervision relating to the provision and distribution of fuel oil and transportation of gas by pipelines.

Sanctions

The MoEMR can issue a written reminder to a PT company that breaches one of the terms of its business licence. In the event of a PT company receiving a written reminder and any breach of regulations not remedied then the MoEMR may suspend the business. In the event the PT company does not comply with the requirements as stipulated by the MoEMR during the period of suspension, the MoEMR may freeze such a business. BPH Migas has the power to determine and impose sanctions relating to breaches by the PT company.

After the imposition of a written reminder, suspension, and freezing of business, the PT company is given an opportunity to remedy the breaches or to fulfill the requirements within a period of 60 days subsequent to the decision to freeze the business. If after expiration of the 60-day period, the corporate body has not remedied the breaches, the MoEMR may nullify the business licence. All damages arising from a breach and loss of licence are to be born by the respective PT company.

Every person or company operating a business without a licence can be penalized pursuant to the law.

Other Provisions

In the case of extreme market fluctuations in fuel oil and gas prices causing a heavy burden to consumers, the Government may take actions to stabilize the prices.

B. Downstream Accounting

Unlike in the upstream oil and gas business, there are not many specific accounting standards promulgated for the downstream oil and gas business. Accordingly, generally accepted accounting standards are usually applicable in the downstream sector. The table below shows some of the key standards and differences relating to downstream oil and gas companies under Indonesian GAAP, US GAAP and IFRS. Currently, Indonesian GAAP is heading towards harmonization with IFRS.

ACCOUNTING IN DOWNSTREAM OIL AND GAS

Comparison between Indonesian accounting and US GAAP and IFRS

Area	Indonesian GAAP	US GAAP	IFRS
PP&E	Generally use historical cost, revaluations are allowed only for those that are in accordance with applicable regulations.	Revaluations not permitted.	Use historical cost or revalued amounts. Regular valuations of entire classes of assets are required when revaluation option is chosen.
Capitalization of borrowing costs	Required, for qualifying assets.	Required, for qualifying assets.	Permitted, but not required, for qualifying assets.
Leases classification	Finance lease if certain criteria, which are more form-driven requirements.	Similar to IFRS, but with more extensive form-driven requirements.	A lease is a finance lease if substantially all risks and rewards of ownership are transferred. Substance rather than form is important.
Impairment of assets	Similar to IFRS except the requirement to reconsider useful lives when no loss arises is not specified.	Impairment is assessed on undiscounted cash flows for assets to be held and used. If less than carrying amount, measure impairment loss using market value or discounted cash flows. Reversals of losses prohibited. For assets held for disposal, impairment is based on lower of carrying amount and fair value less cost to sell. Similar to IFRS; however, use of LIFO permitted.	If impairment indicated, write down assets to higher of net selling price and value in use based on discounted cash flows. If no loss arises, reconsider useful lives of those assets. Reversals of losses permitted in certain circumstances.
Inventory	Similar to IFRS except LIFO method may still be used.	Reversal of write-down is prohibited.	Carry at lower of cost and net realizable value. Use FIFO or weighted average method to determine cost. LIFO prohibited. Reversal is required for subsequent increase in value of previous write-downs.
Provisions - general	Similar to IFRS.	Similar to IFRS, with rules for specific situations (employee termination costs, environmental liabilities, loss contingencies, etc.).	Record the provisions relating to present obligations from past events if outflow of resources is probable and can be reliably estimated.
Provisions - restructuring	Similar to IFRS.	Recognition of a liability based solely on commitment to a plan is prohibited. Must meet the definition of a liability, including certain criteria regarding the likelihood that no changes will be made to the plan or that the plan will be withdrawn.	Recognize restructuring provisions if detailed formal plan announced or implementation effectively begun.

ACCOUNTING IN DOWNSTREAM OIL AND GAS

Comparison between Indonesian accounting and US GAAP and IFRS (continued)

Area	Indonesian GAAP	US GAAP	IFRS
Deferred income taxes - general approach	Similar to IFRS.	Similar to IFRS, but recognize all deferred tax assets and then provide valuation allowance if recovery is less than 50% likely. A number of specific differences in application.	Use full provision method (some exceptions) driven by balance sheet temporary differences. Recognize deferred tax assets if recovery is probable.
Deferred income taxes - main exceptions	Similar to IFRS.	Similar to IFRS regarding non-deductible goodwill. Initial recognition exemption does not exist.	No temporary differences on non-deductible goodwill and initial recognition of assets and liabilities that do not impact on accounting or taxable profit.
Contingencies	Similar to IFRS.	Similar to IFRS.	Disclose unrecognized possible losses and probable gains.
Employee benefits - pension costs – defined benefit plans	Similar to IFRS.	Similar to IFRS conceptually, although several differences in detail.	Specifically to use projected unit credit method to determine benefit obligation.
Employee benefits - other	Similar to IFRS.	Similar to IFRS for post-retirement benefits. More detailed guidance given for termination benefits. Termination indemnity accounted for as pension plans and calculated as either the vested benefit obligation or the actuarial present value of the vested benefits.	Account for post-retirement benefits as pensions. Rules also given for termination benefits arising from redundancies and other post-employment and long-term employee benefits. Account for termination indemnity plans as pensions.
Derivatives and other financial instruments - measurement of financial instruments and hedging activities	Similar to US GAAP.	Similar to IFRS, except no 'basis adjustment' on cash flow hedges of forecast transactions.	Measure derivatives and hedge instruments at fair value; recognize changes in fair value in income statement except for effective cash flow hedges, where the changes are deferred in equity until effect of the underlying transaction is recognized in the income statement. Gains/losses from hedge instruments that are used to hedge forecast transaction may be included in cost of non-financial asset/liability (basis adjustment).
Derivatives and other financial instruments – measurement of hedges of foreign entity investments	Similar to US GAAP	Similar to IFRS, except all hedge ineffectiveness is recognized in the income statement.	Gains/losses on hedges of foreign entity investments are recognized in equity, including hedge ineffectiveness on non-

ACCOUNTING IN DOWNSTREAM OIL AND GAS

Comparison between Indonesian accounting and US GAAP and IFRS (continued)

Area	Indonesian GAAP	US GAAP	IFRS
Derivatives and other financial instruments - measurement of hedges of foreign entity investments (continued)			derivatives. For derivatives, record hedge ineffectiveness in the income statement. Gains/losses held in equity must be transferred to the income statement on disposal of investment.
Functional currency definition	The entity's main currency in terms of economic substance; the currency mainly used in the entity's operation.	Similar to IFRS.	Currency of primary economic environment in which entity operates.
Functional currency - determination	Functional currency if meeting all the following indicators: cash flows, selling prices, and costs.	Similar to IFRS; however, no specific hierarchy of factors to consider. Generally the currency in which the majority of revenues and expenses are settled.	If indicators are mixed and functional currency is not obvious, use judgment to determine the functional currency that most faithfully represents the economic results of the entity's operations by focusing on the currency of the economy that determines the pricing of transactions (not the currency in which transactions are denominated).
Presentation currency	The presentation currency is Indonesian Rupiah (even though Rupiah is not the functional currency). Other currencies may be used as presentation currency provided they meet the functional currency criteria.	Similar to IFRS.	When financial statements are presented in a currency other than functional currency, assets and liabilities are translated at exchange rate at balance sheet date. Income statement items are translated at exchange rate at dates of transactions, or use average rates if rates do not fluctuate significantly.
Acquired intangible assets	Similar to IFRS, except revaluations are not permitted.	Capitalize purchased intangible assets, amortize over useful life and review for impairment. Intangibles assigned an indefinite useful life must be not be amortized but reviewed for impairment annually. Revaluations are not permitted.	Capitalize if recognition criteria are met; intangible assets must be amortized over useful life. Intangibles assigned an indefinite useful life must not be amortized but reviewed annually for impairment. Revaluations are permitted in rare circumstances.
Internally generated intangible assets	Similar to IFRS.	Expense both research and development costs as incurred. Some software and website development costs must be capitalized.	Expense research costs as incurred. Capitalize and amortize development costs only if stringent criteria are met.

ACCOUNTING IN DOWNSTREAM OIL AND GAS

Comparison between Indonesian accounting and US GAAP and IFRS (continued)

Area	Indonesian GAAP	US GAAP	IFRS
Accounting method for business combination	Either purchase method or uniting/pooling of interest method is allowed, with certain criteria to be met.	Uniting of interest method is prohibited.	Virtually all business combinations are acquisitions.
Purchase method -fair values on acquisition	Similar to IFRS. No detailed guidance on this issue. However IFRS approach would be acceptable.	Similar to IFRS, but specific rules for acquired in-process research and development (generally expensed) and contingent liabilities. Some restructuring liabilities relating solely to the acquired entity may be recognized in fair value exercise if specific criteria about restructuring plans are met.	Fair value the assets, liabilities and contingent liabilities of acquired entity. Only recognize liabilities for restructuring activities when the acquiree has an existing liability at acquisition date. Prohibited from recognizing liabilities for further losses or other costs expected to be incurred as a result of the business combinations.
Purchase method - goodwill and intangible assets with indefinite useful lives	Goodwill is amortized over its useful life, normally not longer than five years, unless a longer period of not exceeding twenty years can be justified.	Similar to IFRS; however, impairment measurement model is different.	Capitalize but do not amortize. Review goodwill and indefinite-lived intangible assets for impairment at least annually at the cash-generating unit level.
Purchase method - negative goodwill	Reduce proportionally the fair value assigned to non-monetary assets, record any remaining excess as deferred income and recognize as income over a period not less than twenty years.	Reduce proportionately the fair values assigned to non-current assets (with certain exceptions). Any excess is recognized in the income statement immediately as an extraordinary gain.	Acquirer to reassess the identification and measurement of acquiree's identifiable assets, liabilities and contingent liabilities. Any excess remaining after that reassessment is recognized in income statement immediately.
Special purpose entities (SPE)	Similar to IFRS.	Consolidate SPEs if consolidation requirements for VIEs are met. To avoid consolidation, the SPE must be a qualifying SPE.	Consolidate where the substance of the relationship indicates control.
Presentation of joint ventures	Current guidance only covers Jointly Controlled Operations and Jointly Controlled Assets and is comparable to IFRS. However, for Jointly Controlled Entity, IFRS approach is acceptable.	Equity method is required except in specific circumstances.	Both proportional consolidation and equity method permitted.
Interest expense	Similar to IFRS.	Similar to IFRS.	Interest expense recognized on an accrual basis. Effective yield method used to amortize non-cash finance charges.
Financial assets - measurement	Similar to IFRS.	Similar to IFRS; however, no ability to designate any	Depends on classification of investment – if held to maturity

ACCOUNTING IN DOWNSTREAM OIL AND GAS

Comparison between Indonesian accounting and US GAAP and IFRS (continued)

Area	Indonesian GAAP	US GAAP	IFRS
Financial assets - measurement (continued)		financial asset or liability as at fair value through profit or loss.	or loan or receivable, then carry at amortized cost, otherwise at fair value. Unrealized gains/losses on fair value through profit or loss classification (including trading securities) recognized in the income statement and on available-for-sale investments recognized in equity.
Derecognition of financial assets	No guidance for derecognition of financial assets in general (except for some transactions involving factoring, for example) However IFRS approach is acceptable.	Derecognize based on control. Legal isolation of assets even in bankruptcy is necessary for derecognition.	Derecognize financial assets based on risks and rewards first; control is secondary test.
Related-party transactions - definition	Similar to IFRS.	Similar to IFRS.	Determine by level of direct or indirect control, joint control and significant influence of one party over another or common control of both parties.
Related-party transactions - disclosures	Disclose name of related party, nature of relationship and types of transaction if there have been transactions between related parties. Same exemptions available, including exemption for intragroup transactions in consolidated financial statements and exemption for transactions between state-controlled entities.	Similar to IFRS. Exemptions are narrower than under IFRS.	Disclose name of related party, nature of relationship and types of transaction. For control relationships, give disclosures regardless of whether transactions occur. Some exemptions available for separate financial statements of subsidiaries.

C. Taxation and Customs

Goods and services supplied by downstream operators and Contractors and their businesses are subject to taxes identical to those under the general tax law as set out in the appendices.

In the past, some tax incentives have been granted to mega-projects such as refineries, but the incentives overall have been insufficient to entice investment and mainly relate to provisions for extended loss carry forward, periods and tax holidays.

Some practical general tax issues which should be considered before making any significant downstream investment (e.g. refining, lubricants distribution or blending, etc.) are:

- determining whether a PE exists in Indonesia either as part of the proposed investment or prior to the new investment;
- being aware of the WHT implications of transactions to ensure that margins are not eroded;
- ensuring contracts specifically cater for the imposition of WHT and VAT, that is, the use of net versus gross contracts;
- structuring inter-group transactions and agreements to minimize the WHT and VAT implications that may arise on the charging of, for example, management fees; and
- structuring certain contracts to minimize VAT and WHT implications.

From a customs perspective the top risks in structuring investments are as follows:

- Royalties - The DGoCE is now aggressively pursuing duty on royalty payments in a customs audit - being proactive allows an opportunity to restructure and to minimize the dutiable element of the royalty;
- Transfer pricing adjustments - For Multi-Nationals making year-end adjustments, unless managed properly, the risks are that DGoCE will charge duty and penalties on any additional payments; and ignore any credits received by the importer;
- No sale to the importer - The DGoCE are starting to understand the significance of “no sale” transactions. Such circumstances include leased goods, warranty replacements, and imports by branches. At best, there is a compliance burden in determining the alternative basis of a customs value. At worst, the duty liability may increase significantly;
- Inventory control in Customs Facilities - Companies using customs facilities usually have problems in accounting for the physical inventory vs the bookkeeping records, which may cause huge penalties; and
- Transfer of fixed assets under Customs Facilities - The exempted duties may have to be paid, if the company did not follow the proper procedures.

Taxation on Downstream Investments with Pertamina

Some investments in cooperation with Pertamina or its affiliates occur by way of a joint operation (“JO”) model. Typically a JO does not involve an incorporated entity. Invoicing and the day-to-day operations of the JO will be governed by the associated JOA.

downstream sector

From a tax perspective, a JO does not constitute a tax subject. Therefore, JOs are not obliged to submit tax returns or pay Article 25 or Article 29 Income Tax. The only obligations are as withholders/collectors of Article 21 (employee WHT), Article 23 and Article 26 Income Taxes (i.e. WHT on the fees of service providers). Taxable entrepreneurs must also levy VAT.

Article 22 Income Tax that has been collected by another party can be credited against Income Tax owed by the individual members of a JO by way of an overbooking.

Taxation of Fuel Distribution - Wholesale

As a preliminary remark the current taxation rules for the distribution of fuel, predominantly caters for the existing Pertamina model of fuel distribution. Little accommodation is made for the practices of international fuel retailers.

Income Tax (Article 22)

Pertamina, and other business entities operating in the refined petroleum products sector, have an obligation to collect Article 22 Income Tax from their diesel and petrol sales (or deliveries). The collection is at the rate of 0.3% for transfers to privately owned stations, and at the rate of 0.25% to Pertamina stations. This Income Tax is considered to be a final tax, for the Pertamina distributors/agent, under Article 7(1) of Decree No. 254.

The Article 22 obligation appears to apply to all companies which deliver these products to distributors/agents. The English translation of Decree No. 254 does not consistently refer to “sales” or “deliveries” as the trigger. The payment mechanism is that the buyer makes a deposit to a bank or post office in advance of the delivery of the fuel.

Income subject to a final tax, is generally not included in the ordinary Income Tax calculation. Consequently, related expenses would not be tax-deductible.

Fuel sales to commercial users (described as “Non Retail Stations”) are also subject to Article 22 Income Tax but on a non-final basis. There is very little tax regulation currently on these types of transactions.

VAT on Commercial Sales

For sales to non-retail stations, the general VAT rules are applied. Generally, Pertamina would add VAT to its sales which should be creditable to the purchaser. Onward sales would be subject to VAT, although note that some exceptions do exist in practice.

Taxation of Fuel Distribution - Retail

Income Tax

A Cooperation Agreement, in the form of a joint decree, was entered into between the ITO, Pertamina and the National Association of Private Entrepreneurs in Oil and Gas, with effect from January 1, 1994. The agreement dealt with the imposition, collection, payment and reporting of Income Tax arising from Pertamina product, sold through filling stations or other Pertamina agents/dealers. This agreement was subsequently superseded by the Article 22 Income Tax prepayment arrangement described above. No Article 25 Income Tax is payable in addition to the Article 22 Income Tax.

VAT on Retail Sales

Filling stations are regarded as taxable entrepreneurs. However, for retail sales (by either Pertamina or private-owned stations) the VAT obligation is deemed to have been assessed through to the end consumer at the time of

delivery by Pertamina. The tax due is calculated at 1/11th or 10/110th of the Pertamina selling price. The station owner therefore has no obligation to register as a VATable entrepreneur as long as it has no other business activity.

If the station has a workshop or kiosk etc. which sells non fuel income (such as lubricants, brake, and battery fluids), the station owner must report its activities in order to be confirmed as a Taxable Entrepreneur.

Automotive Fuel Tax

Retail fuel sales are subject to a 5% Automotive Fuel Tax ("AFT"). This is a regional tax, levied at the provincial level.

For sales to the transportation industry (i.e. other than through a retail gas station) the retail fuel price includes only 10% VAT but not AFT. For the transportation sector (at the retail filling station level) the retail fuel price includes a 5% AFT.

Import Duty on Petroleum

Crude oils are classifiable under HS 27.09 (which covers "Petroleum oils and oils obtained from bituminous minerals, crude"). The Import Duty rate for crude oils is 0%, both the general rate and the CEPT rate (for goods of Association of South East Asian Nations ("ASEAN") origin).

Refined oil products are potentially classifiable under HS 27.10, which covers *"Petroleum oils and oils obtained from bituminous minerals, other than crude; preparations not elsewhere specified or included, containing by weight 70% or more of petroleum oils or of oils obtained from bituminous minerals, these oils being the basic constituents of the preparations; waste oils"*

The general Import Duty rate ranges from 0% to 30%, depending on the specific product. The CEPT duty rate ranges from 0% to 5%.

Natural gas is classifiable under HS 27.11, which covers "Petroleum gases and other gaseous hydrocarbons". The Import Duty rate (general and CEPT) is 0%.

Export Taxes

Export Taxes are not applicable for crude oil, refined products and natural gas.

Import Duty on Fuel

Under MoF regulation No. 07/PMK.010/2005 dated January 28, 2005, the Import Duty on certain kinds of fuel oil (e.g. motor fuel and aircraft fuel) was reduced to nil from 5%.

Previously, when fuel imports were taxed at the 5% duty rate, some importers did consider the possibility of seeking an Import Duty reduction on fuel to a 2.5% Import Duty. This was possible provided that the fuel was originating from an ASEAN country and fulfills the 40% ASEAN content. This may again become relevant if the Import Duty on fuel is returned to rates higher than 2.5%.

downstream sector

Customs

For general overview of Indonesian customs rules - please see our summary of the Indonesian tax laws in the appendices.

D. General Downstream Commercial and Tax Issues

When an investment is considered in any downstream asset in Indonesia, investors often find it useful to conduct a thorough review of the financial and taxation affairs of that particular downstream asset.

A summary of issues commonly identified in downstream sector is presented in the table below.

