

Investing in Indonesia

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The main pieces of legislation of which an investor needs to be aware are:

Law No 40/2007 on the *Limited Liability Company*
Law No 25/2007 on *Capital Investment*
Presidential Regulation No 111/2007
Civil Code (which establishes the principles upon which contracts are formed)

Law 25/2007 covers all investment activity, but it has particular relevance for foreign direct investment (FDI). And in this regard, concern centers on the implementing regulations.

The most significant aspect of this law is that it replaces separate laws relating to foreign and domestic investment. The previous law on foreign investment was enacted in 1967 when Indonesia desperately needed to establish links with foreign capital. Foreign capital was sorely needed. Times have changed. Foreign investment is still needed, but there are significant sources of domestic capital (albeit that some of this is parked offshore). And the new law is intended to send a message of equal treatment, as much to state to domestic investors that foreign investors are not receiving special treatment, as to reassure foreign investors that their special interests are in fact being catered for. An interesting balancing act.

But the law has been enacted in an environment of strong; some would

say sometimes over-enthusiastic, nationalist sentiment in parliament and government. So while foreign investors understand that equal treatment does not mean equal opportunity, there remains confusion as to the limits of opportunity. For more on this see below.

Features of the law in summary, especially as the law affects foreign investors, are as follows:

- There is one law covering all investment (domestic and foreign).
- The law deals with direct and not indirect (capital market) investment – which is the role of capital markets law.
- Foreign investors must generally invest through a limited liability company (although there are longstanding exceptions in oil and gas, and construction, not affected by this law).
- It recognises that all companies established in Indonesia are Indonesian entities. The previous use of the term ‘foreign company’ to describe an Indonesian company with foreign ownership is gone. (But there are restrictions on ‘foreign capital’ which includes the capital of an Indonesian company with any foreign ownership – and more on this later).
- The term of an investment project is limited only by the life of the company which owns the project (although relevant operating licences must be gained and renewed as required).
- If 100% foreign ownership is available, divestment is not required.
- Nationalisation is stated not to be intended. However the clear statement is made that if there is nationalisation, there will be compensation based on international arbitration (Indonesia has never been close to repeating the nationalisation of its former Dutch colonists which it undertook in the early sixties, and is very careful to make clear that that is a thing of the past).
- It provides that if a business activity is not specifically restricted in some way (whether that restriction be based on the source of capital or otherwise) then the activity is open to any private investor (This has been the practice for some time, but reverses the strict provision of the previous law).
- It provides for facilities to be provided to investors – be these related to taxation, land use, immigration or importation (The specifics are left to specific executive regulation).
- All business licences are to be obtained through what are referred to as ‘one door integrated services’. These services may be at national or district level. There are as yet no enabling regulations explaining how this will work.
- The role of the Investment Coordinating Board (known universally by its Indonesian acronym BKPM) is set out

in some detail in the law. Its duties relate to coordination, analysis and promotion. What the law does not provide is that BKPM must approve foreign, or any, investment.

- It provides for the resolution of disputes between the investors and government through international arbitration.
- A rather vague attempt is made to provide that agreements under which shares are held for another's benefit (with specific reference to agreements between domestic and foreign investors) are illegal.
- Provision is made for existing investment approvals to continue until their validity expires.

Most FDI is managed by the Investment Coordinating Board (BKPM), which was first established by Presidential Decree in 1973. Direct investment in oil and gas is managed by an authority established under Law No 22/2001 on Oil and Gas, known as BP Migas. Direct investment in banking is managed by the central bank. Direct investment in construction may be undertaken through a (Public Works approved) Representative Office.

A formal investment approval system is not required generally by Law 25/2007. However, approval is needed in order to gain access to fiscal incentives and other facilities. Also a foreign investor needs to obtain reassurance that the investment proposed is not restricted in any way before he

establishes his company. How this reassurance will be obtained (whether by a formal or informal process) is yet to be determined. In the meantime, the BKPM approval system, intended to be done away with, continues. In fact one of the principal issues with the BKPM approval system was the time taken, and therefore the cost involved, in obtaining such approvals. This issue has already been addressed significantly through improved administration within BKPM.

The other issue with the approval system was the informal requirements imposed on investors, especially regarding capital, minimum equity, and the loan/equity mix. This issue remains to be addressed.

INVESTMENT REGIME

An important feature of Law 25/2007 is the principle that foreign and domestic investors are equal before the law (Article 3), and Article 6(1) further asserts that all investors shall be treated equally. However, equal treatment does not imply equal opportunity – naturally certain restrictions are placed on foreign investors.

A feature of particular interest to foreign investors is the guarantee that the government will not nationalise an investment nor revoke ownership rights, except where it is declared by law to be in the national interest to do so, and then only upon payment of compensation based on market

value (Article 7).

