

Indonesia

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Introduction

Indonesia is one of the most rapidly developing countries in the world today. It is the world's largest archipelago, consisting of more than 15,000 islands, of which approximately 6,000 are inhabited, the largest being Sumatra, Java, Kalimantan (Borneo), Sulawesi (Celebes), and Papua (western New Guinea). The archipelago is spread across an area as wide as the United States, with a total surface area equal to four times the territory of France. The population is approaching 240 million and is expected to exceed that of the United States not long into the twenty-first century. Indonesia is rich in natural resources, including labor, and its political climate is one of the most stable in the world, despite the democratic growing pains experienced since the fall of Suharto in 1998.

Until the mid-1980s, revenues from the booming oil industry were sufficient to carry the costs of government and the growing infrastructure. However, with the sharp decrease in oil revenues, Indonesia began to look to other sectors and beyond its own borders for funding, to maintain its rate of development and allow import of new technology and improvement of management skills.

Domestically, new tax laws were enacted, effective in 1984¹ and 1995,² with the intention of increasing the tax base and giving some certainty to what was previously a rather arbitrary system of tax collection. At the same time, the government commenced an ongoing program aimed at encouraging increased foreign investment in the private sector and has since been actively engaged in improving the investment and trade climate to encourage economic growth in general. Today, there are relatively few restrictions on foreign investment, with foreign companies permitted to own up to 100 per cent of local companies, at least for the first 15 years.

Legal System

History and Sources of Law

From the earliest days of Dutch colonization, inhabitants of the Indonesian archipelago were divided into various 'population groups' (*golongan rakyat*,

1 Law Number 6, Law Number 7, and Law Number 8 of 1983.

2 Law Number 9, Law Number 10, and Law Number 11 of 1994, and subsequent regulations.

bevolkings groepen) for legal purposes, based primarily on ethnic origin. Each group had its own legal system: separate regulations administered by separate government officials and enforced in separate courts of law.

The precise motive for this division has been disputed; it was carried through by the Dutch colonial government in Article 163 of the *Indische Staatsregeling*, the Constitution for the Netherlands Indies. Consequently, Indonesian society was divided into three principal groups: Dutch residents of the archipelago, persons of European descent, those equated with Europeans (such as Americans, Australians, South Africans, and Japanese) and ‘equalized’ indigenous Indonesians (*pribumis*); Chinese and other foreign orientals; and indigenous Indonesians (*pribumi*).

Under the colonial legal order, the Civil Code and the Commercial Code were applicable only to the Europeans and the Chinese (except some parts of the Civil Code), while in each region or area the *pribumi* had their own unwritten *adat* law, the concepts and priorities of which differed from the other laws. In 1917, a regulation titled *Vrijwillige onderwerping aan het Europeesch Privaatrecht*³ gave the indigenous groups an opportunity to voluntarily place themselves under colonial civil law. This regulation facilitated the transaction of business with the *pribumi*. Further regulations made the Dutch civil and commercial law (with some deletions) applicable to the ethnic Chinese and later to non-Chinese foreign orientals.⁴

Dutch policy was aimed at the preservation of the native *adat* law, as far as possible. *Adat* law, which was not codified and was largely non-statutory, was once regarded as inferior to European law. In 1926, the Dutch colonial government completed a draft of a Civil Code for the indigenous population. However, this draft failed to gain acceptance, due to heavy criticism by the father of *adat* law, Professor C van Vollenhoven,⁵ who rightly called it a *juridisch confectiewerk*, a juridical ‘ready-made suit’ (implying that it did not fit). This was the turning point. From that time onward, the Netherlands Indies government reverted to the principle of legal dualism, and the preservation of *adat* law was once more secured. Until the Japanese invasion during the Second World War, government policy favored diversity and *adat* law was no longer regarded as inferior. Government policy now favors its maintenance, official study, and description.

There has never been diversity of penal law because the western penal code, *Wetboek van Strafrecht* (*Kitab Undang-Undang Hukum Pidana*, KUHP), has been applicable to all persons in Indonesia, irrespective of their population group since 1918. On 17 August 1945, the Republic of Indonesia proclaimed its independence. One of the basic problems for the new independent Indonesian government was how much of the law applied under the colonial system should be maintained.

3 *Staatsblad* (State Gazette) 1917, Number 12.

4 *Staatsblad* 1917, Number 129 and *Staatsblad* 1924, Number 556, respectively.

5 Van Vollenhoven, *Het adatrecht van Nederlandsch-Indie*, vol I (Leiden 1916–1918).

It was obvious that some aspects of the legal system of that time were at odds with the principles of the newly independent state. It was recognized that, ultimately, the principle of differentiation into population groups, each with different laws, could not be maintained.

Unification of law in as many fields as possible is presently the aim. This has been recognized by the Institute of National Legal Development (*Badan Pembinaan Hukum Nasional*, BPHN), which is presently striving for unification, although some *adat* law does still prevail in certain areas.

The present policy is toward economic law reform to bring Indonesia's laws more into line with those of other jurisdictions and to more fully address the needs of the business community. The entirely new laws already in effect at the time of this revision (late 2003) include a substantial revision of the old Bankruptcy Law; a capital market law; a new company law allowing for modern corporate practices, such as mergers and acquisitions; new tax legislation, effective as of 1995, to tune up and tighten the revolutionary 1984 tax regime; a new Arbitration Law; a law on fiduciary transfers as security instruments; a *Yayasan* (foundations) law; a money-laundering law; new manpower legislation; a new oil and gas law; and Intellectual Property Rights (IPRs) legislation to battle IPR piracy.

New legislation related to mining, bankruptcy, foreign investment, and alternative dispute resolution is presently being considered in Parliament, and other laws are on the drawing board, with more than 30 new laws expected to be enacted over the next few years.

Courts

Under the Constitution, judicial power is vested in the Supreme Court and such subordinate courts as may be established by law.⁶ The Basic Law on Juridical Powers (*Undang-Undang tentang Kekuasaan Kehakiman Nomor 48 Tahun 2009*)⁷ sets out four branches of the judiciary: general courts, religious courts, military courts, and administrative courts.

The state courts (*Pengadilan Negeri* or district courts) are the courts of first instance and try all criminal and civil cases except for bankruptcy and IPR cases, which are now handled by the new commercial courts (*Pengadilan Niaga*). There is a district court in every autonomous regency (sub-district of a province).⁸ The district courts are, according to the text of the law, a college of judges, requiring at least three judges for the validity of each decision.⁹ The Court of Appeal is the *Pengadilan Tinggi*, or High Court. There are plans to have a High Court in every province.

6 Constitution of 1945, art 24.

7 Law Number 48 of 2009.

8 Currently, there are 347 district courts.

9 Law on Judicial Powers (Law Number 19 of 1970, amended by Law Number 4 of 2004), art 17(1).

Decisions of the High Court may be brought for cassation (*kasasi*) before the Supreme Court. The examination is confined to the legal aspects of the case only. The Supreme Court supervises legal practice throughout the country and controls the judges' activities by issuing Circular Letters (*Surat Edaran Mahkamah Agung*), in addition to rendering cassation judgments.

Religious courts preside over civil cases for persons professing the Islamic faith and concerning matters that, as a practical matter, should be judged according to Islamic law, such as marital affairs and, in some regions, inheritance.¹⁰ They exist in all places, side by side with the state courts, and are presided over by experts in the teachings of Islam, appointed by the Minister of Religious Affairs. It is no longer necessary to first obtain an order of execution from the local state court to execute a decision of the religious court.

Military courts hear criminal cases in which members of the Indonesian Armed Forces (*Tentara Nasional Indonesia*, TNI) are the accused. Each of the three TNI services (army, navy, air force) has its own special court, as does the police force. Special military courts may be set up to meet extraordinary emergency requirements, such as trial for treason or rebellion.

A state administrative judicial system was established in 1986,¹¹ which includes a state administrative court in every autonomous regency, the decisions of which are appealable to a state administrative High Court for each province. The administrative system also includes some courts with quasi-judicial powers to settle certain administrative matters, such as the Council for Housing Affairs and a system of Committees for the Settlement of Labor Disputes. The Tax Court is now an independent body and no longer included under the administrative system.

Prosecutors act only in criminal matters, except in certain exceptional civil cases, such as those concerning trade mark violations, where they may act in the national interest.

Civil Procedure

No distinction is made between civil and commercial matters. All cases are brought before the same civil courts.¹² Only bankruptcy and intellectual property actions are not handled by the district courts of first instance, but are now within the jurisdiction of the commercial courts.

10 Law Number 7 of 1989, as amended by Law Number 3 of 2006, codifies regulations regarding religious courts.

11 Law Number 5 of 1986, as amended by Law Number 9 of 2004 and Law Number 51 of 2009.

12 The procedure is governed by the Revised Indonesian Regulation (*Reglement Indonesia Diperbaharui, Herziend Indonesisch Reglement*) Number 57/1848, thoroughly revised and republished as Law Number 44/1941. A new Code of Civil Proceedings has been prepared by the Institute of National Legal Development, but has not yet come into operation.

The competent court of first instance is that of the defendant's domicile or his effective residence. If there is more than one defendant, the plaintiff has the right to choose the domicile of one of the defendants as the place to institute his action. When the defendant's domicile or his effective residence is unknown, proceedings can be started at the plaintiff's domicile.

When the claim concerns immovable property, the competent court will be the court having jurisdiction in the place of its location.¹³

Decisions concerning matters exceeding the minimum value of IDR 100 (US \$0.01) are appealable before the High Court.¹⁴ Appeals may be heard on any grounds. In the last instance, cassation is open to the Supreme Court, in which procedure the hearings are limited to matters of law, the purpose of cassation being to determine whether the lower court has applied the law correctly, not whether there was any confusion regarding the facts of the case. The original purpose of cassation was to maintain uniformity in the interpretation and application of the law.

Civil Law and Commercial Law

In General

The legal system existing prior to the Second World War was pluralistic. The Civil Code and the Commercial Code were promulgated in 1848 and later thoroughly revised in 1938. These Codes derived from the French Code Civil and Code Commerce (Code Napoleon) and were, at that time, applicable only to the Europeans and Chinese.

Both Codes continued to prevail after the Proclamation of Independence of 17 August 1945.¹⁵ Today, for reasons of practicality and certainty, written law is utilized for business by everyone in Indonesia, except in certain remote areas and small homogenous villages, where the unwritten *adat* law may still be in force.

Law of Contracts

Sources

For the businessperson, the law of contracts, as laid down in Book III of the Civil Code under the heading of 'Agreements', is of prime importance. The general principles of the law of contracts contained in the Civil Code form the principles not only in the Civil Code itself, but also of the Commercial Code and other special acts or regulations.

On the one hand, the law endorses the doctrine of freedom of contract, following an open system under which parties may enter into any kind of contract, as long

13 Revised Indonesian Regulation Number 44/1941, art 118.

14 This is only one example of the insufficiency of the old, outdated regulations.

15 Presidential Decree Number 2 of 10 October 1945.

as certain requirements are fulfilled (further discussed in the following subsection ‘The Contract’). On the other hand, there are special or ‘nominated’ contracts, such as contracts of sale, lease, or labor, some of the terms of which are regulated in the Civil Code.

Still other contracts, such as the deed of establishment of a company, contracts for sale of land or share certificates, mortgages, prenuptial agreements, and certain loan and security documentation, must be executed by way of a notarial deed. Contracts of insurance and transportation by sea are regulated by the Commercial Code, while contracts of transportation by air are regulated by special ordinances.

Contract

All lawfully concluded contracts are legally binding on the parties to the contract.¹⁶

A contract is legally concluded when it fulfills the required conditions mentioned in Article 1320 of the Civil Code. There are four conditions.

First, the parties must each have the legal capacity to conclude a contract. All persons are deemed to have such legal capacity except minors (under 21 years of age, unless married)¹⁷ or persons under official custody.¹⁸

Second, there must be a meeting of minds, by free consent, without any coercion, error, or deceit.

Third, the subject matter must be clearly defined. If necessary, the quality and quantity of the subject matter should be expressly stated. The obligations of each of the parties must be clear.

