



Government Regulation Concerning Taxation Rules for the Mineral Mining Sector

The Indonesian President has recently signed the Government Regulation ("*Peraturan Pemerintah*") No. 37 Year 2018 ("PP-37") concerning Treatment of Taxation and or Non-Taxation State Revenue (*Penerimaan Negara Bukan Pajak*, "PNBP") in the Mineral Mining Sector. PP-37 was issued with the aim to provide legal certainty to various mining business licence holders in performing their obligations relating to both tax and/or PNBP. The basis of issuing PP-37 is Article 31D of the Income Tax Law ("ITL") which allows the government to issue special income tax rules for certain business activities such as: mining business including coal and mineral mining, oil and gas, geothermal, and sharia based business activities. A government regulation (PP 79, as amended by PP 27 in 2017) had been issued for oil and gas business activities in 2010, and special rules applicable for coal mining sector are expected to be released in due course.

PP-37 is dated on 1 August and set to be effective from 2 August 2018. The Corporate Income Tax ("CIT") provisions are generally applicable from fiscal year 2019.

RELEVANT MINERAL LICENCE HOLDERS

PP-37 applies for the following holders of:

- a. A Mining Business Licence (Izin Usaha Pertambangan/"IUP") – a general licence to conduct mining business activities in a Mining Business Area;
- b. A People's Mining Licence (Izin Pertambangan Rakyat/"IPR") – a licence to conduct a mining business in an area of a limited size and investment (however, it is not available to foreign investors);
- c. A Special Mining Business Licence (Izin Usaha Pertambangan Khusus/"IUPK") – a licence to conduct mining activities in a State Reserve Area;
- d. A Special Mining Business Licence for "Production Operations" ("IUPK-OP") – a licence that constitutes the change of the contract from a Contract of Work ("CoW") into IUPK, the contract of which has not yet expired;
- e. A CoW following the prevailing income tax regulations; and
- f. A CoW following the specific provisions as stipulated on the contract.

Do note that IUPK-OPs as referred in the context of PP-37 are those issued pursuant to a conversion of a previously signed CoW.

Despite the inclusion of CoWs where the contract stipulates specific taxation provisions, it is important to note that these CoWs would not be subject to PP-37 until the end of its contract. The only exception is that these CoWs holders are still required to comply with the Withholding Tax ("WHT") and /or collection obligations as stated in PP-37 in all circumstances.

In addition to the rules that generally apply to all licence holders, IUPK-OP holders are subject to specific rules as set out in PP-37.

In general, PP-37 sets the tone that *lex specialis* tax clauses would no longer be recognized for the new licences issued in mineral mining activities – income tax provisions should be determined primarily in accordance with the prevailing income tax regulations. Whereas in CoW specific cases, PP-37 suggests that income tax provisions as per CoW shall continue to apply until the end of the contract period, and for hybrid version of CoW and IUPK (i.e. IUPK-OP), specific rules are provided to address the issues.

The key rules under PP-37 are further discussed below.

CORPORATE INCOME TAX ("CIT") TREATMENT

The following CIT treatment generally applies to all mining license holders. The rules are also in general applicable for IUPK-OP holders except certain modifications provided (as discussed below)

1. Taxable object

The tax objects are income received or earned from business operations (income earned from sales of production) and from other activities (e.g. from harbor services or in whatever form).

Whilst the prevailing income tax regulations govern the taxation for both of the two taxable objects in general, PP-37 lays out provisions specifically to address on how taxable income from sales of production should be determined.

2. Gross Income and Deductible Costs

PP-37 stipulates that for CIT purposes, the income from sales of mineral mining production must be reported based on the higher of the actual sales price or the published market price quote at the time of the sale unless the actual sales price is not more than 3% lower than the market price quote. The actual sales price can also be used if there is no market price available.

As per PP-37's explanatory notes, amongst others, references for market prices of metal minerals, non-metal minerals and rocks, include the London Metal Exchange, London Bullion Market Association, Asian Metal, and the Indonesian Commodity & Derivative Exchange.