Rights granted to investors are:

- the right to transfer assets and to repatriate capital, after-tax profits and dividends, expatriate salaries, etc. (Article 8);
- taxation reduction and exemptions and accelerated depreciation (Article 18);
- rights to land, immigration and import facilities (Article 21);
- provision for arbitration of investment disputes (Article 32).

By Law No 5/1968, Indonesia ratified the 1965 *Convention on the Settlement of Investment Disputes between States and Nationals of other States* (the Washington Convention), thus allowing for such disputes involving foreign investors to be submitted to international arbitration under the World Bank's ICSID rules.

Many countries have individual Investment Protection Agreements (IPA) with Indonesia which clarify and/or add to the general protection offered.

Investment Vehicle

Domestic investment may be through a number of business forms, including a sole proprietorship. However FDI must be undertaken through a legal entity incorporated under Indonesian law and domiciled in Indonesia, unless a particular law provides otherwise (Article 5). Foreign investment directly into a partnership of individuals is

therefore precluded.

Except for oil and gas contracts, branches of foreign banks (no longer an option), and construction undertaken through a representative office, the vehicle for FDI is therefore a limited liability company. This company may be either wholly foreign owned or a joint venture with one or more Indonesian partners. Either foreign individuals or foreign legal entities may be founders of such companies. These companies are commonly referred to as PMA (*Penanaman Modal Asing*) companies. It is open to the foreign investor as to whether he forms a company or gains the necessary BKPM approval first.

Ownership

All business activities are stated to be open to investment activity, except those closed or open with restrictions (Article 12). Presidential Regulation 111/2007 sets out activities which are closed to private investment or open with restrictions (the so-called *Negative List*).

For most fields of activity, foreign ownership of a PMA company may be 100% of the issued capital. However restrictions on foreign capital apply especially in the health, construction, education, and transport sectors.

In an attempt to be very specific about the activity intended, the government has expanded the use of the *Standard Classification of Fields of Activity in Indonesia* (KBLI). All activity has a KBLI

number. However, this does not mean that all activity that comes within a specific KBLI number is covered by the same restriction. The restriction generally depends on the sector within which the activity takes place, as the regulation now makes quite clear.

But there is considerable confusion as to the extent of sectors, and the application of restrictions to companies which have varied activities (The conclusion appears to be that where there are differing restrictions, separate companies may be advisable).

BKPM informally attempts to determine minimum amounts of equity capital to be fully paid up front. It does not allow any basic equity to be loan capital, but if loans are to be used to meet approved investment levels, a maximum ratio of 3:1 is applied (Capital may be expressed in Indonesian rupiah or US dollars). The application of such ill-defined policies leads to some subjective and confusing decision-making within BKPM.

Small Business

Presidential Regulation no 111/2007 states that certain activities are restricted to micro, small and medium sized enterprises. Law No 20/2008 on *Micro, Small and Medium Businesses* defines small businesses as having assets up to Rp 500 million (US\$50,000) and medium businesses as having assets up to Rp 10 billion (US\$1 million). The relationship between medium sized enterprises and

foreign ownership is not clear.

Investment Procedures for Foreign Investors

A regime of approval for all FDI, regardless of its size, grew up within the context of implementation of the previous foreign investment law of 1967. With the enactment of Law 25/2007, this approval regime is ended in theory. In practice, as at the time of writing, nothing has changed. This is because new implementing regulations and procedures have not yet been published.

Therefore the pre-existing regime remains in place, and is as follows:

1. A foreign investor must apply to BKPM for approval for the intended investment. Informal requirements may be asked of the investor. The investment must however conform with Presidential Regulation 111/2007 (which explains investment activities closed to investment and those open with restrictions).
2. Any change to an existing approval also requires BKPM approval – and this requirement will remain in place as long as those approvals remain valid (which is up to 30 years).
3. Either before or after obtaining BKPM investment approval, the investor establishes the investment vehicle, which in the case of a foreign investor must be a limited liability company. This company must comply



with the requirements of Law 40/2007 on *Limited Liability Companies*, and reflect features of the BKPM approval.

4. The first step is to reserve the name intended for the company, and then complete a notarial Deed of Establishment. This Deed includes the company's Article of Association. These are to be in standard format, although some details (shareholding, meeting quorum, voting rights etc) are open to the investor to determine.
5. Having completed this Deed, the required equity must be lodged in a new bank account, and evidence of domicile obtained, and the company must register for tax prior to the Deed being submitted to MoL for approval. The minimum paid up capital required by company law is the equivalent of Rp 12.5 million. BKPM does in practice require more of foreign investors.
6. Following approval by and registration with MoL, the company (along with all business activity in whatever form) must be registered with the regional office responsible for trade in the area of the company's domicile. This requirement is imposed by a different law than those controlling investment and companies.
7. Then the company's Deed of Establishment must be published in a supplement to the State Gazette (by MoL).