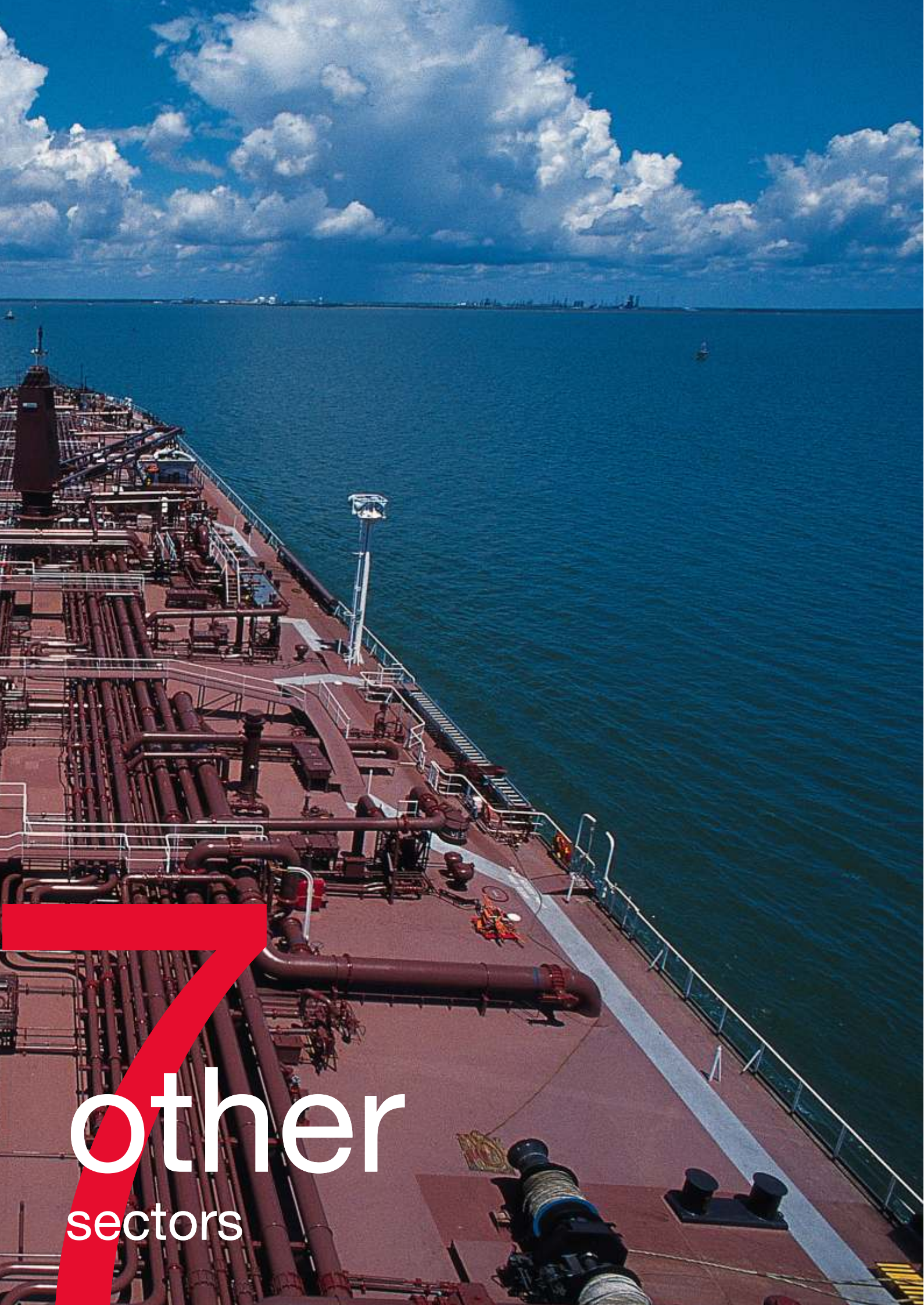
Topics	Issues
Land rights	<ul style="list-style-type: none"> The land where a pipeline is located may not yet been acquired/ owned. There is also possibility that the land ownership is in dispute. The process of land registration is time consuming and subject to government regulation (i.e. use of land).
Valuation of underlying fixed assets and inventory	<ul style="list-style-type: none"> Asset costs may be subject to mark-up. Equipment may not be in a good condition, hence the net book value may not reflect their market value (impairment). The underlying assets may not have been formally verified. Lack of fixed asset and inventory physical verification increases the risk of non-existence of assets. Accounting for turnaround costs. Existence of any contractual or legal obligations for Asset Retirement. Asset validity (including any assets pledged as collateral) may need to be verified.
Underlying regulations and permits	<ul style="list-style-type: none"> Some of the downstream sector related regulations, especially those in relation to the right of access and tariff structure are in a transition stage and unclear. Further clarification may be needed regarding the roles of the MoEMR, BPH Migas and the MoT in the downstream business. The requirement to shares storage facilities needs to be further defined or clarified in more detail. The guarantee by a trading business to have product constantly available for the distribution network needs to be further defined or classified to ensure optimal inventory management. Requirement to supply in remote areas needs to be clarified.
Stand-by Letters of Credit	<ul style="list-style-type: none"> There is a potential exposure to non-payment by a customer if there are no stand-by letters of credit or other credit protection in place.
Contractual Commitments	<ul style="list-style-type: none"> Investors need to assess the impact of the following on their deals: <ul style="list-style-type: none"> Gas Sales and Supply Agreements. Gas Transportation Agreements. Take-or-Pay obligations. Ship-or-Pay Arrangements (including deferred revenue impact and the correct taxation treatment). Potential liquidated damages and other exposures (upsides and downsides). Cash waterfall mechanism.

Topics	Issues
Contractual Commitments (continued)	<ul style="list-style-type: none"> - Recourse against Contractors. - Line-pack gas – treatment, exposures and accounting. - Make-up gas – treatment, exposures and accounting. - Guaranteed product supply (contract, other arrangements, etc.).
Government relationship	<ul style="list-style-type: none"> • Government may have the intention to control refineries as in the past. • Restrictions on further issue of capital/transfer of shares for a certain period of time and nature may be applicable. • The Government usually keeps the right for first refusal, as well as a “tag along” right, on any future sale. • Requirement to pledge shareholding to the Government to secure performance may need to be considered. • Form and content of reports to be filed with the MoEMR and regulatory body need to be understood. • Further guidance is needed on how private investors will work with the Government in maintaining national strategic oil and fuel oil reserves. • Further guidance is required on how investors may set pricing and how any subsidy will be paid to investors until such time that the government fuel subsidy is fully removed. • Designation of trading areas and the requirement to market product in remote areas needs further elaboration. • The requirement to distribute to remote areas needs to be further defined. • Expectations of Regulator’s and Government’s role in the short, medium and long term needs to be understood. • Role in national strategic oil and fuel oil reserves needs to be understood. • Product pricing restrictions may be applicable in some areas based on prevailing GRs.
Profitability	<ul style="list-style-type: none"> • Future operations could be subject to volatility in supply and price of key inputs (other than feed stock), e.g. electricity, water, etc. • Volatility of the cost of the storage and transportation of feed stock and finished product may be significant. • Exposures relating to the commodity price movements need to be considered. • Counter party performance assessment needs to be undertaken. • Demand forecasting must be considered. • Operational performance assessment. • Distortion of trading performance through related party transactions and other undisclosed arrangements. • Inadequate controls and reporting processes. • Cost structure and impact on overall economics.
Technology	<ul style="list-style-type: none"> • Licensing arrangement for technology may not have been formalized. • Operators’ technical expertise/ credit strength may be questionable. • There is a general restriction on the tax deductibility of research and development (“R&D”) expenditure when the R&D is not conducted in Indonesia.
Product mix	<ul style="list-style-type: none"> • Ability to change product mix and associated costs may be limited. • Contractual commitments associated with product mix may be significant.

downstream sector

Topics	Issues
Supply Chain	<ul style="list-style-type: none"> Continuity of feed stock to the refining process is sometimes not secure.
Environmental issues	<ul style="list-style-type: none"> Compliance with existing and future environmental regulations (including remediation/abandonment exposures) may be lacking. Remediation costs for the previous activities of the refinery may be significant. Environmental impact.
Strategic Value enhancement opportunities	<ul style="list-style-type: none"> Opportunities to improve crude procurement and inbound logistics costs. Opportunities to improve refinery utilization. Opportunities to enhance retail outlet throughput may be limited. Branding and value capture opportunities need to be identified.
Competition	<ul style="list-style-type: none"> Prioritization of cooperatives, small enterprises and national companies to own/operate transportation and distribution facilities may hinder development in the short-term due to lack of operational experience and understanding of the industry as well as potential capital or financing constraints. Overall market growth and product specific demand supply need to be considered. Emerging competition in retail market due to liberalization needs to be assessed.





other
sectors

A. Service Providers to the Upstream Oil and Gas Industry

Background – General

As previously discussed in Chapters IV, V and VI, the Government and BP Migas set the guidelines and make the final decision on large purchases of most equipment and services.

Purchases by either BP Migas or PSCs must be made through a local limited liability company. Foreign companies that want to sell petroleum equipment or services therefore must establish a relationship with an Indonesian company. This relationship can take one of several forms.

Some foreign companies establish a temporary relationship for a specific sale or purpose. This provides great flexibility, but can also make it more difficult to get established in the market. Another form is an agency arrangement in which a sole agent represents a foreign company or several foreign companies. This leads to greater continuity and may increase the likelihood of ongoing business, depending on the quality of the agents.

A more committed form is a foreign investment company (PMA), in the form of a joint venture with at least a 5% Indonesian equity. In the service area, only Indonesian companies can bid on most contracts. After enforcement of this policy began in 1987, many foreign service companies formed joint ventures in order to continue doing business in Indonesia. Suppliers of equipment to the oil industry can establish 100% foreign owned PMAs. There is no stated minimum investment required by BPKM as the PMA licensing body, but generally for service companies they will allow a minimum of US\$500,000.

The main marketing channel for most goods and services is direct contact between a technical representative of the seller, and an engineer who is writing tender specifications for the buyer. This once meant an expatriate seller talking to an expatriate engineer, but it is now becoming more common for both parties to be Indonesians. Foreign companies are finding it more economical to hire Indonesian employees and less difficult to do so as the number of skilled Indonesian workers increases.

Tax Considerations - General

Goods and services supplied to production sharing and other Contractors in the oil and gas industry are subject to taxes identical to those under the general Indonesian tax law set out in the appendices. Historically there have been some exceptions to this for oilfield service providers, in regard to import taxes (Article 22 Income Tax, VAT and Import Duty). Historically, the service providers were able to take advantage of a PSC clients ML facility. Please refer to our comments in Chapter V Section D for details of the ML facility.

Drilling Services

Due to the high capital costs and technical expertise required, most drilling rigs, particularly offshore rigs, are owned by foreign businesses. Until 1985, these rigs were contracted directly with PSCs to provide drilling

other sectors

services. After an amendment to the Indonesian foreign investment regulations, PSC entities were required to enter into contracts with companies established in Indonesia – either wholly Indonesian-owned, or those with an approved PMA status. In turn, those companies holding the contracts would enter into rig charter, technical assistance and other agreements with the foreign companies to provide the necessarily facilities and expertise. PMA entities involved in offshore drilling are permitted to have a maximum foreign shareholding of 95%, and those in onshore drilling a maximum of 49%.

Taxation – Drilling Service Providers

Special taxation rates apply to drilling Contractors. These include:

- Foreign-owned Drilling Companies (“FDCs”) typically own the rigs and so will be PEs for Indonesian tax purposes. The tax rate is therefore normally 44%, being 30% corporate Income tax rate, plus a 20% WHT on branch profit remittances (“BPRs”);
- A Certificate of Domicile/Residence will be needed to claim the benefit of any tax treaty;
- FDC taxes are payable at the above rates but on a deemed profit percentage, currently 15%, of drilling income. Drilling income is the FDCs day rate income receivable under the contract;
- Reimbursements and handling charges (including mobilization and demobilization) may not be taxable income, depending on whether a de minimis threshold test is exceeded. The test is generally applied on an annual rather than contractual basis;
- Other non-drilling income, for example interest, is subject to tax at normal rates;
- It is possible for FDCs which have a PE and are effectively taxed at 4.5% to obtain a ruling that exempts PSC’s from WHT (otherwise due at 6%) to prevent the PE ending up in an overpaid tax position. Apart from being unattractive from a cash flow perspective the obtaining of refunds results in an automatic tax audit;
- VAT and WHT is technically due on any intercompany charges for rig hire;
- Indonesian drilling companies are taxed on the basis of actual revenues and costs;
- The provision of drilling services is subject to VAT. Note that, as PSC companies have been reinstated as VAT collectors, this means that many service providers are in a perpetual VAT refund position;
- Foreign employees (who become residents for tax purposes) of a FDC are subject to Article 21 – employer WHT on a deemed salary basis published by the ITO. Individual tax returns should still however be filed on the basis of an individual’s actual earnings; and
- Where rotators or non-resident expatriate staff (i.e. as non-residents of Indonesia) are used it may be possible to file an Article 26 WHT return in relation to tax withheld from their salary.

Note that technically, the lodging of an Employee Income Tax Return in respect of withholding from staff does not remove the obligation of an individual to register for an Indonesian NPWP (tax payer identification number) and to file an Indonesian individual tax return. One practical issue commonly then faced by expatriates is that they could be required to declare an income, which exceeds the income from which Article 21 tax may have been withheld.

Other Matters

Under an old Migas letter, a PSC Contractor cannot pay a service company’s invoice unless each invoice clearly indicates the wages portion of those personnel that the service company considers subject to a severance savings plan. Under this Migas regulation, the PSC Contractor should deduct 8.33% as indicated by the service company in its invoice and deposit this amount into the “Yayasan Dana Tabungan Pesangon MIGAS” (MIGAS Severance Savings Plan).

In practice, many service providers do not provide this detail to a PSC Contractor, so the PSC Contractor needs an indemnification from the service providers.

The severance savings plan deduction can delay contract arrangements and payments, etc service providers should make sure they have a full understanding of this matter with PSC Contractors before signing a contract.

Shipping/FPSO & FSO Services

The Indonesian oil and gas sector uses the services of various shipping and storage providers.

Large crude carriers/tankers are engaged to ship oil from Indonesian territorial waters, typically to Singapore or China. LNG carriers carry LNG cargos from the Bontang and Arun plants to North Asian customers.

Frequently, converted tankers are used as Floating Production Storage & Offload (“FPSO”) vessels or Floating Storage Offload (“FSO”) vessels.

The shipping industry is heavily regulated. Local shipping is closed to foreign investment. International shipping is open to foreign investment through a PMA company in joint venture with a maximum foreign shareholding of 95%. The PMA must own an Indonesian flagged vessel with a gross tonnage of at least 5,000.

Marine Transport Decree No. 33/2001 of October 4, 2001 requires foreign shipping companies, conducting marine transportation within Indonesia, to appoint an Indonesian agent. The agent will fulfill a number of roles including acting as a point of registration contact for the ITO.

BKPM rules allow the licensing of a PMA company to run FPSO/FSO operations (considered as oil and gas support activities) with a maximum foreign shareholding of 95%. The Department of Sea Communications however sees this as a shipping activity which would require a shipping licence.

Taxation of Shipping/FPSO/FSO Service Providers

Putting aside coastal shipping, issues to consider include:

- the taxation of crude/LNG shipping arrangements (i.e. export cargos); and
- the taxation of FPSO/FSO services.

Typically the export activity of shipping a cargo involves the provision of services and is only subject to a WHT on the fees generated. The relevant WHT rates are generally:

- domestic shipping companies (Indonesian incorporated shipping companies) 1.2%; and
- foreign shipping companies 2.64% final tax on gross revenue.

In this regard it should be noted that:

- the 2.64% regime presumes that the foreign shipping company has a PE in Indonesia;
- It may therefore be possible to take advantage of a tax treaty to reduce BPR rates (as the 2.64% is arguably calculated as follows: $(30\% \times 6\%) + (14\% \times 6\%) = 2.64\%$);
- tax treaties have specific shipping articles – which may be relevant;
- it may be that Bare-Boat Charter (“BBC”) rentals (i.e. with no service component) from offshore without any service element are subject to 20% WHT, before tax treaty relief; and
- BBC arrangements may also involve payments which are characterized as royalties (e.g. equipment royalties).

In regard to the VAT treatment of shipping it should be noted that:

- shipping services which include an element of Indonesian “performance” (i.e. within the Indonesian Customs Area) are technically subject to VAT. This is the case irrespective of whether the shipping

other sectors

company has a PE, and irrespective of whether the client is an Indonesian based entity, or an offshore entity;

- a VAT exemption may be available if it can be argued that services with only a small proportion of Indonesian presence/performance should be viewed as entirely ex-Indonesia (i.e. as entirely International);
- shipping services provided entirely outside of Indonesia (say under a separate international contract) should avoid VAT on a “performance” basis. However, VAT could still arise on a self-assessment basis where the services are “utilized” within Indonesia. Whilst utilized is not well defined, in practice the ITO deems this to occur where the shipping cost is charged into Indonesia; and
- historically, some shipping companies have not charged VAT on their services.

Traditionally many PSC entities have simply treated their FPSO/FSO service providers for tax in the same way they have treated shipping companies that move cargo. The ITO’s view on this matter is not clear.

B. Service Providers to the Downstream Oil & Gas Industry

Service providers to the downstream sector will (generally) be subject to less direct regulation and pay tax according to the ordinary income tax law. Please refer to the appendices for a summary of the Indonesian tax law. For service providers operating in the downstream sector, please refer to Chapter VI.

C. Geothermal

History

Indonesia has significant geothermal reserves located mainly on the islands of Java, Bali and Sumatra. By some estimates the country has the potential to produce 20,000MW of electricity from geothermal sources. Progress has however been slow and Indonesia has only developed around 800MW of geothermal power in the past twenty years. There was considerable optimism in the early 1990s when eleven contracts for the development of geothermal power plants were awarded to primarily foreign investors. The plants were targeted to come on stream between 1998 and 2002 with a capacity of around 3,500MW. Unfortunately as a result of the 1997- 1998 financial crisis the Government suspended seven of these projects and has had limited success in restarting them. Indeed there has been some high profile litigation around some of the projects stemming from claims made by foreign investors over their suspension.

Previous Regulations

In the past the Government’s role in the development of Indonesia’s geothermal resources was carried out through Pertamina and state electricity company PLN. Presidential Decree 45/1991 (amending earlier Presidential Decree 22/1981) introduced a system whereby Pertamina and its Contractors could undertake exploration and also build power plants and sell electricity to PLN and other consumers. A JOC was entered into between Pertamina and the Contractor where Pertamina was responsible for managing the operation and the Contractor was responsible for producing geothermal energy from the contract area, converting energy to electricity and delivering energy or electricity.

Law No. 27

The Government enacted Law No. 27/2003 on Geothermal Energy (effective October 22, 2003) (“Law No. 27”) in an effort to increase interest and investment in renewable energy resources to prevent future power shortages. Some of the salient points of Law No. 27 are set forth below.

Objectives

The stated objectives of Law No. 27 are to control the utilization of geothermal energy, support sustainable development and to provide added value and increase revenue for the Government to support growth of the national economy. Popular opinion is that previous legislation was not achieving these objectives and that benefits were accruing to certain parties to the detriment of the national economy.

Control and Supervision

Control of geothermal mining activities is through the Central and Regional Governments so as to comply with regional autonomy legislation. All data and information obtained on geothermal sites however remains the property of the Central Government. Provincial, Regency and City authorities can grant permits and supervise geothermal activities for their jurisdictions. Where the geothermal mining area crosses provincial boundaries the permits will be granted by, and supervision be carried out by, the Central Government.

Concessions

It is intended that Work Areas will be offered to prospective investors by way of tender. The rules relating to tendering will be the subject of a GR.

As you would expect there is a list of areas where geothermal activities may not be conducted. These include cemeteries, nature reserves, land owned by traditional communities and historic buildings. There does appear to be allowance for the restricted areas to be used if the relevant Government permit and consent of the community is obtained. Also, where the Geothermal Energy Business Permit (“IUP”) holder wishes to use plots of land in his work area which are under title rights of another party, are state land or are forest zoned land, the IUP holder must achieve a settlement with the rights holder. This creates the same kind of uncertainty regarding tenure that has impacted the mining industry for the past few years.

Activities

The Geothermal Law divides activities into:

- Preliminary Surveys;
- Exploration;
- Feasibility studies;
- Exploitation; and
- Utilization.

The Central and Regional Governments will conduct Preliminary Surveys but the Central Government may appoint another party to do so. Exploration, Feasibility Studies and Exploitation will be done by businesses (state, regional or private) although it appears that the Central Government may be involved in Exploration.

Utilization is divided into Direct (non-electrical activities) and Indirect Use (generating electrical power). Exploration, Feasibility Studies and Exploitation can be carried out by businesses after obtaining Geothermal Energy Business Permits (“IUP”). The largest Work Area to be granted for one IUP will be 200,000 hectares.

GRs will be issued providing for the Work Area to be returned in stages to the Central or Regional Government through the thirty year life of the IUP.

other sectors

Permits

As previously indicated IUPs can be issued by MoEMR, Provincial Authorities (Governors) or Regencies/Cities (Regents/Mayors) depending upon the areas to be covered. An IUP gives a holder three years for the Exploration period which is extendable twice each time for a maximum of one year. The Feasibility Study period is for a maximum of two years after the end of the Exploration period. Exploitation is for a maximum of thirty years (extendable) after the end of the Exploration period. The IUP holder must commence Exploitation activities within two years of the end of the Exploration period or risk losing the concession.

Responsibilities of IUP Holders

Two of the responsibilities of IUP holders that will be of concern to potential investors are:

1. the requirement to place priority on the use of domestic goods, services, engineering and design capability.
2. the requirement to carry out programs for the development and empowerment of local communities.

The concern will be over the lack of detail in the Law as to how this is to be implemented and monitored. The relevant Article 29 does not indicate that there will be a forthcoming implementation regulation relating to this.

State Revenues and Taxes

Law No. 27 provides that IUP holders will pay taxes in accordance with prevailing laws and regulations. This effectively removes the “lex specialis” all-inclusive tax rate of 34 % paid by Contractors under the old regulations. The fixed rate was attractive to Contractors as it made fiscal planning easier and removed uncertainty.

Non-Tax State Revenues include Fixed Fees, Production Fees, other State Levies (for example, education and training services and research and development services) and Bonuses. Further provisions on these State Revenues are to be stipulated in GRs.

Prospective investors will require the rules and rates applying to Non-Tax State Revenues spelt out very clearly before they can assess any geothermal project.

Transitional Provisions

All existing geothermal contracts remain in force until the end of the contract term but supervision and guidance is transferred from Pertamina to the Government.

Going Forward

In late 2003 the MoEMR held a workshop on a blueprint for the geothermal energy industry to which it invited stakeholders for their input. The objective was to use the inputs in drafting the implementing regulations to the Law No. 27. Representatives of PwC attended the meeting.

