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General Overview of Indonesian Investment Law

Part 2

ABSTRACT

This Article is prepared with the intention to provide general information regarding the procedures of establishment, capitalization and legal basis of company law in Indonesia.

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AN OVERVIEW OF INDONESIAN LAW
ON
FOREIGN INVESTMENT COMPANY

A. OUTLINE OF THE HISTORY OF INVESTMENT LAW IN INDONESIA

In 1958 Indonesia actually had a law regulating foreign investment, namely Law Number 78 of 1958, which ratified by President Soekarno, the first President of the Republic of Indonesia, and came into effect from the date it was promulgated on October, 27th 1958 (“**Foreign Investment Law**”).

The Law was later amended by the Government Regulation in lieu of Law No. 15 of 1960 regarding Amendments to the Foreign Investment Law.

However, the both Laws unfortunately was not attractive to foreign investors due to the unstable political and security situation in Indonesia at that time.

Furthermore, on January 10th, 1967, President Soekarno ratified the new Foreign Investment Law in Indonesia with the issuance of Law No. 1 of 1967 regarding Foreign Investment, which was then followed a year later by President Soeharto - “*the Smiling General*”, the second President of the Republic of Indonesia, which has ratified the Law No. 6 of 1968 regarding Domestic Investment (“**Domestic Investment Law**”).

The new Foreign Investment Law contains various incentives and guarantees to prospective foreign investors. It includes a tax-free period and a guarantee of the absence of nationalization, unless deemed necessary for national interests and with full compensation in accordance with international law. This open door policy attracts new foreign investors to the Country, especially from the mining and manufacturing sectors.

In 1970, the two Laws were amended respectively by Law Number 11 of 1970 regarding Amendments and Supplement to the Foreign Investment Law and Law Number 12 of 1970 regarding Amendments and Supplement to the Domestic Investment Law.

The current legislation in force today is Law Number 25 of 2007 regarding Capital Investment (“**Investment Law**”), which has combined the two previous Laws which regulate separately between foreign investment and domestic investment.

B. THE INVESTMENT CLIMATE

The Indonesian government, under the leadership of President Joko Widodo, has continually updated regulations that can increase the potential of foreign investment in Indonesia. The latest positive changes can be seen with the introduction of a new system called OSS (short for Online Single Submission) in June 2018, as regulated under the Government Regulation Number 24 of 2018 regarding Electronically Integrated Business Licensing Services (“**GR 24/2018**”). The underlying goal is to cut the bureaucracy in processing permits and to increase the ease of doing business in Indonesia.

The issuance and supervision of a significant portion of capital investment licensing was transferred from the Indonesian Investment Coordinating Board (“*Badan Koordinasi Penanaman Modal/BKPM*”) and several other government agencies to the OSS system that supervised by the Coordinating Ministry for Economic Affairs. However, earlier this year, the BKPM was mandated to supervise the OSS system.

In his official statement in April 2019, which can be seen through the following link <https://ekon.go.id/press/view/siaran-pers-presiden.4691.html>, Coordinating Minister for Economic Affairs Darmin Nasution also explained that Indonesian President Joko Widodo had inaugurated three Special Economic Zones (officially known as “**Kawasan Ekonomi Khusus/KEK**”) which were targeted to attract IDR 110 trillion in investment and absorb 120,000 workers. The three KEKs are Bitung in North Sulawesi, Morotai in North Maluku, and Maloy Batuta Trans Kalimantan (MBTK) in East Kalimantan.

OSS system is also applied in KEK, according to the Minister for Economic Affairs Darmin Nasution.

The Government organizes development by encouraging regional development policies. This is done through the construction of KEK, Industrial Estates (officially known as “**Kawasan Industri/KI**”), and National Strategic Tourism Areas (officially known as “**Kawasan**

Strategis Pariwisata Nasional/KSPN”). The policy was aimed primarily at increasing investment, accelerating development, especially outside Java, and increasing economic competitiveness.

In supporting the success of achieving these objectives, the Government accelerated the development of physical infrastructure including the construction of airports, ports, toll roads, railways, drinking water supply, energy such as power plants and oil refineries, as well as Digital ICT.

Indonesia has carried out continuous reforms, both at the central and regional levels to encourage improvement in the business climate. The results of the reform implementation are recorded and recognized in the 2019 Doing Business Report published by the World Bank at the end of October 2018.

