

# ***Oil and Gas in Indonesia***

## ***Investment and Taxation Guide***

May 2014 - 6<sup>th</sup> edition

*Updated for GR 79  
developments, Land  
and Buildings Tax  
and the 2014 negative  
investment list*





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Term	Definition
AFE	Authorisation for Expenditure
AFT	Automotive Fuel Tax
AMDAL	<i>Analisis Mengenai Dampak Lingkungan</i> (Environmental Impact Assessment)
APBN	<i>Anggaran Pendapatan dan Belanja Negara</i> (State Budget)
APPI	Asian Petroleum Price Index
ASEAN	Association of South East Asian Nations
BBC	Bare-boat charter
BI	Bank of Indonesia
BKPM	<i>Badan Koordinasi Penanaman Modal</i> (Indonesia's Investment Coordinating Board)
BPH Migas	<i>Badan Pengatur Hilir Minyak dan Gas Bumi</i> (Oil and Gas Downstream Regulatory Agency)
BPK	<i>Badan Pemeriksa Keuangan</i> (the Supreme Audit Agency)
BPKP	<i>Badan Pengawasan Keuangan dan Pembangunan</i> (the Financial and Development Supervision Agency)
BPPKA	<i>Badan Pengawasan Perusahaan Kontraktor Asing</i> (the Oil and Gas Foreign Contractors Supervision Agency)
BPR	Branch Profit Remittance
BPT	Branch Profits Tax (i.e. on BPRs)
BUMD	<i>Badan Usaha Milik Daerah</i> (Regionally Owned Business Enterprise established by the Regional Government)
CA	Contract Area (also Working Area).
CBM	Coal Bed Methane
CCoW	Coal Contract of Work

Term	Definition
CD	Community Development
CEPT	Common Effective Preferential Tariff
CFR	Cost and Freight
CHP	Combined Heat and Power
CIF	Cost, Insurance, Freight
CIT	Company/Corporate Income Tax
CSR	Corporate and Social Responsibility
DG	Directorate General
DGB	Directorate General of Budget
DGoCE	Directorate General of Customs and Excise
DGOG	Directorate General of Oil and Gas
DGT	Directorate General of Taxes
DMO	Domestic Market Obligation
DNA	Designated National Authority
DPD	<i>Dewan Perwakilan Daerah</i> (Regional Senators)
DPR	<i>Dewan Perwakilan Rakyat</i> (House of Representatives)
DRM	<i>Daftar Rekanan Mampu</i> (vendors qualified for Government procurement bidding).
EOR	Enhanced Oil Recovery
FAS	Financial Accounting Standards
FCR	Foreign Currency Report
FDC	Foreign-owned Drilling Company
FOB	Free on Board
FPSO/FSO	Floating Production Storage and Offload (vessel)/ Floating Storage and Offload (vessel)

Term	Definition
FQR	Financial Quarterly Report
FTP	First Tranche Petroleum
GAAP	Generally Accepted Accounting Principles
G&G	Geological and Geophysical
GoI	Government of Indonesia
GR	Government Regulation ( <i>Peraturan Pemerintah</i> )
GTL	Gas to Liquids
IAS	International Accounting Standards
ICP	Indonesian Crude Price
IFRS	International Financial Reporting Standards
IGA	Indonesian Gas Association
IKTA	<i>Izin Kerja Tenaga Kerja Asing</i> ; now IMTA/ <i>Izin Mempekerjakan Tenaga Asing</i> (Work Permit for Foreign Workers)
INAGA	Indonesian Geothermal Association
IPA	Indonesian Petroleum Association
ITO	Indonesian Tax Office
IUP	<i>Izin Usaha Pertambangan Panas Bumi</i> (Geothermal Energy Business Permit)
JCC/JO	Joint Cooperation Contract/ Joint Operation
JOA/JOB	Joint Operation Agreement/Joint Operating Body
JOC	Joint Operating Contract
KAPET	<i>Kawasan Pembangunan Ekonomi Terpadu</i> (Integrated Development Economic Zone)
KIMS	<i>Kartu Ijin Masuk Sementara</i> (Temporary Entry Permit Card)