Finally, the contract must be for a permissible legal purpose. No obligation or performance may be contrary to the law, public order, or public morality.

If either the first or second condition is not met, the contract is voidable, and annulment of the contract can be demanded from a judge. In cases of ambiguity about the subject matter or illegal cause, the contract is null and void. In the latter cases, the contract is considered as never having been entered into and a judge will, *ex officio*, declare the contract null and void. The action for annulment of a voidable contract should be brought within five years.¹⁹

A contract is said to exist the moment there is an agreement between the two parties, whether or not the agreement is in writing. A contract that fulfills the four requirements becomes legally binding²⁰ and cannot be terminated unilaterally unless the parties clearly agree in the contract to waive the

16 Civil Code, art 1338.

17 Civil Code, art 330.

18 Civil Code, art 433.

19 Civil Code, art 1454.

20 Civil Code, art 1338.

applicable provision of Article 1266 of the Civil Code. Some agreements (eg, ante-nuptial settlements) cannot be terminated even with the consent of both parties.²¹

Every contract must be performed in good faith.²² This requirement has been interpreted to imply that a contract must be fair and equitable, although this is not specifically stated in the law.

Establishment of Enterprises and Business Relationships

Forms of Business Entities

Indonesian law recognizes the following forms of business entities under the Civil Code and the Commercial Code: contractual²³ partnership (*Perserikatan Perdata*) or private association (*Maatschap*), unlimited partnership (*Firma*), limited partnership (*Persekutuan Komanditer* or *Commanditaire Vennootschap*, CV), and limited liability company (*Perseroan Terbatas*, PT).

The contractual partnership is for purposes of a single business endeavor, where partners generally act under their own names.²⁴

The unlimited partnership is for doing business under a trade name, where each partner has full liability, regulated under the Commercial Code.²⁵

A variety of the unlimited partnership is the limited partnership of ordinary and silent partners, where only the ordinary partners bear personal liability.²⁶ Foreign investors may participate in a limited liability company, which is discussed next.

Limited-Liability Company

In General

On 16 August 2007, the new Company Law²⁷ was promulgated by the President of Indonesia, replacing Law Number 1 of 1995. Companies established prior to that time were required to amend their articles of association to bring them into line with the new Company Law not later than August 2008.

Companies that had not amended their articles by that time could be dissolved by the district court on the request of the Attorney General's office or related party.

21 Civil Code, arts 149 and 1338.

22 Civil Code, art 1338.

23 Not necessarily in writing.

24 Regulated by Book III, Title 8, of the Indonesian Civil Code of 1848, SG Number 23/1847. These regulations also are applicable to business entities under the Commercial Law, unless specifically waived.

25 Commercial Code, Chapter III, s 2.

26 Commercial Code, art 19.

27 Law Number 40 of 2007.

The new Law includes several new provisions, such as provisions on corporate social responsibility for companies with activities engaging in or related to natural resources, the obligation to have a *Sharia* supervisory board for companies with business in compliance with Islamic laws, the use of electronic data transfer for the approval of the Minister of Justice, and others.

A limited liability company or PT is a company with fixed capital divided into shares. The shares are held by persons who are liable only to the extent of the value of their shares. A limited liability company must act under its own (company) name. The PT must have at least two shareholders; otherwise, it may lose its limited liability status.

Establishment

The procedure for establishing a PT can be divided into three stages. The first stage involves drawing up the articles of association. The deed of establishment incorporating a PT must be drawn up in an authentic form (ie, by a notarial deed and in the Indonesian language). This is a mandatory legal requirement laid down in Article 38 of the Commercial Code and incorporated into the new Company Law.²⁸ Failure to comply with this provision renders the act of incorporation null and void.

The articles of association must contain all matters pertaining to the existence of the PT and the rights and duties of its shareholders: the name of the company, its purpose, duration, domicile, amount of total capital and value of each share, number of shares taken by the founders and management, and similar matters.

The next step is the approval of the articles of association by the Minister of Justice. Founders of the company must submit the application electronically via the legal entity administration system information technology services (the *Sistem Administrasi Badan Hukum* or “SABH”) to obtain a Ministerial Decree approving the company’s articles. The application must be submitted to the Minister not later than 60 days from the date of signing the deed of establishment. If the Minister raises no objection and after all requirements have been fulfilled, the Minister will issue a decree regarding the ratification of the company as a limited liability legal entity within 14 days.

The final stage in the establishment process is registration and publication. The Law requires the complete articles of association, any amendments to the articles, and the approval from the Minister of Justice to be registered in the Company Registry under the Ministry of Justice. The Minister will announce the deed of establishment of the company and the Ministerial Decree in the Supplement to the *State Gazette (Berita Negara)* of the Republic of Indonesia within 14 days from the issuance date of the Ministerial Decree. In practice, the registration and publication is done by the notary public who has drawn up the articles.

²⁸ Company Law, art 7.

Primary Characteristics

The primary characteristic of a PT is the limited liability of its shareholders. A shareholder is only liable to the amount of his shares. A PT is considered to be an independent legal entity. It acts independently and has its own property and rights and obligations, separate from those of its shareholders.

The PT comes into existence and constitutes a legal entity (*badan hukum*) at the moment the articles of association have been approved by the Minister of Justice. The articles must then be registered at the Company Registry and published in the *State Gazette*.

Until this registration and publication take place, the directors of the company are jointly and severally liable to third parties for acts committed in the name of the company.

Corporate Governance

Within the organizational framework of a PT, there are three organs through which it conducts its business: the shareholders' general meeting, the board of managing directors (*Direksi*), and the board of supervisors (*Dewan Komisaris*).

The highest and most important body is the shareholders' general meeting, which can be considered the most powerful body of the PT. It determines the general policy of the company and appoints and dismisses its managing and supervisory officers.

The board of managing directors executes the policy laid down by the general shareholders' meeting and represents the PT in dealings with third parties.

The board of supervisors has a supervisory function. Acting on behalf of and in the interest of the shareholders, it controls the performance of the managing directors. Directors are usually obliged to obtain the approval of the *Dewan Komisaris* to purchase or sell major assets, make or take loans, or perform other major actions.

The *Dewan Komisaris* also may temporarily suspend a director for failure to perform properly. The suspension will be decided at the next shareholders' general meeting, at which the suspended director must have an opportunity to be heard on the matter.

Previously, the Commercial Code did not require that every PT have a *Dewan Komisaris*,²⁹ although most Indonesian PT companies function with a dual-board system. The new Company Law now requires every PT company to apply the dual-board system and thus to appoint at least one member to the *Dewan Komisaris*.

Sharia Supervisory Board

A company having its business activities based on *Sharia* principles also is obliged to have a *Sharia* supervisory board.³⁰ The *Sharia* supervisory board

²⁹ Commercial Code, art 44(1).

³⁰ Company Law, art 109.

consists of one or more *Sharia* experts, appointed by the shareholders' general meeting based on the recommendation of the Indonesian Ulama Council (*Majelis Ulama Indonesia*).

The *Sharia* supervisory board is obligated to provide advice and suggestions to the board of directors and to supervise the activities of the company in order to comply with *Sharia* principles.

Capital

Under the new Company Law, the minimum amount of authorized capital is IDR 50 million (approximately US \$5,500), and at least 25 per cent of the authorized capital must be issued and fully paid. The share capital can be remitted in the form of money and/or other forms such as tangible or intangible goods that can be expressed in terms of money.

Social and Environmental Responsibility

The Company Law requires a company undertaking business activities in the field of and/or related to natural resources to undertake social and environmental responsibility.³¹

A company undertaking business activities in the field of natural resources is a company whose business activities manage and utilize natural resources. A company undertaking business activities related to the natural resources sector is a company not managing and utilizing natural resources but one whose business activities affect the preservation of natural resources.

Forms of Foreign Participation in Business

Foreign Direct Investment Company

Foreign companies wishing to transact business with or in Indonesia have a variety of options, depending, of course, on the type and purpose of the business. As a general rule, foreign companies may not incorporate branch offices within Indonesia or act as partners in partnerships. Only banks may actually open branch offices within Indonesia, and these are closely regulated by the Ministry of Finance.

Today, foreign interests may participate in the ownership and control of Indonesian PT companies either by entering into joint ventures with Indonesian partners or, in some cases, by setting up 100 per cent foreign-owned PT companies. PT companies with partial or full foreign ownership are known as Foreign Direct Investment companies (known locally as *Penanaman Modal Asing* or PMA companies). Participation in a PMA company may be characterized as doing business in Indonesia, while most other types of structure would be doing business with Indonesia.

³¹ Company Law, art 74.

Foreign Direct Participation in Indonesian Companies

In 2007, Indonesia passed a new Investment Law,³² which deals not only with domestic but also foreign investment, thereby replacing the original Foreign Investment Law³³ and the Domestic Investment Law.³⁴ Under the new Investment Law, foreign enterprises are permitted to participate in the ownership and control of certain Indonesian companies, with certain restrictions on ownership of shares.

Frequent implementing regulations, promulgated every few years in the form of deregulation ‘packages’ by various ministries and departments, have steadily made it a little easier and more attractive for foreign interests to participate in the growth of Indonesia’s economy. Nonetheless, as is true in all cases, companies intending to invest in Indonesia should consult local counsel to ascertain the exact benefits and structures available at the relevant time.

PMA companies are regulated by an agency set up specifically to assist foreign applicants and their local partners to navigate through and (for the most part) avoid the maze of red tape required in applying for the government’s approval for the foreign company to own a piece of Indonesia’s economy. This agency is the Investment Coordinating Board (*Badan Koordinasi Penanaman Modal*, BKPM).

Sectors Open to Foreign Investment and Restricted Sectors

Foreign investment is presently available in most sectors, limited by the new Investment Law and the periodically published ‘Negative List for Investment’ (*Daftar Negatif Investasi*). Article 12(2) of the new Investment Law sets out certain areas of activity important to national defense, such as production of arms, ammunition, explosives, and other war equipment, which are closed to foreign investment. Other sectors, such as harbors, shipping and railways, telecommunications, aviation, drinking water, atomic energy, and mass media,³⁵ are closed to full control by foreign investment because of the importance of such sectors to the country.

Article 12(3) of the new Investment Law further provides that the government may determine certain fields of activity in which foreign capital may no longer be invested. Pursuant to Article 12(4), the government promulgates a ‘Negative List’ for capital investments, which is revised every few years, with the number of closed fields progressively reduced. The last issued and presently effective Negative List was issued in 2010³⁶ and is available online.³⁷

32 Law Number 25 of 2007.

33 Law Number 1 of 1967.

34 Law Number 6 of 1968.

35 Production, transmission, and distribution of electric power was originally also banned, but was subsequently opened to foreign investment by Presidential Decree Number 37 of 1992, as amended by Presidential Regulation Number 111 of 2007.

36 Presidential Decree Number 39 of 2014.

The Negative List is not exhaustive, however. In addition to the sectors that are officially closed under the general investment regulations, there are some sectors that are not available for foreign investment at the behest of the specific ministries governing these sectors.

A PMA company may export its own products as well as those of other companies.³⁷ Under the present regulations, a PMA that produces all or any portion of its production for the domestic market may not act as its own distributor. A second PMA may be set up, with the PMA production company as partner, to act as the main distributor, and that company may distribute down to the retailer level, but still may not distribute to the ultimate consumer. Retail sales of all goods are reserved for fully domestic interests.

A PMA company may invest in other Indonesian companies, either through the stock exchange or privately. However, if a PMA company becomes a substantial partner in another Indonesian company, approval of the BKPM will be required.

Capitalization Requirements

The 1994 deregulation measures have eliminated the minimum capital requirement for approval of a foreign investment joint venture, generally having been set at US \$1 million, on the principle that the parties should be free to make their own determination as to the required quantum of their investment. As a practical matter, however, few (if any) approvals have been issued for projects where the projected investment is stated as less than US \$250,000.

The total investment commitment may consist of a combination of equity and loan capital. The equity portion is invested by the partners in proportion to their respective shareholding in the PMA company. Today, in most fields, the foreign partner may initially subscribe to up to 95 per cent of the equity, in which case there is no longer any further divestment required.