In the report, Indonesia was recorded as having successfully implemented 17 types of reforms in the last three years. Especially for 2018, Indonesia has conducted three types of reforms, namely: Starting Business Indicators, Getting Credit and Registering Property.

C. THE KEY REGULATIONS

One of the key regulations governing foreign investment in Indonesia is the Presidential Regulation No. 44 of 2016 regarding List of Business Fields that Are Closed and Business Fields that Are Open with Requirements for Capital Investment (“**Negative Investment List**”).

The Negative Investment List provides the areas in which investment is prohibited for foreign entities and areas that have certain investment restrictions for foreign entities. In addition to the Negative Investment List, the relevant laws and regulations that governing the particular business sector must be reviewed to determine whether the business sector is open for foreign investment.

For example, a construction services business is open for up to 67% foreign investment, and an insurance business is open for up to 80% foreign investment.

If a business sector is not listed in the Negative Investment List then it should be open 100% for foreign investment without any conditions. However, in practice, investors must confirm this with the prevailing relevant law and regulations, the BKPM and other relevant government officials before making any investment in Indonesia.

The main regulatory body for foreign investment is the BKPM. However, depending on the business, specific industry regulators may require the foreign investor to acquire an operating licence. It is always advisable for foreign investors to get a full picture of the required licences in the early stage of investment.

It is worth noting that the Government recently introduced the Online Single Submission (OSS) system, as regulated under GR 24/2018, under which the issuance and supervision of a significant portion of capital investment licensing was transferred from the BKPM and several other government agencies to the OSS system supervised by the Coordinating Ministry for Economic Affairs. However, the BKPM was mandated to supervise the OSS system.

Further, under BKPM Regulation No. 6 of 2018 regarding Guidelines and Procedures for Capital Licensing and Investment Facilities (“**BKPM Reg. 6/2018**”), not all licensing applications and approvals were transferred from the BKPM to be managed by the OSS system, therefore the BKPMs One-Stop Integrated Services is still processing and issuing licences in the following sectors:

- Energy and mineral resources (electricity, oil and gas, minerals and coal);
- Public works and public housing;
- Customs and excise facilities; and
- Other foreign investment licences (representative office, branch office, limited stay visa, change of status from stay permit on arrival into limited stay permit, and change of status from limited stay permit into permanent stay permit).

With the newly established OSS system, the effect on foreign investment in Indonesia, specifically, and business in the larger context remains to be seen. There is a transition period of six months to get the OSS system up and running, but in practice, it may take longer and require co-operation across relevant ministries.

D. INCORPORATION

Registration and formation

The main registration requirements to establish an investment company in Indonesia (officially known as “PT Penanaman Modal Asing/**PT PMA**”), are as follow:

1. The PT PMA must comply with any shareholding limitation requirement set out in the Negative Investment List;
2. Executing a deed of establishment in the Indonesian language before a public notary (“**DoE**”);
3. Obtaining approval from the Ministry of Law and Human Rights (MOLHR) on the DoE;
4. Obtaining a certificate of domicile (*Surat Keterangan Domisili Perusahaan/SKDP*) from the relevant government officials;
5. Obtaining a taxpayer registration number (*Nomor Pokok Wajib Pajak/NPWP*) from the relevant tax office;
6. Opening a bank account in Indonesia; and
7. The company must then obtain the appropriate business licence before it commences production/operation.

E. REPORTING REQUIREMENTS

A PT PMA must normally submit the following reports:

1. Capital Investment Activity Report (*Laporan Kegiatan Penanaman Modal/LKPM*) quarterly before it obtains a business licence, and every semester once it has obtained a business licence.;
2. Audited Annual Financial Statement to the Ministry of Trade (MOT);
3. Mandatory Manpower Report to the local manpower office; and
4. For Companies that engaged in the financial services sector must submit a monthly report and audited annual financial statement, as well as an annual business plan and implementation of good corporate governance report, to the Indonesian Financial Services Authority (*Otoritas Jasa Keuangan*).

F. CAPITAL INJECTION AND SHARES

The minimum capital requirements for foreign investment differ from one industry to another.

