



A Newsletter of RSM AAJ Associates

Wake up Call

Quarter III/2014 Edition



RSM AAJ
Audit • Tax • Advisory



Inside this issue:

1. Grow your business strategically through an M&A
2. Understanding Islamic financial products
3. Clarity on VAT for agriculture produce
4. Our activities

Grow your business strategically through an M&A

Wiljadi Tan, Transaction Support Practice

“When you stop growing you start dying”

– William S. Burroughs –

Due to the current rapid business development, corporations are now challenged to grow quicker in a sustainable manner. When growing through organic way is already limited, corporation have to consider non-organic way as a new growth strategy.

The popular way to grow non-organically is through Merger and Acquisition (M&A). In Indonesia, M&A deals has grown significantly, especially during 2010 and 2011.

foreign fund, hedge fund and private equity fund. The latter have the biggest contribution to the significant number of deals in M&A.

The third aspect is a new opinion that **M&A is a growth strategy**. A lot of corporations now have considered M&A as their main strategy to grow. Most of them have hijacked a lot of M&A expertise built-in the management team.

However, performing M&A is not as simple and easy as it appears. Not that many M&A can create value. For that particular reason, corporations have to consider several aspects to perform successful M&A that can really create value.

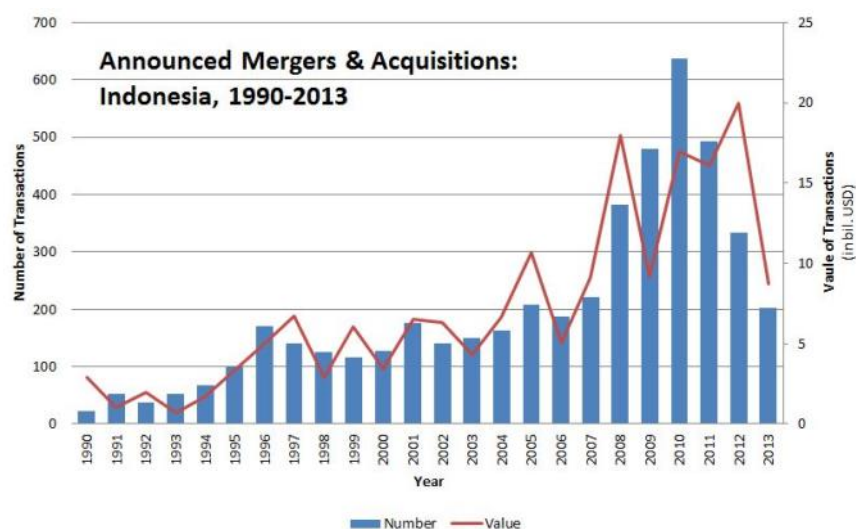
Due diligence is no doubt the most important pre-deal work that needs to be performed before deciding to close the deal or not. There are a lot of issues and risks revealed during a good due diligence process.

Integration planning also need to be considered as an important pre-deal exercise. There is a need to consider a transition team/management to further ensure that when the deal is on, no significant gap will jeopardize the business or block the synergy to be realized.

Synergy evaluation should be performed during the initiation of the M&A. Usually this should be addressed while finding the right acquisition targets. Synergy could be materialized through increase in revenue or decrease in cost.

Corporations would also need to consider potential conflict issues such as cultural shock and proper communication during the M&A process. Thus appointment of a good management team is a must.

In conclusion, M&A is really a growth strategy that can create value, however, to have successful M&A that can create value, we need to do the right planning through due diligence and integration.



Source: http://www.imaa-institute.org/statistics-mergers-acquisitions.html#MergersAcquisitions_Indonesia

From my professional experience and analysis, M&A is becoming popular nowadays due to several aspects.

The first aspect is due to **globalization** where the “world is flat” is no longer an imagination. Technology has highly contributed to the speed of the globalization.

Second aspect is the significant **growth of international funds** in the form of sov-

The fourth, and last aspect is due to the **regulation**. For instance, in Indonesia, we have many banks with smaller size of assets. Government has restricted licenses for new banks thus expect existing banks to perform M&A to increase their size as well as their competitiveness in the market locally, regionally or even globally. This is becoming very relevant due to the ASEAN Economic Community (AEC) in year 2015.