In some fields, foreign interests may initially subscribe to 100 per cent of the share capital, but must divest a portion, described as 'nominal' but as yet unspecified, to Indonesian interests within 15 years. Notably, although 100 per cent foreign ownership is permitted by the new foreign investment regulations, Indonesian law does not permit establishment of any Indonesian company with a sole shareholder, and the new Indonesian Company Law denies limited liability status to any company owned by a single shareholder for more than six months.

37 Regulation Number 36 of 2010, containing the 2010 Negative List, is available at http://www.bkpm.go.id/file_uploaded/PPres-36-2010.pdf. The list of closed business sectors is on pp 9–11; the list of business sectors open to investment, with certain conditions, is on pp 12–101 (the new Presidential Decree <http://www4.bkpm.go.id/contents/general/117139/negative-investment-list#.VG2eYDSUeSo>).

38 Governmental Regulation Number 2 of 1996 (has been changed with Governmental Regulation Number 46 of 1998).

Procedure for Foreign Participation

The foreign party or parties wishing to participate in a foreign investment PMA company must, together with the local partner (if any), complete and file a foreign investment application with the BKPM. Submitted in triplicate, this application requires certain information and supporting documentation regarding all partners, the proposed project, the investment, the expectations, the usage of labor and infrastructure, the impact on the environment, and similar matters, including a complete draft of the joint venture agreement between or among the partners.

Once the application is properly filed, the BKPM will be responsible for submitting it to the relevant ministries and other government departments, for arranging all approvals, and for issuance of the government's formal approval letter. The approval letter will be signed by the President and issued within a month of the date of application; in practice, this often takes somewhat longer.

Once the government's letter of approval for the foreign investment has been obtained, the parties may formulate the PMA company. As with any Indonesian PT company, the PMA is formed by execution of the articles of association in the form of a notarial deed executed before a notary public. The articles will set out the relationship of the partners and their rights and obligations in their capacity as shareholders in the company. Voting rights, management, powers and authority, meetings, and the like are regulated by the articles, as in the case of a PT company.

Within a few days after execution, the notary will deliver to the shareholders true copies of the articles, with which the company may open its bank account (or accounts) and generally commence operation.

The company will not attain limited liability status until the articles have been approved by the Ministry of Justice. Directors also will remain personally liable for their acts until the articles have been published in the *State Gazette*. Under the new Company Law, directors are not fully absolved from all liability even after the articles have been published.

Compliance Requirements

Applicants are encouraged to submit to the BKPM both a 'manpower plan' and a 'master list' of capital goods to be imported, as soon as possible after issuance of the government approval letter. The BKPM will subsequently also arrange for the issuance of additional benefits as relevant tax facilities, if any — such as postponement of value-added tax (VAT) and exemption from import duties for equipment or supplies specified by the parties on the master list — and approval of residence visas and work permits for the number of expatriate personnel required, as specified in the application and the manpower plan.

Once the PMA company is formed, it must apply for its necessary business licenses, expatriate work permits, tax registration number, and an importer

identification number and customs clearances for the import of its capital goods and raw materials, as relevant. The BKPM also assists in these applications.

Periodic reports are required to be submitted to the BKPM to demonstrate that the parties are complying with the schedules proposed in their application. Projects that are not performed for an inordinate period of time after approval may find their investment license revoked, after due warning.

Duration of Foreign Investment

An Indonesian company is usually formed for a period of 75 years.³⁹ However, Government Regulation Number 20 of 1994, as amended by Government Regulation Number 83 of 2001, provides that a foreign investment license may not exceed 30 years, calculated from commencement of commercial production or operation.

The license may be renewed for an additional 30 years if the business is continuing and benefiting the economy. Thus, as the law stands today, the PMA status may endure for a maximum of 60 years.

Current Scope of Foreign Investment

Today, foreign investment joint ventures have been established and are active in most areas of the Indonesian economy. In the first semester of 2013, Indonesia saw foreign direct investment surge by 22.19 per cent to IDR 132.2 billion (US \$115.485 billion) compared to the same period in 2012, excluding oil and gas and banking, with the property sector attracting the most investment.

According to data released by the BKPM,⁴⁰ the top business sectors attracting foreign investments are Mining (US \$1.7 billion); Food Industry (US \$0.8 billion); Transport Equipment and Other Transport Industry (US \$0.6 billion); Food Crops and Plantation (US \$0.6 billion); and Paper and Printing Industry (US \$0.5 billion).

The largest investments by country of origin are Japan (US \$2.3 billion), Singapore (US \$1.9 billion), United States (US \$1.3 billion), South Korea (US \$1.2 billion), and United Kingdom (US \$600 million).

Clearly, foreign capital is recognized as a very important element in the development of Indonesia toward its goal of becoming a fully industrialized country. The government is constantly increasing its efforts to improve the investment climate and encourage foreign investment joint ventures, particularly in the private sector, to boost the economy.

³⁹ Commercial Code, art 51.

⁴⁰ Information for 2014 BKPM Domestic and Foreign Direct Investment Realization Quarter I 2014 Break the Highest Record of Investment Realization and Nearly Reach The Annual Target available at [http://www.bkpm.go.id/img/Press%20Release%20TW%20I%202014%20\(narasi\)%20English.pdf](http://www.bkpm.go.id/img/Press%20Release%20TW%20I%202014%20(narasi)%20English.pdf).

Other Business Relationships Available to Foreign Interests

Production Sharing Contracts in Oil and Gas Sector

Investment policy in oil and gas mining is administered by the Directorate General of Oil and Gas, known as Dirjen Migas, in cooperation with the state oil and gas mining company, Pertamina, and its newly established regulatory body, BP Migas.

Indonesia's Constitution stipulates that all of the natural wealth contained in the land and water of Indonesia will be controlled by the state and utilized to maximize prosperity and promote the welfare of the people of Indonesia; therefore, foreign interests may not engage in direct investment in oil and gas mining in the form of joint venture companies. However, the Law on the State Mineral Oil and Gas Mining Corporation (the Pertamina Act)⁴¹ recognized Pertamina as the sole state oil enterprise authorized to exploit the oil and gas in Indonesia.

The Pertamina Act established the legal basis for Pertamina to enter into production sharing contracts with other parties, including foreign oil company contractors, for the exploration and development of oil and gas resources. After recovery by the contractor of its production costs, the production is to be shared between Pertamina and the contractors in the ratio of 85 per cent and 15 per cent, respectively.

One or a consortium of foreign oil companies may act as contractor. The contractor provides all of the capital, but is entitled to recoup the capital expenditure first out of production revenue. Title to all assets purchased and brought into Indonesia by the contractor passes to Pertamina, although the contractor is allowed to depreciate those assets as cost recovery items.

The contractor must relinquish a percentage of the acreage after a specified period. Generally, 15 per cent to 25 per cent of the acreage must be relinquished after three years and 30 per cent to 35 per cent by the end of the fifth year. The entire contract area must be relinquished if there has been no commercial discovery by the end of the specified exploration period, unless Pertamina grants an extension.

If a field is declared commercial, the contract would normally run for 30 years from the date of signing. The Law on Petroleum and Natural Gas,⁴² promulgated on 23 November 2001, divested Pertamina of its regulatory power over new upstream (extraction) contracts, and Pertamina's function has become more and more limited to downstream activities, such as refineries and distribution.

Mineral and Coal Mining Investments

In General. The year 2009 marked a new era for mining in Indonesia, after the Parliament finally passed the long-awaited new mining law, the Law on Mineral

41 Law Number 8 of 1971.

42 Law Number 22 of 2001.

and Coal Mining (the Mining Law).⁴³ However, the new law provides only the general framework and requires further implementing regulations to be enacted before the new mining regime can be truly understood. Two key implementing Regulations are in effect from 1 February 2010 and govern the issuance of mining licenses (a new form of tenure established by the Mining Law)⁴⁴ and the delineation of mining areas.⁴⁵

Essentially, the new mining law simplified the mining licensing system for all investors by eliminating distinctions between foreign and domestic investors and does not treat foreign investors differently from locals. The old mining concessions (*Kuasa Pertambangan*, KP) allowed foreign and domestic investors to carry out mining activities — foreign investors through contracts of work (CoWs) or coal contracts of work (CCoW) with the central Indonesian government and domestic investors by directly applying for KP licenses. These mining concessions have been abolished, and investors must now operate by way of a ‘mining business license’, available for exploration and production operation, and which is non-transferable. Existing CoWs/CCoWs and KPs remain valid for the remaining period of their terms, but were required to convert to the new mining business licenses by 1 May 2010.

Mining Business Licenses. Mining business licenses are granted depending on the type of proposed activity in areas designated as open for mining. Mining outside of those areas is therefore illegal. Areas open to mining are ‘commercial mining areas’ (*Wilayah Usaha Pertambangan*, WUPs), and ‘state reservation areas’ (*Wilayah pencadangan Negara*, WPNs). WUPs are open to general commercial exploitation. A license for mining in a commercial mining area is known as a mining business permit (*Izin Usaha Pertambangan*, IUP). State reservation areas are those reserved for the national strategic interest. A license for mining in WPNs is known as a special mining business permit (*Izin Usaha Pertambangan Khusus*, IUPK). WPNs are prioritized for state-owned and regional-owned enterprises.

In addition to the IUP and IUPK, there is the People’s Mining License (*Izin Pertambangan Rakyat*, IPR) for conducting mining business in the people’s mining area (*Wilayah Pertambangan Rakyat*, WPR), but this is not applicable for either foreign investment or general commercial operations.

Licenses are first obtained through a competitive tender process for a mining business license area (*Wilayah Izin Usaha Pertambangan*, WIUP), not merely by direct application. Bidders must be entities established and domiciled in Indonesia. This means that foreign investors would only be able to participate through a PMA company. The bid winner who obtains the WIUP must then

43 Law Number 4 of 2009.

44 Government Regulation Number 22 of 2010 on Mining Areas.

45 Government Regulation Number 23 of 2010 on Conduct of Minerals and Coal Mining Business Activities.

separately apply for an IUP within five business days of the announcement; otherwise, the WIUP and the bid bond paid for the tender will be forfeited. Further details of the tender process are to be set out in an upcoming Ministry Regulation. However, a license for production operation is guaranteed to the holder of a license for exploration under the new Mining Law.

The period and acreage for which mining licenses are granted also depends on the type of mining conducted. Exploration licenses are granted for a maximum of eight years and 100,000 hectares, and production operation licenses are granted for a maximum of 20 years and 25,000 hectares; both may be extended twice for 10 years each. Exploration licenses for coal are granted for a maximum of seven years and 50,000 hectares, and production operation licenses are granted for a maximum of 20 years and 15,000 hectares, both of which also may be extended twice for 10 years each.

Key Provisions of the Implementing Regulation. In accordance with Government Regulation Number 23 of 2010 that requires relinquishment of mining areas, IUP license holders must reduce the specified mining areas progressively to 50,000 hectares (in the fourth year of exploration) and 25,000 hectares (by the end of the exploration or in the eighth year of exploration) for metals, and 25,000 hectares (by the fourth year of exploration) and 15,000 hectares (by the end of the seventh year of exploration) for coal mining.

The new Mining Law requires all mined minerals to be processed and smelted domestically rather than exported in raw form. The Law prioritizes domestic needs for minerals, provides a domestic market obligation (DMO), requires divestment, and establishes that unless there is no local mining services company available, holders of IUPs/IUPKs must prioritize local mining services companies over PT PMA (foreign investment) mining services companies. Subsidiaries or affiliates also are prohibited from providing these services without prior permission granted by the Ministry.

Twenty per cent of the shares of a foreign company holding an IUP/IUPK must be divested to an Indonesian party within five years of commencing commercial production. For the purpose of divestment, shares must be offered directly to the state government, the provincial governments or district governments, state-owned entities (*Badan Usaha Milik Negara*, BUMN), regional-owned entities (*Badan Usaha Milik Daerah*, BUMD), and national private entities, in that order.

Representative Office of Foreign Trade Company

A foreign company may open a representative office in Indonesia. According to a decision of the Minister of Trade,⁴⁶ the representative of a foreign trade company in Indonesia may be an individual Indonesian citizen or a foreign individual who has been appointed by the foreign company or collaboration of foreign corporations or companies.