Some of the industry’s specific concerns raised on Law No. 27 included:

- existing contract holders need some comfort regarding contract sanctity. For example there seems to be a contradiction in relation to taxes and import. On the one hand Law No. 27 states that existing contracts will remain in force while on the other hand it states that IUP holders will pay taxes (including import) in accordance with prevailing laws and regulations;
- there needs to be a proper policy covering all types of renewable energy not just geothermal;
- the implementing regulations need to clearly specify the pricing policy on the sale of geothermal energy to the electricity industry;
- the Government is targeting 6,000MW of electricity from geothermal power by the year 2020. In order to encourage the investment needed to achieve this target there will have to be some form of investment incentive;
- in 1998 a number of geothermal independent power producer contracts were terminated by the Government due to the economic crisis. The contracts were not clear in relation to penalties and recourse for the investors resulting in some acrimonious disputes. New contracts will have to address this issue;

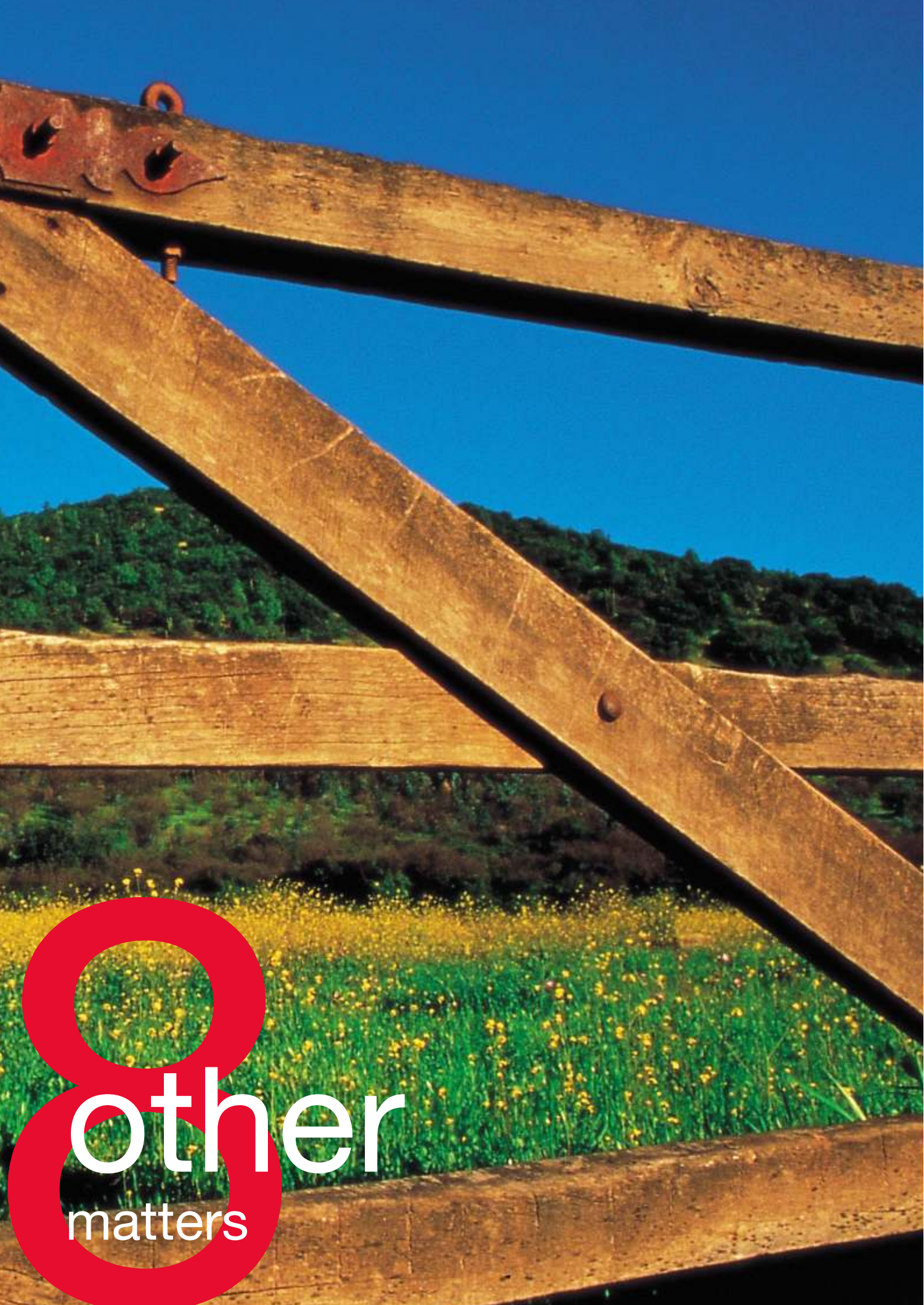
- there is no clear picture of how conflicts will be resolved between Central and Local Governments;
- there is no information at this point as to who will have the right to audit geothermal projects – will it be the state auditors (“BPKP”) or BP Migas? Will the ITO audit these projects as they now do oil & gas PSCs?;
- existing Contractors need to know how Pertamina production allowances will be treated in the future; and
- discussions also included matters regarding conducive financing schemes. One possible scheme is by way of a Trustee Paying Agent Arrangement (to date used in LNG financing) where project receivables are routed through a trust bank account and payments to lenders are made from the account before the remainder is remitted to the borrower. This may require some adaptation where the project is supplying electricity to the national grid and there are a number of customers.

Import Taxes Exemption

As indicated earlier for the Upstream Oil & Gas sector there remains uncertainty over the status of a proposed import taxes exemption for the geothermal industry.

After the enactment of Law No. 27, the MoF issued MoF Regulation No. 26/PMK.010/2005 (Regulation No. 26) dated April 27, 2005 regarding the exemption from Import Duty on goods imported for Geothermal activities. The regulation stipulates that goods imported for Geothermal activities will be exempted from Import Duty, hence the Import Duty tariff will be 0%. Regulation No. 26 is silent on VAT and Article 22 Income Tax. Regulation No. 26 came into force from the date of stipulation (April 27, 2005) but expires July 15, 2006. It is also expressed to be retroactive to October 22, 2003.

Further, the MoF has also issued a draft MoF Regulation regarding the Import Duty and Import Taxes Exemption on goods imported for Geothermal activities before the enactment of Law No. 27/2003. However at the time of writing as a result of a meeting between the MoF and ITO, the ITO has sent a response letter indicating that the draft of the MoF Regulation did not have a legal basis, because Article 16B of Law No. 18/2000 regarding VAT, stipulates that a tax facility should be regulated by a GR not a MoF regulation. This dispute remains unresolved.



o
other
matters

Outlined below are other matters investors should consider, which include:

- licences;
- labor laws and other employment matters;
- land acquisition; and
- recordkeeping and statutory reporting requirements.

A. Licences

Below is a summary of licence requirements in relation to the main activities within upstream, downstream and related services sectors.

Sector	Presence/Field of Activity	Approvals and Licences
Upstream	1. Presence is by way of a Co-operation Contract with BP Migas. This can be a PSC or a Service Contract. Foreign companies will create a PE for tax purposes and a branch in Indonesia through their interest in the Co-operation Contract.	1. A prospective upstream investor must bid for exploration acreage as described earlier in this publication.
	2. A MIGAS Representative Office can be set up by foreign oil and gas companies to have a presence in Indonesia while they search for suitable acreage.	2. A MIGAS Representative Office licence is issued by the Director of Oil and Gas Business Development.
	3. Development of a commercial discovery.	3. Initial PoD requires approval of the MoEMR; subsequent PoDs together with work plans and budgets require approval of BP Migas.
	4. Field processing, transportation, storage and sale of own production by a Contractor under a Co-operation contract do not require a business licence provided those activities are not intended to make a profit. In cases where a profit is to be earned, for example where excess capacity is rented out for fees, the Contractor is required to establish a separate business entity and obtain a downstream business licence.	4. Business licence will be obtained from BPH Migas, if profit oriented.
	5. Importing.	5. An Import Licence is obtained from the Director General of International Trade at the MoT. A Customs Registration Certificate should be applied for from the Director General of Customs and Excise.

other matters

Sector	Presence/Field of Activity	Approvals and Licences
Downstream (continued)	1. Corporate bodies involved in processing to produce refined product including fuel oil, gas fuel, LPG and LNG. This does not include field processing.	1. Business licence from the MoEMR. (The MoEMR may assign this authority to other parties).
	2. Corporate bodies involved in transportation of crude oil, gas and refined products for commercial purposes.	2. As 1. above.
	3. Corporate bodies involved in the storage of crude oil, gas and refined products for commercial purposes.	3. As 1. above.
	4. Corporate bodies involved in purchasing, selling, exporting and importing crude oil, gas and refined products including gas through pipelines.	4. As 1. above but consisting of a Wholesale Trading Business Licence and a Trading Business Licence.
	5. Processing activities.	5. Where processing is the primary business and transportation, storage and trading are secondary a processing business licence only is required. This is except where the corporate body intends to operate a wholesale trading business and so must obtain a wholesale trading business licence first.
	6. Transportation of gas.	6. Transportation of gas through the national pipeline system requires approval from BPH Migas.
	7. Transportation to support storage.	7. Where a transportation business is operated purely to support a storage business the corporate body will only require a storage business licence.
	8. Transportation and storage supporting a trading business.	8. Where transportation and storage businesses are operated purely to support a trading business the corporate body will only require a trading business licence.
	9. LNG.	9. A separate licence to store LNG is required.
	10. Product registration.	10. Oil and gas products sold in the domestic market are required to be registered with the DGOG.
	11. Importing.	11. An Importer Licence is obtained from the Director General of International Trade at the MoIT. A Customs Registration Certificate should be applied for from the DGoCE.

Sector	Presence/Field of Activity	Approvals and Licences
Service Providers	1. PMA licence.	1. The licensing of certain oil and gas support activities is assigned to BKPM. These include metal construction, underwater testing, offshore and onshore drilling, sand blasting and coating, seismic, geological survey, logging, perforating, cementing, wire line, formation testing and evaluation, casing and tubing, high pressure pumping and blow out control services, placement and installation of offshore drilling installations, construction and development planning, renting of equipment, floating production and processing storage and offloading facilities and temporary production system, making and assembling field and rig equipment, bottling and transport of LPG.
	2. Additional licenses.	2. In some cases additional licences may be required e.g. in the case of underwater testing an Underwater Work Licence from the Ministry of Transportation and a Special Transportation Licence for FPSO/FSO also from the Ministry of Transportation.
	3. BP Migas Registration.	3. Oil and gas service companies intending to bid on work for co-operation contracts must apply for BP Migas registration from the DGOG.
	4. Company Certification (SP).	4. Oil and gas service companies intending to bid on work for co-operation contracts should have the relevant SPs for the work being bid. The SPs should be applied for through the relevant business association.
	5. Importing.	5. An Importer Licence is obtained from BKPM in the case of PMA companies. A Customs Registration Certificate should be applied for from the DGoCE.

B. Labor Laws and Other Employee Matters

Labor relations in Indonesia are governed by Law No. 13/2003 (“Law No. 13”) which became effective on March 25, 2003. The Law No. 13 replaced Law No. 25/1997 and Minister of Manpower Decree No. 25/1997 both of which were somewhat controversial. Law No. 13 was intended to give more legal protection to workers while creating a positive investment climate. The effectiveness of the Law No. 13 is dependent on the passing of many implementing regulations. At date of writing this publication twenty-five out of an intended forty-six implementing regulations have been signed.

Below are some of the stipulations that have a direct impact on day-to-day business.

Working Hours

Working hours can be arranged at seven hours a day for forty hours a week in a six day week or at eight hours a day for forty hours a week in a five day week. Employees are not required to work on public holidays unless the nature of the work requires otherwise. An implementing regulation deals with working hours in oil and gas and mineral companies operating in remote areas or offshore and allows up to a maximum of eleven hours a day for a maximum of fourteen days after which a rest period of five days is required.

Minimum Wage

Minimum wages are determined by the Minister of Manpower (“MMP”) on a regional basis and are subject to regular review. The regional minimum wage is the minimum monthly wage consisting of basic wage plus fixed allowances in the particular province.

Compulsory Bonus

Employers are obliged to pay a month’s salary by way of annual bonus for employees who have been employed for more than twelve months and a proportionate amount of one month where employment has been less than twelve months. The bonus is payable at least seven days before the main religious holidays (Idul Fitri and Christmas).

Annual and Long Service Leave

Employees are entitled to twelve days of annual leave for each twelve months worked. Employees may also be entitled to a two month long service leave after each six years of continuous service. The two months is to be taken in the seventh and eighth years of employment in lieu of the normal twelve day annual leave entitlement. The employees are however entitled to be compensated in cash for their annual leave in the eighth year of employment in the amount of one half month’s salary. The implementing regulation on long service leave entitlement allows that companies that are obligated to provide long service leave are those who were providing long service leave prior to the effective date of the implementing regulation dated April 8, 2004. The MMP can stipulate a change in the companies that are obligated to provide long service leave depending on developments in the workplace.

Termination

On termination an employer is obliged to pay severance pay, long service leave (but note above) and compensation. The maximum severance pay under the manpower Law is nine months salary for employees working for eight or more years. The maximum long service leave payable is ten months salary for a service period of twenty four or more years. In addition an employer must pay compensation for untaken leave, repatriation costs, housing and medical allowances and any other compensation set out in the employment contract, company regulations or collective labor agreement. When an employee voluntarily resigns or employment is terminated because of employee's behavior no long service leave is payable. PSC Operators under the guidance of BP Migas (formerly under the guidance of Pertamina) provide a severance payment upon termination referred to as "Tabel Besar" or the "Big Table". A Big Table severance payment is a form of defined benefit whereby an employee is given a certain number of months' pay based on his/her years of service.

Training

Under the Manpower Law employers are responsible for training their workforce in accordance with procedures for setting competency standards based on MMP Decree No. 227/2003. Training plans and costs for oil and gas PSCs are subject to BP Migas approval.

Outsourcing

The Manpower Law permits outsourcing only where it is separate from the employer's main activity and does not impinge on the production process. Cleaning services, security guards, catering, auxiliary services in the mining and oil sectors and employee transportation services are among the types of activities that can be outsourced. The law stipulates that where conditions for outsourcing have not been met the employees of the outsourcing company will become employees of the client company. The implementing regulation in this area is still under discussion.

Social Security

A first ever Law on National Social Security was passed at the end of 2004, but implementation of this law is pending GRs that are yet to be issued at the time this guide went to print. Law No. 3/1992 on Worker's Social Security however remains in place as does JAMSOSTEK, the social security provider for private sector workers.

JAMSOSTEK provides occupational accident, death, old age and health cover for employees. Employers are responsible for the entire amount of the contributions to the occupational accident and death program. Contributions for accident cover range from 0.24% to 1.7% of an employee's wage depending on the employer's business. Rates for employees in the oil and gas industry are at the top end of the range. The contribution for death cover is 0.3% of the employee's wage.

The premium for old age pension is jointly born by employer (3.7% of wages) and employee (2% of wages).

Health cover is available for up to 3 dependents. Contributions are 6% of wages for a married employee and 3% of wages for a single employee. A company that provides better health insurance to its employees can elect not to join the health care program under JAMSOSTEK.

Employee contributions are collected by the employer through payroll deductions. Employers are not required to enroll expatriates in JAMSOSTEK if the expatriates have coverage through a social security insurance program similar to JAMSOSTEK in their home country. This should be evidenced by an original insurance policy.

Expatriate Work Permits

Employers must obtain stay and work permits for expatriates who will work in Indonesia. Stay and work permits are normally issued for twelve-month periods, and may be extended. An expatriate working in Indonesia on a full-year work permit must also have a Temporary Stay Permit Card (“KITAS”) or Temporary Entry Permit Card (“KIMS”).

The procedures to obtain a work permit are as follows:

- The employer submits a Foreign Manpower Employment Plan (RPTKA) and a Manpower Report to the MMP for approval. The RPTKA will include the job title, job description, Indonesian counterparts (normally three for each non-director expatriate) and the training programs planned for the Indonesian employees;
- The RPTKA approval is forwarded to the Immigration Department who will forward a recommendation to the relevant Indonesian Embassy overseas;
- The expatriate collects the Temporary Stay Visa (“VITAS”) at the Indonesian Embassy;
- On arrival in Indonesia the expatriate reports to the Immigration Department for processing;
- The Immigration Department issues a KITAS and stamps a Multiple Exit Re-entry (“MERP”) stamp in the expatriate’s passport;
- The employer arranges payment of US\$1,200 into the MMP’s Skill Development Fund. The funds are used to provide training for Indonesian workers; and
- The MMP issues the Work Permit (“IMTA”).

Expatriates require a number of other documents related to residence from various government departments:

- A Residence Registration and Amendments Book (otherwise known as a Blue Book) from the Immigration Department;
- A Certificate of Police Registration (otherwise known as a Yellow book) from the Foreign Persons Registration Department of the Police; and
- Certificate of Registration for Temporary Resident (“SKPPS”) and Certificate of Domicile (“SKTT”) from the Regional Government.

Indonesian labor law requires that companies employing foreign nationals obtain written permission from the MMP (effectively obtain a work permit as described above). Directors of companies who fail to do so are subject to a jail term of minimum one year and maximum four years and a fine of a minimum of Rp100 million (US\$10,000) and a maximum of Rp400 million (US\$40,000).

Expatriate Taxes

Please refer to Section V, Part D for a brief description of employee income taxes for PSC entities. Further details on an employer’s obligations with respect to WHT from employees and individual’s (i.e. an employee’s) income tax obligations are set out in the appendices.

Care should be taken where an overseas company seconded an expatriate employee to an Indonesian company. The details of whether the expatriate employee is working for the benefit of the Indonesian company or the home country employer and whether his/her compensation cost is born by the Indonesian company or the home country employer need to be made clear. Apart from ensuring that any local tax withholding obligation is met, care should be taken to avoid the risk of creating any PE (i.e. a taxable presence) for the home country employer.

C. Land Acquisition

In general, land rights acquisition in the oil and gas industry will be obtained by negotiating with owners and occupiers in accordance with prevailing laws. According to the Law No. 22, the settlement shall be done under a way of deliberation to reach a consensus by means of transactions, granting a reasonable compensation, and recognition or other forms of compensation to the right holder or users of the Government land. However, the Contractor's rights to working areas shall not cover rights to land being earth surface. A Contractor will be granted a right to use land plots ("hak pakai") directly for petroleum and natural gas-related business activities and surrounding areas in accordance with the provisions of laws in force, and be obliged to maintain and keep the land plots.

Chapter VII of GR No. 35 sets out detailed provisions on the procedures for settlement of use of land under rights or state land.

Risks involved in land acquisition are as follows:

- Lengthy administration procedures as the land may not be legally documented or under tribal title requiring identification of owners, negotiators and then certification of the land by the Local Government resulting in a lengthy and costly process;
- Disputes as land owners could feel that the process is not "fair" or that they are being taken advantage of;
- Involvement of speculators and others; and
- Acquisition costs could exceed fair market price, etc.

A framework for land affairs and detail regulations on land matters still needs to be established to ensure timely development of natural resources and land disputes. Matters which need to be addressed include how will compensation be paid, who will appear as owner of "hak pakai" after acquisition, what government bodies will need to be included in any land acquisitions, how will the value of the tribal land be determined, etc.

D. Recordkeeping and Statutory Reporting Requirements

General Recordkeeping Requirements

The Company Documents Law (Law No. 8/1997) stipulates that a company should maintain documents and records such as the journals and ledgers, the balance sheet, the income statement and other documents describing rights, obligations and other matters relevant to the company. The law also requires that those records be kept for ten years.

The records for a local investment company ("PMDN") must be kept in Bahasa Indonesia unless approval is obtained to maintain the records in English. PSC entities, locally incorporated downstream entities and representative offices may keep records in English if notification is given to the tax authorities within a specified time period. In addition to the obligation to keep records, management is required to prepare financial statements in compliance with Indonesian accounting standards within five months of the end of the financial year (but see later discussion for PSC entities). Tax laws provide that books and records must be retained for ten years.

Statutory Reporting Requirements

In February 2002, the MoT issued Ministerial Decree No. 121/MPP/KEP/2/2002 on the Filing of a Company's Annual Financial Statements. This decree amended several regulations on the same subject, such as PP No. 64/1999 and PP No. 24/1998. Similar to the previous regulations, the decree establishes that the following types of entities are required to submit annual financial statements:

- publicly listed companies;
- companies involved in accumulating funds from the public (such as banks and insurance companies);
- companies issuing debt instruments;
- companies with assets of Rp25 billion or more;
- bank debtors whose financial statements are required by the bank to be audited;
- foreign entities engaged in business in Indonesia in accordance with the prevailing regulations and are authorized to enter into agreements; and
- state-owned enterprises in the forms of Persero, Perum and Perusahaan Daerah (local government enterprise).

According to this regulation, while the submission may be conducted by either the management or the auditor, the responsibility to ensure the filing is made rests with the management. This is reflected in Article 13 of the decree that states that a company that does not fulfill its responsibility in filing the annual financial statements will be penalized in accordance with Law No. 3 of 1982 on Mandatory Registration of a Company. The decree also states that the management is responsible to fulfill the form and content requirements of the financial statements.

The financial statements should be prepared based on Indonesian Statement of Financial Accounting Standards and audited by a registered public accountant (except for certain state-owned enterprises that should be audited by a government auditor or the supreme audit institution). The audited financial statements should be submitted within 6 (six) months after the financial statements period ends. The package of annual financial statements to be submitted to the MoT consists of:

- 1 (one) hard copy of a set of financial statements and a company profile;
- 1 (one) copy of a letter of the company authorizing the auditor to submit the annual financial statements, should the company decide to authorize the auditor to do so; and
- a soft copy or file containing the annual financial statements in PDF (Portable Document Format) and the company profile.

The decree sets the forms to disclose considerably extensive information by the company, as there are 38 pieces of information that have to be filled out. The decree also determines that the information contained in the annual financial statements and the company profile will be made available to relevant parties in the forms of hard copy, discs, CD ROM or through the internet.

All locally incorporated downstream companies must comply with this requirement.

The practice in the upstream oil and gas industry

Despite the requirements noted above, upstream oil and gas companies in Indonesia do not file their financial statements to the MoT. The rationale is that upstream oil and gas companies in Indonesia have submitted their financial statements under the underlying contract (i.e. PSC or other type of contracts) to BP Migas on a quarterly basis. As such, the companies believe that they have met their obligation for filing their financial statements to the Government.

Currently there has been no action taken by the MoT relating to this practice, but there is no assurance that the approach taken by the MoT will not be different in the future.

It is common for a PSC Contractor to keep two set of records: one set of accounting records under PSC principles in Indonesia, and one set under the PSC Contractor's home office's promulgated GAAP, which may or may not be maintained in Indonesia. BP Migas and the ITO require a complete set of PSC accounting records to be maintained in Indonesia.

Although the PSC itself allows the company to maintain its books in US dollars, most companies also apply for approval from the ITO for US dollar book keeping. Transactions denominated in currencies other than US dollars are converted to US dollars using the prevailing exchange rate at the date of the transactions.