Understanding Islamic financial products

Renato M Leuterio, Business Services & Outsourcing Practice

Conventional and Islamic financial institutions are ultimately commercial enterprises, taking risks and seeking returns on their investment and efforts.

Islamic institutions have some very distinct features stemming from their strict adherence to Islamic principles. Islamic institutions share these three features:

- The abolition of interest but the promotion of profit and loss sharing. This is the principal basis for all activities which involve money, assets and labor.
- The management of an Islamic Institution must be based on Muamalah Islamiah (Islamic acts and practices).
- An Islamic institution does not practice activities that are contrary to the interest of the Islamic community.

These features may be relevant to some conventional institutions but for Islamic institutions, they are universally relevant.

ISLAMIC DEPOSIT ACCOUNTS

Like conventional banks, Islamic banks have products for savings, checking and fixed deposits. The difference is that they are structured to comply with Shariah principles. Conventional deposits are prohibited by Shariah because of *riba*. Such deposits that pay and guarantee interest clearly involve *riba*.

Not all conventional products are exposed to *riba* hence there are many such products offered by Islamic banks without any need for modification. Ex-

amples of such products are those for which fees are charged, including the safekeeping of securities, safe deposit boxes, the wiring of money and import-export transactions. Shariah-compliant deposit accounts are based on three main structures: *wadiah*, *mudharabah* and *qard hassan*.

Wadiah Deposit

In a *wadiah* deposit, the bank safe keeps your money and pays it back to you on demand. Unlike a conventional deposit, a *wadiah* account does not promise a fixed return, although the bank has the discretion to provide you with *hibah* (gift), or none at all.

In practice, banks generally offer some form of *hibah*. If Islamic banks were to refrain from such a practice, they would find it difficult to attract depositor funds, while at the same time, Islamic banks cannot promise that they will surely provide customers with *hibah*. There are two types of *wadiah* accounts: *wadiah yad amanah* and *wadiah yad dhamanah*.

Wadiah Yad Amanah (WYA). With such an account, the bank performs a pure safekeeping function for deposits, e.g., if you deposited cash, the bank has to keep the money in its vaults. As custodian, the bank is not allowed to utilize the funds for profit generation or any other purpose and does not charge any fees for safekeeping. As a result, no returns in any form can be expected. The depositor also faces the risk that the bank does not guarantee the return of your money in the event of loss due to theft, fire or some unforeseen mishap.

Wadiah Yad Dhamanah (WYD). In this case, the bank guarantees the return of

the money even if it is stolen. In return, the bank is allowed to utilize the funds, enjoys all profits and absorbs all losses. It is with this version that the bank provides *hibah*.

Mudharabah Deposit

The typical *mudharabah* arrangement comprises an investor (or *rabb al-mal*) who supplies the capital and an entrepreneur (or *mudharib*) who provides the expertise on investing. In a *mudharabah* deposit, the customer making the deposit is the investor while the bank is the entrepreneur. With your money deposited, you become a capital provider to the bank who then assumes the role of fund manager. The bank has the free-hand in the management of your money for profit.

At the outset of your *mudharabah* deposit, you and the bank would agree to a profit-sharing ratio (PSR). If the PSR was struck at say 60-40, any profit that the bank subsequently makes will be shared accordingly in that ratio.

In the event of losses, however, you as capital provider will have to bear them all. The bank, as fund manager, will suffer no losses other than its time and effort. By the same token, the bank is not allowed to take any form of remuneration unless the project is profitable.

The roles of capital provider and fund manager may also be reversed. The actual return on deposits is known only upon maturity or the periodical payment of profit. Returns can be negative although Islamic banks are careful to direct the investments towards those with relatively predictable outcomes such as mortgages and business loans.

There are two types of mudharabah, depending on whether the bank is limited in the way it invests the deposits.

Mudharabah muqayyadah. The bank is limited by how it can deploy the funds. Such limitations could be on the period of time, the type of business, the business location, or the kinds of services.