46 Minister of Trade Decree Number 28/M-DAG/PER/6/2010).

The representative office also can take the form of a selling agent, manufacturing agent, and/or buying agent (or any combination of these agencies). An application must be made to the Ministry of Trade, giving particulars of the principal company, the intended representative, the field of operations, and the size and location of the intended office.

The representative may open an office and employ local staff and expatriate (foreign national) staff. However, positions for expatriates are limited by the license. A foreign representative will automatically be entitled to the necessary work permit and residence visa.

A representative office in Indonesia has limited authority. It has authority to engage only in certain activities, such as introducing and promoting goods and conducting market research in the domestic market.

In addition, the representative office also has the authority to sign and close contracts with local companies, but may do so only for export activities. It may not, however, engage in trading in the country or sales within the country, nor may it conclude any contracts for sales or provision of services, including joining a project tender.⁴⁷

In short, a representative office may spend money, but may not directly earn any money on its own in Indonesia. Consequently, if it wishes to provide goods or services to the Indonesian market, any contracts must still be handled by an Indonesian company acting as its agent or distributor.

Agency Agreements

Any foreign company may appoint an Indonesian company or person to act as its agent in Indonesia. An agent is not limited in function, as is the representative office, and may perform any type of trading activity and may maintain any number of offices throughout the country.

An import license from the Department of Trade is required for the import of any goods or products into Indonesia for sale or distribution or for assembling, production, or manufacturing in Indonesia. The import license will be issued on the basis of registration of a sole agency agreement either with the Department of Trade or, if the products fall within the purview of the Department of Industry, on the basis of that Department's letter of recognition of sole agency.

Investment in Industry

Goods falling within the purview of the Department of Industry and the requirements for a sole agency agreement with respect to such industrial goods are set out in Minister of Industry Decree Number 295 of 1982. This legislation was designed to protect local agents who make a substantial capital investment in inventory and spare parts.

47 According to Minister of Trade Decree Number 10/M-DAG/PER/3/2006.

Protected goods include certain electronic appliances, electrical household appliances, motor vehicles, and heavy equipment, all of which are stipulated from time to time by the Minister of Industry in further decrees. Agencies with respect to goods not enumerated in these decrees will fall within the province of the Ministry of Trade.

The requirements of the Ministry of Industry for sole agency agreements are clearly enumerated in Decree Number 295. This agreement will be closely reviewed by the Ministry before issuance of its approval and recognition letter. Ministry of Industry agency agreements are among the few private agreements whose terms are regulated, the general rule being wide freedom of contract. The agreement must include specific conditions.

The agent must be an Indonesian legal body, not an individual. The agent for one line of goods must be given priority to handle any additional line of goods of the principal to be imported into Indonesia and, generally, the sole agency must cover the whole of Indonesia. The agent must carry out marketing and must guarantee after-sales service to the customer, employ technical experts where required, and submit semi-annual progress reports to the Ministry of Industry.

The principal must be a company that manufactures goods under its own trade mark. The principal may not engage in any direct sales of goods for which the agent has been appointed and must regularly provide components and spare parts for after-sales service, training and guidance, and information and research and development regarding the products.

The sole agency must be an exclusive arrangement enduring at least three years. In the case of an agency 'which leads toward assembling and manufacturing', the exclusive arrangement must endure for at least five years. The agency may not be transferred by the principal without reference to the Ministry of Industry. After expiration of the term, priority must be given to the same agent for extension.

The agency may not be terminated unilaterally by the principal, except in the event of non-performance or insolvency or liquidation of the agent. In the event of termination by the principal, the principal must compensate the agent for remaining inventories, capital investments, and severance of its personnel, and also must continue to provide spare parts for at least two years, during which time the agent will remain responsible for after-sales service to its customers. This last requirement will not apply to the appointment of a new agent, but the new appointment will not be approved by the Ministry until all matters related to the cancellation of the agreement with the former agent have been settled.

Dispute resolution, unless resolved amicably, must be submitted to Indonesian arbitration, under the rules of the Indonesia National Board of Arbitration (*Badan Arbitrase Nasional Indonesia*, BANI)(further discussed in the section 'Dispute Resolution').

If the products to be imported are not among those enumerated in the Ministry of Industry's implementing regulations to Decree 295, the agent or distributor

may register its sole agency or distribution agreement directly with the Ministry of Trade. Procedures and requisites for agreement content are not as clearly outlined, freedom of contract prevails, and it is not necessary for either the form or the content of the agreement to be approved by the Ministry to be registered.

Once registered, however, the Indonesian agent is well protected against termination of the agency or appointment of an alternative agent, at least for the same product line; regardless of the termination provisions set out in the agreement, the Ministry of Trade is unlikely to accept a new agent without the consent of the previous agent.

Production under License

If the foreign party wishes to have its product produced in Indonesia but does not wish to participate in the ownership of a foreign investment joint venture company, it may license a local company to produce the product and to use the name, formulae, and other proprietary information necessary for production.

The foreign company could sell some (or even all) of the ingredients and/or components to the local production company, license the production and trademarks, authorize local distribution and/or purchase some or all of the production back for international distribution, and, if required, provide technical assistance to the production company.

Management Contract

A foreign company may enter into a management contract to manage and/or operate a project or facility, such as a power plant or a hotel, owned by Indonesian interests.

There is no compliance necessary; however, a management contract, in and of itself, constitutes a permanent establishment for the foreign managing company, thus rendering it a resident for income tax purposes (further discussed in the section 'Tax Considerations'). This is true even if all of the personnel become employees of the Indonesian company.

Technical Assistance

Foreign companies may render technical assistance to Indonesian companies through various types of technical assistance arrangements.

Until 1994, if the technical assistance was performed by the foreign company entirely outside Indonesia — such as offshore procurement or the rendering of architectural or engineering drawings that were subsequently shipped in — there was no Indonesian income tax exposure. This situation has changed under the new Income Tax Law,⁴⁸ but still applies to payments made to qualified residents of countries with which Indonesia has a double-taxation treaty.

48 Law Number 10 of 1994.

If the technical assistance is performed in Indonesia by personnel of the foreign company, the foreign company would probably be deemed to be a resident for income tax purposes.

Intellectual Property Rights Licensing

Indonesia has recently promulgated new patent,⁴⁹ trade mark,⁵⁰ and copyright⁵¹ legislation to protect intellectual property rights, not only of Indonesian owners, but also of foreign owners.

Registration of trademarks and copyrights is neither complicated nor particularly expensive, and the laws provide for criminal penalties for violations. Patents are, of course, somewhat more complicated, and implementing regulations are still in process, but it is the clear intention of the government to protect these rights and to bring Indonesia up to western standards in these matters. The evidence of this is a constant crackdown on counterfeit products that were once quite common in Indonesia.

Franchises and other licensing arrangements are common and, as with almost all other types of international business relationships, the parties are free to contract for such matters in accordance with their own requirements, within the general framework of contracts and subject to the relevant laws.

Financial Sector

Foreign banks, licensed by the Ministry of Finance, are permitted to operate in Indonesia and may engage in most normal banking activities within the framework of the banking regulations and limitations as promulgated, from time to time, by the Ministry of Finance.

Joint ventures in the financial sector, such as banks, leasing companies, insurance companies, and capital market or venture capital companies, also are permitted. These joint ventures are regulated not by the BKPM but directly through the Ministry of Finance.

The general application procedure and requirements for joint ventures in the financial sector are generally the same as for normal PMA joint ventures (discussed in the earlier section 'Forms of Foreign Participation in Business'). The only differences are that the required capitalization will differ, depending on the type of business to be transacted; the financial stability of the parties is more closely scrutinized; and, although the maximum foreign interest permitted now varies between 80 to 90 per cent, depending on each business,⁵² there is no requirement to divest below the initial level later on.

49 Fourth Amendment to the Income Tax Law (Law Number 36 of 2008).

50 Law Number 15 of 2001.

51 Law Number 19 of 2002.

52 Government Regulation Number 77 of 2007, as amended by Government Regulation Number 111 of 2007.

Legislative Framework for Agreements, Licenses, and Permits

Agreements

Formal Requirements

Notarial deeds and other agreements subject to government regulation, including production sharing contracts, employment contracts, articles of association, sole agency and joint venture agreements, and those relating to property situate in Indonesia, such as leases and mortgages (*hak tanggungan*), must be governed by Indonesian law. Most other cross-border private agreements may be governed by the parties' choice of law. As a practical matter, however, few Indonesian judges are willing to apply foreign law; should a dispute arise that must be heard in an Indonesian court, it is best to have chosen Indonesian law to govern the agreement at the outset.

Most private agreements not required to be in the form of notarial deeds may be in any language, but also should be translated into Indonesian. The Indonesian language is often not sufficiently precise for the interpretation of complex business points, and thus it is wise to obtain a very good translation of any agreement made in Indonesian into English or the language of the foreign party, to be able to ensure that the agreement does set out what has been agreed on by the parties. The agreement also should state which version is to prevail in case of inconsistencies.

An agreement will be valid if it meets the legal requirements (as discussed in the earlier section, 'Law of Contracts') and is properly executed. For private agreements executed in Indonesia, the parties need only execute the document on dated, stamped paper of IDR 6,000 (approximately US \$0.75); the execution will be binding on the party that has executed the agreement, even in a court of law.

For stronger proof of execution, the signatures should be legalized by a notary. Certain documents must be executed in the form of a notarial deed to be effective. These include documents of transfers of real property or shares in Indonesian companies, deeds of establishment of Indonesian companies, or amendments to the deeds of establishment, and certain financial instruments that have the force of law. In a notarial deed, not only the execution but also the actual contents of the document are sworn to and notarized.

Powers of attorney or other documents executed outside Indonesia should be executed before an Indonesian Consulate in the country in which they are executed to have legal force within Indonesia. Local notarization also will suffice, but in this case the signature of the notary must be legalized by the government of the country in which the notary serves and the governmental signature then legalized by the Indonesian Consulate or Embassy in that country.

Dispute Resolution

Access to the courts is freely available to any aggrieved party in Indonesia, although the judicial process is slow and uncertain. However, if an agreement

contains a clause calling for arbitration, the courts may not entertain jurisdiction. If arbitration is the preferred method of dispute resolution, the relevant agreement should contain a clear arbitration clause, setting out the location for arbitration, the language of the arbitration, and the preferred number of arbitrators and the method of their appointment.

Indonesia's Arbitration Law⁵³ allows the parties to mutually designate any arbitral institution to administer the arbitration or any *ad hoc* rules to govern the procedure. If no institution or rules are designated, the rules contained in the Arbitration Law will govern the procedure. Indonesia's national arbitral body, BANI, has adopted new rules consistent with those of the Law and comparable to the International Chamber of Commerce (ICC) rules. Reference to BANI arbitration must be clearly specified in the agreement from which the dispute arises or should otherwise be mutually agreed upon, in writing, by the parties.

Foreign arbitration also may be agreed upon. Indonesia is a signatory to the 1958 United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the New York Convention) and the International Center for the Settlement of Investment Disputes (ICSID) Convention.

The Arbitration Law sets out in detail the procedures for enforcement of foreign-rendered awards in Indonesia, which does not differ substantially from procedures for enforcement of domestic awards. The Arbitration Law also includes provisions supporting alternative means of dispute resolution (ADR).

There is currently a draft Courts (Consolidation and Reform) Bill, providing further procedures to make ADR more effective. The provisions in this draft bill complement the Law Reform Commission's report on ADR, published in November 2010.⁵⁴ Most disputes are settled through negotiation in any case, and it is hoped that expansion of ADR practices will continue to reduce court and arbitral caseloads.

Licenses and Permits

All businesses require business licenses issued by the Department of Trade and usually by the local government in the location where the business is to be transacted. The normal business license, known as *Surat Izin Usaha Perdagangan* (SIUP), is difficult to obtain, even provided all regulations are being complied with. Certain other types of businesses will require certain other specific licenses, depending on the practices and regulations of the ministry or other governmental authority having jurisdiction over the corresponding field of activity.