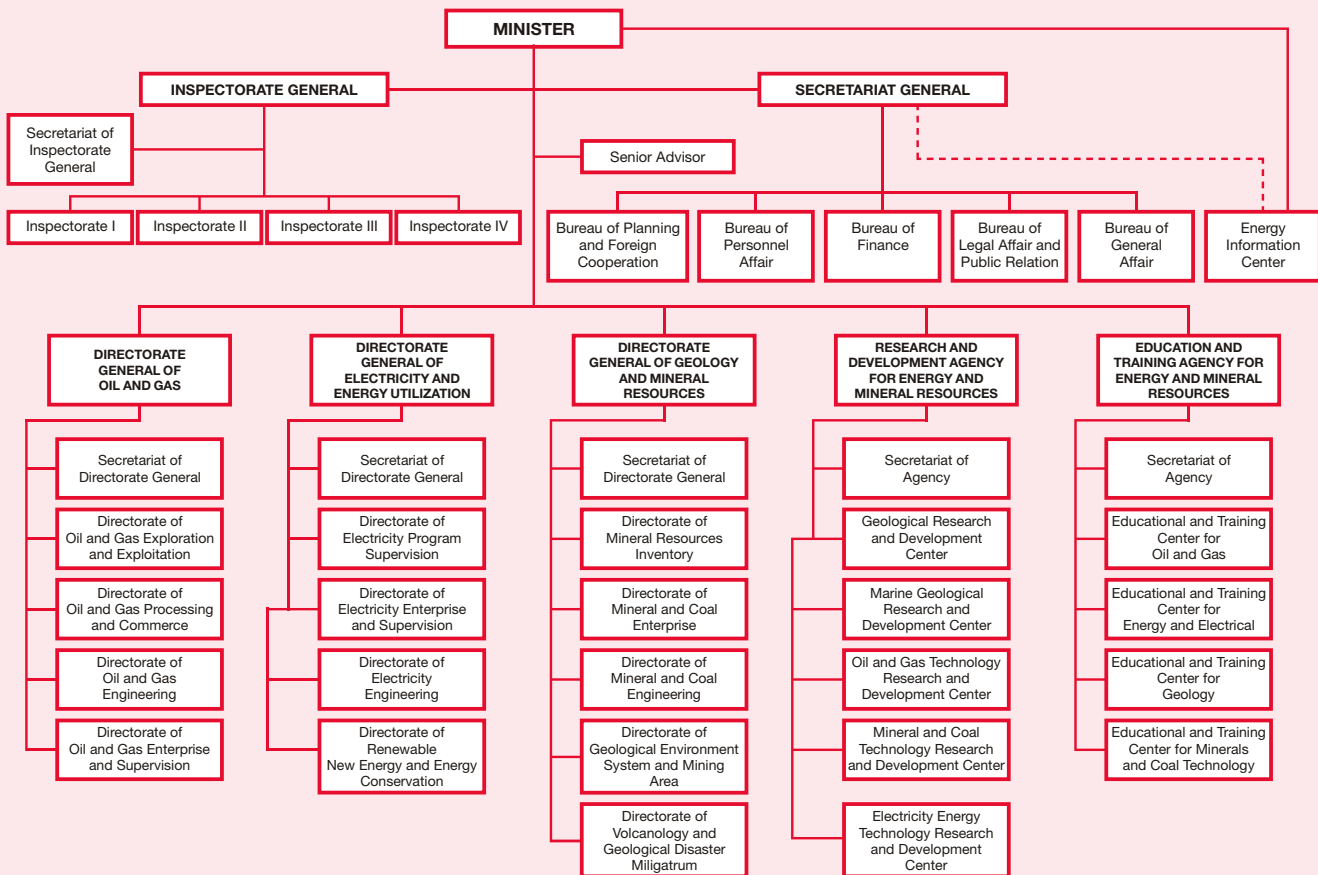
Accounting records are subject to audit by BP Migas and BPKP. Occasionally, Badan Pemeriksa Keuangan ("BPK"), another audit body that has its establishment in the Constitution and is independent to the Government, performs audits of PSCs (and other contracts). BP Migas has the right but generally does not require PSC Contractors to be audited by an independent auditor. In the case of a TAC, where the contract was signed with Pertamina, Pertamina has also the right to perform an audit on the TAC.

If a Contractor engages an independent auditor for purposes of its worldwide audit, these costs are generally recoverable if all participants of the PSC are perceived to have received a benefit from the audit, but recovery of audit fees has been disallowed if the audit only benefits the Operator.



appendices

Ministry of Energy and Mineral Resources Organization Chart



Key Roles and Responsibilities

Directorate General of Oil & Gas:

- to prepare policy on lifting calculation formula and the division there of between Local and Central Government;
- to prepare policy on gradual reduction of fuel subsidy;
- to offer new exploration and production blocks; and
- to prepare other policies on oil and gas industry.

Directorate General of Electricity & Energy Utilization:

- to prepare policy on electricity and energy utilization; and
- to implement policy on electricity and energy utilization, which is in line with other regulations.

Directorate General of Geology & Mineral Resources:

- to prepare policy on geology and mineral resources; and
- to implement policy on geology and mineral resources, which is in line with other regulations.

Inspectorate General:

- to control implementation of policy and to ensure all activities in the department complies with regulations.

Ministry of Energy and Mineral Resources Organization Chart (continued)

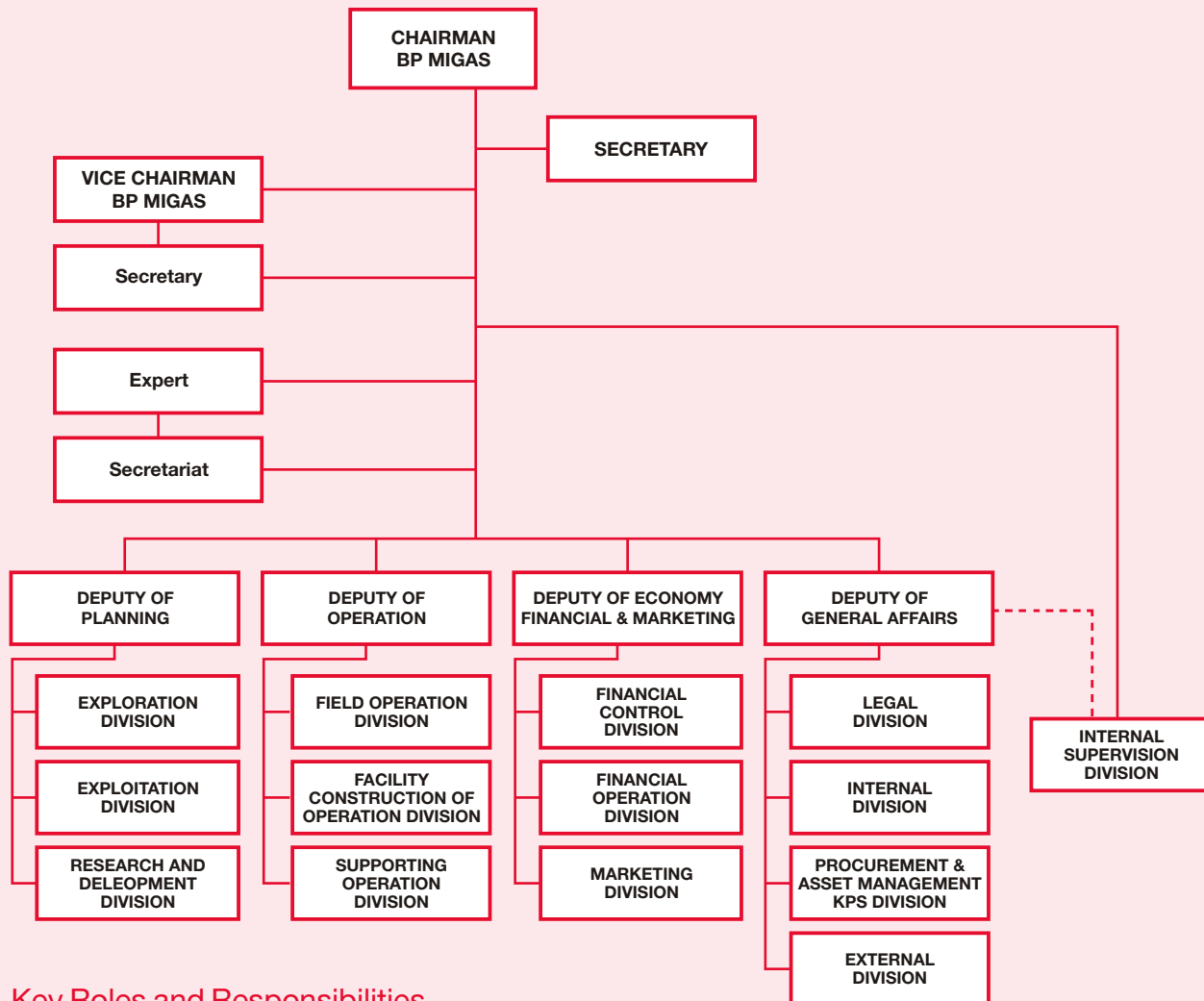
Board for Research and Developing of Energy and Mineral Resources:

- to implement research and development program on energy and mineral resources; and
- to give their contribution on policy and evaluation of energy and mineral resources.

Board for Education and Training of Energy and Mineral Resources:

- to prepare policy on education and training to develop human resources of Department of Energy and Mineral Resources.

BP Migas Organization Chart



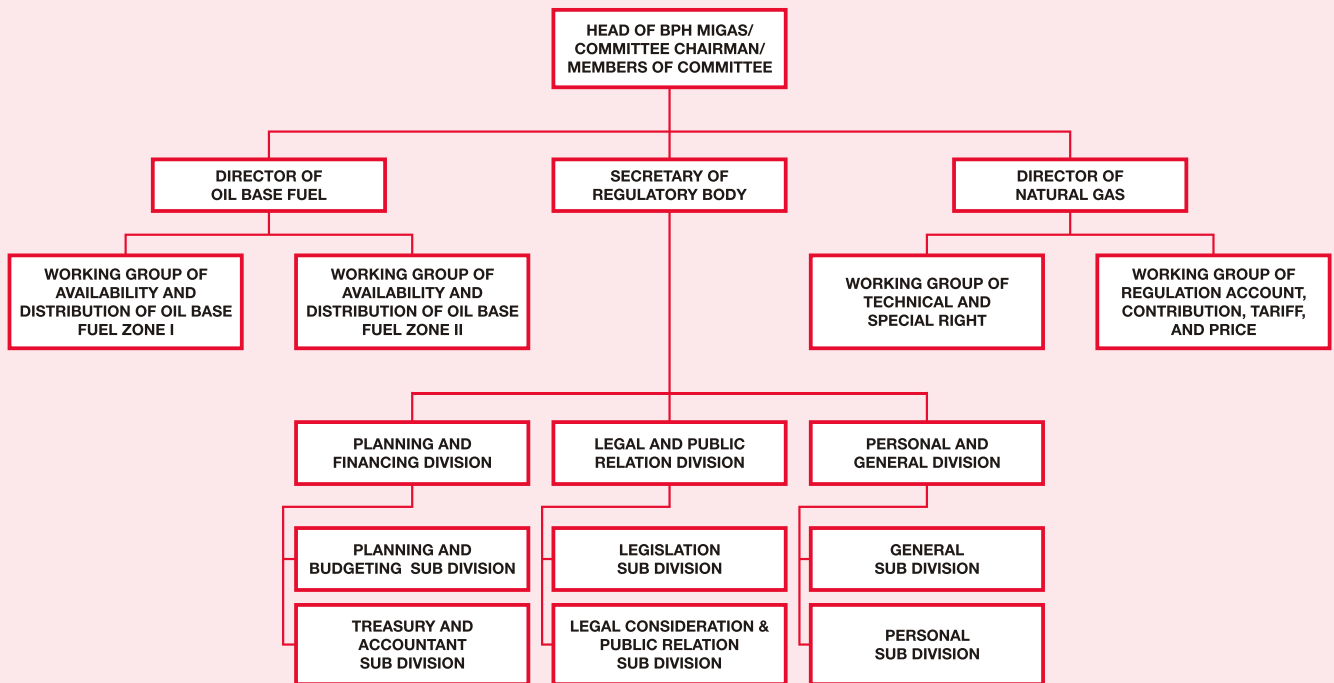
Key Roles and Responsibilities

Upstream business activities are executed and controlled through Cooperation Contracts between BP Migas and PEs/ business entities. BP Migas exercises supervision and control over execution of the Cooperation Contracts.

In summary, BP Migas has the following key mandatory roles and responsibilities:

- to provide opinions to the MoEMR regarding its policies on matters of preparation and offers of work areas and Cooperation Contracts;
- to conduct the signing of Cooperation Contracts;
- to evaluate plans for development of fields that are to produce for the first time in a given work area and to submit the evaluation to the MoEMR to obtain approval;
- to grant approval for field development plans;
- to grant approval for work plans and budgets;
- to conduct monitoring of, and reporting to the MoEMR on, the implementation of Cooperation Contracts; and
- to appoint sellers of the State’s share of crude oil and/or natural gas that can provide the greatest possible advantage to the Government.

BPH Migas Organization Chart



Source : BPH Migas

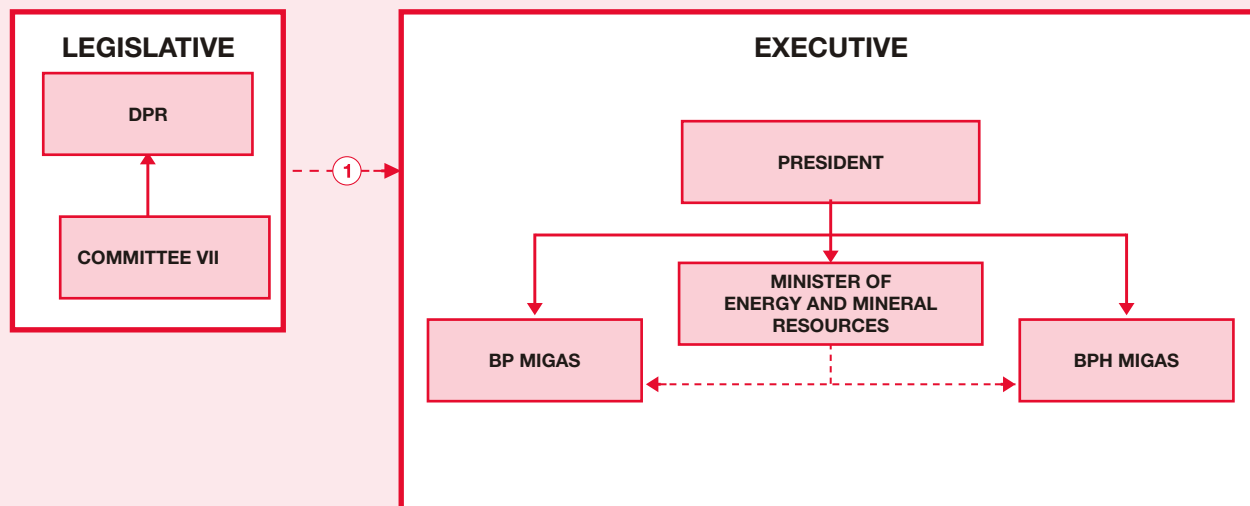
Key Roles and Responsibilities

The functions of BPH Migas are to be a single regulator who supervises the implementation of the supply and distribution of oil fuel and the transportation of natural gas via pipelines so as to ensure the supply and distribution of oil fuel and natural gas as stipulated by the Government.

In summary, BPH Migas has the following mandatory roles and responsibilities:

- to monitor and manage the supply and distribution of fuel oil;
- to establish and manage national fuel oil reserves;
- to monitor and manage the utilization of fuel oil transportation and storage facilities;
- to monitor and manage tariffs for the transportation of natural gas via pipeline;
- to monitor and manage the prices of natural gas for households and small consumers; and
- to monitor and manage activities for the transmission and distribution of natural gas.

House of Representatives/DPR - Committee VII



Legend:

- 1 Committee VII of the House of representative has oversight function for all oil and gas activities undertaken by the Government. Committee VII has the right to perform fit and proper tests in relation with the election of chairman of BP Migas;
- 2 Minister for State-owned Enterprises is the government’s representative for shareholders PT Pertamina meetings;
- 3 Oil and gas upstream regulatory body has oversight function in all Contractors including PT Pertamina; and
- 4 BPH Migas reports to the President, and the Head of BPH will also periodically report to the President through the Minister (on a semi-annual basis).

Key Roles and Responsibilities

Members of DPR are divided into eleven committees. Committee VII is charged with energy, mineral resources, research and technology and environment matters.

Committees are the main working unit in the DPR. Almost all DPR’s activities are substantially done in committees. Generally, the task and authority of committees can be summarized as follows:

1. Legislation - to prepare, study/research and complete draft laws;
2. Control - to control the implementation of laws, including the state budget (“APBN”) and regulations, to discuss and follow up results from BPK, to control Government policy, and to discuss and follow up and advise from the senate (“DPD”); and
3. Budgeting - to discuss and provide any suggestions to Government in relation to APBN.

Summary of PSC Generations

Elements	1 st Generation PSC (1965 – 1975)	2 nd Generation PSC (1976-1988)	3 rd Generation PSC (1988 - recent)	4 th Generation – 1995 East Indonesia*	New Contracts (Post Law No. 22)
FTP	None.	None.	15 – 20%	15%	10% to BP MIGAS and not to be shared with Contractor.
Cost recovery limit	40%	100%	80 – 85%	85%	90%
Income tax <ul style="list-style-type: none"> • Effective on net income • On distributable income after tax (with-holding) • Total 		<ul style="list-style-type: none"> • 45% to 35% • 20% or 11% to 13% 56%, 48%	<ul style="list-style-type: none"> • 35% to 30% • 20% or 13% to 14% 48%, 44%	<ul style="list-style-type: none"> • 30% • 14% 44%	30% 14% 44%
Equity split Government/ Contractor <ul style="list-style-type: none"> • oil • gas • oil • gas • oil • gas • oil • gas 	Determined on after tax basis: <ul style="list-style-type: none"> • 65/35% • N/A. 	Determined on after tax basis: <ul style="list-style-type: none"> • 85/15% split • 70/30% - 65/35% split. Before tax at 56%: <ul style="list-style-type: none"> • 65.909/34.091% • 31.8181/68.1819% • 20.4546/79.5454% Before tax at 48%: <ul style="list-style-type: none"> • 71.1538/28.8462% • 42.308/57.592% • 32.693/67.307% 	Determined on after tax basis: <ul style="list-style-type: none"> • 85/15% split • 70/30% - 65/35% split. Before tax at 56%: <ul style="list-style-type: none"> • 65.909/34.091% • 31.8181/68.1818% • 20.4546/78.5454%. Before tax at 48%: <ul style="list-style-type: none"> • 71.1538/28.8462% • 42.308/57.592% Before tax at 44%: <ul style="list-style-type: none"> • 73.215/26.785% • 46.429/53.571% • 37.5/62.5% 	Determined on after tax basis: <ul style="list-style-type: none"> • 85/15% split • 60/40% split. 	Determined on after tax basis (based on negotiation): <ul style="list-style-type: none"> • 75/25% split • 60/40% split.
Investment credit	0%	20%	17% to 20%	0%	17% (oil), 55% (gas)
DMO - oil	DMO was defined as 25% of Contractor share of total oil production at .20 cents/bbl.	25% of Contractor share of total oil production, full price for first years and .20 cents/bbl thereafter.	25% of Contractor share of total oil production, full price for first five years and 10% of export price thereafter.	25% of Contractor share of total oil production, full price for first five years and 25% of export price thereafter.	A floor percentage of Contractor share of total oil production, full price for first five years and 25% of export price thereafter.
DMO - gas	N/A.	N/A.	N/A	N/A.	A floor percentage of Contractor share of total gas production, weighted average contract price.

Summary of PSC Generations (continued)

Elements	1 st Generation PSC (1965 – 1975)	2 nd Generation PSC (1976-1988)	3 rd Generation PSC (1988 - recent)	4 th Generation – 1995 East Indonesia*	New Contracts (Post Law No. 22)
Depreciation • oil	No distinction between oil and gas. DDB or SLD as follows: • Fourteen years for production facilities; • 3-18 years for moveable equipment; and • 14-20 years for others.	• Seven years for capital costs (DDB) and ten year amortization of non-capital costs (switching to SLD). Post 1985 seven years DB (Balance of unrecovered capital costs is eligible for full depreciation at the end of the individual assets' useful lives).	• Seven years DB (Balance of unrecovered capital costs is eligible for full depreciation at the end of the individual assets' useful lives).	• Seven years DB (Balance of unrecovered capital costs is eligible for full depreciation at the end of the individual assets' useful lives).	• Seven years DB (Balance of unrecovered capital costs is eligible for full depreciation at the end of the individual assets' useful lives).
• Gas		• Fourteen years (switching to SLD). Post 1985 seven years DB (Balance of unrecovered capital costs is eligible for full depreciation at the end of the individual assets' useful lives), except for certain contracts still use fourteen years.	• Fourteen years (switching to SLD). Post 1985 seven years DB (Balance of unrecovered capital costs is eligible for full depreciation at the end of the individual assets' useful lives), except for certain contract still use fourteen years.	• Seven years DB (Balance of unrecovered capital costs is eligible for full depreciation at the end of the individual assets' useful lives).	• Seven years DB (Balance of unrecovered capital costs is eligible for full depreciation at the end of the individual assets' useful lives).
Interest recovery	None.	None.	Available.	Available.	Available.
Abandonment liability to PSC Contractor	None.	None.	None. Post 1995 PSCs require the Contractor to provide for abandonment.	None. Post 1995 PSCs require the Contractor to provide for abandonment.	PSCs require the Contractor to provide for abandonment.