Term	Definition
KITAS	<i>Kartu Ijin Tinggal Sementara</i> (Temporary Stay Permit Card)
KKS	<i>Kontrak Kerja Sama</i> (Production Sharing Contract/ PSC)
KP	<i>Kuasa Pertambangan</i> (Coal Contract of Work Area)
KRIS	Kost Reduction Indonesian Style (Cost Reduction)
LEMIGAS	<i>Lembaga Minyak Bumi dan Gas Alam</i> (Research & Development Center for Oil & Gas Technology)
LNG	Liquefied Natural Gas
LPG	Liquefied Petroleum Gas
LTIP	Long Term Incentive Plan
LTO	Large Taxpayer Office
MMBBLs	Million Barrels
MMBOD	Million Barrels of Oil per Day
MIGAS	<i>Minyak Bumi dan Gas Alam</i> (Oil and Gas)
ML	Master List
MMCF	Million Cubic Feet
MMP	Ministry of Man Power
MoEMR	Ministry of Energy and Mineral Resources
MoF	Ministry of Finance
MoT	Ministry of Trade
MMT	Million Tonnes
MW	Mega Watt
NBV	Net Book Value
NBTF	Net Back to Field



Term	Definition
NEP	National Energy Policy
NPWP	<i>Nomor Pokok Wajib Pajak (Tax Payer Identification Number)</i>
O&G	Oil and Gas
O&M	Oil and Mining
OPEC	Organisation of Petroleum Exporting Countries
PE	Permanent Establishment
PGN	<i>Perusahaan Gas Negara (State Gas Company)</i>
PLN	<i>Perusahaan Listrik Negara (State Electricity Company)</i>
PMA	<i>Penanam Modal Asing (Foreign Investment Company)</i>
PMDN	<i>Penanam Modal Dalam Negeri (Local Company)</i>
PMK	<i>Peraturan Menteri Keuangan Republik Indonesia (Ministry of Finance Regulation)</i>
PoD	Plan of Development
PP&E	Property, Plant & Equipment
PSAK	<i>Pernyataan Standar Akuntansi Keuangan (Indonesian Financial Accounting Standards)</i>
PSC	Production Sharing Contract ( <i>KKS - Kontrak Kerja Sama</i> )
PwC	PwC , which refers to a network of member firms of PwC International Limited, each of which is a separate and independent legal entity.
R&D	Research & Development
RIM	Energy Market Data Provider
RPTK	<i>Rencana Penggunaan Tenaga Kerja (Annual Manpower Plan)</i>

Term	Definition
RPTKA	<i>Rencana Penggunaan Tenaga Kerja Asing</i> (Foreign Manpower Employment Plan)
SFAS	Statement of Financial Accounting Standard
SKK Migas	<i>Satuan Kerja Khusus Pelaksana Kegiatan Usaha Hulu Minyak dan Gas Bumi</i> (Special Taskforce for Upstream Oil and Gas Business Activities)
SP	<i>Sertifikasi Perusahaan</i> (Company Certification)
TAC	Technical Assistance Contract
TDR	<i>Tanda Daftar Rekanan</i> (Registered Vendor ID)
TCF	Trillion Cubic Feet
US GAAP	Generally Accepted Accounting Principles (in the United States)
VAT	Value Added Tax
WA	Working Area (also Contract Area)
WAP	Weighted Average Price
WHT	Withholding Tax
WP&B	Work Program & Budget



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# *Foreword*



Welcome to the 6th edition of the PwC Indonesia Oil and Gas in Indonesia - Investment and Taxation Guide. The 6th edition captures the latest tax and regulatory changes that have occurred in the oil and gas industry during the past two years. In particular, this edition covers the most recent developments related to GR 79, land and building tax and the new negative investment list.

This publication has been written as a general investment and taxation tool for all stakeholders and those interested in the oil and gas sector in Indonesia. We have therefore endeavoured to create a publication which can be of use to existing investors, potential investors, and others who might have a more casual interest in the status of this important sector in Indonesia.