53 Law Number 30 of 1999 regarding Arbitration and Alternative Dispute Resolution.

54 Law Reform Commission, *Report on Alternative Dispute Resolution: Mediation and Conciliation* (2010), available at http://www.lawreform.ie/_fileupload/Reports/r97Courts.pdf.

Foreigners entering Indonesia require visas, except when they are from certain countries.⁵⁵ The major Indonesian air and seaports have facilities to issue two-month, single-entry tourist or business visas to citizens of certain countries. Tourist visas, social visit visas, and multiple-entry business visas may be obtained at any Indonesian Consulate in a matter of one or two days.

The current regulation⁵⁶ requires a visa fee to be paid for the entry of citizens from most countries, except those under particular circumstances.⁵⁷ Business visas also may be obtained at any Indonesian Consulate before departure to Indonesia. A business visa will permit a foreigner to discuss and transact business in Indonesia on behalf of his foreign company or principal, but not to be employed by or perform any work or service for or on behalf of an Indonesian entity.

To be employed to work in Indonesia, a temporary residence visa must be obtained from the local immigration office, and a work permit must be obtained from the Department of Manpower. These can only be obtained through or by an Indonesian sponsor, and it must be established that it is necessary that a foreigner is appointed to the relevant position either because no Indonesian is qualified or because of a necessity or benefit to the Indonesian economy or other interests.

Work permits are issued on an annual basis and may be extended, although it is expected that the foreign employee will transfer technology to Indonesians so that his position may be filled by an Indonesian in due course.

Foreign investors are entitled to obtain work permits for a certain number of expatriate personnel in accordance with the terms of their investment application and the approval granted, and the BKPM will assist in obtaining these permits and residence visas.

Investment in Real Estate

Title to and Rights in Land

Title to land in Indonesia follows a totally different system from that of most western countries. Indonesian land legislation does not recognize the concept of freehold land ownership; instead, the various rights attached to land are divided into separate elements and are subject to separate titles.

The closest equivalent to the common law 'fee simple' or freehold is *Hak Milik*, or the right to own, which is a full and infinite ownership of the land, but is available only to Indonesian individual citizens and certain other entities designated by the government. Thus, no foreign company or interest will be entitled to actually 'own' land in the sense that is generally understood in western countries.

55 Law Number 6 of 2011.

56 Government Regulation Number 38 of 2009.

57 Government Regulation Number 38 of 2009, art 3.

The Agrarian Law⁵⁸ recognizes seven types of land rights, including *Hak Milik*. Only three of these types of rights are available to foreign entities: the right to engage in agricultural or similar business on the land (*Hak Guna Usaha*, HGU), the right to build on the land (*Hak Guna Bangunan*, HGB), and the right of use (*Hak Pakai*).

HGU, or the land cultivation right, is the right to use state-owned land for purposes of agriculture, including plantation, fishing, or cattle-raising. Under the new Investment Law, an HGU title will be granted for 35 years, extendable for an additional 25 years if the land is properly maintained and managed.⁵⁹ Further renewals also may be made subsequently.

HGU is given to Indonesian persons or legal entities domiciled in Indonesia, including PMA (foreign investment joint venture) companies (discussed in the earlier subsection ‘Foreign Direct Investment Companies’), and can be used as collateral.

HGB is the right to construct and own buildings on the land and may now be granted for 30 years, extendable for another 20 years, and may be renewed at the discretion of the National Agency of Land Affairs for a maximum of a further 30 years, provided the land continues to be properly utilized.⁶⁰ HGB may be held by individuals or companies, including PMA companies, and may be used as collateral.

Hak Pakai, or right to use land for any purpose for a certain period, is now bestowed for a period of 25 years, extendable for another 20 years, and may be renewed for up to 25 more years. This right may be bestowed for an indefinite period on ministries and other representatives of foreign countries or religious or social agencies.⁶¹

A *Hak Pakai* title may be held by any Indonesian interests, by foreign companies, or even by foreign individuals domiciled in Indonesia and, under the regulations promulgated in 1996,⁶² also may be used as collateral. Subsequent regulations also set out parameters for ownership of dwelling houses by foreigners.⁶³

Leasing of land also is available to foreign as well as Indonesian interests, but the lessor remains the holder of the title and the lessee takes only a contractual lease right, *Hak Sewa*. There is no legal limit on the duration of a lease. Because of the superiority of the *Hak Milik* title, the general trend for Indonesian companies and PMA companies alike is for the individual shareholder to take or

58 Law Number 5 of 1960, *State Gazette* 1960, Number 104.

59 Investment Law, art 22a. Art 22 has been corrected by the Constitutional Court in its Decision in Case Number 21-22/PUU-V/2007, stating that reference on this matter is made to Government Regulation Number 40 of 1996.

60 Government Regulation Number 40 of 1996.

61 Government Regulation Number 40 of 1996.

62 Government Regulation Number 40 of 1996.

63 Government Regulation Number 41 of 1996.

retain a *Hak Milik* title in the land and lease the land to the company on a long-term, renewable basis.

Land held by way of certificated titles can be ‘mortgaged’ by establishment of a *Hak Tanggungan* covering the property, and the rights of the creditor can be further secured by the physical holding of the actual title document (*Sertipikat*), which embodies the ownership right. Theoretically, only one *Sertipikat* will be issued to cover any parcel of land, and a duplicate cannot be issued without surrender of the existing one. In the past, there have been some cases of improper issuance of duplicate *Sertipikats*, but this practice is very much on the wane. As a general rule, possession by one party of the original *Sertipikat* of the land will prevent any kind of alienation by any other party.

Foreign investors who obtain mining contracts from the Minister of Mines and Energy or forest exploitation rights from the Ministry of Forestry may automatically use the land within their concession boundaries for purposes directly related to their business license, in some cases even when the land is held by other persons by a *Hak Milik* or a lesser title. When investors want to use the land for a different purpose, a special application must be made to the Ministry concerned.

Industrial Estates

Certain areas have been established to provide the facilities for foreign investment projects to set up their factories within the industrial area. The advantage of having the factory within such an area is that the infrastructure has been set up and waste disposal is controllable.

The trend is that it is preferable to have industries clustered together to avoid the kind of environmental problems that arose in the past, when industries were scattered throughout residential and agricultural areas.

Security

In General

The general rule on responsibilities in Indonesian law is that all property of a person, movable or immovable, present or future, becomes a guarantee for all personal obligations.

Generally, however, this responsibility is not considered sufficient to secure most indebtedness of debtors, and thus specific security is often required. Specific security is characterized as either ‘real security’ (*jaminan kebendaan*), such as a hypothec (mortgage), pledge, or fiduciary transfer of proprietary rights, or as personal security (*jaminan perorangan*), such as a guarantee.

Hypothec

The best security, of course, is a mortgage. This would be in the form of *Hak Tanggungan* for real property or a hypothec for seagoing vessels only, and is referred to generically as a ‘mortgage’.

A mortgage may be perfected by endorsement on the *Sertipikat* of land, or the marine document of a seagoing vessel, and registration at the respective registry office (local agrarian office if for land, or the Directorate of Sea Communications for vessels). Mortgage documentation will contain an irrevocable power of attorney to sell the property at public auction in case of default. However, the creditor may only sell the property; he may not simply appropriate it.

A mortgage may only exist as security for a principal obligation set out in a loan agreement or an acknowledgment of indebtedness. It may secure the initial debt and any interest and further advances or future debts. The mortgage attaches to the property and remains valid even if the property should pass to a third party. A mortgage must be in the form of an authentic act or deed and thus must be drawn up by a notary or other authorized public official. Successive mortgages may be registered and have priority according to their chronological date of registration.

Foreign interests may hold a mortgage for security purposes and may sell the property on foreclosure, but may not purchase at a foreclosure sale unless the title is a *Hak Pakai*.

As a practical matter, the mortgage itself is rarely executed by the debtor. Instead, the practice is for the debtor to execute, in favor of the lender, a power of attorney to create a mortgage, also in notarial form.

Recent regulations restrict the validity of such powers of attorney to one month only, and thus it is essential to affect registration immediately or risk losing the priority status of the mortgage lien.

In case of bankruptcy of the debtor, the property will be deemed the property of the holder of the mortgage (to the extent of the outstanding debt) over and above all other creditors (with certain statutory exceptions).⁶⁴

Pledge

In a pledge situation, the actual movable property of the debtor is delivered to the creditor or to a third party to hold, pending repayment of the debt. If the pledgor defaults on the debt, the property may be sold by the creditor at public auction or, with the court's permission, the creditor may retain the property for itself in part or full satisfaction of the debt, with any shortfall or excess to be recompensed, as ordered by the court.

Shares in a company may be pledged by deed, but the pledge is only effective if the original share certificates are delivered to and held by the pledgee.

Fiduciary Transfer of Propriety Rights

The Fiduciary Law⁶⁵ has now codified this type of security interest and given it priority in bankruptcy. By this instrument, which requires a notarial deed and

64 Law on Bankruptcy (Law Number 37 of 2004), effective since 18 October 2004.

65 Law Number 42 of 1999.

must be registered in a special registry, the debtor executes a transfer of his rights of ownership in movable collateral, such as machinery or equipment, while still retaining physical possession of such collateral when the machinery or equipment is required in its operation or production.

A fiduciary right also may cover intangible rights *in rem*, such as accounts receivable and insurance proceeds. The transfer of these rights is executed in a fiduciary capacity and for the purpose of security. If there are any documents evidencing title to the property, these also should be held by the creditor. The borrower is required to maintain the property properly and to keep the property insured, as is customary when holding property in trust.

A fiduciary right differs from a pledge primarily in that the collateral itself is not delivered into the possession of the creditor. Theoretically, in case of default by or bankruptcy of the debtor, the creditor may claim and sell the collateral directly.

Acknowledgment of Indebtedness

Another form of documentary security for a loan that has evolved, although not provided for in the basic laws, is a notarial deed of acknowledgment of indebtedness (*Grosse Akte*). The debtor swears before a notary that he is indebted to the creditor in a certain amount and will repay the amount on a certain date.

In case of non-payment, this document establishes the debt at the outset, and the debt itself need not be proved in court, although the creditor would still need to apply to the court to attach or sell any assets.

Other Forms of Security

Other normal forms of security, such as assignment of accounts receivable, letters of credit, and bank guarantees, as well as personal and corporate guarantees and the like, also are commonly used, as appropriate. Lease financing also is often utilized, both for its security and its tax advantages.

Bank Restructuring Agency

As a result of the Asian economic crisis of 1997–1998, Indonesia set up a Bank Restructuring Agency (*Badan Penyehatan Perbankan Nasional*, BPPN), which took over distressed banks and the non-performing loans of other banks.

Government Regulation Number 17 of 1999 gave extraordinary powers to the BPPN to enforce and execute against security when bad debtors fail to meet their restructured obligations, so that such recovery can be effected without reference to the courts.

The BPPN was terminated *de jure* on 27 February 2004 by Presidential Decree Number 15 of 2004 and *de facto* on 30 April 2004. An Asset Management Company (PT *Perusahaan Pengelola Aset*, PT PPA) was established by

Presidential Decree Number 15 of 2004 (regarding the termination of BPPN's duty) and Government Regulation Number 10 of 2004 (regarding the establishment of the PT PPA) to finalize disposal of the assets that remained with BPPN upon its dissolution.

Taxation

Legislative Framework

In 1983, Indonesia enacted three new tax laws that brought taxation in Indonesia into the modern world, providing an integrated system of self-assessment and affording some certainty to what was previously a rather arbitrary system of tax collection.⁶⁶

Substantial amendments were made to each of these laws in 2004 to address some of the concerns that had arisen regarding the new tax laws. Thus, Indonesia's tax regime is embodied primarily in the Law on General Tax Provisions,⁶⁷ as amended,⁶⁸ the earlier Income Tax Law,⁶⁹ as amended,⁷⁰ and the Law on Value-Added Tax on Goods and Services and Sales Tax on Luxury Goods,⁷¹ as amended.⁷² Further amendments are under consideration, and other tax laws have been or are in the process of being modernized as non-oil revenues become more important to the nation's economy.