Summary of PSC Generations (continued)

Elements	Incentive Packages		New Contracts (Post Law No. 22)
	1988, 1989, 1992	1995 Eastern Frontier*	
Oil – after tax equipment split Government/Contractor	<p>Frontier production:</p> <ul style="list-style-type: none"> • <50 MBOD = 80%:20%; • 50 – 150 MBOD = 80%:15%; and • >150 MBOD = 90%:10%. <p>Conventional area = 85%:15%</p> <p>Marginal fields and EOR in Tertiary reservoir:</p> <ul style="list-style-type: none"> • Conventional area = 80%:20%; • Frontier = 75%:25% Pre-Tertiary and deep sea (over 600 ft) production; and • Incremental split as for frontier production. <p>Field development in frontier areas = 80%:20%</p> <p>Field development in areas with water depth >1500m = 75%:25%.</p>	65/35% without investment credit.	Negotiable.
Gas – after tax equity split Government/Contractor	<p>Frontier production = 70%:30%. Conventional area = 70%:30%. Field development in conventional areas = 60%:35%.</p> <p>Field development in frontier areas = 60%:40%.</p> <p>Field development in areas with water depth >1500m = 55%:45%.</p>	60/40% without investment credit.	Negotiable.
DMO oil fee	10% to 15% of export price (after first five years).	25% of export price (after first five years).	Maximum of 25% of Contractors' share using WAP.
Investment	<p>For deep sea areas: 110% (oil) over (600 ft):55% (gas).</p> <p>Development areas:</p> <ul style="list-style-type: none"> • Pre-Tertiary reservoir rocks = 110% for oil and gas. • Water depth 200 – 1500m = 110% for oil and gas. • Water depth below 1500 m = 125% for oil and gas. 		Brown field and marginal field incentives provided.
Additional cost recovery for marginal fields			20%.

- Eastern Frontier and part of Western Frontier Having Similar Geological and Geophysical Conditions; and
- All Eastern Frontier excluding Bintuni, Salawati and Seram Basins.

Western Indonesia applies only to Offshore areas West of Sumatera, Offshore areas South of Java, any offshore areas with water depth of more than 200m and Intramontane Basins of Sumatera, West Kalimantan and Central Kalimantan.

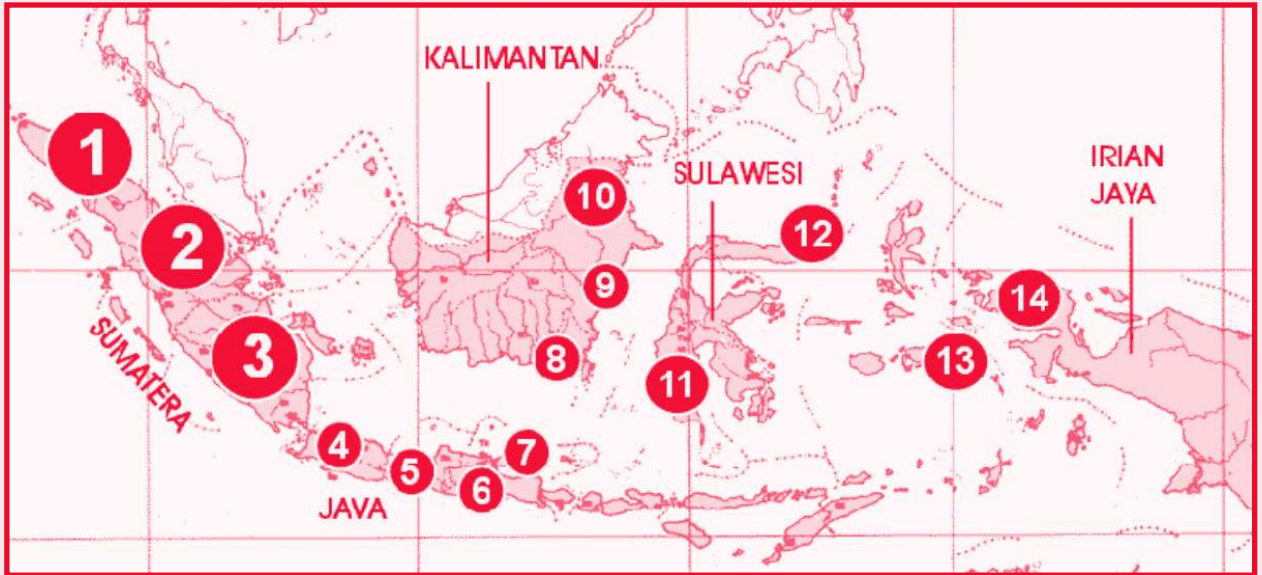
Comparison of Indonesian PSC Terms to Other Countries' PSC Terms

	Indonesia*	Brunei	China	India	Malaysia	Philippines	Vietnam
Duration:							
- Exploration	6-10 yrs.	8 yrs for onshore, 17 yrs off shore.	7 years offshore, 8 yrs on shore.	Negotiable.	5 yrs.	1 yrs seismic option, 10 yrs maximum.	5 yrs.
- Production	30 yr inclusive of exploration.	38 yrs on shore and 40 yrs for offshore inclusive of exploration.	15 years, total 30 years.	Negotiable.	4 yrs development, duration 15 yrs for oil and 20 yrs for gas.	30 yrs.	20-25 yrs.
- Extension	20-30 yrs.	30 yrs available.	Offshore-available, onshore-none.	Negotiable.	Negotiable.	Negotiable.	Negotiable.
Cost recovery limits	80-85% for oil, none for gas.	None.	Offshore-50-62.5%, on shore-60%.	None.	50% for oil, 60% for gas.	70%.	40%.
Signature bonus	Amount negotiable.	Amount negotiable.	Amount negotiable.	None.	None.	Amount negotiable.	Amount negotiable.
Production bonus	Amount negotiable.	Amount negotiable.	Amount negotiable.	None.	None.	None.	Amount negotiable.
Royalty	None.	12.5% on shore, 8-10% of shore.	Offshore: 4-12.5% for oil, 1-3% for gas, plus 5% commercial tax for both based gross revenue; On shore: 1-12.5% for oil and gas, plus 5% commercial tax based on gross revenue.	None.	10% plus 0.5% for research.	1.5-7.5%.	None.
Equity oil (in favor of the Government) after tax	85%/15%.	None.	Negotiable ranging from 10-60% in favor of the Government.	Government share ranges from 10-40%.	70-50%/0-50% depending on production.	60/40%.	84-68%/16-32% depending on production.
Equity gas (in favor of the Government) after tax	70-65%/30-35%.	None.	Negotiable.	Negotiable.	70-50%/30-50% depending on production	Negotiable.	Negotiable.
DMO	25% of equity entitlement (oil).	None.	None.	None.	None.	Pro rata amount of Contractors oil.	Government has option to take all production at market price.
Depreciation	7 yrs declining balance for oil, and 14 yrs declining balance for gas.	n/a.	6 yrs straight line depreciation.	4 yrs straight line depreciation.	10% straight line depreciation.	10% per yr.	Varies per contract.
Tax rate	44% above equity split after tax.	55%.	30% income tax, 3% local tax and 10% surcharge.	50%.	20% duty on equity oil exported, 40% tax paid by government, above equity split after tax.	None, paid out of government share.	Paid by Government, above equity split after tax.
Ring fencing	Applicable for cost recovery and tax.	-	Applicable for cost recovery, for tax - not applicable (offshore) but applicable (on shore).	Applicable for development costs, not applicable for exploration costs.	Applicable for cost recovery and tax.	Applicable except for deepwater blocks.	Applicable for cost recovery and tax.
National participation	10% undivided interest upon commerciality.	Government has option to acquire 50%.	Government has option acquire 51% upon commerciality.	Government has a 30% back-in.	Government has option up to 15%.	None, interest acquired through national participating units.	Government has an option to acquire a negotiated percent.

(*) Typical terms (up to 1995 Generation PSC)

Infrastructure Maps

MAP OF INDONESIA'S SIGNIFICANT OIL, GAS, AND GEOTHERMAL FIELDS

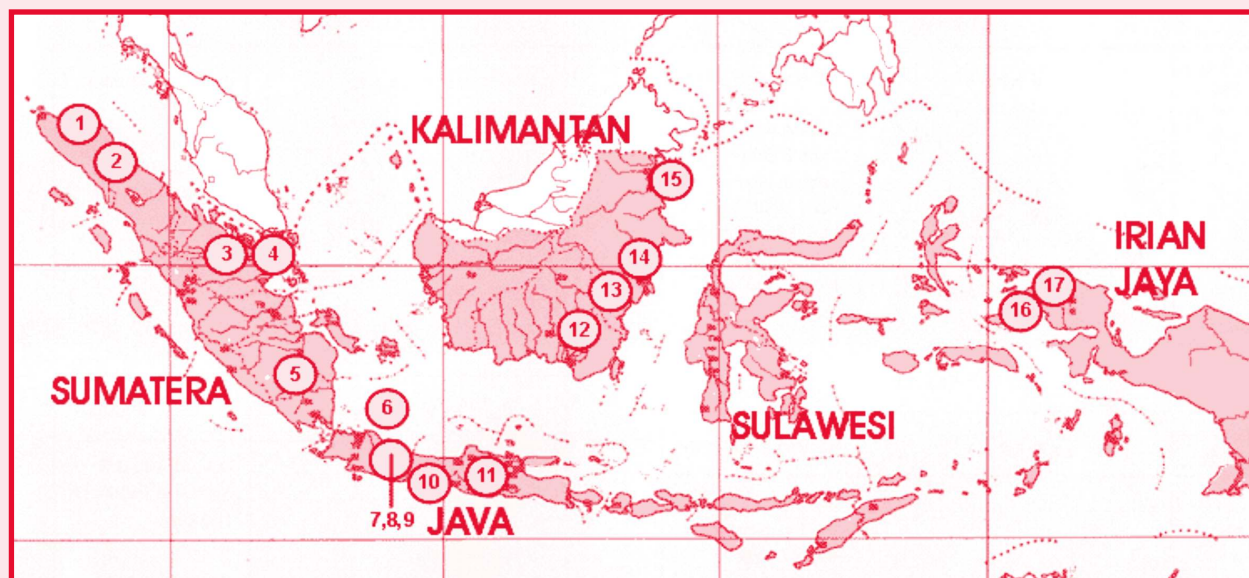


Number	Location	Oil Field	Gas Field	Geothermal
1	NORTH SUMATERA	Rantau	Arun	Sibayak
2	CENTRAL SUMATERA	Minas Duri	Libo	Lempur
3	SOUTH SUMATERA	Ti.Akar Rambe Jene	Musi Betung Rawa	-
4	WEST JAVA	Jati Barang Cemara Arjuna Arimbi Widuri -	Jati Barang Parigi Subang - -	Kamojang Darajat Cisolok Banten Wayang Windu Salak
5	CENTRAL JAVA	-	-	Dieng
6	EAST JAVA	Poleng Camar Kawengan	-	-
7	EAST JAVA (MADURA ISLAND)	-	Pangerungan	-
8	SOUTH KALIMANTAN	Tanjung	-	-
9	EAST KALIMANTAN	Attaka Bekapai -	Badak Nilam Handil	-
10	EAST KALIMANTAN	Bunyu Tarakan	-	-
11	SOUTH SULAWESI	-	Kampung Baru	-
12	NORTH SULAWESI	-	-	Lahendong
13	MALUKU	Bula	-	-
14	IRIAN JAYA	Sorong Walio Kasim Cendrawasih Klamono	Wiriagar Deep Tangguh - - -	-

Source: <http://www.tender-indonesia.com/english/index-eng.php>

Infrastructure Maps (continued)

MAP OF INDONESIA'S SIGNIFICANT REFINERIES



Number	Location	LPG Refinery	LNG Refinery	Oil Refinery	Petrochemical Refinery
1	ARUN	●	●		
2	PANGKALAN BRANDAN	●		●	
3	DUMAI	●		●	
4	SEI PAKNING			●	
5	PLAJU	●		●	●
6	ARJUNA	●			
7	BALONGAN	●		●	
8	TUGU BARAT	●			
9	MUNDU	●			
10	CILACAP	●		●	●
11	CEPU			●	
12	TANJUNG SANTAN	●			
13	BALIKPAPAN	●		●	
14	BONTANG	●	●		
15	BUNYU	●			●
16	KASIM			●	
17	ARAR	●			
TOTAL		14	2	9	3

Source: <http://www.tender-indonesia.com/english/index-eng.php>

Infrastructure Maps (continued)

FUEL DISTRIBUTION



Source: BPH Migas

DOMESTIC FUEL SUPPLY FACILITIES

Domestic distribution facilities have been added, modernized and upgraded to keep up with the country's demand for oil, gas and oil products. The domestic distribution network managed by Pertamina covers an area of five million square kilometers and includes 3,000 kilometers of pipeline grids for domestic gas transmission.

THE PRESENT FUEL SUPPLY FACILITIES COMPRISE

6 Transit Terminals

- Bungus - Padang
- Tanjung Gerem - Merak
- Lomanis - Cilacap
- Balongan - Indramayu
- Manggis - Bali
- Wayame - Ambon

5 Installations

- Belawan
- Tanjung Priok
- Pengapon
- Surabaya
- Ujung Pandang

80 Seafed Depots

22 Inland Depots

40 Aircraft Standard Filling Stations

13 Aircraft Pilot Filling Stations

Summary of Indonesian Tax Laws

Corporate Income Tax

Rates of Tax

	Taxable Income Rp.	Rate	Tax Rp.
On the first	50,000,000	10%	5,000,000
On the next	50,000,000	15%	7,500,000
Over	100,000,000	30%	-

Tax Residence

A company is treated as a “tax resident” of Indonesia if it is incorporated or domiciled in Indonesia. Although a foreign company does not lose its status as a non-resident taxpayer by operating a PE or taxable branch in Indonesia, the PE itself must assume the same tax obligations as a resident taxpayer.

Collection of Tax

Most tax resident companies, businesses and PEs are required to pay monthly instalments of tax (Article 25). These monthly instalments are generally calculated with reference to the most recent corporate tax return. Special calculations of instalments apply to new taxpayers, finance lease companies, banks and state or regional government owned companies, and certain individual traders in the consumer goods retail business with outlets in several locations (excluding restaurants and motor vehicle dealers).

Tax on interest, royalties, rent, dividends, prizes and awards, insurance premiums paid to offshore insurance companies, gains on the sale of property in Indonesia and service fees, including those to non-resident construction Contractors is collected by means of withholding tax (Article 4, Articles 23 and 26). The tax withheld is a prepayment of the recipient’s income tax liability (except Article 4, which is a final withholding tax) if the recipient is a tax resident of Indonesia and a final tax if the recipient is a nonresident.

Based on the self-assessment system, when submitting their yearly tax returns, taxpayers have to pay: the amount of tax calculated in the annual tax return (Article 29) to the extent this amount exceeds tax instalments paid during the year (Article 25), tax withheld by third parties (Article 23), tax paid on imports (Article 22), tax paid or due overseas on income obtained overseas (Article 24) and fiscal exit tax.

Tax on the income of resident taxpayers subject to final tax is generally collected by designated withholders and treated as exempt income which is excluded from the annual tax return.

Business Profits

Taxable business profits are computed on the basis of normal accounting principles as modified by certain tax adjustments.

Generally, a deduction is allowed for all expenditures incurred to obtain, collect, and maintain taxable business profits.

Summary of Indonesian Tax Laws (continued)

Deductions Disallowed

These include:

- Benefits-in-kind (BIKs) (e.g. free housing, 50% of the acquisition and maintenance costs of certain company provided cars), except food and drink provided to all employees in the work place, employee benefits required for job performance such as protective clothing and uniforms, transportation costs to and from the place of work, accomodation for ship crews and the like and the cost of providing BIKs in 'remote' areas, 50% of the acquisition and maintenance costs of cellular phones;
- Private expenses;
- Non-business gifts and aid, except 'zakat' (Islamic alms);
- Provisions/reserves, except for the provisions for doubtful debts of banks and finance lease companies, provisions for premiums and claims of insurance companies and provisions for reclamation costs of mining companies;
- Income tax payments;
- Tax penalties;
- Distributions of profits;
- Employer contributions for life, health and accident insurance and contributions to unapproved pension funds, unless the contributions are treated as taxable income of employees;
- Expenses relating to income which is taxed at a final rate, e.g., interest on loans relating to time deposits;
- 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; and
- Salaries or compensation received by partnerships or "firmas" members where their participation is not divided into shares.

Losses

Losses may be carried forward for a maximum of five years. However, for a limited category of businesses in certain regions, the period can be extended up to ten years. A carry-back of losses is not possible. Tax consolidation is not available.

Profit Distribution

Tax is withheld from dividends as follows:

i) Resident recipients

Individuals: 15% withholding tax, which is an advance payment of the recipient's income tax.

Companies: dividends received from Indonesian companies by limited liability companies incorporated in Indonesia (PT), cooperatives, and state or region-owned companies (BUMN/BUMD) are exempt from income tax if all of the following conditions are met:

- the dividends are paid out of retained earnings;
- the shareholder holds at least 25% of the paid-in capital; and
- the shareholder has an "active business" other than the shareholding.

If the above conditions are not met, the dividends are subject to 15% withholding tax.

Dividends received by "firmas", "commanditaires", foundations and similar organisations are always subject to 15% withholding tax.

ii) Non-resident recipients

20% (lower for treaty countries) withholding tax, which is the final tax liability of the non-resident recipient.

Summary of Indonesian Tax Laws (continued)

Deemed Profit Margins

The following businesses have deemed profit margins for tax purposes:

	On gross revenues	Effective income tax rate
Domestic shipping operations	4%	1.2%
Domestic airline operations	6%	1.8%
Foreign shipping and airline operations	6%	2.64%
Foreign oil and gas drilling service operations	15%	-
Certain Ministry of Trade representative offices	1%	0.44%

of export value

Toll manufacturing services in children toys rendered by a resident company to its foreign affiliates have their taxable income deemed at 7% of the total manufacturing costs excluding materials, and have taxable at a single rate of 30%.

Special Industries and Activities

As with all tax systems, there is a range of exceptions to “normal” treatment. In Indonesia, such exceptions include the tax treatment of production sharing contracts, metal, mineral and coal mining contracts of work, geothermal power plants, companies in bonded zones and bonded warehouses and foreign aid projects. Partnerships, sole proprietorships, and other business forms are also subject to special tax treatment, but are basically within the general tax framework outlined in this appendix.

Investment funds and venture capital companies enjoy certain exemptions from income tax.

Land and Building Transfers

A 5% income tax on sales value applies to companies and cooperatives for sales/transfers of land and/or buildings. The tax paid, however, can be credited against the annual corporate income tax payable. Real estate companies holding property as stock in trade are exempt. For foundations or similar organisations holding property as stock in trade, the 5% tax is final.

A notary is prohibited from signing a transfer of title deed until the tax payment has been made.

Land and building transfers are also subject to a 5% transfer duty.

Incentives

Corporate Restructuring

Tax-neutral restructuring is available for taxpayers undergoing mergers, consolidations, and certain expansions with the following requirements:

- the taxpayers have paid all outstanding tax debts;
- for taxpayers that will transfer and utilize the balance of the tax losses carried forward to the surviving company in a merger or consolidation: all fixed assets will be revalued, the taxpayer has an active business prior to the merger or consolidation, and the taxpayer receiving the transferred property is actively running the business for at least two years after completion of the merger or consolidation process.

Summary of Indonesian Tax Laws (continued)

Debt Forgiveness

For specified categories of small-scale debtors, debt-forgiveness income is not taxable. This concession can only be claimed once per annum and only where the debt is not more than Rp. 350,000,000.

Interest on Bonds

Income tax on interest earned on bonds sold on Indonesian stock exchanges is fixed at a final 20% rate for resident taxpayers and 20% (or a lower treaty rate) for non-resident taxpayers.

Banks operating in Indonesia, Government approved pension funds and mutual fund companies registered with the Capital Market Supervisory Board ("Bapepam") are exempt from this tax within 5 years of their establishment.

Tax Facilities

Investors in certain business sectors and/or locations may be eligible for the following income tax incentives:

- A reduction in net income of up to 30% of the amount invested, prorated at 5% for 6 years provided that the assets invested are not transferred within 6 years;
- Acceleration of fiscal depreciation;
- Extension of tax loss carry-forwards up to 10 years; and
- A reduction to 10% in the withholding tax on dividends paid to nonresidents.

Integrated Economic Development Areas (KAPETs)

To encourage the development of the East Indonesia Region, the following tax facilities are available to approved taxpayers:

- VAT and sales tax on luxury goods are not collected on certain transactions;
- A reduction in net income of up to 30% of the amount invested, prorated at 5% for 6 years, provided that the assets invested are not transferred within 6 years;
- Acceleration of fiscal depreciation;
- Extension of tax loss carry-forwards up to 10 years;
- A reduction of withholding tax on dividends paid to non-residents to 10%;
- Exemption from prepaid income tax (Article 22) on the importation of capital goods and other equipment directly related to production activities;
- Postponement of import duties on capital goods and equipment and goods and materials for processing; and
- Exemption from import duties for 4 years on machinery and certain spare parts.

Currently there are approximately 25 areas designated as KAPETs.

Transfer Pricing

The ITO is authorized to recalculate taxable income or deductible costs arising from transactions between related parties so that they conform with "arm's length principles".

The law authorises the ITO to enter into advance pricing agreements ("APAs"), which are valid for agreed periods, renegotiable and can involve a foreign tax authority. Unilateral or bilateral APAs may be an advantageous way of resolving transfer pricing uncertainties.

Exporters

Exporters are granted special tax concessions designed to encourage exports. These concessions, which include bonded warehouses, generally relate to VAT relief by zero-rating exported goods and the recovery of other indirect taxes (such as import duty and sales tax on luxury goods) relating to the production of goods intended for export.

Summary of Indonesian Tax Laws (continued)

Foreign Aid Projects

For main Contractors, consultants and suppliers, projects that qualify for foreign aid status (FAS) are effectively exempted from:

- Import duty on capital equipment;
- VAT and sales tax on luxury goods;
- Prepaid income tax (Article 22) on imported goods;
- Income tax and withholding tax on profit and gross revenue; and
- Employee tax for foreign employees if the project is financed with grants and the contract was signed before 23 June 2000.

In addition, the following exemptions apply to second-level Contractors, consultants or suppliers:

- Income tax and withholding tax on profit and gross revenue if the project is funded by a foreign grant and the contract was signed before 23 June 2000; and
- Employee income tax for foreign employees if the project is financed with loans or grants and the contract was signed before 23 June 2000.