Mudharabah muthalaqah. The bank has the freedom to utilize the funds without restrictions, meaning the restrictions of mudharabah muqayyadah are not in force, not that the bank can invest in anything it likes.

Qard Hassan Deposit

This is another type of deposit account—based on qard hassan—which offers absolutely no returns at all, and the bank can use the money as it wishes. Such deposits are not as popular and less available because depositors do not receive returns.

ISLAMIC SAVINGS ACCOUNTS

Savings Accounts Based on WYD

The most common form of Islamic savings accounts is based on wadiah yad dhamanah (WYD), where the bank guarantees the return of money deposited on demand. Some depositors like such accounts because they offer safe custody of their money, and the possibility of some profits in the form of hibah. Since depositors are not taking part in any sort of business risk (the bank absorbs all losses), they are thus justifiably entitled to only non-guaranteed hibah.

Savings Accounts Based on WYA

Wadiah yad amanah (WYA) accounts are uncommon. Since the bank is not allowed to utilize the funds, and the depositor is not guaranteed his money back if there is a legitimate physical loss (such as from theft), it is easy to see that such accounts will not be as commercially available as WYD accounts.

ISLAMIC CHECKING ACCOUNTS

Current accounts are based on these three Islamic methods:

- Wadiah current accounts guarantee the paying back of money but not any returns.
- Mudharabah current accounts are less popular than those of wadiah mainly because the customer is responsible for all losses incurred, and he may get back less than what he had put in.
- Qard hassan current accounts allow the bank to utilize the funds without having to provide any returns.

ISLAMIC GENERAL INVESTMENT ACCOUNTS

Islamic banks have general investment accounts that work like conventional fixed deposits.

They are typically based on mudharabah muthalaqah, which means that the bank has the freedom to utilize the funds with few restrictions. Returns to depositors are based on pre-agreed PSR, and the actual returns are not known ahead of time.

Fixed deposits have higher profit-sharing ratios in favor of the depositor than do savings accounts. This is understandable because they cannot be withdrawn for a certain period of time and generally speaking, the longer the term, the better the yield you can expect on your money.

COMPARING ISLAMIC AND CONVENTIONAL DEPOSITS

Monetary benefits are paid to depositors in both Islamic and conventional banks but they are not the same. Payment to depositors by Islamic banks is variable while that to depositors by conventional banks tends to be fixed. Islamic banking is based on shared risk

Islamic banking not only prohibits interest but also regards such an arrangement as in your favor and unfair to the bank.

An Islamic bank would accept your \$1,000 deposit, invest it and profit-share with you, based on the bank's investment performance and a pre-agreed PSR. This is the case of a mudharabah account. With such an account, you will bear all losses should the bank incur any. If you prefer a safer option, the bank can safekeep your money in a wadiah account and promise to return it upon maturity.

With the mudharabah account, the actual amount of returns to the depositor is not specified at the start. The fact that the depositor does not know his actual returns ahead of time, and his returns depend on the investment performance of the bank, indicates that risk is being shared. The depositor does not earn interest on a fixed rate in the Islamic banking system but accepts some of the business risks and earns a share of the bank's profits on the investment.

The Islamic bank's financial statements reflect this difference. When the bank incurs a profit or loss, the value of the depositor's account is increased or reduced accordingly, and instantaneously reflected at its fair value. In a conventional bank, the value of its deposits is not directly linked to its investment activities. When the conventional bank makes a profit or a loss, the value of the depositor's account remains unchanged.

ISLAMIC CREDIT CARDS

Credit cards are generally opposed to desirable Islamic economic behavior because they can encourage wasteful spending.

When we consider how conventional credit cards have been misused through overspending and wrongly tapped on for emergency funds, we can understand the painful indebtedness

they cause from the very high interest rates and penalties they charge.

Debit cards, on the other hand, are generally accepted in Islamic practice because they draw on the individual's own bank funds.

Shariah nevertheless permits the use of credit cards. Various requirements have to be observed as compared with conventional credit cards:

- Islamic credit cards cannot offer cash advances which is a form of money-lending.
- Interest is not compounded on account balances. An additional interest charge due to any delay in payment is prohibited.
- Credit card users can carry out only halal (permissible) transactions. Credit card issuers will normally decline transactions on haram (forbidden) activities such as alcohol purchase and paying the entrance fee to a casino.