Given the need to determine the gross income for CIT purposes based on a published market price, concerns may be raised in the areas:

- a. the need for reconciliation as there is a deviation from accounting principles (and hence the general tax principles) where the reve-

nue / income is generally recognized based on the actual consideration received rather than adopting an 'valuation' approach – no specific accounting standards for pricing is provided for the purpose of compliance

- b. as long as the market price is 3% higher than the actual price, the taxable basis will be equivalent to the published market price, or actual price received if it is even higher than the market price. Taxpayers may consider such exercise unfair, especially if the transactions are customized with independent buyers from time to time
- c. the published market price available at the platforms as suggested may be different

In determining the taxable income bases, except for certain costs for which existing mine-specific regulations will be relevant, such as provisions for reclamation costs (Minister of Finance ("MoF") Regulation No.219/PMK.011/2012) and donations (PP No.93 Year 2010), prevailing Income Tax regulations would serve as the general governing regulations for deductible and non-deductible costs. Debt to equity ratio at maximum of 4:1 for the purpose of interest expense deduction as per prevailing Income Tax regulations (i.e. MoF Regulation No.169/PMK.010/2015) will also be generally applicable

3. Depreciation and amortization

Expenditure incurred for the acquisition of tangible and intangible assets having a useful life of more than 1(one) year should follow the prevailing income tax regulations.

Specific rules, however, apply for stripping/overburden removal activities :

Stripping / overburden removal activities	Expenditure	Amortization	Calculation
Prior to the start of Production Operation	Capitalized	Start from the month that the Production Operations are approved by the Minister of Energy and Mineral Resources	<ul style="list-style-type: none"> • Pro-rata basis over the period of license or contract; or • Production unit method over the period of license or contract
During the period of Production Operation, including seeking new reserves	Charged as costs (i.e. deducted in the year that incurred)	N/A	N/A

As per PP-37, taxpayers holding more than one mining license and that are conducting both pre-Production Operations and Production Operations at the same time will also be subject to the above rules.

Given the government's attempts to standardize the capitalization rules on pre-production costs, the deduction of such costs against gross income can be effectively deferred over a longer period – the scheme may be of concern for projects where the mining income is foreseen to be derived largely from the initial years of production operation which can be much shorter than the period of license.

The absence of the option to claim a deduction on the available pre-production costs against the mining income could give rise to additional tax outflow burden for the investors. On the other hand, since

tax loss carry forward limit following the prevailing income tax regulations is 5-year, the post production costs incurred may be foregone if there is no sufficient mining income realized.

4. Donations

The tax treatment of donations should follow the prevailing regulations regarding claiming deductions for donations:

- Mitigation of national disasters
- Research and development
- Education facilities
- Sports development
- Social infrastructure development costs

SPECIFIC TAX RULES FOR IUPK-OP HOLDERS

1. Tax, PNBP and Regional Tax Obligations for Holder of IUPK-OP

In accordance with PP-37 the following tax, PNBP and regional tax obligations shall be applicable for IUPK-OP issued up to 31 December 2019, from the time of its issuance until the end of the IUPK-OP period:

- a. CIT rate is fixed at 25%, applicable from the tax year following the issuance of the IUPK-OP
- b. Royalty (production contribution) and dead rent in accordance with Ministry of Energy and Mineral Resources Regulation No. 9 year 2012 on the PNBP for mineral mining
- c. PNBP in the field of environment and forestry in accordance with PNBP Law No. 12 year 2014
- d. Central Government Share due at a rate of 4% of net profit (see below basis of determining net profit) in accordance with the Mining Law and Regulations, applicable from the calendar year following the issuance of the IUPK-OP
- e. Regional Government Share due at a rate of 6% of net profit (see below basis of determining net profit) in accordance with the Mining Law and Regulations, applicable from the calendar year following the issuance of the IUPK-OP; and with break-down as follows
 - ↳ The regency / city government where production occurs - 2.5%
 - ↳ Provincial government - 1%
 - ↳ Other district / city governments in the same province - 2.5%
- f. Land and building tax in accordance with the Land and Building Tax (PBB) Law, applicable from the tax year following the issuance of the IUPK-OP

The net profit to be used for determining the Central Government and Regional Government Share is the audited net profit after deducting CIT every year from the commencement of production. In this context, it appears that the Central Government Share and Regional Government Share calculation is derived from 'accounting profit' rather than after-adjustment taxable income. The explanatory notes to PP-37 state obligations for Central Government and Regional Government Share are regarded as 'profit sharing' and are not deductible for CIT purposes.