Income Tax

The Income Tax Law provides for tax collection based on self-assessment, requiring taxpayers to make monthly or other periodic prepayments toward their own tax obligation or toward withholdings against their creditors' tax obligations. Taxpayers must prepare and file an annual tax return by the end of March in the year following that to which the return relates, paying at that time the full balance of their income tax, based on their worldwide income.

Based on the regulation on income tax, the earlier tax rate for corporate resident taxpayers at a single rate of 28 per cent has been reduced to 25 per cent since 2010.⁷³ This measure aimed to attract more investors as well as to

66 This section is a very brief summary of the Indonesian tax laws. Detailed information is provided in the loose-leaf publication *Taxation Laws of Indonesia*, published by the International Bureau of Fiscal Documentation (Amsterdam).

67 Law Number 6 of 1983.

68 By Law Number 9 of 1994 and its amendment, Law Number 16 of 2000, which has again been amended by Law Number 28 of 2007 and Law Number 36 of 2008 (Fourth Amendment of the Income Tax Law).

69 Law Number 7 of 1983.

70 By Law Number 7 of 1991, Law Number 10 of 1994, Law Number 17 of 2000, and Law Number 36 of 2008.

71 Law Number 8 of 1983.

72 By Law Number 11 of 1994 and Law Number 18 of 2000.

73 Law Number 36 of 2008, art 17(2a).

promote the development of small and local enterprises in the private sector. Based on the government's consideration, there has been a lot of support for an immediate income tax cut to 25 per cent starting from tax year 2010, to make the country more competitive in netting investors and boosting private sector investment.

This system of new rates differs from the previous system in that it has three scales, depending on the income of resident individual taxpayers, as indicated in Table I.

Table I: Income Tax Rates for Resident Individual Taxpayers

| Income | Tax |
|------------------------------------|--|
| Up to IDR 50,000,000 | 5% |
| IDR 50,000,001 to IDR 250,000,000 | IDR 2,500,000 plus 15% on excess of IDR 50,000,000 |
| IDR 250,000,001 to IDR 500,000,000 | IDR 32,500,000 plus 25% on excess of IDR 250,000,000 |
| More than IDR 500,000,000 | IDR 95,000,000 plus 30% on excess of IDR 500,000,000 |

Resident taxpayers include not only Indonesian individuals and companies, but also foreign individuals resident or working in Indonesia and foreign companies that regularly carry on business in Indonesia so as to be deemed to have a 'permanent establishment' in Indonesia, as defined in either the Income Tax Law or in any relevant convention for the elimination of double taxation (tax treaty) which may be in force between Indonesia and the country of domicile of the relevant company.

As a general rule, a foreign company that is deemed to have a permanent establishment in Indonesia is subject to the domestic income tax laws as a resident. This provision includes any foreign company that maintains an office (including a representative office); a seat of management; an office building; or a construction project, mine, or natural resource site; or provides consulting or other services through its employees or other personnel in Indonesia. In addition, the after-tax profits of a permanent establishment will be subject to a final withholding tax at a rate of 20 per cent under the Income Tax Law or (usually) at a reduced rate if domiciled in a country that has a tax treaty with Indonesia.

A PMA company is an Indonesian company and thus clearly a resident taxpayer, subject to all the domestic income tax laws. Ownership of shares in a PMA company does not, in itself, constitute a permanent establishment for the foreign shareholder, although other activities of that shareholder, such as provision of technical services in Indonesia, may do so.

Resident taxpayers also are required to keep proper books of account and to make withholdings of income tax against certain payments made to third parties,

both residents and non-residents, and pay these to the tax office. Payments subject to withholding include dividends, interest (except interest paid to a resident bank), royalties, rents, and payments for technical, management, and professional services. When paid to non-residents, such withholding is generally at a rate of 20 per cent, which is a final tax with respect to the income from that payment. The rates are reduced for residents of countries that are party to tax treaties with Indonesia.

When payments are made to Indonesian resident taxpayers, most withholdings are at a rate of 15 per cent, except for payments for management, constructions service, consultant services, and other services which are subject to withholding at 2 per cent.⁷⁴ As mentioned previously, such withholdings are credited as prepayments toward the annual income tax obligation of the recipient of the payment against which the withholding was made.

At the time of writing, there are more than 57 tax treaties in force between Indonesia and other nations and several other such treaties in various stages of negotiation or ratification. Tax treaty rates on dividends and interests are provided in Appendix A1. Appendix A2 lists the countries and the reduced withholding rates for each with respect to interest, dividends, royalties, and after-tax profits of a permanent establishment.

Taxable income is determined by deducting from gross income certain expenses incurred by the resident taxpayer in earning its income, including depreciation of capital assets. The rate of depreciation will depend on the class of asset (based in most cases on its deemed useful life) and will range from 50 per cent to 10 per cent annual depreciation, on either a straight line or a declining balance basis.

Payroll Tax

Employers of resident individual taxpayers must make prepayments toward the annual income tax of all personnel resident in Indonesia, Indonesian and foreign nationals alike.

Unlike other withholdings, this ‘payroll’ tax does not need to be grossed-up if borne by the payer (employer) rather than withheld from the remuneration of the recipient (employee). The usual practice, although not mandatory, is for employers to bear payroll tax and to pay salaries net of tax.

Value-Added and Sales Taxes

Value-added tax (VAT) of 10 per cent is imposed on payment for imports, manufactured goods, and almost all services. If the payer is registered as a VAT collector and thus charges VAT to its customers, the VAT paid out may be credited against any VAT collected before remission of the collected amount of VAT to the tax office.

⁷⁴ Law Number 36 of 2008, art 23(1)(a) and (c).

There also is a sales tax on luxury goods, which ranges from 10 per cent to 35 per cent. A PT PMA company may be granted certain deferments and exemptions of VAT and sales tax on luxury goods.

Tax on Land Buildings

Every person or entity who owns a right in land, obtains the profit or utility of land, or owns, occupies, and/or obtains the utility of the improvements on land, is required to pay property tax, calculated at the rate of 0.5 per cent of the 'taxable sale value' of the property (*Pajak Bumi dan Bangunan*).⁷⁵

The taxable sale value is determined as 20 per cent of the 'sale value', which is determined by the government based on the average price of the land and buildings, adjusted according to location, neighborhood, type of title held, and other relevant factors. The taxpayer is entitled to deduct from the sale value of a residence an amount of up to IDR 8,000,000 as non-taxable value.

Taxpayers may apply for a reduction of the tax if they can show that the 'sale value' determined by the government is out of line with the market or, in the case of pensioners or persons with disability, that they simply can no longer afford the tax.

Customs Regulation, Foreign Exchange, and Investment Incentives

Customs Regulation

Goods imported into Indonesia are subject to customs duties. The foreign investment approval may entitle a PMA joint venture company to exemption from customs duties on equipment, parts, materials, and components that will be used in their production, provided this is reported to the BKPM on a 'master list' in a timely manner.

Customs duties vary and are constantly being adjusted, and clearance procedures are complicated and time consuming.

Foreign Exchange

There are no exchange control regulations and no restrictions on repatriation of profits (provided proper tax has been paid) or removal of assets, but there are reporting requirements for transfers with a value equivalent to US \$10,000 or more. The Foreign Investment Law provides that foreign shareholders in PT PMA companies have the right to transfer out their after-tax profits, depreciation of fixed assets, and certain other costs in the original currency of the invested capital, calculated at the exchange rate at the time of investment approval.

The Indonesian rupiah is pegged to the United States dollar. Prior to the economic crisis of 1997–1998, the value was controlled by a market-generated

75 Regulated by Law Number 12 of 1985, as amended by Law Number 12 of 1994.

float which had manifested in a very gradual downward trend, dropping only between 2 per cent and 5 per cent against the dollar each year. The rupiah was allowed to float freely from late 1997, with a resulting rapid drop to as low as 15 per cent of its mid-1997 value.

The currency has recovered significantly in the past year or so, but still has not risen above a third of its pre-crisis value. The government has guaranteed that all major currencies are freely convertible in Indonesia, and the International Monetary Fund has declared the rupiah to be a fully convertible currency.

Investment Incentives

In keeping with the effort to increase and attract foreign trade and investment, Indonesia has established a system of duty-free bonded zones in two locations of strategic importance. The bonded zones combine the characteristics of a free trade zone and an industrial estate. A bonded zone is an area with definite limits within a customs area in Indonesia where specific rules prevail in the customs domain.⁷⁶

Each bonded zone is supported by an infrastructure comprising an advanced system for cargo handling, shipping, and communications. The bonded zones enable manufacturers to import, store, and transship goods and components free of all duty when used in the production of goods for export. The already established bonded zones include the whole of Batam Island, just south of Singapore, and an area of approximately nine hectares (22.5 acres) in Jakarta's main commercial port, Tanjung Priok.

The Batam Authority administers Batam, and applications for investment approvals on the island must be made directly to the Authority. Applications from foreign investors are then processed by the BKPM with assistance from the Batam Authority.

The Tanjung Priok free trade zone is administered by PT *Kawasan Berikat Nusantara*, a semi-governmental organization. The Indonesian government intends to build additional bonded areas to facilitate international trade and industry.

Entrepôts for Exports

Pursuant to a government regulation,⁷⁷ 14 state companies have been set up to develop and manage certain industrial estates with the special status of bonded zones, designed to aid export-oriented industry.

Factories in such estates, including those owned by joint venture PMA companies, may import their base materials, ingredients, components, and spare parts free of

⁷⁶ Government Regulation Number 22 of 1986, as amended by Government Regulation Number 14 of 1990.

⁷⁷ Government Regulation Number 14 of 1990.

import duty. Companies operating in these entrepôts may now also sell up to 25 per cent of their production back into Indonesia.⁷⁸

Competition Law

Law on Monopolistic Practices and Unfair Business Competition

In the aftermath of the Asian economic crisis in 1998, the focus on trade and investment liberalization became a major issue in Indonesia. A key measure to promote investment, trade, and stronger competition called for the elimination of barriers to entry in order to ensure equitable opportunities to new market entrants and to promote consumer welfare.

The Law Concerning the Ban on Monopolistic Practices and Unfair Business Competition (the Competition Law)⁷⁹ was enacted on 5 May 1999, granting companies six months to comply with its provisions, and was fully implemented in September 1999. The purpose of the Competition Law is to protect public interest so as to improve national economic efficiency; to ensure equal treatment for small, medium, and large businesses; to prevent monopolistic practices and unfair competition; and to improve the overall efficiency of business operations.

The Competition Law contains specific provisions on prohibited agreements,⁸⁰ prohibited activities,⁸¹ dominant position,⁸² and exemptions.⁸³

The Competition Law defines monopolistic practices:

‘Monopolistic practices is the centralization of economic power by one or more entrepreneurs causing the control of production and/or marketing of certain goods and/or services, resulting in an unfair business competition and can cause damage to the public interests.’⁸⁴

Unfair business competition is defined as:

‘Unfair business competition is the competition among entrepreneurs in conducting their production activities and/or in marketing goods and/or services, conducted in a manner which is unfair or contradictory to the law or hampering business competition.’⁸⁵

The Competition Law also contains several provisions on presumptions based on market share.

78 Additional information (in Indonesian) is available on the Customs and Excise website at <http://www.beacukai.go.id/library/readLib.php?ID=1523&Ch=23>.

79 Law Number 5 of 1999.

80 Competition Law, arts 4–16.

81 Competition Law, arts 17–24.

82 Competition Law, arts 25–28.

83 Competition Law, art 50a to 50i.

84 Competition Law, art 1(2).

85 Competition Law, art 1(6).

Companies are prohibited from entering into contracts with other companies with the intention of jointly controlling the production and/or the marketing of goods and services that can cause monopolistic practices and/or unfair business competition.