In general, the minimum capital requirement for foreign investment is at least IDR2.5 billion, payable on the establishment of the PMA Company, and within one year it must be paid to at least in the amount of IDR 10 billion. However, specific industries can have higher capital requirements.

Share Capital

A PT PMA must have a total investment value (excluding land and buildings) of more than IDR10 billion. The minimum paid-up capital of the PT PMA must be IDR2.5 billion, and each shareholder must have at least IDR10 million participation in the PT PMA.

Please note that certain business sectors may have higher minimum share capital requirements.

Non-Cash Consideration

Non-cash consideration or in-kind contributions can be used to pay up shares in a company, but such consideration must be appraised by a non-affiliated appraiser.

Rights Attaching to Shares

The rights attached to shares are restricted in as far as the shareholder must not act in bad faith and potentially cause the company to suffer losses.

Every shareholder is entitled to attend and vote at the general meeting of shareholders. Each share constitutes one vote in the general meeting of shareholders.

Every shareholder is also entitled to call for a GMS, receive dividends and liquidation proceeds, and file a lawsuit against the BoD and/or BoC for losses due to their negligence.

However please note that shares owned directly or indirectly by the company itself, or shares controlled by its own subsidiary, do not have voting rights under the Indonesia Investment Law.

G. COMPANY'S STRUCTURE

An unlisted PMA company must have the following governance (management) structure:

- General Meeting of Shareholders (“**GMS**”);
- Board of Commissioners (“**BoC**”); and
- Board of Directors (“**BoD**”).

The authority of the general meeting of shareholders is defined by Law No. 40 of 2007 regarding limited liability company (“Indonesia Company Law/**ICC**”), the articles of association of the company or both.

The ICC adopts two board structure. The BoC has a supervisory function while the BoD has managerial or daily operational responsibilities. The boards have equal status notwithstanding their different functions. The purpose of the two board structure is to enhance checks and balances.

The GMS is entitled to:

1. Nominates and approves membership of the BoD and BoC;
2. Approves the annual report and the financial statements;
3. Approves the distribution of profits and losses (including the payment of dividends);
4. Approves amendments to the articles of association, re-organisation and dissolution including amendments to the companys authorised capital; and
5. Approves extraordinary transactions.

For listed companies, the following governance (management) structure is required:

- GMS;
- BoD;
- BoC;
- Internal audit unit;
- Audit committee; and
- Corporate secretary.

In addition, listed companies can establish the following (and other committees) at their discretion:

- Risk policy committee.
- Corporate governance committee.
- Nomination and remuneration committee.

According to Article 1 point 1 of the Regulation of Financial Services Authority No. 55/POJK.04/2015 regarding the Establishment of Audit Committee, the Audit Committee is a committee that established by and responsible to the BoC.

H. RESTRICTIONS

The ICC requires the BoD to obtain the GMS' approval for the following:

- Transfer company assets or encumber company assets as security for a loan if those assets are more than 50% of the companys total net assets in one or more related or unrelated transactions;
- Increase or decrease the companys capital;
- Buyback the companys shares;
- Amend the articles of association;
- Approve the companys merger, consolidation, acquisition, separation or dissolution; and
- File a bankruptcy petition in the commercial court on behalf of the company.

The GMS can limit the powers and authority of the BoD through the articles of association.

Under a power of attorney, the BoD can assign one or more of the companys employees (or any third party), to undertake certain legal actions for and on behalf of the company.

The ICC sets out certain specific duties of the BoD, including the duty to submit annual work plans to the board of commissioners or GMS and annual reports to the GMS after consideration by the BoC (please see *Article 63 to 69 of the ICC*).

The ICC also requires the members of the boards to perform their duties in good faith, prudently and responsibly in the interests of the company, and in accordance with its purpose and objectives.

Each member of the boards that is at fault or negligent in performing his or her duties is personally liable for any of the resulting losses to the company.

A director or commissioner is not liable for the company's losses or bankruptcy if he or she can prove that:

1. The losses or bankruptcy are not attributable to his or her fault or negligence;
2. He or she managed the company in good faith, prudently and responsibly in the interests of the company and in accordance with the company's purpose and objectives;
3. He or she had no personal interest, directly or indirectly, in the actions causing the losses or bankruptcy; and
4. He or she has taken action to prevent the occurrence or continuation of the losses, or the bankruptcy.