The following obligations in accordance with prevailing income tax regulations are also applicable for IUPK-OP holders:

- a. Other PNBP outside those as set out in points (a), (b), and (c) above
- b. Withholding tax and/or collection
- c. Value Added Tax and/or Luxury-goods Sales Tax
- d. Stamp Duty
- e. Import Duty and Export Duty
- f. Excise Duty
- g. Regional taxes and retributions

2. Administrative requirements

Holders of IUPK-OP may maintain bookkeeping using the language and currency in accordance with the provisions stipulated in the CoW up to the end of the tax year following the issuance of the IUPK-OP. It is thereafter mandatory for IUPK-OP to maintain bookkeeping in Indonesian language and also IDR currency except in the case where there is a written

application for bookkeeping in foreign language and currency (other than IDR) submitted according to the relevant tax regulations.

3. Modification on the treatment of depreciation and amortization

In addition to the CIT rate which is separately stipulated at 25% for IUPK-OP holders, applicable from the tax year following the issuance of the IUPK-OP until the end of IUPK-OP, there are also special rules provided for IUPK-OP holders in calculating fiscal depreciation and/or amortization:

Asset obtained	Depreciation / amortization rules	Remarks
Pre-issuance of IUPK-OP	<ul style="list-style-type: none"> Up to the end of the financial year in which the IUPK-OP is issued: to follow as per CoW (except for buildings) From the financial year following the issuance of IUPK-OP: to follow the prevailing rules based on tax book value at the beginning of said financial year 	<ul style="list-style-type: none"> The remaining useful life of assets in which the tax book value will be depreciated/amortized upon will need to be re-determined as a starting point based on the most matching asset class (in terms of useful life) under the prevailing Income Tax regulations The taxpayer has the right to depreciate/amortize the residual tax book value of assets with remaining useful life terminated in the fiscal year after the issuance of the IUPK-OP
Post-issuance of IUPK-OP	To follow the prevailing rules	N/A

The residual tax value of the assets can be claimed as a deduction if the IUPK-OP ends before the period specified in the license for whatever reason.



OBLIGATION TO WITHHOLD AND/OR COLLECT INCOME TAXES

The WHT obligations will be in accordance with the prevailing regulations – this is even for CoW holders with *lex specialis* taxation provisions. Therefore the relevant CoW taxpayers should withhold tax as per the provisions of Articles 23, 26, which is confirmed under the MoF Decree No. 39 year 2014.

In the past there were cases suggesting that the Tax Office will take the position of whichever provision (CoW or general tax rules) results in higher WHT rates. Therefore, there is a chance that the Tax Office may challenge this 'general tax treatment' and not accept the tax treatment applicable for the relevant CoW holders despite the MoF Decree and several rulings been issued in confirming the use of prevailing withholding tax rates.

We do hope by issuance of PP-37, different interpretation on which WHT rates should apply whether follows the general rules or CoW provisions, would no longer be raised by the Tax Office.

TAX AND/OR PNBP RIGHTS AND OBLIGATIONS FOR COOPERATION ARRANGEMENTS

Mining licence holders may cooperate with other mining licence holders, and other parties.

Under PP-37 mining license holders that have entered into a cooperation arrangement are obliged to fulfill their tax rights and obligations on a separate basis (i.e. the obligations remain with the respective mining licence holder). There will be a separate MoF regulation issued on provisions regarding tax rights and obligations related to cooperation arrangements.