As outlined on the contents page, this publication is broken into chapters which cover the following broad topics:

1. an industry overview;
2. the regulatory framework;
3. the upstream sector;
4. the downstream sector;
5. oilfield service providers; and
6. unconventional gas.

Certain key legislation, regulations, Government organisational charts and other useful information has also been included in the Appendices on a CD-rom enclosed inside the back cover to the publication.

As most readers would know, oil and gas production has a long and relatively successful history in Indonesia with the sector being historically characterised by its relatively stable and well understood regulatory framework. In many areas, including the development of the “Production Sharing Contract” model and the commercialisation of LNG, Indonesia has also been an international pioneer.

However, the industry in Indonesia is arguably now in a transition phase, with growing domestic need for gas (both for consumers and for industrial use), the issuance of 54 CBM PSCs and a shale gas PSC, the commencement of LNG imports and construction of further LNG regasification units. Indonesia’s production and opportunity profile has moved steadily away from oil and towards gas - a trend which may ultimately represent a permanent shift. In short, the age of relative stability in this sector has probably passed. The pace of change to be absorbed is probably also only likely to accelerate. It is hoped that this guide will provide readers with some of the information necessary to better understand these dynamics.

With a particular focus on where the industry is at right now, readers would probably be aware that crude oil production in Indonesia has been on a downward trend for the past decade with most oil production also now from mature fields. As a result, the country became a net oil importer in late 2004 and suspended its OPEC membership shortly thereafter. Although Indonesia has found recent success in developing its gas reserves, Government efforts to really stimulate exploration through offering new acreage and the joint study facility, offering incentives by way of improved splits and a Presidential Instruction to improve the environment for crude oil production (INPRES No.2/2012) are yet to truly bear fruit. Other developments, including the Suspense Account regulation allowing for deferral of cost recovery, have generated renewed investor concern around contract sanctity. The mixed message sent by the 2013 assessments of land and buildings tax on certain offshore exploration PSCs and the failure to quickly resolve this and other issues are also of concern to the industry.

How Indonesia improves its reserve replacement and guarantees its domestic energy security will have a significant bearing on Indonesia's continued relevance as a international oil and gas player and upon Indonesia's share of associated global investment dollars. Indonesia should continue to be an important component of the region's energy marketplace from both a demand and supply perspective however the supply side of the equation appears in need of substantial increase in underlying exploration and development activity.

Finally, readers should note that this publication is largely current as at 1 May 2014. Whilst every effort has been made to ensure that all information was accurate at the time of printing many of the topics discussed are subject to interpretation and continuously changing regulations. As such this publication should only be viewed as a general guidebook and not as a substitute for up to date professional advice.

We hope that you find this publication of interest and of use and wish all readers success in their endeavours in the Indonesia oil and gas sector.



# Industry Overview





## 1.1 Introduction

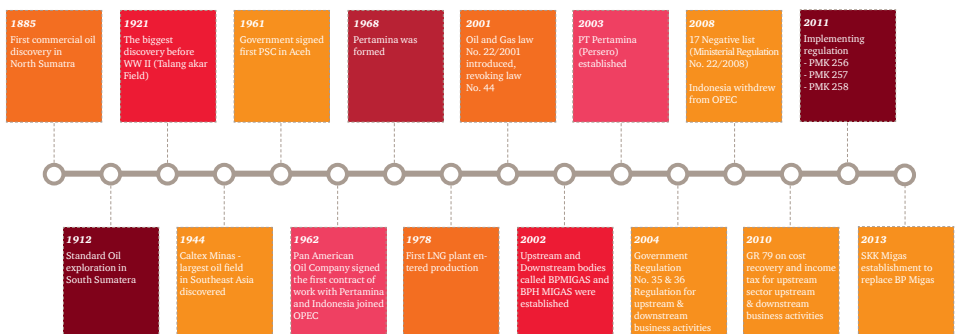
The landscape of the oil and gas industry, both in Indonesia and globally, has experienced dramatic changes in recent years. The industry experienced a significant resurgence in investment coinciding with the run up in crude oil prices which peaked at approximately US\$145 per barrel in mid 2008. This was then tempered with the onset of the global financial crisis and ensuing global recession which gained momentum in the latter half of 2008. From its peak in mid-2008, the oil price collapsed by more than 70% and ended 2008 at approximately US\$40 per barrel. With market confidence returning crude prices recovered somewhat in 2009 to approximately US\$75 per barrel. Prices have increased to average (on an annual basis) approximately US\$94-98 a barrel (WTI) in the period from 2011 to 2013.