Companies may be deemed to jointly control production if two or three companies or groups of companies own more than 75 per cent of the market share of a particular type of product or service.⁸⁶

Companies are prohibited from controlling any production and/or marketing of products and/or services that could result in monopolistic practices or unfair business competition. They may be suspected of doing so when the relevant products and/or services are not substitutable at that time, or when their conduct prevents other companies from entering the market with the same type of products or services, or when a company or a group of companies controls more than 50 per cent of the market share of one type of certain products or services.⁸⁷

Companies are prohibited from controlling supplies or being the sole purchasers of goods and/or services in the relevant market when this conduct could result in monopolistic practices and/or unfair business competition. They may be suspected of doing so if a company or a group of companies controls more than 50 per cent of the market share of the same type of certain goods or services.⁸⁸

Companies are prohibited from holding majority shares in several companies engaged in the same business sector in the same relevant market or from establishing several companies engaged in the same business activities in the same relevant market.

This prohibition only applies if the ownership results in one company or a group of companies controlling 50 per cent or more of the market share of one type of product or service or results in two or three companies or groups of companies controlling 75 per cent or more of the market share of one type of products or services.⁸⁹

The prohibitions on anti-competitive practices in the Competition Law seem to include both rule of reason (as indicated by the phrase ‘that may result in monopolistic practices and unfair competition’) and illegality.

Conduct subject to the rule of reason regarding monopolistic practices or unfair competition includes ‘the intention to divide the marketing areas or market allocation of the goods and/or services’,⁹⁰ ‘the intention to influence the price by determining production and/or marketing of goods and/or services’ (cartels),⁹¹ joint collaboration with ‘the intention to control production and/or marketing of

86 Competition Law, art 4.

87 Competition Law, art 17.

88 Competition Law, art 18.

89 Competition Law, art 27.

90 Competition Law, art 9.

91 Competition Law, art 11.

goods and/or services’,⁹² and ‘conspiring with other parties to arrange and/or determine the winner of the tender’ (bid rigging).⁹³

Conduct that could be illegal includes price discrimination;⁹⁴ exclusivity in supply, tying, reciprocal dealing, and exclusive dealing;⁹⁵ abuse of dominant position;⁹⁶ and cross-share ownership.⁹⁷

Supervision of Business Competition

The Competition Law established the Business Competition Supervisory Commission (*Komisi Pengawas Persaingan Usaha*, KPPU),⁹⁸ which is responsible for the enforcement of the Law. The KPPU is authorized to investigate and report on possible violations of the Competition Law.⁹⁹

The primary functions of the KPPU are law enforcement, competition advocacy, and issuing guidelines and policy statements. To this end, the KPPU investigates and enforces the provisions of the Competition Law, provides advice on government regulations and legislative measures on monopolistic and/or unfair practices, and publishes the required guidelines.

The KPPU may initiate an enquiry into alleged violations of the Competition Law based either on a report (complaint) from an aggrieved party or on its own initiative.

The complaint report will only be considered if it is complete. To be deemed complete, the report must be in writing, in Indonesian, and must include the complainant’s name, address, and signature; must provide the details of the alleged violation; and must include supporting evidence or documentation.

If the KPPU finds a report incomplete, it will notify the complainant, along with details of the missing information. The complainant has 10 days to complete the report and re-submit it. If no notice is given, the report is deemed complete. The KPPU’s decisions can be appealed to the district court, and a final appeal may be made to the Supreme Court.

Labor Law

One of the primary attractions for foreign companies to set up production facilities in Indonesia is the enormous and relatively inexpensive labor force. The government is eager to improve skills and expects both foreign and domestic projects to include provision for training and transfer of technology.

92 Competition Law, art 12.

93 Competition Law, art 22.

94 Competition Law, art 6.

95 Competition Law, art 15(1)–(3).

96 Competition Law, art 25.

97 Competition Law, art 27.

98 The KPPU was established under the Competition Law, arts 30–37, and Presidential Decree Number 75 of 1999.

99 Competition Law, arts 38–46.

Indonesia has clearly defined labor laws and regulations that include minimum wage, regulation of working hours, termination procedures, and the like.¹⁰⁰ These are frequently adjusted, and new labor legislation is under consideration at the time of writing. The currently applicable regulations and practices are summarized below.

Work Hours

The standard work week consists of 40 working hours. These can be spread across up to six days. Overtime is payable for work in excess of eight hours in any one day or in excess of 40 hours in any one week.¹⁰¹

Vacation and Leave

Regulations¹⁰² require a minimum annual vacation of 12 working days. After six years, a long service leave of two months may be given.

Sick leave must be allowed, and a medical certificate should be produced if the employee is absent for three days or longer. Female employees also are entitled to maternity leave of six weeks before and six weeks after birth. In addition, one or two days' compassionate leave is granted for cases of death or certain other rites of passage for immediate family members.

Employees of the Islamic faith also are entitled to one-time leave of up to three months to join a *haj* pilgrimage to Mecca.

Compensation

Although labor is relatively inexpensive (the minimum wage is presently roughly the equivalent of US \$130 per month in Jakarta), some highly qualified technical, financial, or administrative personnel may command compensation nearing the international remuneration scale.

However, even the highest paid local personnel cost the employer far less than employing expatriate personnel, whose compensation packages usually include housing, utilities, schooling for their children, a car and driver, home leave expenses, and even club membership.

100 Law Number 13 of 2003 concerning Manpower; Law Number 12 of 1948 concerning Work; Law Number 21 of 1954 on Agreements Between the Labor Union and the Employer; Law Number 80 of 1957, ratifying the ILO Convention on Equalization of Wages for Men and Women; Law Number 14 of 1969 on Basic Regulations concerning Manpower; and Law Number 1 of 1970 regarding Safety in the Workplace, together with various implementing regulations promulgated from time to time.

101 Law Number 13 concerning Manpower, art 78. Decree of the Minister of Manpower and Transmigration Number 772/MEN/84 of 1984.

102 Law Number 13 concerning Manpower, art 79(2); Decree of the Minister of Manpower and Transmigration Number 10 of 1951; for employees working with heavy machinery, Government Regulation Number 21 of 1954.

In addition to normal compensation, employers are required to pay a thirteenth month's salary as a bonus: before *Lebaran* for employees of the Islamic faith, and before Christmas for Christian employees. In some industries, such as the oil and oil service sectors, it has become the practice to pay a fourteenth month's salary to each employee prior to his taking his annual leave.

Income Tax

Payroll tax, in an amount equal to one-twelfth of the anticipated annual income tax of the employee, must be paid monthly by the employer. This may either be deducted from the employee's salary or covered by the employer without the necessity to gross up. It is the general practice for employers to offer employees salaries net of tax and cover the tax themselves, but there is no legal obligation to do so. For expatriate employees, some employers cover the tax and others deduct or use a tax equalization scheme.

Transport and Meals

It is customary for employers to provide a company transport system to shuttle employees to and from work or to provide employees with a transport allowance that is sufficient to cover public transport. Employees who are required to work overtime, particularly until after dark, are usually provided with the cost of taxi fare to return to their homes. Senior staff may either be provided with a company car or with financial assistance to permit them to purchase a car.

There is no standard or requirement to provide meals or meal allowances, but most companies do provide either lunch in the office, usually through catering services, or a modest allowance to employees.

Medical Allowance

Employees are required to be covered for medical expenses. This can be handled by reimbursement for actual documented costs by a monthly allowance, through enrollment in a medical scheme or clinic, or by private arrangement with a doctor. Group medical insurance also is readily available from most internationally known underwriters.

Probation

The standard period of probation for new employees is three months. Unless specific representations have been made in the terms offered to the employee on engagement, there are no requirements for giving notice and for payment of benefits on termination during the probation period.

After three months, an employee becomes permanent staff, and the full protection of the Ministry of Labor and Manpower regulations, formulated so as to protect employees quite strongly, come into play, making termination a very difficult proposition.

Termination

Termination procedures should be set out in the company's staff rules and regulations, which should be approved by the Department of Labor and Manpower. Violations of company rules usually require three warning letters and counseling to attempt to correct the offense. Immediate termination is permitted for gross violation of the staff regulations or for offenses such as drunkenness, use of narcotics, threatening staff and/or management with violence, or conduct involving moral turpitude, such as theft or other criminal offenses.

Under the Law on Industrial Dispute Settlement,¹⁰³ a special court for labor disputes, the Industrial Court, has been established at each district court at the regency/city level, located in each provincial capital. However, the Law also recognizes several dispute mechanisms such as bipartite negotiation, mediation, conciliation, and arbitration.

The regulations require severance and other termination benefits to be paid, based on length of service and amount of compensation, including all benefits as well as salary.¹⁰⁴ As a general rule, severance in the amount of one-month's full compensation for each year (or part of the year) of service should be paid to any employee terminated for any reason whatsoever.

If an employee does not agree to the termination or to the severance benefits, it is often difficult to justify the termination to the Industrial Court. Moreover, obtaining the Court's approval can take some time, during which interval the employee must either remain engaged by the company or may be suspended on 50 per cent salary, payable for a period of up to six months. Thus, there is generally a tendency to be quite generous in offering termination benefits in an attempt to negotiate termination by resignation, saving time and red tape while also avoiding the possibility of continuing vindictive recriminations on the part of the employee.

Training

It is incumbent on employers to provide ongoing staff training, regardless of the size of the operation. Training programs should be reported annually to the Department of Labor and Manpower, and provision should be made for general employee costs. The benefit of employee training is not deemed to be additional income to the employee and can be deducted as an expense for the employer.

Pension Funds

The Law on Pension Funds¹⁰⁵ governs the establishment and organization of pension funds for those companies that choose to offer them. There is not as yet a blanket requirement to provide pension funds.

103 Law Number 2 of 2004.

104 Decree of the Minister of Manpower and Transmigration Kep-150/MEN/2000 of 20 June 2000, as amended by the Decree of the Minister of Manpower and Transmigration Kep-78/MEN/2001 and Decree of the Minister of Manpower and Transmigration Kep-111/MEN/2001.

105 Law Number 11 of 1992.

Previously, the pension system in Indonesia only applied to civil servants. The enactment of the Law on Pension Funds changed this regime by making pension funds applicable to both public and private employees.

There are two categories of pension funds: the employer's sponsored pension fund (*Dana Pensiun Pencari Kerja*, DPPK) and the financial institution pension funds (*Dana Pensiun Lembaga Keuangan*, DPLK). The DPPK is a defined contribution or defined benefit scheme, while the DPLK is a defined contribution scheme.

Most pension funds are partly funded, and the employers have relatively limited participation. Although the pension fund system has been established by law, private companies have resisted the implementation of the law, and public awareness remains low. The system is in the process of being worked out among the government ministries, the tax office, and the finance and insurance companies.

Workmen's Compensation and Social Security

Employers employing 10 persons or more or having a monthly payroll of IDR 1,000,000 (approximately US \$90) are required by law to make monthly payments into the national insurance fund and the workers' social security system, *Jamsostek*, administered by the Minister of Labor and Manpower.¹⁰⁶

The contribution required for workmen's compensation is in an amount equal to 6 per cent of the base salary of each employee: five per cent to be contributed by the employer and, theoretically, 1 per cent by the employee. The contribution required for social security is 5.7 per cent: 3.7 per cent to be contributed by the employer and two per cent by the employee. In practice, however, these entire amounts are almost always borne by the employer.

Conclusion

With its enormous population and wealth of natural resources, Indonesia presents an excellent opportunity for all types of business, both local and cross-border, to prosper. The stable political climate is an added incentive, particularly with the government making continual efforts to modernize, coordinate, and streamline the various laws inherited from Indonesia's colorful culture and history and to relax requirements and procedures for foreign investment and other international business transactions.

Indonesia enjoys a pleasant tropical climate, with a multitude of as yet relatively undeveloped tourist destinations and a diversity of cultures rich in art and creativity. From the remote outer islands of eastern Indonesia to the booming cosmopolitan metropolis of Jakarta, Indonesia offers the full range of opportunities for foreign investment.

¹⁰⁶ Government Regulation Number 14 of 1993.

A list of addresses of some of the relevant ministries and other governmental authorities and private organizations is attached as Appendix B for those wishing to pursue business opportunities directly. Readers also are welcome to contact the author for further information or assistance at any time.

