KPMG

ENR Alert

Implementing Regulations concerning Cost Recovery and Income Tax on Upstream Oil and Gas Activities

July 2017
(Originally Issued in February 2012)

KPMG Advisory Indonesia
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Implementing Regulations for Government Regulation No. 79/2010 finally issued

Three Ministry of Finance Decrees have been issued recently to supplement the provisions under Government Regulation No. 79/2010 ("PP 79"). PP 79, which indicated that implementing regulations would be issued at the Minister or Director General level.

The Decrees were all dated 28 December 2011, but were only made publicly available in the second week of January 2012.

The three Ministry of Finance Decrees are:

1. Ministry of Finance Decree No. 257/PMK.011/2011 ("PMK 257"), regarding the Procedures for Withholding and Payment of Withholding Taxes on Contractor's Other Income in the Form of Uplift or Other Similar Income, and/or Contractor's Income from the Transfer of Participating Interest;
2. Ministry of Finance Decree No. 256/PMK.11/2011 ("PMK 256"), regarding Maximum Recoverable Home Office Overhead Costs for Production Sharing and Corporate Income Tax calculation under the PSC.
3. Ministry of Finance Decree No. 258/PMK.11/2011 ("PMK 258"), regarding Maximum Remuneration Costs for Expatriates working for the PSC.

PMK 257

The release of PP 79 in December 2010 had required that all transfers of participating interests ("PIs") in production sharing contracts ("PSCs") occurring subsequent to 20 December 2010 be subject to tax in Indonesia, and further stated that income received by a contractor related to financing of participatory obligations of another contractor ("Uplift Income") would be subject to a final tax of 20% on the gross amount. However, PP 79 did not clarify the required mechanisms and details for imposing tax on such income. PMK 257, dated 28 December 2011 and effective 1 January 2012, is intended as an implementing regulation for PP 79, and covers the procedures for withholding and paying income tax arising from uplift income, as well as direct and indirect transfers of PIs.

KPMG comments:

The release of PMK 257 has been much anticipated and contains few surprises. Nevertheless, it states that on top of the 5% or 7% tax, branch profit tax will also be imposed, and that the effective date of PMK 257 is 1 January 2012, meaning that a number of investors and operators need to rapidly assess their potential tax exposures for any transfers they have undertaken subsequent to 20 December 2010, but prior to the issuance of this new regulation.

1. Transfer of a PI

Applicable Tax Base and Rate

Introduced in PP 79, as of 20 December 2010, transfers of PIs are subject to a final tax of 5% for an exploration PSC, and 7% for a producing PSC. Note that PMK 257 defines exploration as commencing on the effective date of the PSC, and ending on the effective approval date of the first Plan of Development ("PoD") in a Contractor's work area. The exploitation period commences thereafter, and ends on the expiration date of the PSC.

The tax base to which the tax rate applies is the gross sales proceeds from the transfer (to be determined by arm's length principles in the case of transfers between related parties).

In spite of the foregoing, transfers of PIs under PMK 257 occurring within the exploration period may be exempted from income tax when certain conditions are satisfied:

a. The contractor does not transfer its entire holding in the PI;

b. The contractor has held the PI for more than three years;

c. Exploration has been undertaken in the work area and the Contractor has incurred investment expenditure for carrying out the exploration; and

d. The transfer of the PI was not undertaken with the intention of gaining any profit.

KPMG comments:

Although PP 79 indicates that an indirect transfer of a PSC is also subject to tax in Indonesia, the position is now better defined, as PMK 257 expressly states that the tax on transfers of PIs should also be applied to indirect transfers (i.e. to the shares of companies ultimately holding PIs in Indonesia). PMK 257 also provides examples of tax calculations relating to the indirect transfer of a PSC.