Despite ongoing regulatory changes, investment in the oil and gas industry in Indonesia reached US\$16.1 billion in 2012 and US\$19.3 billion in 2013 and contributed around 12% of total state revenue. In 2012 there were 25 new oil and gas contracts entered into along with a further 14 in 2013. Most recently, in February 2014, seven new contracts were signed.

## 1.2 Global Context

Indonesia has been active in the oil and gas sector for nearly 130 years after its first oil discovery in North Sumatra in 1885, and continues to be a significant player in the international oil and gas industry.

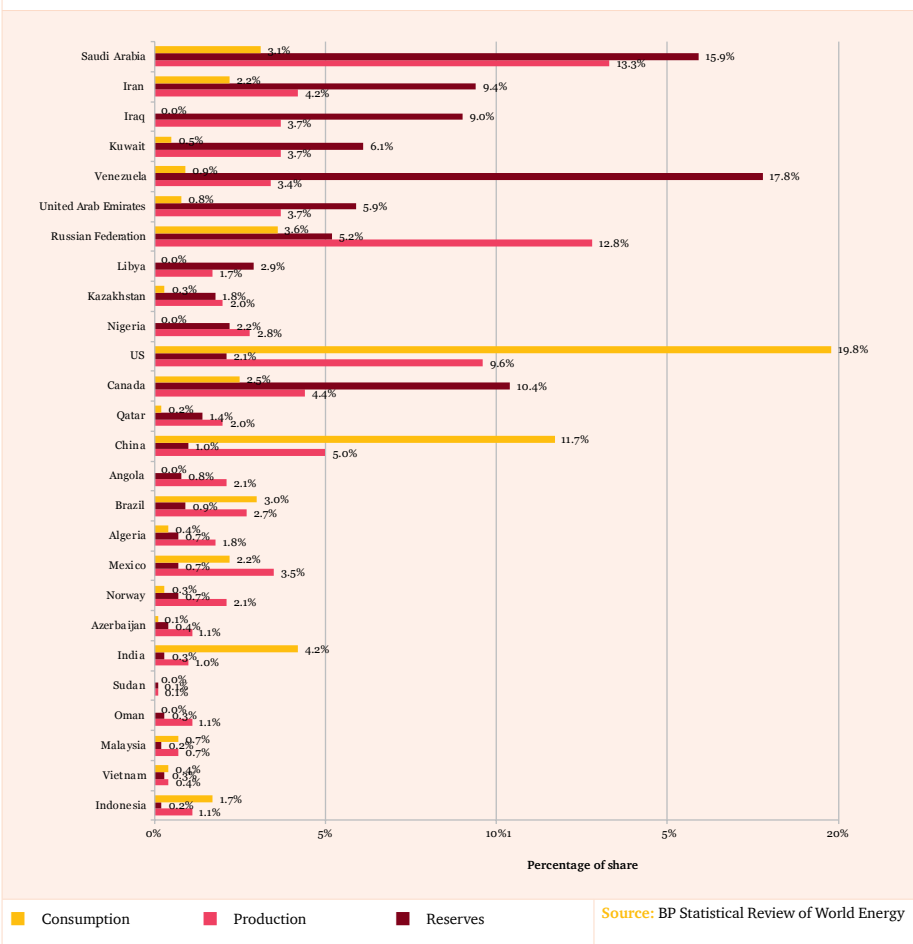
### Significant events in the history of Indonesia's Oil and Gas Sector