FAS is granted by the National Development Planning Agency (BAPPENAS) to projects funded by foreign grants and certain foreign loans.

Revaluations of Fixed Assets

Asset revaluations are subject to 10% final tax.

Individual Income Tax

Rates of Tax

For resident individuals (general):

	Taxable Income Rp.	Rate	Tax Rp.
On the first	25,000,000	5%	1,250,000
On the next	25,000,000	10%	2,500,000
On the next	50,000,000	15%	7,500,000
On the next	100,000,000	25%	25,000,000
Over	200,000,000	35%	-

Tax is withheld from pensions, old-age security savings and severance payments at the following rates:

	Taxable Income Rp.	Rate	Tax Rp.
On the first	25,000,000	-	Nil
On the next	25,000,000	5%	1,250,000
On the next	50,000,000	10%	5,000,000
On the next	100,000,000	15%	15,000,000
Over	200,000,000	25%	-

Summary of Indonesian Tax Laws (continued)

Main Personal Reliefs

Annual non-taxable income (PTKP) for resident individuals:

	<u>Rp</u>
Taxpayer	12,000,000
Spouse	1,200,000
Each dependent (max. of 3)	1,200,000
Occupational expenses (5% of gross income, max Rp. 108,000/month)	1,296,000
Employee contribution to Jamsostek for old age security savings (2% of gross income)	Full amount
Pension expenses (5% of gross income, max Rp. 36,000/month)	432,000

Tax Residence

An individual is regarded as a tax resident if he/she:

- is domiciled in Indonesia; or
- is present in Indonesia for more than 183 days within any 12-month period; or
- is present in Indonesia within a fiscal year and intends to reside in Indonesia.

Note: The provisions of tax treaties may modify these rules.

Non-resident individuals are subject to a 20% withholding tax (Article 26, subject to treaty provisions) on Indonesian source income.

Registration and Filing

All expatriate and Indonesian individuals who receive or earn income which is higher than the PTKP threshold must register with the Indonesian Tax Office and file personal tax returns.

The personal tax return should report all of the individual's income, including compensation from employment, investment income, capital gains, overseas income and other income. Starting from 2001, it should also report the assets and liabilities of the individual.

Collection of Tax

Employers are required to withhold tax monthly (Article 21) from salaries and other compensation paid to employees based on their income and personal relief entitlement.

Pension funds approved by the Minister of Finance are required to withhold tax from pension payments using the progressive tax rates specified earlier in this appendix.

For severance payments transferred to a Manpower Severance Pay Management Board (*Pengelola Dana Pesangon Tenaga Kerja*), any interest earned from severance pay received by an employee is subject to 20% final tax if the Board is a bank or 15% withholding tax under Article 23 if the Board is not a bank.

Tax must also be withheld from fees paid to independent, individual professionals such as lawyers, notaries, accountants, architects, doctors, actuaries and appraisers. The effective tax rate is 7.5% of the fees.

Salaries or compensation received by partnership or "firmas" members are not subject to employee withholding tax so long as their participation is not divided into shares.

Summary of Indonesian Tax Laws (continued)

The Government will bear a portion of the income tax liability for employees whose monthly salaries not exceed Rp. 2,000,000. On this regard, the government will bear the income tax liability on the first Rp. 1,000,000 (or part there of) at such employees monthly salary.

Fiscal exit tax

An “exit tax” (Rp. 1,000,000 per exit from Indonesia by plane, Rp. 500,000 by ship) is another form of prepayment of an individual’s income tax. If the exit tax is borne by an employer and the overseas trip was for business purposes, the amount paid is a prepayment of the employer’s income tax, otherwise the exit tax can be credited against the individual’s income tax.

Benefits-in-kind

BIKs e.g., car, housing, education, home leave and reimbursement of an employee’s Indonesian tax liability provided by the employer, are not taxable in the hands of the employee.

The same principle applies to BIKs required for job performance such as protective clothing, uniforms, transportation costs to and from the place of work and accomodation for ship crews and the like, and the cost of providing BIKs in ‘remote’ areas.

However, BIKs are taxable in the hands of the employee if provided by:

- Mining companies and production sharing Contractors which are subject to tax under the ‘old’ tax laws;
- Representative offices of offshore companies not constituting taxpayers;
- Final-taxed companies; or
- Deemed profit companies.

Jamsostek-Social Security

Indonesia does not have a comprehensive social security system, however, there is a Worker’s Social Security program (Jamsostek).

Employers are responsible for the entire amount of contributions to the occupational accident security and death security programs. Contributions for accident security range from 0.24% to 1.74% of an employee’s wage, depending on the employer’s business (employers are classified under one of five industry categories). The contribution for death security is 0.3% of the employee’s wage.

The premium for old age security is jointly borne by the employer and the employee; the employer’s share is 3.7% of wages and the employee’s share is 2% of wages. Employee contributions to Jamsostek are collected by the employer through payroll deductions. Expatriates need not be enrolled in Jamsostek if they can provide evidence that they are covered by social security programmes of the same type in their home country.

Health maintenance security for up to 3 dependants is another feature of Jamsostek. A company which provides better company health insurance to its employees can elect not to join the health care program under Jamsostek. The contribution for the health care program under Jamsostek is 6.0% for a married employee (max. Rp. 60,000 per month) and 3.0% for an unmarried employee (max. Rp.30,000 per month).

Payments of old-age security savings to individuals by Jamsostek are subject to income tax.

Summary of Indonesian Tax Laws (continued)

Deemed Salaries

Employees in the oil and gas drilling sector are taxed on deemed salaries according to their job titles, as follows:

	<u>US\$per month</u>
General managers	11,275
Managers	9,350
Supervisors and tool pushers	5,830
Assistant tool pushers	4,510
Other crew	3,245

Land and Building Transfer

A final 5% income tax on the higher of sales/transfer value and the value forming the basis of the land and building tax (NJOP) applies to individuals for sales or transfers of land and/or buildings.

A notary is prohibited from signing a transfer of title deed until tax payment has been made.

Land and building transfers are also subject to a 5% transfer duty.

Withholding Taxes

General

Indonesian income tax is collected mainly through a system of withholding taxes. Most withholding taxes must be paid by the 10th day of the month following payment or its accrual in the books whichever is earlier. These withholding taxes are commonly referred to by the relevant article of the Income Tax (PPH) Law.

(i) Article 21 – Salaries

On salaries, as stated in Individual Income Tax.

(ii) Article 22 – Imports

On imports, payments from the State Treasury and certain state owned companies for goods, and payments for products sold/delivered locally by specific industries or Government bodies.

Taxpayers are required to prepay income tax by making payments at the rate of 2.5% (or 7.5% if the taxpayer has no import licence) of the CIF value of imports plus any import duty.

Payments from the State Treasury and certain state-owned companies such as PT Telkom, Pertamina, BPPN, Bulog, Bank Indonesia, PLN, PT Indosat, PT Garuda Indonesia, PT Krakatau Steel and state-owned banks, for goods are also subject to Article 22 tax at 1.5%, which is deducted by the State Treasury state-owned companies. Payments from industries and exporters for plantation, forest, fishery goods are also subject to Article 22 tax at 0.5%. The Article 22 tax rates for specific industries are determined by the Ministry of Finance.

Exemptions may apply for the importation of the following goods:

- Those belonging to foreign country representatives and international organisations;
- Scientific books;

Summary of Indonesian Tax Laws (continued)

- Gift packages for public worship, charities or social purposes;
- Goods for museums, zoos and similar places;
- Sample goods;
- Personal effects;
- Goods imported temporarily for re-export;
- Gold bars to be processed to produce gold jewellery for export; and
- Re-imported goods used for exhibitions or goods that have been repaired or modified.

Final-taxed companies are not subject to Article 22 tax if they have a certificate of exemption from the Tax Office.

Subject to certain requirements, a certificate of exemption may also be granted by the Tax Office provided the taxpayer can show that the estimated corporate tax liability will show an overpayment position.

(iii) Article 23 – Residents

On payment to tax residents of dividends, interest, rents, royalties, prizes and awards, and fees for technical, management or other services.

Resident companies, permanent establishments, representatives of foreign companies, organizations, and appointed individuals are required to withhold 15% tax from the following payments to other residents:

- a. On gross amounts:
 - Dividends (however, refer comments earlier under “profit distribution”);
 - Interest, including premiums, discounts, and loan guarantee fees (except payments to investment funds within 5 years from the earlier of establishment or business licence and to venture capital companies under certain conditions);
 - Royalties; and
 - Prizes and awards.

Note:

Interest on time deposits, savings accounts and discounts on Bank Indonesia certificates (SBIs) are subject to 20% final tax, except that received or earned by a pension fund registered with the Minister of Finance under certain conditions.

- b. On estimated net income (ENI):

	ENI	Actual withholding (% of gross amounts)
Rentals other than land and/or buildings		
• rental of land transportation vehicles	20%	3%
• others	40%	6%
(payments under finance leases are not subject to withholding tax)		

Summary of Indonesian Tax Laws (continued)

	ENI	Actual withholding (% of gross amounts)
Fees for services:		
• professional services	50%	7.5%
• consulting services, except construction consulting services	50%	7.5%
• construction contracting services, including installation and maintenance services provided by licensed construction companies	13.33%	2%
• construction planning services	26.67%	4%
• construction supervisory services	26.67%	4%
• technical and management services	40%	6%
• design services including interior, landscape, machine, equipment, vehicle, transportation equipment, advertising/logo and packaging design services	40%	6%
• accounting and bookkeeping services	50%	7.5%
• installation services, except those provided by licensed construction companies	40%	6%
• maintenance/repair services, except those provided by licensed construction companies	40%	6%
• support services in flight services and airport, including catering support	40%	6%
• custodial/storage/consignment services (excluding those provided by KSEI and storage rental which is already subject to final tax)	40%	6%
• securities trading services except those provided by BEJ, BES, KSEI and KPEI	40%	6%
• technology information services, including internet services	40%	6%
• telecommunication services not for public purposes	40%	6%
• waste treatment and disposal	40%	6%
• forest felling services, including land clearing	40%	6%
• drilling and support services in mining (excluding drilling services in oil/gas provided by PEs)	40%	6%
• mining and support services in non-oil/gas mining industry	40%	6%
• intermediary services	40%	6%
• appraisal services	50%	7.5%
• actuarial services	50%	7.5%
• film dubbing/mixing services	40%	6%
• toll manufacturing (“maklon”)	40%	6%
• recruitment/manpower supply	40%	6%
• computer software services	40%	6%
• pest control and cleaning services	10%	1.5%
• catering services	10%	1.5%
• services other than the above the payments for which are borne by government budgets (APBN and APBD)	10%	1.5%

Summary of Indonesian Tax Laws (continued)

(iv) Article 26 – Non-residents

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

- a. On gross amounts:
- 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;
 - Pensions and any other periodic payments; and
 - The Notional annual distributions of after-tax profits of a branch or PE. After-tax profits of a PE will be 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.

	ENI	Actual withholding (% of gross amounts)
b. On ENI:		
Insurance premiums paid to non-resident insurance companies:		
• by the insured	50%	10%
• by Indonesian insurance companies	10%	2%
• by Indonesian reinsurance companies	5%	1%
Sale of non-listed shares by non-residents	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.

(v) Article 4 – Final tax

Resident companies, permanent establishments, representatives of foreign companies, organizations, and appointed individuals are required to withhold tax from the following gross payments to residents:

Rentals of land and/or buildings 10%

Fees for the services of “small construction companies” that have obtained a “small-scale entrepreneur’s certificate” issued by an authorised institution and have a contract of not more than Rp. 1 billion:

- Construction contracting 2%
- Construction planning 4%
- Construction supervision 4%

Income on prizes from lotteries is subject to 25% final tax on the gross income amount.

Summary of Indonesian Tax Laws (continued)

Sales of Shares

Sales of listed shares are subject to withholding tax of 0.1% of the transaction value. An additional final tax of 0.5% applies to the value of founder shares at the time an initial public offering is made, irrespective of whether the shares are held or sold. Founding shareholders may elect to pay tax at normal tax rates at the time the shares are actually sold. Residents of tax treaty countries may be entitled to an exemption from these taxes.

Sales of non-listed shares by non-residents are subject to a final tax of 5% of the transaction value unless protected by a tax treaty.

Final withholding tax also applies to bank interest and to interest and discounts on publicly traded bonds.

Double Tax Treaties

Indonesia's tax treaties provide for the following reduced rates of withholding tax (1):

		Dividends		Interest	Royalties	Branch Profit Tax
		(Portfolio)	(Substantial Holdings)			
1. Australia		15%	15%	10/0%	15/10%	15%
2. Austria		15%	10%	10/0%	10%	12%
3. Belgium		15%	10%	10/0%	10%	10%
4. Brunei		15%	15%	15/0%	15%	10%
5. Bulgaria		15%	15%	10/0%	10%	15%
6. Canada		15%	10%	10/0%	10%	15%
7. China	(9)	10%	10%	10/0%	10%	10%
8. Czech Republic		15%	10%	12.5/0%	12.5%	12.5%
9. Denmark		20%	10%	10/0%	15%	15%
10. Egypt		15%	15%	15/0%	15%	15%
11. Finland		15%	10%	10/0%	15/10%	15%
12. France		15%	10%	15/10/0%	10%	10%
13. Germany		15%	10%	10/0%	15/10%	(4) 10%
14. Hungary		15%	15%	15/0%	15%	20% (5) (6)
15. India		15%	10%	10/0%	15%	10%
16. Italy		15%	10%	10/0%	15/10%	12%
17. Japan		15%	10%	10/0%	10%	10%
18. Jordan		10%	10%	10/0%	10%	20% (5)
19. Korea (North)	(3)	10%	10%	10/0%	10%	10%
20. Korea (South)		15%	10%	10/0%	15%	10%
21. Kuwait		10%	10%	5/0%	20%	10/0% (7)
22. Luxembourg		15%	10%	10/0%	12.5% (4)	10%
23. Malaysia		15%	15%	15/0%	15%	12.5%
24. Mauritius	(10)	10%	5%	10/0%	10%	10%
25. Mexico		10%	10%	10/0%	10%	10%
26. Mongolia		10%	10%	10/0%	10%	10%

Summary of Indonesian Tax Laws (continued)

			Dividends		Interest	Royalties	Branch Profit Tax
		(Portfolio)	(Substantial Holdings)				
27.	Netherlands	(2)	10%	10%	10/0%	10%	10%
28.	New Zealand		15%	15%	10/0%	15%	20% (5)
29.	Norway		15%	15%	10/0%	15/10%	15%
30.	Pakistan		15%	10%	15/0%	15% (4)	10%
31.	Philippines		20%	15%	15/10/0%	15%	20%
32.	Poland		15%	10%	10/0%	15%	10%
33.	Romania	(8)	15%	12.5%	12.5/0%	15/12.5%	12.5%
34.	Russia		15%	15%	15/0%	15%	12.5%
35.	Seychelles		10%	10%	10/0%	10%	20% (5)
36.	Singapore		15%	10%	10/0%	15%	15%
37.	Slovakia		10%	10%	10/0%	15/10%	10%
38.	South Africa		15%	10%	10/0%	10%	20% (5) (6)
39.	Spain		15%	10%	10/0%	10%	10%
40.	Sri Lanka		15%	15%	15/0%	15%	20% (5)
41.	Sudan		10%	10%	15/0%	10%	10%
42.	Sweden		15%	10%	10/0%	15/10% (4)	15%
43.	Switzerland		15%	10%	10/0%	12.5%	10%
44.	Syria		10%	10%	10%	20/15%	10%
45.	Taiwan		10%	10%	10/0%	10%	5%
46.	Thailand		15%	15%	15/0%	15/10%	20%
47.	Tunisia		12%	12%	12/0%	15%	12%
48.	Turkey		15%	10%	10/0%	10%	10%
49.	Ukraine		15%	10%	10/0%	10%	10%
50.	United Arab Emirates		10%	10%	5/0%	5%	5%
51.	United Kingdom		15%	10%	10/0%	15/10%	10%
52.	United States		15%	10%	10/0%	10%	10%
53.	Uzbekistan		10%	10%	10/0%	10/0%	10%
54.	Venezuela		15%	10%	10/0%	20/10%	10%
55.	Vietnam		15%	15%	15/0%	15%	10%

Note: Numbers in parentheses correspond to the following notes:

- (1) The withholding tax rates quoted above relate to the treaty presently in force unless indicated otherwise.
- (2) The re-negotiated tax treaty has been effective since 1 January 2004.
- (3) The tax treaty has taken effect starting 1 January 2005. This treaty also cover VAT at 10%.
- (4) Fees for technical, management and consulting services rendered in Indonesia are subject to withholding tax at the rates of 5%, 7.5%, 10% and 15% for Switzerland, Germany, Luxembourg and Pakistan respectively.
- (5) The treaty provisions are silent on the rate. The ITO interprets this to mean that the rate as regulated by Indonesian Tax Law (20%) should apply.
- (6) Tax only applies if profits are actually remitted.
- (7) Tax is only applicable if profits are remitted to a head office within the 12 month period after the profits accrue.
- (8) Includes a 10% withholding tax on commissions.
- (9) The tax treaty has taken effect starting 1 January 2004.
- (10) No longer effective starting 1 January 2005.

In addition to the above treaties, there are agreements with Saudi Arabia, Morocco, Bangladesh, Croatia, South Africa and Laos for the reciprocal exemption of taxes and customs duty on the activities of the two countries' air transport enterprises.

Summary of Indonesian Tax Laws (continued)

PE Time Test (1) (2) (3)

		Bldg. Site Construction (4)	Installation (4)	Assembly (4)	Supervisory Activities (4)	Other Services (4)
1.	Australia	120 days	120days	120 days	120 days	120 days
2.	Austria	6 months	6 months	6 months	6 months	3 months
3.	Belgium	6 months	6 months	6 months	6 months	3 months
4.	Brunei	183 days	3 months	3 months	183 days	3 months
5.	Bulgaria	6 months	6 months	6 months	6 months	120 days
6.	Canada	120 days	120 days	120 days	120 days	120 days
7.	China	6 months	6 months	6 months	6 months	6 months
8.	Czech	6 months	6 months	6 months	6 months	3 months
9.	Denmark	6 months	6 months	3 months	6 months	3 months
10.	Egypt	6 months	4 months	4 months	6 months	3 months
11.	Finland	6 months	6 months	6 months	6 months	3 months
12.	France	6 months	-	6 months	183 days	183 days
13.	Germany	6 months	6 months	-	-	-
14.	Hungary	3 months	3 months	3 months	3 months	4 months
15.	India	183 days	183 days	183 days	183 days	91 days
16.	Italy	6 months	6 months	6 months	6 months	3 months
17.	Japan	6 months	6 months	-	6 months	-
18.	Jordan	6 months	6 months	6 months	6 months	1 months
19.	Korea (North)	(6) 12 months	12 months	12 months	12 months	6 months
20.	Korea (South)	6 months	6 months	6 months	6 months	3 months
21.	Kuwait	3 months	3 months	3 months	5 months	3 months
22.	Luxembourg	5 months	5 months	5 months	-	-
23.	Malaysia	6 months	6 months	6 months	6 months	3 months
24.	Mauritius	(7) 6 months	6 months	6 months	6 months	4 months
25.	Mexico	6 months	6 months	6 months	6 months	91 days
26.	Mongolia	6 months	6 months	6 months	6 months	3 months
27.	Netherlands	(5) 6 months	6 months	6 months	6 months	3 months
28.	New Zealand	6 months	6 months	6 months	6 months	3 months
29.	Norway	6 months	6 months	6 months	6 months	3 months
30.	Pakistan	3 months	3 months	3 months	3 months	-
31.	Philippines	6 months	3 months	3 months	6 months	183 days
32.	Poland	183 days	183 days	183 days	183 days	120 days
33.	Romania	6 months	6 months	6 months	6 months	4 months
34.	Russia	3 months	3 months	3 months	3 months	-
35.	Seychelles	6 months	6 months	6 months	6 months	3 months
36.	Singapore	183 days	183 days	183 days	-	90 days
37.	Slovakia	6 months	6 months	6 months	6 months	91 days
38.	South Africa	6 months	6 months	6 months	6 months	120 days
39.	Spain	183 days	183 days	183 days	183 days	3 months
40.	Sri Lanka	90 days	90 days	90 days	90 days	90 days
41.	Sudan	6 months	6 months	6 months	6 months	3 months
42.	Sweden	6 months	6 months	6 months	6 months	3 months

Summary of Indonesian Tax Laws (continued)

		Bldg. Site Construction (4)	Installation (4)	Assembly (4)	Supervisory Activities (4)	Other Services (4)
43.	Switzerland	183 days	183 days	183 days	183 days	-
44.	Syria	6 months	6 months	6 months	6 months	183 days
45.	Taiwan	6 months	6 months	6 months	6 months	120 days
46.	Thailand	6 months	6 months	6 months	6 months	183 days
47.	Tunisia	3 months	3 months	3 months	3 months	3 months
48.	Turkey	6 months	6 months	6 months	6 months	183 days
49.	Ukraine	6 months	6 months	6 months	6 months	4 months
50.	United Arab Emirates	6 months	6 months	6 months	6 months	6 months
51.	United Kingdom	183 days	183 days	183 days	183 days	91 days
52.	United States	120 days	120 days	120 days	120 days	120 days
53.	Uzbekistan	6 months	6 months	6 months	6 months	3 months
54.	Venezuela	6 months	6 months	6 months	6 months	-
55.	Vietnam	6 months	6 months	6 months	6 months	3 months

Note: Numbers in parentheses correspond to the following notes:

- (1) All tax treaties contain provisions defining the concept of a PE and stipulating time tests, within which an entity can carry on activities in a contracting state without creating a PE. Where an entity's corporate presence exceeds the time test as stipulated in the relevant treaty, a PE will be deemed to exist. This results in increased obligations in terms of filing and taxes payable as PEs are considered local taxpayers. As such, a company's presence in Indonesia should be carefully monitored and kept within time test limits if it wishes to avoid creating a PE in Indonesia.
- (2) In the absence of a treaty, Indonesian domestic tax law allows the furnishing of services in whatever form by employees or other people for up to 60 days in any 12-month period, without creating a PE in Indonesia.
- (3) To use tax treaty facilities, the Indonesian payer should self-assess and obtain a certificate of residence and other necessary supporting documents from the foreign payee.
- (4) There are slight variations in the wording of the PE provisions in each treaty, but the time tests generally relate to various activities which continue for a stipulated period, usually within the time frame of any consecutive 12-month period except Japan the calendar year.
- (5) The re-negotiated tax treaty has been effective since January 1, 2004.
- (6) The tax treaty has been effective from January 1, 2005.
- (7) The tax treaty is no longer effective starting January 1, 2005.