Receiving Rewards without Risk

When your deposit is based on wadiah or qard hassan, you can almost always be sure that you will get your money back. The initial sum of your deposits does not decline even if the bank incurs losses from the investments it makes on your funds.

Yet Islamic banks offer gifts and other benefits to depositors in order to attract and retain their funds. The issue that arises is whether such benefits are permissible under Shariah, since depositors are not exposed to any risk. Receiving returns without any risk-taking is unfair and is equivalent to riba. On the other hand, such benefits and gifts are not contractual in nature, and the bank is not obligated to offer them. Gifts thus do not bring about riba.

When such gifts become predictable and recurring, however, they start to look like riba as the customer would be receiving benefits without taking on any risk. Riba arises because the depositor is being rewarded for the use of his money.

This could be due to local requirements (the regulator may require such protection for vulnerable groups of people), or to market practice (in order to attract funds). In any case, any sort of guarantee on the principal amount placed in a profit-sharing account is generally viewed as constituting riba.

CONCLUSION

You have just acquired a flavor of some of the practical product differences between conventional and Islamic finance.

Islamic finance forbids riba, unjustness and earning a return without taking risk, but encourages profit and risk sharing. In the end, while the differences in actual cash flows could be the same, the underlying structures are quite distinct.

There is obvious competition for funds, especially in a dual system where both conventional and Islamic banking are available.

For this reason, it is sometimes difficult to tell the difference between conventional and Islamic products unless one carefully examines their underlying structures.

For non-Muslims who have access to both conventional and Islamic deposit products, we urge you to maintain an account in each type. This direct experience will give you a practical perspective that this and other treatises cannot give. Besides, the amount to start a savings account is minimal.

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SOME PRODUCT ISSUES

Islamic deposit products have several issues, especially those concerning riba. Part of the challenge for Islamic products is that they have to be competitive when compared with conventional products and be Shariah-compliant too.

Guaranteed Return in Mudharabah

Mudharabah deposits expose the depositor to both profits and losses. It is possible that the bank's investment experience is negative. However, instances are not uncommon where the original amount deposited in a mudharabah account is guaranteed to incur no losses.

Clarity on VAT for agriculture produce

Veronica Ngatio & Roria Sihombing, Tax Practice

The Indonesia Supreme Court granted the request for judicial review on Government Regulation No. 31/2007 (PP-31/2007) regarding "Import and/or Delivery of Certain and/or Strategic VAT-able Goods Exempted from VAT" that was filed by the Indonesian Chamber of Commerce & Industry (KADIN).

In 2013, KADIN has requested a judicial review for PP-31/2007, as it believed that several articles in that government regulation were conflicting to Article 16B of Law No. 8 Year 1983 as last amended by Law No 42 Year 2009 (the VAT Law); and in late February 2014, the Supreme Court has completed the review and has granted the request to annulled those articles.

The decision that was formalized in Putusan Mahkamah Agung No.70 P/HUM/2013 of Year 2014 has provided clarity on what before considered as ambiguity in applying VAT to certain goods, including on agriculture produce.

Basis for the Judicial Review

KADIN argued that point (j) in the elucidation of Article 16B paragraph 1 VAT Law clearly mentions the tax facilities should encourage national development. However, the implementation of PP-31/2007 to exempt strategic agricultural produce from VAT would not achieve the spirit of Article 16B because Input VAT related to agricultural produce would be absorbed as a cost due to the VAT exemption on the sale.

Therefore, the seller would need to include the Input VAT in the selling price. This would lead to a cascading effect or "tax on tax". This is not in accordance with the VAT Law.