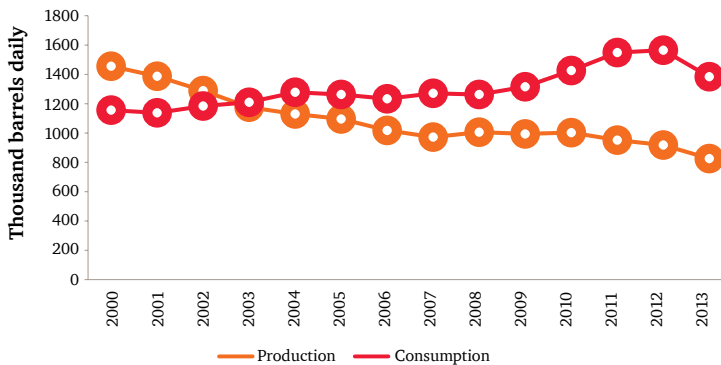
1. Industry Overview

Indonesia holds proven oil reserves of 3.6 billion barrels and ranks 20th among world oil producers, accounting for approximately 1.1% of world oil production. Declining oil production and increased consumption resulted in Indonesia becoming a net oil importer in late 2004. This factor, along with high oil prices in 2004-2008, led the Government to substantially scale back the domestic fuel subsidy in 2008 and to decide to temporarily withdraw from the Organisation of Petroleum Exporting Countries (OPEC) – an organisation representing approximately 45% of world oil production. As the only Asian member of OPEC since 1962, the Government has indicated it will consider rejoining OPEC if the country's oil production can be increased and it can become a net exporter again.

Share of World's Oil 2012



## Indonesia Oil Production and Consumption



Source for 2000 - 2012: BP Statistical Review of World Energy

Source 2013: Energy Information Administration, US Government

Indonesia is ranked 10th in world gas production, with proven reserves of 104 trillion cubic feet in 2012. This ranks Indonesia as the 11th largest gas producer in the world and the second largest in the Asia Pacific region<sup>1</sup> after China.

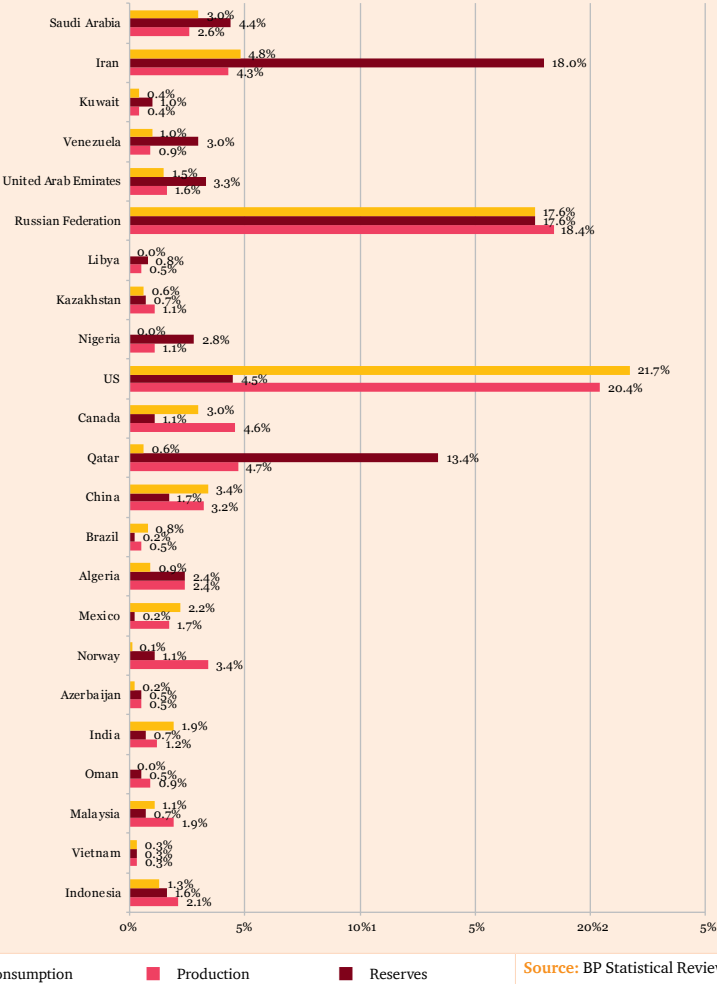
Indonesia's gas industry is also being transformed by more competitive liquefied natural gas (LNG) markets, new pipeline exports, and increasing domestic gas demand. Indonesia's natural gas production has decreased in recent years (Indonesia supplied 2.6% of the world's marketed production of natural gas in 2010 and 2.1% in 2012<sup>2</sup>) and the country is facing a declining global LNG market share to LNG producers in Qatar. After announcing its 2006 policy to re-orient natural gas production to serve domestic needs, Indonesia dropped from its status as world's largest exporter of LNG in 2005 to the world's fourth largest exporter of LNG in 2012, behind Qatar, Malaysia and Australia. It exports to South Korea, Japan, China, Taiwan, Mexico and India around 8% of the world's LNG exports.