Capital Allowances

Depreciation

Expenditures incurred in relation to assets with a beneficial life of more than one year are categorised and depreciated from the month of acquisition by consistently using either the straight-line or declining-balance method as follows:

1. **Category 1** - 50% (declining-balance) or 25% (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.

Summary of Indonesian Tax Laws (continued)

2. **Category 2** - 25% (declining-balance) or 12.5% (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, machinery for agriculture, plantation, forestry, fishery, 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.
3. **Category 3** - 12.5% (declining-balance) or 6.25% (straight-line) on assets with a beneficial life of 16 years. Examples of assets in this category are machinery for general mining other than oil and gas, machinery 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.
4. **Category 4** - 10% (declining-balance) or 5% (straight-line) on assets with a beneficial life of twenty years. Example of assets in this category are heavy machinery for construction, locomotives, railway coaches, heavy vessels, and docks.
5. **Building Category** - 5% (straight-line) on assets in the permanent building category with a useful life of 20 years; or 10% (straight-line) on assets in the non-permanent building category with a useful life of 10 years. Included in the cost of buildings is the land and building transfer duty (BPHTB) on building rights.

Lists of the assets included in each category are set out in Minister of Finance decrees. Separate lists of assets and depreciation rates for the oil and gas sector are also specified in a Minister of Finance decree.

Special rules apply to assets used in certain areas for certain industries and KAPETs.

Amortisation

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

1. 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 - Four years
 - Category 2 - Eight years
 - Category 3 - Sixteen years
 - Category 4 - Twenty years

The category is determined on the basis of the nearest useful life (i.e. an intangible asset with a useful life of 6 years may be Category 1 or Category 2, while an intangible asset with a useful life of 5 years is Category 1).

2. Costs of incorporation and expansion of the capital of an enterprise are claimed in full in the year the expenditure is incurred or are amortised using either the declining-balance or straight-line method at the following rates:
 - Category 1 - 50% declining-balance; 25% straight-line
 - Category 2 - 25% declining-balance; 12.5% straight-line
 - Category 3 - 12.5% declining-balance; 6.25% straight-line
 - Category 4 - 10% declining-balance; 5% straight-line

Summary of Indonesian Tax Laws (continued)

3. Costs incurred for acquiring the right to oil and natural gas concessions having a beneficial life greater than one year are amortised using the production-unit method.
4. Costs incurred for acquiring mining rights, forest concessions, and other rights to exploit natural resources and natural products with a beneficial life of more than one year are amortised using the production-unit method but not exceeding 20% per annum.
5. Costs incurred before commercial operations commence with a useful life of more than one year are capitalised and amortised according to the rates in paragraph 2.

Asset Transfers

For transfers of property or rights, the remaining book value of the property or rights is deducted and the amount received as compensation constitutes income in the year of the transfer.

Revaluation of Fixed Assets

Resident corporate taxpayers and PE may revalue any income-earning tangible fixed asset (not intended for transfer or sale) on a selective basis provided:

- The taxpayer has no outstanding tax obligations;
- The taxpayers are not keeping accounts in US dollars; and
- The revaluation is based on fair value as confirmed by a Government recognised assessor.

The difference between the fair market value and the tax book value of the revalued assets is offset against any current and prior year tax losses. A net gain is then subject to 10% final tax. Taxpayers conducting "business combinations" can spread payment of the final tax over 5 years.

Additional final income tax of 20% is imposed if the revalued assets are sold or transferred before the end of their new useful lives (does not apply to assets transferred to the Government or transferred in the course of a tax-free business merger, "combination" or "expansion").

Stamp Duty

Stamp duty is nominal, at either Rp.6,000 or Rp.3,000 on certain documents.

Examples of documents which are subject to stamp duty include:

- a. Letters of agreement and other letters (such as authorization letters, letters bestowing gifts, declarations) which are prepared for the purpose of being used as evidence of act, fact, or condition of a civil nature.
- b. Notarial deeds and their copies.
- c. Deeds prepared by Pejabat Pembuat Akta Tanah (officers who are responsible for the preparation of land deeds), including their copies.
- d. All documents bearing a sum of money which:
 - state the receipt of money
 - state the recording or deposit of money in a bank
 - contain notification of a bank balance
 - contain the acknowledgement of debt wholly or partly paid or compensated
 - are in the form of valuable documents such as drafts, promissory notes, acceptances

Summary of Indonesian Tax Laws (continued)

- are in the form of securities in whatever name or form
 - are in the form of cheques.
- e. Documents to be used as instruments of evidence before a court:
- ordinary letters or internal papers
 - papers originally exempt from stamp duty on the basis of their purpose of use, if they serve other aims or are used by other parties, and deviate from their original purpose.

The Rp.6,000 rate is applicable to (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 Rp.1 million. Values below Rp.250,000 are not subject to stamp duty. For cheques, the rate is Rp.3,000 regardless of the money value stated.

Land and Building Tax

Land and building tax is payable annually on land, buildings, and permanent structures. The effective rates are nominal, typically not more than 0.1% per annum of the value of property. An effective rate of 0.2% is applicable to certain tax objects such as forestry, plantations, mining and other objects that have a value of more than Rp1 billion.

The sales value of property is determined every three years by the Minister of Finance, except in certain regions, where it is determined annually according to development in the region concerned, for example, the addition of toll roads.

Special calculation formulas apply to plantations, mining and forestry businesses. The thresholds of non-taxable tax objects are stipulated by each regional government but may not be more than Rp 12,000,000. Land and buildings used for religious worship, social affairs, health, national education and culture, graveyards, archeological relics, protected forests, nature reserves, tourist forests, national parks, pastures under village control and other state lands, diplomatic offices and consulates (on a reciprocal basis) and designated international organisations are non-taxable. A 50% reduction is given for hospitals.

Taxpayers are those who have “rights over land”, “possess or control buildings” or “obtain benefits from land or buildings”. The law is not clear on whether the landlord or tenant is liable, but the tenant may be taxed if the landlord cannot be traced.

Objections to assessments may be submitted to the Head of the Tax Office for Land and Building Tax (KPP-PBB) in the area where the property is located, who has 12 months to make a decision.

Land and Building Transfer Duty

BPHTB of 5% is payable by an individual or corporate entity obtaining rights to land or buildings. The 5% rate is computed on the transfer value or the value forming the basis of the NJOP, whichever is higher.

Summary of Indonesian Tax Laws (continued)

BPHTB applies only if the acquisition value is greater than certain value which is stipulated by each regional government but may not be more than Rp. 60,000,000. The non-taxable tax object acquisition value of rights acquired due to an inheritance is stipulated regionally at no more than Rp. 300,000,000.

A number of exemptions or reductions apply, including:

- Transfers to diplomatic representatives and certain international organisations;
- Transfers intended for general government activities or in the public interest;
- Rights conversions without changes in the name of ownership;
- Wakaf (religious donations);
- Transfers for religious purposes;
- Where the land or buildings are used for social or educational activities that are non-profit-seeking – 50% reduction;
- Grants to blood relatives in a straight line, either one step above or below – 75% reduction;
- Where the land and/or buildings are transferred in connection with a merger – 50% reduction; and
- Where the land or buildings are auctioned and the purchase price is lower than the NJOP – reduction equal to the difference between the transfer duty according to the NJOP and the transfer duty according to the auction price.

A notary is prohibited from signing a transfer of title deed until duty payment has been made.

Value Added Tax

General

VAT is levied at 10% on imported and locally produced goods, on most services and also at the retail level, including disposals and transfers of assets not originally intended for resale whose input VAT paid at the time of purchase could be credited. VAT is also levied on deliveries of goods from a head office to branches or between branches and on deliveries to intermediaries, except for companies allowed or required to centralize their VAT reporting.

Companies registered with the "PMA", "Badora", Go Public, LTO, and MTO tax offices, are required to centralize their VAT reporting. Other companies can only centralize their VAT reporting based on special DGT approval.

In principle, input VAT on purchases related to a taxpayer's business may be credited against output VAT due on sales with some exceptions, most notably VAT on expenditures associated with making exempt supplies and employee benefits-in-kind. Input VAT on imports paid by an importer on a customs underpayment assessment issued by the Customs Office may also be credited against output VAT. Any excess of output VAT over input VAT must be paid to the Tax Office by the 15th of the following month. A monthly tax return must be lodged by the 20th of that month.

VAT Refund

Where input VAT exceeds output VAT, a refund of input VAT can be requested on a monthly basis or the excess amount can be credited against the output tax in future periods. The approval periods for refunds are determined as follows:

- a. Certain qualifying taxpayers will receive approval within 1 month.
- b. Exporters and suppliers to VAT collectors who do not qualify for the one month approval will receive approval within two months.

Summary of Indonesian Tax Laws (continued)

- c. Other taxpayers will receive approval within 6 months.
- d. If the Tax Office elects to audit all taxes, the refund in all cases must be determined within twelve months.

Except for (a), VAT refunds are subject to the tax authority's audit/review before payment.

Crediting Input VAT

An input tax credit must be claimed not later than three months after the end of the tax period in which it should have been claimed. If this deadline is missed, the credit can still be claimed, but only by submitting an amended VAT return for the period when it should have been claimed. An input VAT invoice issued late for more than three months, is considered as an invalid tax invoice. Therefore, it is not creditable.

Exemptions

The following goods and services are not subject to VAT by legislation.

Goods

- a. mining or drilling products extracted directly 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;
- b. basic commodities needed by society – rice, salt, corn, sago and soya beans;
- c. food and drink served in hotels, restaurants and the like; and
- d. money, gold bars and securities.

Services

- a. medical health services;
- b. social services such as orphanages and funeral services;
- c. mail services with stamps;
- d. banks, insurance, and finance leasing services;
- e. religious services;
- f. educational services;
- g. commercial art and entertainment services which are taxed under regional entertainment tax;
- h. broadcasting services for advertising;
- i. public transportation on land and water and international air transport;
- j. manpower services;
- k. hotel services; and
- l. public services provided by the Government.

The following goods and services are categorised as strategic goods that are exempted from the imposition of VAT, under certain circumstances, on their import and delivery:

- a. Certain machinery and factory equipment used to manufacture taxable goods (excluding spare parts)
- b. agricultural, plantation and forestry products, animal husbandry products, including hunting and trapping, and cultivation or fishery products, including the catching and cultivation of fish produced by farmers;
- c. electricity, except household electricity exceeding 6,600 watts;
- d. piped water, or through drinking water tankers;
- e. cattle, poultry and fish feed, and the raw materials for manufacturing cattle, poultry and fish feed; and
- f. seeds and seedlings for agricultural, plantation, forestry, farm and animal husbandry products.

Summary of Indonesian Tax Laws (continued)

In addition, imports and local deliveries of the following goods or services are exempted from VAT:

- a. weapons, ammunition and transportation for use by the armed forces which are not yet produced in Indonesia;
- b. polio vaccines for the National Immunization Program;
- c. general textbooks and religious books;
- d. ships and spare parts imported for use by national commercial shipping companies or national fishing companies;
- e. services received by national commercial shipping companies or national fishing companies, including ship rental, seaport services and ship maintenance or docking services;
- f. aircraft and spare parts imported for use by national commercial airline companies;
- g. services received by national commercial airline companies including aircraft rental and maintenance services;
- h. trains and spare parts imported by PT Kereta Api Indonesia;
- i. train maintenance and repair services received by PT Kereta Api Indonesia;
- j. low-cost housing, modest flats and student accommodation;
- k. services rendered for the construction of low-cost housing, modest flats and places of worship; and
- l. leasing services for low-cost housing.

VAT in Batam

For years Batam has been treated as a special bonded zone with more VAT facilities than those granted to ordinary bonded zones. After several times of deferment, certain steps have finally been taken to turn Batam into an ordinary bonded zone. Hence, except for companies qualifying for a bonded zone status, starting 1 January 2004 VAT and luxury sales goods tax (LST) has been applied in Batam as follows:

- Starting 1 January 2004 VAT shall be imposed on deliveries of automotive, cigarette and liquor products
- Starting 1 March 2004 the list of taxable goods shall be extended to include electronic products
- No more goods and services have been added to the list of taxable goods and services after 1 March 2004 despite the original target to extend the list every 6 months.

VAT Collectors

During 2004 only the State Treasury qualified as a VAT collector. This situation continued up to 1 February 2005 when PSC Contractors were reappointed as VAT collectors. Since then VAT collectors have comprised the State Treasury and PSC Contractors. Given the change, the ordinary input - output mechanism should be applicable for any transaction involving VAT except those requiring payments from the State Treasury and PSC Contractors.

Self-Assessed VAT

Where an Indonesian taxpayer receives and utilises certain services from outside Indonesia, including royalties, the recipient of the services must self-assess, report, and pay VAT by the 15th of the following month. The VAT due under this procedure is available for input tax credit, subject to the normal VAT input tax rules.

Special Rates of Output VAT

Special rates apply to certain goods and services. For example, VAT on:

1. services rendered by a travel agent are levied at 1% of invoice value;
2. cigarettes sold by manufacturers are levied at 8.4% of invoice value;
3. courier services are levied at 1% of invoice value;
4. independent construction (self-building) is levied at 4% of total costs incurred or paid, exclusive of the acquisition price of land;
5. factoring services is levied at 0.5% of the total fee, including service fees, provisions, and discounts;

Summary of Indonesian Tax Laws (continued)

6. sales of second-hand motor vehicles by motor vehicle dealers is levied at 1% of total sales value.
7. redemption of VAT on "paid" stickers on audio tapes and video recordings;
8. own use and free gifts of taxable goods and/or services are levied at 10% of the cost of sales.

VAT Invoices

VAT invoices must contain the following information:

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

Documents that can be considered VAT invoices are:

- a. import declarations (PIBs) together with tax payment slips or tax collection slips issued by Customs;
- b. export declarations (PEBs);
- c. instruction letters for the distribution of milled flour from Bulog or Dolog;
- d. Pertamina delivery invoices;
- e. telephone/telecommunications service bills, electricity bills, airway bills, or delivery bills issued for domestic air transportation services; and
- f. sales invoices issued for deliveries of port services.

VAT Base

Generally, tax imposition base is the sales price or compensation paid.

Luxury sales tax is not included in the tax imposition base for importers or manufacturers.

Administrative Penalties

An administrative penalty of 2% of the tax imposition base is applied in the following circumstances:

- a. A qualified taxpayer has not registered as a VAT enterprise ("PKP").
- b. A taxpayer issues VAT invoices without being confirmed as a VAT enterprise.
- c. A VAT enterprise does not issue VAT invoices or issues incorrect, late, or incomplete VAT invoices.

If a tax overpayment is incorrectly used as an offset or the 0% rate was incorrectly applied, a 100% penalty will be imposed in addition to the tax itself.

Sales Tax on Luxury Goods

Sales tax is levied at 10%, 20%, 30%, 40%, 50%, 60% and 75% on imported and domestically produced luxury goods as stipulated by the Minister of Finance.

Sales tax is collected at the import and manufacturing levels, not at the end-consumer level.

The monthly payment and reporting deadlines are the same as those for VAT, i.e., the 15th of the following month for payment and the 20th for reporting.

Summary of Indonesian Tax Laws (continued)

Taxable items include the following (note that a number of items are taxed at several rates and specific rates and specific advice should be sought in relation to the appropriate rate):

- (1) Taxable at the 10% rate:
 - a) fermented cream or milk, nuts or cocoa, yoghurt, kephir, whey, cheese, butter
 - b) bottled/package fruit or vegetable juices
 - c) bottled/package non-alcoholic drinks including soda water
 - d) certain household utensils, coolers, heaters, and certain TV receivers
 - e) equipment and accessories for sports
 - f) air conditioners
 - g) visual recording or reproducing apparatuses, radio receivers
 - h) photography, cinematography apparatuses and their equipment
 - i) motor vehicles with more than 10 to 15 seats using petrol, diesel or semi-diesel
 - j) motor vehicles with less than 10 seats, except sedans and station wagon with 4x2 wheel drive, using petrol, diesel or semi-diesel fuel with a cylinder capacity of less than 1500 cc

- (2) Taxable at the 20% rate:
 - a) certain household utensils, coolers, certain heaters, except those under (1)
 - b) luxury apartments, condominiums, town houses
 - c) air conditioning units, washing machines, dryers, electromagnetic instruments, and musical instruments
 - d) perfumes
 - e) certain carpets, except those made from choir, silk or wool, or animal fur or feathers
 - f) motor vehicles with less than 10 seats, except sedans and station wagons with 4X2 wheel drive, using petrol, diesel or semi-diesel with a cylinder capacity of 1500 cc to 2500 cc
 - g) motor vehicles with double cabin

- (3) Taxable at the 30% rate:
 - a) ships, vessels and water vehicles, dugouts, canoes, except those for government and public use
 - b) equipment and accessories for sports, except those under (1)
 - c) motor vehicles in the form of sedans/station-wagons, using petrol diesel or semi-diesel with a cylinder capacity of up to 1500 cc
 - d) motor vehicle, beside sedans and station wagon

- (4) Taxable at the 40% rate:
 - a) certain alcoholic beverages
 - b) goods made of leather or imitation leather
 - c) silk or wool carpets
 - d) goods made of crystal for table, kitchen, home or office decoration
 - e) goods made of precious metals and/or precious metals or combinations thereof
 - f) ships, vessels, and water vehicles, except those for government and public use and those under (3)
 - g) balloons and private aircraft
 - h) bullets and other weapons, except those for government use
 - i) footwear
 - j) household and office furniture and fittings
 - k) goods made of porcelain, land, chinese land or ceramic
 - l) goods made of stone

Summary of Indonesian Tax Laws (continued)

- m) motor vehicles, besides sedan and station wagons using petrol with 4X2 wheel drive and having a cylinder capacity of 2500 to 3000 cc
 - n) motor vehicles with 4X4 wheel drive using petrol and having a cylinder capacity of 1500 cc to 3000 cc
 - o) motor vehicles using diesel or semi-diesel in the forms of sedan or station wagon, and beside sedan or station wagon using petrol with 4x2 wheel drive and having a cylinder capacity of 1500 cc to 2500 cc
- (5) Taxable at the 50% rate:
- a) carpets made of animal fur or feathers
 - b) aircraft, except those under (4) and except those for government and public use
 - c) equipment and accessories for sports, except those under (1) and (3)
 - d) weapons and shooting equipment, except those for government use
 - e) all motor vehicles used as golf carts
- (6) Taxable at the 60% rate:
- a) 2-wheeled motor vehicles with a cylinder capacity of 250 cc to 500 cc
 - b) special motor vehicles used for the snow, beach, mountain and the likes.
- (7) Taxable at the 75% rate:
- a) alcoholic beverages, except those under (4)
 - b) goods made of precious metal, precious stones, pearls or combinations thereof, except those under (4)
 - c) luxury yachts, except those for government and public use
 - d) motor vehicles with less than 10 seats using petrol and having a cylinder capacity of more than 3000 cc or using diesel or semi-diesel and having a cylinder capacity of more than 2500 cc
 - e) 2-wheeled motor vehicles with a cylinder capacity more than 500 cc
 - f) trailers and semi-trailers for caravans for camping or home use

Luxury goods exempt from the imposition of luxury sales tax are:

- a) motor vehicles used as ambulances, police vans, fire-engines, hearses, and public transportation
- b) motor vehicles used for the official duties of State protocol
- c) motor vehicles with more than 10 seats using diesel or semi-diesel of all cylinder capacities used for the official duties of the Indonesian Armed Forces/State Police

If the luxury goods which are exempted from luxury sales tax are transferred/sold within 5 years or are not to be used for main purposes, the luxury sales tax exempted must be paid within 1 month after the goods are transferred/sold or not used for main purposes, otherwise the ITO may impose penalties for late or non-payment of such tax.

Regional Taxes

This appendix does not cover regional taxes and local charges as determined by Provinces and Regencies/Cities.

Summary of Indonesian Tax Laws (continued)

Underpayment of Tax

Where a tax assessment has been issued, an interest penalty is chargeable on tax not paid by the due date, calculated from the due date until it is paid. The rate of interest is 2% per month for a maximum of 24 months.

Administrative surcharges levied on under reported tax:

- 50% of the income tax not paid or underpaid in a tax year if a tax return is not filed or not filed within the specified period as stated in the reminder letter issued by the Tax Office.
- 100% of the income tax not withheld or underwithheld, not collected or undercollected, or not deposited or underdeposited.
- 100% of any VAT or sales tax on luxury goods not deposited or underdeposited, in certain circumstances.

If a taxpayer corrects its own tax return (2-year limit after the tax is due or after the end of tax period or tax year) with the result that the tax owed increases, a penalty in the form of 2% interest per month is applied to the total tax underpayment (to a maximum of 48%), calculated from the end of the filing date for the period until the date of payment arising from the corrected tax return.

Even though a tax return has been corrected or the 2-year limit has passed, a taxpayer may declare an error in the tax return as long as the Tax Office has not issued a tax assessment and the revision results in a higher taxable profit or a lower tax loss. Any tax underpaid and the administrative surcharge of 50% of the tax underpaid should be paid before the tax return is submitted.