The ICC is silent on whether the company can indemnify a director (or commissioner) against liabilities. This issue can be addressed in the articles of association of the company. It is not common for a company to indemnify directors (or commissioners). A company can only indemnify its directors (or commissioners) if the indemnity is made in the company's best interests and there is no conflict of interest or violation of duties by the directors or commissioners.

The GMS can resolve to discharge the BoD or BoC from liability to the company to the extent that these matters are disclosed in the company's annual report. This discharge does not release the board of commissioners or board of directors from liability to third parties.

I. TAXATION AND INCENTIVES

Under Indonesia's tax regulations, there are domestic taxpayers and foreign taxpayers.

Foreign individuals who reside or are present in Indonesia for more than 183 days in a 12-month period or who are present in Indonesia and have the intention to live in Indonesia are deemed domestic taxpayers. The 12-month period is based on the current date going back 12 months; it is not a calendar year.

The intention to live in Indonesia can be proven through actions such as:

1. Applying for a work permit.
2. Owning or renting a house for an extended period; and/or
3. Bringing family members.

The threshold for the period can differ based on the prevailing tax treaties.

The Indonesian personal taxation system is based on worldwide income. This includes the following (whether the source of the income is onshore or offshore):

1. Any salary paid to the foreign individual;
2. Dividend and interest income;
3. Rental income; and/or
4. Capital gains from sale of property.

There are no tax advantages for high-net worth individual investors entering and/or investing in Indonesia.

Tax Allowances

Tax allowances are set out under Law No. 7 of 1983, as amended by Law No. 36 of 2008 regarding Income Tax (“**Income Tax Law**”), which provides investors with the following facilities:

1. Additional net income reduction, up to a maximum of 30% of the amount of investment in fixed assets, including land, used for main business activities, which are charged at 5% per annum for six years from the commencement of commercial production;
2. Accelerated depreciation of tangible assets and accelerated amortisation of intangible assets;

3. A loss carry-forward period of between five and ten years; and
4. Tax on dividends at 10%, unless the relevant tax treaty stipulates a lower rate.

However please take note that not all business sectors are entitled to receive tax allowances. The list of business sectors and regions that can be granted tax allowance are stipulated in Government Regulation No. 18 of 2015, as amended by Government Regulation No. 9 of 2016 regarding Income Tax Facilities for Capital Investment in Certain Business Fields and/or in Certain Regions.

Tax Holidays

Government Regulation No. 94 of 2010 regarding Calculation of Taxable Income and Redemption of Income Tax in the Current Tax Year (“**GR 94/2010**”) provides that the taxpayers conducting new investments in certain pioneer industries, which do not receive a tax allowance (*see above*) can be granted corporate income tax exemption or reduction facilities known as tax holidays under the Investment Law.

The corporate income tax facility reduction starts at 10% and goes up to a maximum 100%. This reduction can be given at least for five years and at the most for ten years.

Import Duty Facilities

Import duty exemptions exist for the importation of machines, defined as any machine, machinery, factory installation apparatus, equipment or appliance, both in installed and uninstalled, used in industrial construction or expansion.

The facility is available if the company is:

1. An industrial company producing goods;
2. A service company (in the sectors of tourism and culture, public transportation, public health service, mining, construction, telecommunications and ports).

In addition, there is another facility for the import of goods and materials, defined as all goods or materials, without considering types and composition, used as materials or components to produce finished goods.

The facility can only be granted if the goods or materials are:

1. Not yet produced in Indonesia;
2. Produced in Indonesia but without meeting the required specification;
3. Produced in Indonesia but not in sufficient quantities to meet the industrial needs in Indonesia.

The Government is currently in discussions on additional tax holidays and tax allowances to attract more foreign investors. The new tax incentives are yet to be announced and it remains to be seen what form they will take.

A reduction to corporate income tax is available to pioneer industries with a capital investment plan of IDR500 billion to IDR1 trillion.

Pioneer industries generally relate to firms which:

1. Have a wide range of connections;
2. Provide additional value and high external output;
3. Introduce new technologies (for example, in relation to industries such as upstream metal, oil refinery, sea transportation, and/or processing);
4. Have strategic value for the national economy.