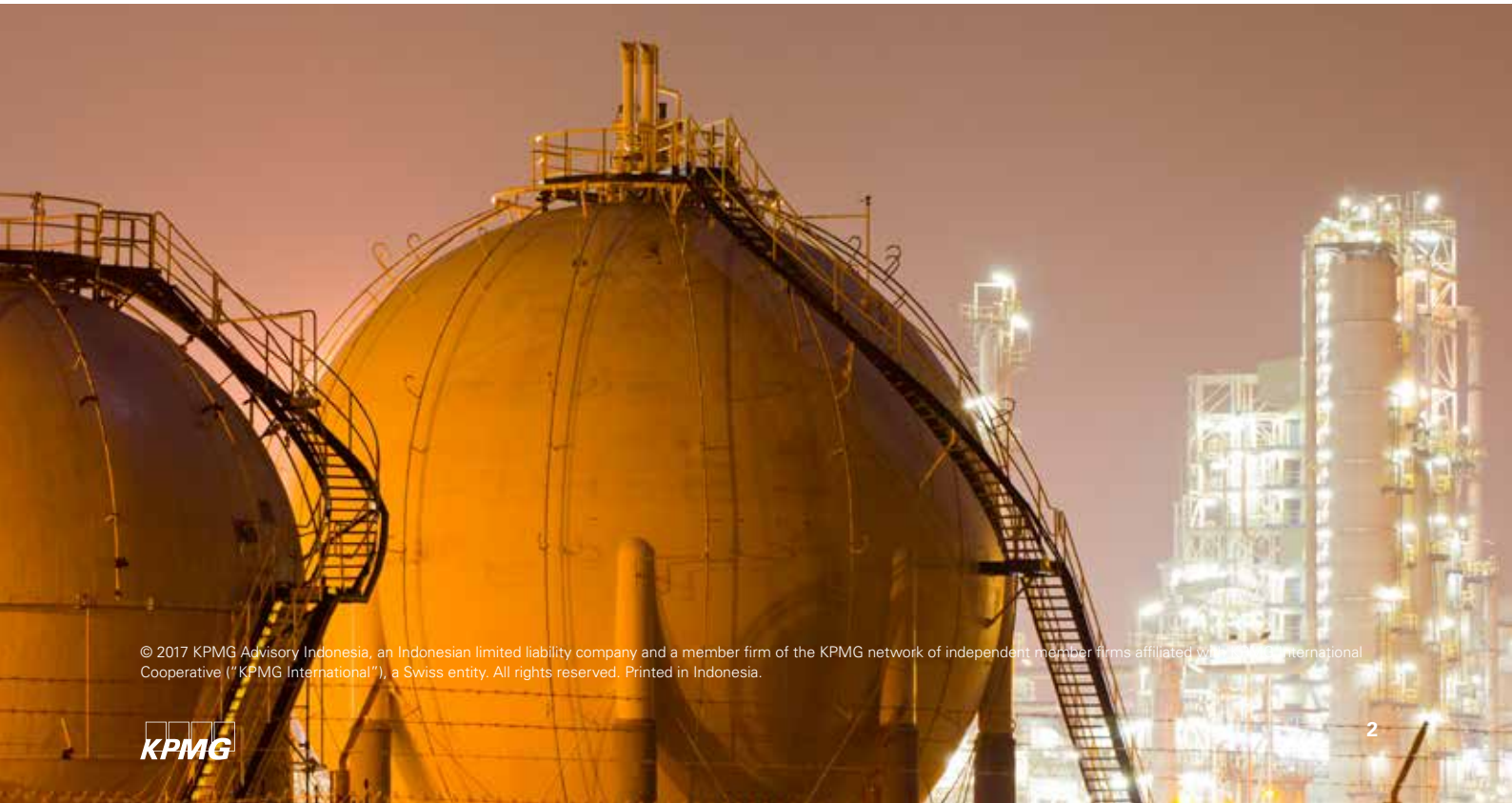
Initial Reporting Obligations

The transfer of a PI must be reported to the Indonesian Tax Office ("ITO") within at most 14 working days following the date the transfer agreement is signed. If the buyer is registered with the ITO on the date the transfer agreement is signed, the reporting should be done by the buyer. If the buyer has not yet been registered with the ITO, the obligation would fall to the seller to report the transfer.

The reporting template is provided by PMK 257.

KPMG comments:

For transactions occurring after 20 December 2010, but prior to the release of this regulation, PMK 257 does not indicate the date such transactions are required to be reported, but it is suggested that it should be done as soon as possible.



Due Date for Payment

Under PMK 257, income tax arising from the transfer of a PI becomes payable on the earlier of:

a. The date of payment;

b. The date the PI is transferred; or

c. The date of PI transfer approval by the Minister of Energy and Mineral Resources.

In the case of direct transfers and provided the buyer is a registered Indonesian taxpayer on the date the tax becomes payable, the buyer would be required to withhold the applicable tax from the payment made to the seller. Where the buyer is not registered as an Indonesian taxpayer as of the date that the tax becomes payable, the buyer must pay the tax using a tax payment slip in the name of the seller. If the buyer does not pay the tax on behalf of the seller using a tax payment slip, the buyer must pay the tax upon registration with the ITO as a taxpayer.

As the tax is to be paid by the buyer under a withholding tax mechanism, the tax must be settled no later than the 10th of the month following the month in which the tax becomes payable, and report the withholding no later than the 20th of the same month.

In the case of indirect PI transfers, if the tax identification number of the contractor to the PSC would not change, the contractor transferring the indirect interest in the PI is required to report and submit the applicable income tax to the ITO using a tax payment slip.

Note that for transactions occurring after 20 December 2010, but before the release of this regulation, the tax is taken to be payable on the effective date of this regulation (i.e. 1 January 2012).