What did the VAT Law stipulate?	What did PP-31/2007 stipulate?
<p>VAT Law Article 16B paragraph 1 in conjunction with sub-paragraph (b) stated that Government Regulations may be issued to stipulate the circumstances when the VAT payable shall not be collected in part or in full or VAT shall be exempt, either temporarily or permanently, for the supply of specified VATable Goods or the rendering of specified VATable Services.</p> <p>Under the elucidation of Article 16B paragraph 1 it was further explained that "The meaning and purpose of facilities granted are mainly for achieving success in economic sectors of high national priority, encouraging the improvement of the business world and enhancing competitiveness, supporting national defense, and also accelerating national development."</p> <p>Further, point (j) in the elucidation of Article 16B paragraph 1 specifically states that the specified taxable goods should encourage national development by helping the provision of strategic goods.</p>	<p>PP-31/2007 stipulated that various VATable goods, including agricultural produce (defined as goods produced from activities in agriculture, plantation and forestry, excluding those goods classified as basic necessities under Article 4A of the VAT Law) are "strategic" and exempt from VAT.</p>



The Ambiguity It Created

This created uncertainty as to whether Input VAT could be regarded as non-creditable if it directly related to the phase of production that produced non-VATable agricultural produce even though this agricultural produce was processed into VATable goods through either internal processing or via a third-party processor.

That is, there was concern that the Tax Office would only allow Input VAT that directly related to the processing phase of the production.

Consequences of the Annulment

Based on the Decision of the Supreme Court, the import and/or delivery of agricultural produce are no longer VATable goods exempted from VAT. These are now subject to VAT.

Issuance of New Regulation

As a consequence, the Minister of Finance (MoF) issued Regulation No.135/PMK.011/2014 (PMK-135/2014) on 18 June 2014 as an amendment to PMK-21/PMK.011/2014 of 4 February, 2014 (PMK-21/2014). PMK-21/2014 was an amendment to MoF Regulation No.78/PMK.03/2010 (PMK-78/2014) regarding guidance on calculating Input VAT claims for VATable entrepreneurs delivering VATable and non-VATable goods and/or services.

PMK-21/2014 states that VATable entrepreneurs operating an integrated business are allowed to claim their Input VAT, provided that related non-VATable goods initially produced will be further processed and sold as VATable goods either by their own processing units or by subcontracting the process to other VATable entrepreneurs.

PMK-21/2014 was particularly relevant for agricultural produce (and the example provided was for FFB/CPO integrated production). Following the Supreme Court Decision, this is no longer necessary and the FFB/CPO example has been deleted – PMK-135/2014 is therefore only relevant for taxpayers undertaking other businesses that produce/deliver non-VATable goods and services.

Companies' ability to impose VAT

Companies that were previously only involved in producing agriculture produce, provided that their sales price can be adjusted to charge VAT. This is because, through the Supreme Court Decision the products of these activities are no longer exempted from VAT and therefore all Input VAT will become a credit and not a cost.

Key items on VAT for agriculture produce

- **Any Input VAT from imports and/or purchases can be credited if the output of the business is agricultural produce.** As noted above agricultural produce are defined as goods produced from activities in agriculture, plantation and forestry, excluding those goods classified as basic necessities under Article 4A of the VAT Law.
- **Any taxpayer that delivers agricultural produce exceeding IDR 4.8 billion per year must register for VAT and charge VAT (once registered they can claim a credit for Input VAT incurred from the date of registration).**
- **Existing VATable entrepreneurs must charge VAT on the delivery of agricultural produce.**

When are these changes effective?

Agricultural produce are subject to VAT (and Input VAT can be claimed as a credit) commencing 25 February, 2014.

From 1 January, 2014, businesses with integrated operations that cultivated agricultural produce and then further processed 100% of the agricultural produce (e.g. processed FFB into CPO) have no change to their VAT position. That is the Input VAT remains creditable and the processed output is subject to VAT. (This is on the basis of PMK-21/2014 and then the Supreme Court Decision.)

Businesses with integrated operations that cultivated agricultural produce and then further processed some of these were subject to the proportionate credit of Input VAT from 1 January-24 February, 2014 for Input VAT related to any deliveries of agricultural produce (per PMK-21/2014). From 25 February, 2014 all Input VAT is creditable unless the business also delivers other goods that are non-VATable (e.g. rice). Under PMK-135/2014 the proportionate calculation will continue to apply for Input VAT related to any such non-VATable goods.