Either before or after MoL approval, the company must acquire whatever

operating licences are required by Ministries responsible for the sector within which the new company's business activity is located (Some activities may not have any specific requirements, although these would be exceptional).

COMPANY ESTABLISHMENT

Usually after obtaining the investment approval (before if investors wish), a company is established (which is a requirement if foreign capital is involved).

The Deed of Establishment containing the Articles of Association of the proposed company must be signed before an Indonesian notary in Bahasa Indonesia. These Articles of Association must then be submitted by the notary to and approved by the Ministry of Law and Human Rights (MoL). Under company law, MoL is required to approve or reject the submitted Articles within sixty days of submission.

To obtain approval, the applicants must have a Letter of Domicile for the proposed company, have registered it as a taxpayer, and be able to show evidence of the transfer of the capital equity funds into an account in the name of the company. Issued shares must be fully paid for.

Following approval by MoL (upon which the company becomes a separate legal entity), the Deed of Establishment must be registered

in the Company Register at the Department of Trade, and published in a Supplement to the State Gazette.

Contracts may be entered into in the name of the company before approval from the MoL, but the founders are considered to be acting individually and therefore to be individually liable until ratification of these contracts by the first general meeting of shareholders of the company held after the issue of the MoL approval. If all founding shareholders and directors and commissioners have signed, such acts automatically become acts of the company upon MoL approval.

In addition to the requirements to be met to satisfy the requirements of the incorporation process, the company must meet certain further requirements:

- Companies with at least 10 employees (or a payroll of Rp 1 million or more) must register its employees in the social security program administered by PT Jamsostek – in effect all companies.
- Companies with at least 10 employees must have a Company Regulation approved by the Ministry of Manpower.
- Depending on its type of activity, a company may need a permit issued under the Hindrance Ordinance and to complete an Environment Impact Analysis.
- Any offshore loan obtained by a company must be registered with and reported on time to



Bank Indonesia.

LICENCES

Business Licence

The investment approval received is the temporary business licence of the proposed PMA company. A permanent business licence (*Izin Usaha Tetap*) must be obtained when the venture is fully operational.

Import Licence and Master List

PMA companies which intend to import equipment and supplies must apply to BKPM to obtain a Limited Import Licence (*Angka Pengenal Importir Terbatas* or APIT). The investor may submit a list of equipment for which import duty concessions are sought (the Master List).

Manpower Plan Approval

Also after receipt of the investment approval, the investor must submit a Foreign Manpower Utilization Plan (*Rencana Penggunaan Tenaga Kerja Warga Negara Asing Pendatang* or RPTKA) reflecting the number of expatriate positions expected to be used. The Manpower Plan must be submitted to the Ministry of Manpower in accordance with procedures stipulated (in Ministry of Manpower Decree No. 228/2003).

The Manpower Plan must set out the number of positions to be occupied by foreigners in the company's organisational chart,

wages to be paid, the qualifications required of the foreigners, the period of employment, the number of Indonesian employees who will be assigned as counterparts and the program for the training of Indonesian staff to replace the foreigners. The latter two requirements do not apply to foreigners who are company directors.

When an investor has received an approved Manpower Plan, which is intended to cover a five year period, separate applications must be filed for each foreign person to be employed. Manpower approval must be followed by immigration approval and police registration of the individuals concerned.

Land Use Approval

All companies are restricted to registered leasehold rights over land – freehold may be held only by individual Indonesians. Foreign investment companies are entitled to obtain Right to Build (HGB), Right to Cultivate (HP), and Right of Use (HGU). In order for foreign investors to obtain such rights, the land area required must be identified in the application. The investor must then obtain a Location Permit which will specify the amount and intended use of the land (in effect, a zoning permit)

Industrial Estates

The purchase of land in an industrial estate is ordinarily more straightforward for foreign investors than the purchase of isolated blocks. These estates are divided

into parcels for which land rights are readily available. An investor must submit a letter of confirmation of availability from the Industrial Estate with its application. In addition to comfort with respect to the status of the land, the investor acquiring land in an industrial estate is also assured that it is clearly and permanently designated for industrial use.

Reporting Requirements

BKPM requires PMA companies to submit semi-annual reports (in January and July) on the progress of their investments throughout the life of the company (annually after the IUT has been obtained). This report is known as the investment activity report (*Laporan Kegiatan Penanaman Modal* or LKPM).

THE CAPITAL MARKET/ INDIRECT INVESTMENT

Capital market regulations allow all companies regardless of foreign shareholding to sell shares through the Indonesian Stock Exchanges. And there are generally no restrictions on foreign investors (be they individual or corporate) in buying shares made available through the stock exchanges. However buyers who are financial institutions may own no more than 85% of the issued capital of a listed company. In the banking sector, foreign ownership may be up to 99%. ↓