Appendix A: Tax Treaty Rates on Dividends and Interest and on Royalties and Branch Profits

Appendix A1: Tax Treaty Rates on Dividends and Interest¹⁰⁷

| Country | Dividends | | | Interest | | |
|----------------|-----------|-------|-------------------------------------|----------|-------|---------------------------|
| | Normal | Lower | Conditions for Lower ¹⁰⁸ | Normal | Lower | Conditions ¹⁰⁹ |
| Algeria | 15 | - | - | 15 | 0 | Government |
| Australia | 15 | - | - | 10 | 0 | Government |
| Austria | 15 | 10 | 25% | 10 | 0 | Government |
| Bangladesh | 15 | 10 | 10% | 10 | 0 | Government |
| Belgium | 15 | 10 | 25% | 10 | 0 | Government |
| Brunei | 15 | 0 | Government | 15 | 0 | Government |
| Bulgaria | 15 | - | - | 10 | 0 | Government |
| Canada | 15 | 10 | 25% | 10 | 0 | Government |
| China | 10 | - | - | 10 | 0 | Government |
| Czech Republic | 15 | 10 | 20% | 12.5 | 0 | Government |
| Denmark | 20 | 10 | 25% | 10 | 0 | Government |
| Egypt | 15 | - | - | 15 | 0 | Government |
| Finland | 15 | 10 | 25% | 10 | 0 | Government |
| France | 15 | 10 | 25% | 15 | 10/0 | Industry/ Government |
| Germany | 15 | 10 | 25% | 10 | 0 | Government |
| Hungary | 15 | - | - | 15 | 10 | Government |
| India | 15 | 10 | 25% | 10 | 0 | Government |
| Italy | 15 | 10 | 25% | 10 | 0 | Government |
| Japan | 15 | 10 | 25% voting stock | 10 | 0 | Government |
| Jordan | 10 | - | - | 10 | 0 | Government |
| Korea, North | 10 | - | - | 10 | 0 | Government |
| Korea, South | 15 | 10 | 25% | 10 | 0 | Government |
| Kuwait | 10 | 0 | Government | 5 | 0 | Government |
| Luxembourg | 15 | 10 | 25% | 10 | 0 | Government |
| Malaysia | 15 | - | - | 15 | 0 | Government |
| Mexico | 10 | - | - | 10 | 0 | Government |
| Mongolia | 10 | - | - | 10 | - | Government |

107 Table obtained from KPMG, *Indonesian Tax Treaties: Quick Reference Guide* (March 2009), available at <http://www.kpmg.com/ID/en/IssuesAndInsights/ArticlesPublications/Documents/TaxTreaties-QRG-February-2009.pdf>.

108 Percentage for lower rate refers to level of shareholding unless otherwise specified.

109 Normally exempt if paid to the government or a subdivision of the government.

| Country | Dividends | | | Interest | | |
|----------------|-----------|-------|-------------------------------------|----------|-------|-------------------------------|
| | Normal | Lower | Conditions for Lower ¹⁰⁸ | Normal | Lower | Conditions ¹⁰⁹ |
| Netherlands | 10 | - | - | 10 | 0 | Government/ loan > 2 years |
| New Zealand | 15 | - | - | 10 | 0 | Government |
| Norway | 15 | - | - | 10 | 0 | Government |
| Pakistan | 15 | 10 | 25% | 15 | 0 | Government |
| Philippines | 20 | 15 | 25% | 15 | 10/0 | Bonds/ Government |
| Poland | 15 | 10 | 20% | 10 | 0 | Government |
| Portugal | 10 | - | - | 10 | 0 | Government |
| Romania | 15 | 12.5 | 25% | 12.5 | 0 | Government |
| Russia | 15 | - | - | 15 | 0 | Government |
| Seychelles | 10 | - | - | 10 | 0 | Government |
| Singapore | 15 | 10 | 25% | 10 | 0 | Government |
| Slovakia | 10 | - | - | 10 | 0 | Government |
| South Africa | 15 | 10 | 10% | 10 | 0 | Government |
| Spain | 15 | 10 | 25% | 10 | 0 | Government |
| Sri Lanka | 15 | - | - | 15 | 0 | Government |
| Sudan | 10 | - | - | 10 | 0 | Government |
| Sweden | 15 | 0 | 25% | 10 | 0 | Government |
| Switzerland | 15 | 10 | 25% | 10 | - | - |
| Syria | 10 | - | - | 10 | - | - |
| Taiwan | 10 | - | - | 10 | 0 | Government |
| Thailand | 15 | - | - | 15 | 0 | Government |
| Tunisia | 12 | - | - | 12 | 0 | Government |
| Turkey | 15 | 10 | 25% | 10 | 0 | Government |
| UAE | 10 | - | - | 5 | 0 | Government |
| United Kingdom | 15 | 10 | 15% voting stock | 10 | 0 | Government |
| Ukraine | 15 | 20 | | 10 | 0 | Government |
| United States | 15 | 10 | 25% voting stock | 10 | 0 | - |
| Uzbekistan | 10 | - | - | 10 | - | - |
| Venezuela | 15 | 10 | 10% | 10 | 0 | Government |
| Vietnam | 15 | - | - | 15 | 0 | Government |

Appendix A2: Tax Treaty Rates on Royalties and Branch Profits¹¹⁰

| Country | Royalties | | | Branch Profits Tax rates N/A to some PSCs |
|----------------|-----------|--------|---|--|
| | Normal | Lower | Lower applies to: | |
| Algeria | 15 | - | - | 10 |
| Australia | 15 | 10 | Equipment/information ¹¹¹ | 15 |
| Austria | 10 | - | - | 10 |
| Bangladesh | 10 | - | - | 10 |
| Belgium | 10 | - | - | 10 |
| Brunei | 15 | 0 | Government | 10 |
| Bulgaria | 10 | - | - | 15 |
| Canada | 10 | - | Excludes technical services | 15 |
| China | 10 | - | - | 10 |
| Czech Republic | 12.5 | - | - | 12.5 |
| Denmark | 15 | - | - | 15 |
| Egypt | 15 | - | - | 15 |
| Finland | 15 | 10 | Copyright | 15 |
| France | 10 | - | Excludes use of equipment | 10 |
| Germany | 15 | 10/7.5 | Equipment, information/technical services | 10 |
| Hungary | 15 | - | - | 20 if transferred/0 if not |
| India | 15 | - | - | 10 |
| Italy | 15 | 10 | Equipment/ information | 12 |
| Japan | 10 | - | - | 10 |
| Jordan | 10 | - | - | 20 |
| Korea, North | 10 | - | - | 10 |
| Korea, South | 15 | - | - | 10 |
| Kuwait | 20 | - | - | 10 |
| Luxembourg | 12.5 | 10 | Technical services | 10 |
| Malaysia | 15 | - | - | 12.5 |
| Mexico | 10 | - | - | 10 |
| Mongolia | 10 | - | - | 10 |
| Netherlands | 10 | - | Excludes technical services | 10 |
| New Zealand | 15 | - | - | 20 |
| Norway | 15 | 10 | Other than copyright | 15 |

110 Table obtained from KPMG, *Indonesian Tax Treaties: Quick Reference Guide* (March 2009).

111 Industrial, scientific, commercial equipment/information, unless otherwise specified.

| Country | Royalties | | | Branch Profits Tax rates N/A to some PSCs |
|----------------|-----------|-------|------------------------|--|
| | Normal | Lower | Lower applies to: | |
| Pakistan | 15 | - | - | 10 |
| Philippines | 15 | - | - | 20 |
| Poland | 15 | - | - | 10 |
| Portugal | 10 | - | - | 10 |
| Romania | 15 | 12.5 | Other than copyright | 15 |
| Russia | 15 | - | - | 12.5 |
| Seychelles | 10 | - | - | 20 |
| Singapore | 15 | - | - | 15 |
| Slovakia | 15 | 10 | Copyright | 10 |
| South Africa | 10 | - | - | 10 |
| Spain | 10 | - | - | 10 |
| Sri Lanka | 15 | - | - | 20 |
| Sudan | 10 | - | - | 10 |
| Sweden | 15 | 10 | Equipment/ information | 15 |
| Switzerland | 12.5 | 5 | Services | 10 |
| Syria | 20 | 15 | Copyright | 10 |
| Taiwan | 10 | - | - | 5 |
| Thailand | 15 | 10 | Copyright | 20 |
| Tunisia | 15 | - | - | 12 |
| Turkey | 10 | - | - | 10 |
| UAE | 5 | - | - | 5 |
| United Kingdom | 15 | 10 | Equipment | 10 |
| Ukraine | 10 | - | - | 10 |
| United States | 10 | - | - | 10 |
| Uzbekistan | 10 | - | - | 10 |
| Venezuela | 20 | 10 | Technical assistance | 10 |
| Vietnam | 15 | - | - | 10 |

Appendix B: Useful Addresses

| | |
|--|--|
| Investment Coordinating Board (BKPM) Badan Koordinasi Penanaman Modal Jl. Gatot Subroto Number 44 Jakarta Selatan Tel: (6221) 525 2008 Website: http://www.bkpm.go.id | The Ministry of Environment B. Building, 2nd Floor, Jl. D.I. Panjaitan Kav. 24 Kebon Nanas Jakarta 13410 Tel: (6221) 8517184 or 8580067 Website: http://www.menlh.go.id |
| The Ministry of Industry Jl. Jend. Gatot Subroto Kav. 52–53 Jakarta Selatan Tel: (6221) 525 5509 Website: http://www.dprin.go.id | Agency for the Assessment and Application of Technology Jl. MH Thamrin Number 8 Jakarta Pusat Tel: (6221) 324 767 or 316 2222 Website: http://www.bppt.go.id |
| The Ministry of Trade Jl. M. I. Ridwan Rais Number 5 Jakarta Pusat Tel: (6221) 381961 | Pertamina (National Oil Company) Jl. Merdeka Timur 1-A Jakarta Pusat Tel: (6221) 381 5111 or 381 6111 |
| The Ministry of Manpower and Transmigration Jl. Gatot Subroto Kav. 51 Jakarta Selatan Tel: (6221) 525 5733 | Ministry of Culture and Tourism Deputy of Tourism Development Jl. Medan Merdeka Barat 17, Lt. 14 Jakarta Pusat Tel: (6221) 383 8401 |
| The Ministry of Finance Jl. Lapangan Banteng Timur 2–4 Jakarta Pusat Tel: (6221) 344 9230 Website: http://www.depkeu.go.id | The Directorate General of Immigration Jl. HR Rasuna Said Kav. 8–9 Kuningan Jakarta Selatan Tel: (6221) 522 5030 or 522 4658 Website: http://www.imigrasi.go.id |
| The Ministry of Justice Jl. HR Rasuna Said Kav 4–5 Jakarta Selatan Tel: (6221) 525 3004 Website: http://www.dephumkam.go.id | BP Migas (Directorate of Oil & Gas) Patra Office Tower Jl. Jend. Gatot Subroto Kav. 32-34 Jakarta 12950 Tel: (6221) 52900245 Website: http://www.bpmigas.com |
| The Ministry of Education Jl. Jend Sudirman Pintu 1 Senayan Jakarta Selatan Tel: (6221) 5731 177 Website: http://www.depdiknas.go.id | Tax Office Jl. Jend Gatot Subroto Number 40–42 Jakarta Selatan Tel: (6221) 525 1609, 525 0208, or 526 2880 Website: http://www.pajak.go.id |

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|---|---|
| <p>The Ministry of Foreign Affairs Jl. Taman Pejambon Number 6 Jakarta Pusat Tel: (6221) 344 1508 Website: http://www.deplu.go.id</p> | <p>Badan Arbitrase Nasional Indonesia Wahana Graha 2nd Floor Jl. Mampang Prapatan No. 2 Jakarta 12760 Tel: (62 21) 7940542 Website: http://www.bani-arb.org</p> |
| <p>Batam Industrial Development Authority Jl. Mayjen DI Panjaitan Kav 24 Jakarta Timur Tel: (6221) 858 0009 or 858 0010-11 BIDA Building, BATAM Center Batam 29400 Tel: (62778) 462 027 or 462 071 Website: http://www.batam.go.id</p> | <p>PT Kawasan Berikat Nusantara (Tanjung Priok Bonded Zone Authority) Jl. Raya Cakung Cilincing Jakarta Utama Tel: (6221) 44820909 Website: http://www.kbnez.com</p> |