Final Remark

Although the Supreme Court Decision is expected to be favorable for corporate taxpayers operating in agriculture be-

cause these businesses have the systems for administering VAT, the Decision has the potential to create an uneven playing field for the individual farmers who are too small to register for VAT and/or unable to attend to the administration. As a result any Input VAT will become a cost. Alternately, if they do register but they have no sales price negotiation power then there is potential that the buyers will reject any price increase due to VAT and the farmer will need to accept a lower after-VAT sales price.

In addition, unless the Decision is widely announced and publicized, then it is possible that taxpayers will not be aware of the obligation (or opportunity) to register for VAT, charge VAT and claim Input VAT as a credit.

On the positive side, by broadening the number of VAT registered taxpayers, it will strengthen the tax system, creating tax justice, and will increase government revenue in the future.

Finally, the important message from the Supreme Court decision is that the Government does not always drafted an aligned tax regulation - and there is a legal way to challenge the basis of the Government's tax regulations through a judicial review process.

Global strategies start with **local** plans.

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In over 100
countries.

Where do you
call home?

Wherever you do.

Travel much?

In 50 years, we've
seen the world.

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2014 marks an exceptional year for us as we celebrate 50 years of global connections. **To find out more connect to rsmi.com.**



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Celebrating
50
years
1964 - 2014

Our activities



On June 2014, Senior Managers, Directors and Partners again enjoyed the opportunity to network with each other, Regional Leaders and senior personnel from member firms. They also learnt about RSM, business development, sales, culture and much more, with the objective to return home with the knowledge and confidence to promote RSM's international capabilities and expertise to prospects and peers. This year's case study was themed on private equity. From Indonesia, our Audit Assurance partner, Leknor Joni was among the 47 audit, tax and consulting professionals from RSM member firms in 13 different countries that attended the 8th annual RSM Academy, bringing the total number of graduates of this programme to 432.



RSM showcases at the Institute of Internal Auditors (IIA) Annual Conference in London. This year, the IIA held its 73rd annual conference in London, at the ExCel Exhibition and Convention Centre, from 7 - 9 July 2014. RSM is an annual exhibitor at the conference and this year, coupled with the fact that we are celebrating 50 years as a network. The conference is an intense three-day showcase of the offerings from different providers, and professional and technology services. Some 2000 internal audit professionals from around the globe attended to network, listen to outstanding speakers and earn professional education credits. The conference was opened with a surprise welcome video from His Royal Highness Prince Charles. His address focused on integrated reporting and sustainability, a topic that HRH Prince Charles has championed through his Accounting for Sustainability project and the International Integrated Reporting Council. His message delivered a strong call to action for internal audit professionals to "help shine a far brighter light on the risks we all face." We hosted a client event on the evening of the first day where 50 guests attended. This was a great way to network with those clients that we have existing relationships with, and with those that we look forward to working with in the future.

Our activities



On 25 June 2014, we held “RSM AAJ Network Gathering: An Afternoon with Friends” at Soehanna Hall, Energy Building, SCBD Jakarta. We have the pleasure of hosting this event and having an Indonesian prominent economist Faizal Basri, along with our Tax Partner Yustinus Prastowo to talk about Indonesian economy, a forecast for after the election. The event was opened by our Chief Executive Partner, Amir Abadi Jusuf, and acting as moderator for the talk was our Senior Partner, Irwan Afiff. Questions raised from the floor were very exciting and as the speakers were known to always have interesting and stimulating comments and facts, it has made the gathering very alive and a success by itself.

Our activities



On 4 August 2014, we held “Halal Bihalal” at RSM AAI office. This event is held every year after celebrating Islamic’s Ramadhan and Iedul Fitri. All staffs and partners of RSM AAI gathered and by tradition, they would perform hand-shake to congratulate each one of them who completed a full month of fasting during Islamic’s Ramadhan, and asking for each other’s forgiveness. The event was closed with a nice buffet lunch at the office.

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RSM AAJ Associates
Plaza ASIA Level 10 Jl. Jend. Sudirman Kav.59
Jakarta 12190 Indonesia
www.rsmaaj.com

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