Tax holidays are to be granted at a flat rate of 100% of the total amount of income tax payable by the relevant corporate taxpayers and can be given over the next five to 20 years (from the start of commercial production). In addition, after the above-mentioned tax-holiday period has elapsed, taxpayers can also be granted a 50% tax holiday for the following two-year period.

J. DIVIDENDS, INTEREST AND IP ROYALTIES

There should be paid-up capital made by the foreign investor depending on their shareholding. Dividend distribution (if any) is payable to the shareholders and subject to withholding tax at the rate of 20%, except when reduced by the relevant tax treaties.

In addition to capital, shareholder loans can be provided to the PMA Company. However, any shareholders loan arrangement is usually subordinate to the commercial loans entered into by the PMA Company and any third parties.

In addition, there is a benefit in the form of exemptions and/or suspension of import duties for capital goods, raw materials, or other goods imported as part of the manufacturing process. This benefit requires approval from the BKPM.

The same structure applies for individuals that investing in shares and loan capital.

Dividends paid

Dividends paid to a non-resident taxpayer are subject to a 20% withholding tax, unless otherwise reduced by an applicable tax treaty.

Dividends received

Dividends received from foreign companies are subject to tax, if at least 50% of the shares of the foreign company are owned by one or more resident taxpayers. If so, income tax applies to the dividends received by the resident taxpayer.

Interest paid

Interest paid to a non-resident taxpayer is subject to 20% withholding tax, unless otherwise reduced by an applicable tax treaty.

IP royalties paid

IP royalties paid to a non-resident taxpayer are subject to 20% withholding tax, unless otherwise reduced by an applicable tax treaty.

A foreign subsidiarys profit would be imputed to a tax resident parent company. If an Indonesian company owns at least 50% of a foreign companys shares, or the Indonesian company together with another Indonesian company owns at least 50% of a foreign companys shares, dividends on the shares of the foreign company are considered to be taxable income.

Transfer pricing occurs when a taxpayer transfers income and/or costs to another taxpayer with which it has a special relationship, under an arrangement that reduces the total outstanding amount of the tax imposed. The Directorate General of Taxation (DGT) has the authority to re-determine the amount of income and deductions, and to re-characterise debt as capital, for parties where such a special relationship exists.

Taxable income would then be calculated according to fairness and ordinary business conditions that are not influenced by such a special relationship.

The DGT has issued guidelines on transfer pricing under DGT Regulation No Per-43/PJ/2010 as amended by DGT Regulation No Per-32/PJ/2011 regarding the Implementation of the Arms Length Principle in a Transaction between Taxpayers and Parties Having a Special Relationship (“**DGT Reg. 43/2010**”).

Under DGT Reg 43/2010, a special relationship is deemed to exist where either:

1. A taxpayer possesses a direct or indirect capital participation of at least 25% in two or more taxpayers;
2. A taxpayer has control over another taxpayer, or two or more taxpayers are under the same control, whether directly or indirectly; and
3. There exists a family relationship between individuals either through bloodline or marriage of one degree of direct or indirect linkage.

Customs duties

Imports of goods are subject to:

1. VAT of 10%;
2. Sales tax on luxury goods; and
3. Income tax of 7.5%, if imported without an Importer Identification Number (*Angka Pengenal Importir*) (API), or 2.5% if imported with API.

Key legislations:

- Law No. 25 of 2007 regarding Investment (“**Indonesia Investment Law**”);
- Law No. 40 of 2007 regarding Limited Liability Companies (“**Indonesia Company Law**”);
- Presidential Regulation No. 44 of 2016 regarding List of Business Fields that Are Closed and Business Fields that Are Open with Requirements for Capital Investment (“**Negative Investment List**”);
- Regulation from the Capital Investment Coordinating Board (*Badan Koordinasi Penanaman Modal/BKPM*) No. 6 of 2018 regarding Guidelines and Procedures for Capital Licensing and Investment Facilities (“**BKPM Reg. 6/2018**”);
- Regulation from the Capital Investment Coordinating Board (*Badan Koordinasi Penanaman Modal/BKPM*) No. 7 of 2018 regarding Guidelines and Procedures for Capital Investment (“**BKPM Reg. 7/2018**”); and
- Government Regulation No. 24 of 2018 regarding Integrated Online Submission of Business Licensing Services.

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