KPMG comments:

For transactions that occurred prior to the release of this regulation (i.e. with a tax due date of 1 January 2012), payment of the applicable tax should follow general withholding payment requirements, with the applicable tax being paid no later than 10 February 2012, and reported to the ITO no later than 20 February 2012.

With regard to indirect transfers, PMK 257 does not discuss whether, in the case of a seller of an indirect interest not reporting and submitting the applicable tax, the ITO would have any recourse to claim the tax from either the indirect buyer or the direct contractor to the PSC.

Branch Profit Tax ("BPT")

Based on PMK 257, after deducting applicable tax for the transfer of a PI, the remaining profits are subject to an additional BPT.

KPMG comments:

It is now confirmed that in addition to the 5% or 7% tax, BPT will also be payable on the PI transfers. PMK 257 states that BPT is not payable for transactions that occurred prior to the issuance date (28 December 2011).

PMK 257 does not offer clear guidance whether a reduced BPT rate is permitted if the seller is a resident of a treaty country. Further analysis is required to determine whether a reduced BPT rate is possible, specifically reviewing the PSC and treaty provisions.

For an indirect transfer, if the seller is a resident of a treaty country, the tax may be exempted under the capital gains provisions. Please note that some treaties do not provide an exemption where the assets in Indonesia are principally immovable property. PSC assets should be considered as immovable property under those treaties.

2. Uplift Income

As previously clarified in PP 79, Uplift Income is subject to final tax of 20% on the gross amount, and there is no change to that under PMK 257.

Income tax with respect to Uplift Income is due on the date when the Uplift Income is paid, or on the date it is accrued as an expense by the payer, whichever is earlier. The contractor that pays the Uplift Income is required to withhold the applicable tax and submit the withholding payment to the Indonesian Tax Office no later than the 10th of the month following the month in which the tax becomes payable, and report the withholding no later than the 20th of the same month.

BPT

Based on PMK 257, after deducting the applicable withholding tax on Uplift Income, the remaining profits are subject to an additional BPT of 20% under domestic law, but may be reduced under an applicable tax treaty.

PMK 256

PMK 256 discusses the maximum Home Office overhead costs that can be allocated to the branch, for the purpose of production sharing and corporate income tax calculations.

The requirements for the costs to be treated as cost recoverable and tax deductible are:

a. The costs must be incurred for the purposes of earning, collecting and maintaining income as stipulated in the prevailing tax regulations, and should be directly related to oil and gas operations within the Contractor's Work Area in Indonesia.

b. The costs must be incurred to support business activities in Indonesia;

c. The Contractor has submitted a consolidated financial statements of Home Office; and

d. The Contractor must submit the basis of the Home Office overhead allocation in the form of:

   1) A Work Plan and Budget for a Contractor in the exploration period, which has been approved by BPMigas.

   2) For a Contractor in the Exploitation period:

      a. A written approval confirmation of the method of Home Office overhead allocation from BP Migas; or

      b. Where there has not been a detailed study conducted by BP Migas, a proposal of the method of Home Office overhead allocation declared complete by BP Migas.

If one or more of these requirements is not met by a Contractor, the Home Office overhead allocation can not be claimed in the profit sharing calculation, and can not be deducted from gross income in the income tax calculation.

The allowable percentages of Home Office overhead allocation are:

a. A maximum of 2% of capital and non-capital expenditure incurred during the exploration period within the Contractor's Work Area in Indonesia; and

b. A maximum of 2% of the capital and non-capital expenditure incurred in a given year, during the exploitation period within the Contractor's Work Area in Indonesia.

KPMG comments:

While PMK 256 is consistent with the previous regulation, which determined the allowable percentage of Home Office overhead allocation to be 2%, PMK 256 now provides Contractors with the specific conditions under which the 2% allocation may be applied.

PMK 258

PMK 258 discusses the maximum salary per year that can be treated as cost recoverable and tax deductible for each level within an oil and gas company. The salaries, denominated in USD per year, are:

Level of Employment	Rate of Expatriates Hold Passport from			Notes
	Asia, Africa and Middle East regions	Europe, Australia and South America regions	North America region	
Highest Executive	562,200	1,054,150	1,546,100	Level 1: President, Country Head, General Manager
Executive	449,700	843,200	1,236,700	Level 2: Senior Vice President, Vice President
Managerial	359,700	674,450	989,200	Level 3: Senior Manager, Manager
Professional	287,700	539,450	791,200	Level 4: Specialist

The listed remuneration includes salary, allowance, and/or other payments related to annual performance not granted in long-term periods.

KPMG comments:

It is mentioned in the regulation that any remuneration that exceeds the maximum amount listed in the table will not be recoverable or deductible. The amounts listed in the table are to be reviewed every two years.

This Alert is intended to provide general information for the issues discussed, but it is not intended as professional advice. We recommend you to consult with your regular contact at KPMG, should you have any specific concerns related to these matters.

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