The prevailing PNBP Law and its implementing regulations shall serve as the guiding regulations for provisions regarding imposition, collection and settlement of PNBP for mining licence holders.

TRANSITIONAL PROVISIONS

The following transitional provisions are stipulated under PP-37:

- a. Provisions for CoWs with *lex specialis* will continue to be applied until the end of the relevant contract period.
- b. The transitional year being the year in which the IUPK-OP is issued applies for all the tax and PNBP obligations as provided under PP-37. As such, tax and PNBP obligations arising prior to the issuance of IUPK-OP should be settled according to the provisions of the original CoW.

Based on the above, the relevant provisions of the original CoW generally apply up to the end of the fiscal year in which the IUPK-OP is issued and the new prevailing regulations start from the following year.

CONCLUSION

1. Relevance of the Articles

PP-37, as far as the tax and PNBP regulations are concerned, can be seen as relevant to the following categories of mining license holders:

PP-37 Provisions	IUP, IPR, IUPK and CoW following prevailing Income Tax Regulations	IUPK-OP	CoW following the provisions on the Contract
Art 4: Tax objects and Calculation of income	✓	✓	
Art. 5, 6 and 7: Calculation of Taxable Income	✓	✓*	
Art. 8 and 9: Calculation of depreciation and amortization as well as recording of residual book value of assets	✓		
Art. 10: Calculation of depreciation and amortization as well as recording of residual book value of assets		✓	
Art. 11 and 12: Donations and /or costs	✓	✓	
Art. 13: Debt to equity ratio	✓	✓	
Art. 14: Withholding tax obligation	✓	✓	✓
Art. 15: Tax and PNBP rules specifically for IUPK-OP		✓	
Art. 16: Administrative requirements for IUPK-OP		✓	
Art. 17: Taxation Rights and Obligations and/or PNBP for IUP, IUPK, IPR or CoW holders	✓	✓	✓
Art. 18 and 19: Transitional Provisions		✓	✓
Art. 20: Closing Provision	✓		

* Except for Art. 7 which stipulates the procedures for calculation of net income, tax loss carry-forward calculation, taxable incomes, and the rates is different for IUPK-OP holders

2. RSM Conclusion

Whilst the issuance of PP-37 is a step towards establishing a taxation framework for taxpayers in the mineral mining sector, challenges and uncertainties remain in areas where there are limited real case examples and experiences which might potentially create practical implementation issues given the still generic provisions of certain rules.

PP-37 does not appear to have considered certain industry-specific concessions given that the investment in mineral mining activities often features long exploration periods along with high debt, downstream processing activities, and high commercial and economic risks at each stage of activity.

All these features linking with adopting prevailing income tax regulations pose challenges for investors finding themselves in a position where they do not have sufficient support in any forms of tax reliefs or availability of incentives. For example, the obligation to share payments to the central and regional governments as mandated in the Mining Law of 2009 is categorized as PNPB which should also be deductible under general tax principles. However, obligations are treated as a profit distribution under PP-37 and therefore as non-deductible which results in an effective increase on the investors' overall fiscal burden.

In addition, we also note some investors' concern and also some other issues that need to be further clarified:

- a. In case of different published market price across different published platforms for a given mineral, which published market price should be used? Further, there may also be

complications if the transaction involves a related party.

- b. On withholding tax obligations – whether the general rules for CoW with *lex specialis* provisions can be implemented where there are inconsistencies with the PP-37 provisions?
- c. The possibility of negotiating bespoke tax reliefs or concession with the government for certain case by case transactions e.g. in determining gross income.
- d. Application of maximum 5 years tax loss carry forward provision may not be sufficient to compensate the significant preliminary investment in mineral mining activities.
- e. Whether the general tax rules will override the mine-specific regulation in case of conflict? e.g. on deductibility of cost.

NOTES:

This alert is intended to provide you with a general overview of some of the matters and issues in the contents of PP 37; it is not intended as professional advice. Please consult with your regular contact within RSM Indonesia regarding any specific concerns or questions in relation to this new regulation.

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