Filing of Tax Returns

A tax return and its attachments not submitted completely will be considered not to have been submitted at all.

Monthly tax returns (corporate/individual Article 25 income tax, VAT, Article 21 employee tax, Article 4(2), Article 15, and Articles 23/26 withholding tax) must be filed by the 20th of the following month. Individual resident taxpayers who do not have any business activities and all of whose regular income has been subject to Article 21, 22, 23 and final withholding taxes are not required to file monthly income tax returns.

Taxpayers who issue 500 or more standard VAT invoices a month must report the VAT return attachments electronically in diskette, digital data storage (DDS), digital audio tape (DAT) or compact disc (CD) format.

Tax payments, if any, for the above monthly tax returns must be made by the 10th of the following month for Article 21 and Article 23/26 and by the 15th of the following month for Article 25 and VAT. VAT collectors must also pay their tax due by the 15th.

Annual corporate income tax returns must be filed within 3 months of the end of a book year.

Annual employee and individual income tax returns must be filed by 31 March of the following year.

Tax payment, if any, for the above annual tax returns must be made by the 25th of the month in which the return is filed.

Summary of Indonesian Tax Laws (continued)

No annual tax returns are due for VAT, Article 4(2) and Article 23/26 withholding tax.

Effective from 1 January 2005, companies registered with certain district tax offices (LTO, MTO, PMA, Badora, and state-owned company tax service offices) are required to file tax returns in digitalized form (e-tax return).

The administrative fines for late filing are Rp.50,000 per monthly tax return and Rp.100,000 per annual tax return.

Recording and Accounting

Generally, accounts and records must be kept in Indonesia, denominated in rupiah, and composed in Indonesian or a foreign language approved by the Minister of Finance.

PMA companies, permanent establishments of foreign companies, production sharing Contractors, contract of work companies and other entities with foreign affiliations are allowed to keep records in English and accounts in US dollars, subject to approval from the ITO.

PMA companies, permanent establishments, and other entities with foreign affiliations must obtain this approval at least 3 months before the beginning of the relevant accounting year or within 3 months of a new taxpayer being established.

Production sharing Contractors and contract of work companies must notify the Tax Office in writing at least one week before US dollar/English bookkeeping is adopted.

A taxpayer who uses English (only) in its bookkeeping has to submit written notification to the Tax Office within 3 months after the beginning of the book year when English bookkeeping commences.

Tax Audits, Assessments, Objections, and Appeals

Tax Audits and Assessments

The Indonesian tax system is based on the principle of "self-assessment". However, the Tax Office has the rights to issue an assessment within a 10-year limitation period ("statue of limitation"), if, after an audit, it considers that the taxpayer has not self-assessed the correct amount or if no tax return has been lodged. However, an assessment can be issued after expiry of the 10-year limitation period if the taxpayer has committed a criminal act.

The Tax Office conducts the following types of audits:

- full audits, which should be completed within 2 months, but may be extended to 8 months;
- simple field audits, which should be completed within 1 to 2 months;
- simple office audits, which should be completed within 4 to 6 weeks;
- if any transfer pricing issues are identified, the tax audit may be extended up to years, although this does not apply if the taxpayer requests a refund.

Additional Assessments

An additional tax assessment letter may be issued within the 10-year limitation period if new data and/or data previously undisclosed is discovered shows that the tax liability has been understated. An administrative

Summary of Indonesian Tax Laws (continued)

surcharge of 100% is levied on such additional assessments. An additional assessment can be issued after expiry of the 10-year limitation period if the tax payer has committed a criminal act, in which case an administrative (interest) penalty of 48% is applied to the additional assessment in addition to the above surcharge.

Objections

A taxpayer may object to an assessment or an additional assessment within 3 months of its date of issue. The Tax Office has one year in which to issue a decision. The Tax Office may reduce the assessment, confirm it, or even increase it. Failure to issue a decision means the taxpayer's objection is deemed to be accepted.

Upon a partially or fully successful objection, the tax already paid based on a tax underpayment assessment (SKPKB) and/or additional tax underpayment assessment (SKPKBT) will be returned to the taxpayer plus compensation of 2% interest per month up to a maximum of 24 months.

Reduction or Cancellation

A taxpayer may submit an application to reduce or cancel administrative penalties on tax assessments (request for reconsideration) to the Tax Office. The application has to be processed within 12 months, otherwise the application is deemed to be accepted.

Appeals and Suits

A taxpayer may appeal to the Tax Court (Pengadilan Pajak/PP) against a decision of the Tax Office on the taxpayer's objection. This appeal must be made within 3 months of receiving the decision but requires that at least 50% of the assessed tax has first been paid.

A taxpayer may also file a law suit with the PP in relation to the tax collection process for tax assessment decisions other than those against which an objection can be filed and any correction decision issued by the Tax Office with respect to a tax collection letter.

Lawsuit and appeal decisions must be issued within 6 and 12 months respectively, but may be extended by an additional 3 months under certain circumstances.

A decision of the PP can be appealed by filing a request for reconsideration with the Supreme Court (Mahkamah Agung/MA) within 3 months of discovery of one of the following conditions:

- if the decision is considered to be based on perjury or deception on the part of the opposing party or based on evidence that is subsequently found to be invalid by a criminal court judge.
- if there is new very important written evidence that could alter a decision if it had been discovered in an appeal or a law suit.
- if a decision clearly does not conform with prevailing tax regulations.

Upon a partially or fully successful appeal or suit, the tax already paid based on SKPKB or SKPKBT will be returned to the taxpayer plus compensation of 2% interest per month up to a maximum of 24 months even if one of the disputing parties files a request for reconsideration with the MA.

Payments

Payment is due within one month of the issuance of an assessment or additional assessment, even where an objection is lodged. Application may, in certain circumstances, be made to install or postpone payment. The application should be filed at least 15 days before the due date. The application must be processed by the Tax

Summary of Indonesian Tax Laws (continued)

Office within 10 days, otherwise a taxpayer's application is deemed to be accepted, except if the taxpayer submits a request for reconsideration, an objection or an appeal.

General Customs Rules

The implementation of the Indonesian Customs Law No. 10/1995 ("Law No. 10") is overseen by the DGoCE, MoF.

On a day-to-day basis the DGoCE is involved in assessing (in theory) all shipments for customs valuation and tariff classification purposes. In practice, taxpayers self declare duties and import taxes which are then subject to audit by the DGoCE within the subsequent two years, in regard to value and classification of the goods.

We have set out below some general guidelines on three key areas of Indonesian customs practice:

- a) customs valuations;
- b) related party transactions; and
- c) royalty issues.

Customs Valuation

Customs valuation is a sensitive issue in Indonesia due to the common perception that importers are not declaring the correct value of their goods and that the relevant taxes are therefore being underpaid.

DGoCE is focusing considerable attention on the valuation of imported goods, scrutinizing declared values both on a transaction by transaction basis at the time of each importation and in post-clearance audits of importers' records using a systems-based approach.

DGoCE maintains price databases of values of goods imported into Indonesia to provide parameters for testing the genuineness of the declared customs values.

DGoCE requires importers to provide valuation declarations and evidence to substantiate invoice prices, including requiring test values, where declared values are less than the values in the DGoCE databases. Penalties equivalent to between 100% and 500% of any duty short payments may be imposed where DGoCE re-determines declared values.

Law No. 10 provides a facility to obtain a formal valuation ruling, if the company desires certainty for the acceptance of the declared customs value. Alternatively, a degree of comfort can be obtained by seeking informal agreement to valuation methods from the Valuation Section at DGoCE Headquarters.

Based on Customs Law, there are six methods of determining the customs value of imported goods, and these methods are to be applied in hierarchical order:

- Method I : Transaction Value;
- Method II : Transaction Value of Identical Goods;
- Method III : Transaction Value of Similar Goods;
- Method IV : Deductive;
- Method V : Computed; and
- Method VI : Fall Back, using Methods I to V flexibly.

Summary of Indonesian Tax Laws (continued)

- The transaction value is the price actually paid or payable by the buyer to the seller for the goods being sold for export to the customs area, adjusted (if necessary) to include a number of dutiable costs including:
 - a) particular costs incurred by the buyer that are not included in the price paid or payable;
 - b) the value of goods and services supplied directly or indirectly by the buyer, free of charge or at reduced cost;
 - c) royalties and licensing costs relating to the goods being valued that the buyer must pay either directly or indirectly as a condition of sale of the goods being valued; and
 - d) the value of any part of proceeds of any subsequent resale, disposal or use of the imported goods that accrues directly or indirectly to the seller.

- The price actually paid or to be paid is the total payment made or to be made by the buyer to and for the interests of the seller for the imported goods, but it does not include:
 - costs incurred by the buyer for activities undertaken for his own benefit;
 - costs incurred after the importation of the goods;
 - dividends; and
 - interest charges.

- Transaction value cannot be used as the customs value if there are restrictions as to the disposition or use of the goods by the buyer other than those which:
 - are imposed or required by law or by the public authorities in the country of importation;
 - limit the geographical area in which the goods may be resold; or
 - do not substantially affect the value of the goods.

Related Party Transactions

Since most of the importation is between related parties, there are important valuation issues to consider.

- Where the buyer and seller of imported goods are related parties, DGoCE can accept the transaction value provided the relationship between the parties has not affected the price of the goods.
 - As far as is possibly relevant in each case, the definition of “related parties” includes:
 - o parties where one party directly or indirectly oversees the other;
 - o parties that are directly or indirectly overseen by a third party;
 - o parties that jointly, either directly or indirectly, control a third party; and
 - o party where it directly or indirectly controls 5% or more of the shares of the counter party.

- There are two ways in which DGoCE determines whether the relationship has affected the price:
 - Investigating matters relating to the sale, including:
 - o examining all documents relating to the transactions;
 - o considering all matters related to the procedures used by the buyer and seller to regulate the trading relations; and
 - o how the sale price was determined.
 - Comparing the price of the goods with a test value i.e.:
 - o Transaction value of identical or similar goods, in transactions between non-related parties;
 - o Customs value of identical or similar goods determined on the deductive method; or
 - o Customs value of identical or similar goods determined on the computed method.

Summary of Indonesian Tax Laws (continued)

Royalty Issues

Royalty arrangements, if any, must be carefully managed, as there can be important customs implications. A major consideration is that in some circumstances, royalties are subject to customs duties.

In calculating customs value, royalty and licence fees are to be added to the “price” provided the fees:

- are related to the imported goods whose customs value is being determined;
 - The imported goods contain an intellectual property right which may comprise among other things:
 - o right on brand;
 - o copy right; and
 - o patent (e.g. the imported goods may constitute a patented work process).
- must be paid either directly or indirectly by the buyer;
 - It doesn’t matter whether the royalty payment is made to the seller or some other party (royalty holder or proxy) who is not involved in the transaction of the imported goods concerned.
- are a condition of sale for the imported goods; and
 - A buyer is required to pay royalty or licence fee, for the purchase of the goods.
- are not included in the price actually paid or payable.

It is therefore important to ensure that any royalty agreement is carefully scrutinized from a customs perspective before it is introduced.

Import Duty

Import duty is payable at rates from 0% - 170% on the customs value of imported goods. Customs value is calculated of the cost, insurance and freight level (CIF).

Group	Good	Rate (%)
Automobiles	Passenger & commercial vehicles	25 to 80
AutomobileParts		15
Electronic Goods		5 to 15
Footwear		10 to 15
Ethyl Alcohol & Alcoholic Drinks	Ethyl alcohol, beer, wine, spirits	30 to 170
Agricultural Products	Animal & vegetable products	Mostly 5
Other	Chemicals, pharmaceutical products, rubber, etc.	Mostly 5

As a commitment to liberalising trade, the Indonesian Government is progressively lowering import duty rates on most products. Higher duty rates remain to protect certain industries and goods regarded as sensitive for security or for social and cultural reasons.

Summary of Indonesian Tax Laws (continued)

ASEAN duty rates

Limited relief is given to ASEAN countries on imports of goods that have at least 40% ASEAN content and are directly shipped between such countries.

This scheme is intended to boost inter-ASEAN trade by reducing duty rates on most goods to between 0% and 5% by the year 2003, with the aim of eliminating most duties by 2010.

Duty Relief/Exemption/Deferral

The Indonesian Government offers duty relief, duty exemption and duty deferral facilities to foreign and domestic investors in order to promote the development of local and export industries. Such facilities include the BKPM Masterlist, Bonded Zone, Bonded Warehouse and KITE (*Kemudahan Impor Tujuan Ekspor, previously BINTEK*) facilities.

BKPM Masterlist Facility

The BKPM masterlist facility provides duty relief for eligible machinery and raw materials, with a maximum 5% duty rate payable.

Bonded Zone

A Bonded Zone is a facility for encouraging exports by exempting imported capital equipment and raw materials from import duty, provided at least 66% of the production value of finished goods (or 50% in the case of semi-finished products) is exported.

Bonded Warehouse

The Bonded Warehouse facility allows for the payment of import taxes to be deferred until goods are delivered to the domestic market.

KITE Facilities

The KITE exemption allows for goods to be imported without payment of import taxes, provided the finished products are mostly exported. A KITE drawback allows for the recovery of import taxes paid on imported goods that are incorporated into goods which are subsequently exported.

Import Licenses

Import restrictions apply to certain products, including alcoholic drinks, ammunition and hazardous waste. A special Importer Identification Number (NPIK) also needs to be obtained to import certain items, including textile products, shoes, and electronic goods.

Customs compliance environment and administrative penalties

Customs may re-determine the classification or valuation of an importer's goods within 2 years of the date of an import declaration.

Administrative penalties of up to 500% may be imposed where within 30 days Customs determines that import duty has been underpaid.

Key Players/Organizations

Indonesia Petroleum Association (IPA)

History of IPA

Following the introduction of the production-sharing concept in 1966, Indonesia experienced a period of accelerated growth in petroleum activities, especially in offshore exploration. As the number of individuals and organizations participating in these activities increased it became clear that the establishment of an industry association would be beneficial to further development to the Nations resources as well as the petroleum community. Rather than forming separate associations or branches of other petroleum orientated international associations and societies, it was felt that the industry could be better served by one organization through which direct and free communication of all professional industry skills and disciplines could be realized. With this objective in mind, representatives from seven organizations - Pertamina, Lemigas, BP, Caltex, Jenny Joint Venture, Shell and Union Oil, formed a steering committee in 1969 for the purpose of establishing an association of individuals and companies connected with the Indonesian petroleum industry. The result was the charter of the IPA, formally announced on March 24, 1971.

During the last thirty years the IPA has already achieved much in terms of bringing people with common interests together and contributing to Indonesia's national development. In the process it has assisted in the realization of company member goals, the advancement of individual members' professional interest and has acted as successful bridge between industry and the Government. The IPA is the chosen vehicle to promote partnership in the Indonesian petroleum industry.

IPA consists of several committees as follows:

1. **Convention Committee**
The Convention Committee has the function of coordinating, planning and conduct of the Annual IPA Convention & Exhibition.
2. **Downstream Committee**
The Downstream Committee was established to advance the development of the downstream petroleum sector such as marketing, distribution and refining in Indonesia. The purpose of Downstream Committee is:
 - To provide a forum to assist BP Migas and Government on issues related to the Oil & Gas Law and in general terms, Downstream Regulation in Indonesia;
 - To represent the companies who are IPA members as potential stakeholders in Indonesia downstream by providing a clear and collective voice to BPH Migas and other groups with regard to downstream activities in Indonesia; and
 - To communicate to the IPA member companies and receive feedback with regard to regulations and plans for downstream deregulation as they happen.
3. **Environmental Affairs Committee**
The Environmental Affairs Committee is dedicated to utilize non-confidential and non-proprietary information to compliment the ongoing environmental activities of Government/Pertamina and to promote a consistently high standard of environmental management performance.

Key Players/Organizations (continued)

Indonesia Petroleum Association (IPA) (continued)

4. Finance and Tax Committee

The purpose of Finance Committee is:

- To provide a focal point for the communication of finance-related information for the benefit of IPA members;
- To provide a forum to interpret, clarify and communicate issues of financial importance to IPA membership. Among other things, these issues include tax, regulations, procedures and other activities important to the petroleum industry in Indonesia;
- To recommend actions to the IPA Board concerning financial matters; and
- To represent the IPA as authorized by the Board of Directors to other persons/bodies in connection with finance-related matters.

5. Human Resources Committee

The purpose of the Human Resources Committee is:

- Provide a forum to discuss, interpret, clarify and communicate all matters concerning human resources and industrial relations related laws and regulations for IPA company members; and
- Represent the oil and gas sector in providing advocacy or input to the Government on creating/changing regulations related to the human resources and industrial relation matters.

6. ICP Committee

The ICP Committee provides a forum for member companies to discuss and exchange ideas on the Indonesia crude price formula and to evaluate issues and concerns related to the current crude price formula.

7. Kost Reduction Indonesian Style (“KRIS”) Committee

The KRIS Committee is an IPA committee formed to provide a multidiscipline team effort to implement the joint IPA and Pertamina KRIS initiative.

8. Data Management Committee

The committee provides a forum for joint cooperation between industry and government organizations in the development of technical data standards, the formulation of regulatory requirements, and the design and implementation of Government-sponsored, technical data management initiatives and the operation of technical data management systems.

9. Professional Division Committee

The Professional Division is a standing committee whose charter is to recruit and retain individual members to the IPA, and to disseminate technical information and foster individual development within the Indonesian petroleum and geothermal industry.

10. Natural Gas Exports Committee

The purpose of the Natural Gas Exports Committee is:

- To analyze regulations being developed by BP Migas with regards to the export of natural gas and determine their impact on the IPA members; and
- To develop recommendations to the IPA Board on actions which would maintain the existing level of Indonesian LNG and Pipeline natural gas exports and increase the level of such exports.

Key Players/Organizations (continued)

Indonesia Petroleum Association (IPA) (continued)

The Committee provides a forum to review, clarify and communicate issues covering natural gas exports to the IPA Membership.

11. University Assistance Committee

The main purpose of University Assistance Committee is to assist in improving the education system through cooperation and assistance. The Committee also coordinates with the Government and industry groups to provide assistance to universities which have petroleum related faculties and facilities. Committee activities are now focused into five areas: direct financial assistance, commercial courses, one-day industrial courses, journal/book donations, and research grants.

12. Security of Operations Committee

The purpose of the Security of Operations Committee is:

- To provide a focal point for the communication of security-related issues between the IPA and Central Government Security authorities;
- To provide a forum to interpret, clarify and communicate issues of security important to IPA membership. Among other things, these issues include a joint program with the Government Security authorities, best sharing practice on handling security and community development, ensuring implementation of Voluntary Principles on Security, and Human Rights in resolving the security issues;
- To recommend actions to the IPA Board concerning security matters; and
- To represent the IPA as authorized by the Board of Directors to other persons/bodies in connection with security-related matters.

13. Service Committee

The purpose of the Service Committee is:

- To provide a focal point for the communication of Upstream Service Company related information and issues for the benefit of the IPA membership;
- To provide a forum to identify, interpret, clarify and communicate issues of importance to the IPA membership. Among these issues is to include regulations, procedures and other activities important to Service Companies that operate in the Petroleum Industry in Indonesia;
- To recommend actions to the IPA Board;
- To represent the IPA as authorized by the Board of Directors to other persons/bodies in connection with the Petroleum Industry; and
- To assist in the fostering of a Service Company sense of belonging while ensuring transparency.

Eligibility

There are three member classifications.

1. Corporate Member: corporate that is active as a PSC Contractor;
2. Associate member: corporate that is active as Contractor of a PSC company; and
3. Individual Member: persons that is active in the PSC environment.

Key Players/Organizations (continued)

Indonesia Petroleum Association (IPA) (continued)

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Key Players/Organizations (continued)

Indonesia Gas Association (IGA)

The IGA was formed to promote the growth of the natural gas industry for the development of the economy and the prosperity of the nation.

The IGA's primary roles and responsibilities are to provide an industry forum for joint cooperation between industry players and the Government:

- To promote the growth of a domestic gas industry providing fair risk and reward throughout the gas chain;
- To assist and support the development of a domestic energy policy that permits natural gas to compete on a level playing field compared to alternative liquid fossil fuels;
- To promote and support the development of a regional gas transmission and distribution system built on free market principles providing dependable services;
- To assist and support the adoption of domestic gas prices on commercial terms between independent sellers and buyers; and
- To assist and support a domestic gas industry committed to world class Health, Safety & Environmental principles, industry best practices and technology, and compliance with the highest ethical standards.

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Key Players/Organizations (continued)

Indonesia Geothermal Association (INAGA)/ Asosiasi Panasbumi Indonesia (API)

INAGA/API reviews the Government's role in developing the utilization of Indonesia's geothermal energy potential. INAGA's/API's mission is to create a favorable environment that will be conducive to attract investments in the geothermal industry and to simulate the growth of the industry under increasing competitive conditions in the face of environmental concerns and a market oriented economy.

Eligibility

There are three member classifications:

1. The Ordinary Members of API consist of:
 - a. Individual Members: men/women of Indonesian citizenship who have professions or participate in the sector of geothermal in its broadest sense; and
 - b. Corporate Members: corporates that are active in the sectors of geothermal, such as services, engineering, exploration, construction, maintenance, equipment, and operation, which are established based on Indonesian regulations and laws and have Indonesia as their place of establishment. The corporates that become members may appoint a maximum of five persons to represent the corporates and they have the status as Ordinary Members.
2. Extraordinary Members of API consist of:
 - a. Individual Members: men/women of foreign citizenship who have professions or participate in the sector of geothermal in its broadest sense and who are domiciled in Indonesia; and
 - b. If a Corporate Member appoints a man/woman of foreign citizenship as its representative, his/her status becomes an Extraordinary Member.
3. Honorary Members: individuals of Indonesian or foreign citizenship because of their great contributions in motivating the expansion of geothermal are proposed and appointed as Members, and whose membership is determined by the Central Executive Board.

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