Indonesia struggles to maintain LNG production levels and continues to feel the pressure of balancing revenues from gas exports with meeting stronger demand from its domestic market and it is likely to increase LNG imports in 2014. Indonesia's three existing LNG facilities are based in Arun in Aceh, Bontang in East Kalimantan, and Tangguh in West Papua (which commenced first production in mid 2009). The Lampung LNG facility is expected to start-up in 2014 while Pertamina has planned the full decommissioning of Arun LNG in order to convert it into an import terminal.

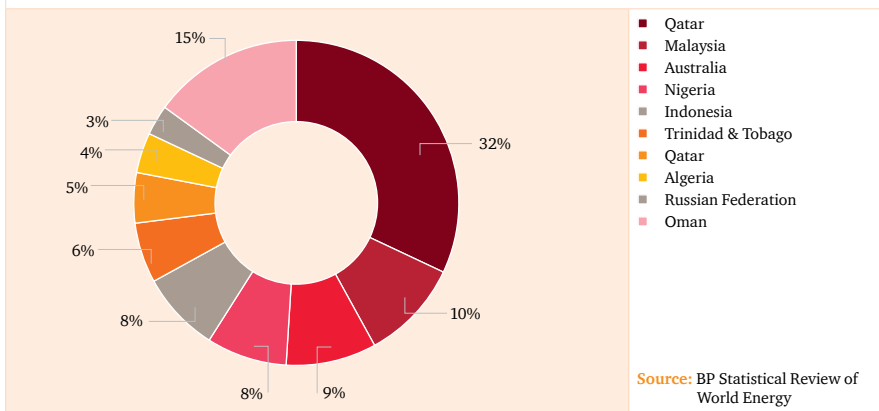
1 BP Statistical Review of World Energy June 2013

2 BP Statistical Review of World Energy June 2013

Share of World's Gas 2012



World's Top LNG Exporters 2012



### 1.3 Resources, Reserves and Production

Indonesia has a diversity of geological basins which continue to offer sizeable oil and gas reserve potential. Indonesia has 60 sedimentary basins including 36 in Western Indonesia that have been well explored. Fourteen of these are producing oil and gas. In under-explored Eastern Indonesia, 39 tertiary and pre-tertiary basins show rich promise in hydrocarbons.

About 75% of exploration and production is located in Western Indonesia. The four oil-producing regions are Sumatra, the Java Sea, East Kalimantan and Natuna and the four main gas-producing regions are East Kalimantan, Arun (North Sumatra), South Sumatra and Natuna.

Indonesia's crude oil production declined over the last decade due to the natural maturation of producing oil fields combined with a slower reserve replacement rate and decreased exploration/investment. During 2012, Indonesia's total crude oil production, although up slightly from 2011 at 0.918 million barrels per day, was around two-thirds of its 2001 daily production. As per Presidential Instruction No.2/2012, the national oil production target for 2014 is 1.01 million barrels per day. Despite this target, actual production for 2013 was 0.826 million barrels per day and the expectation for 2014 is 0.798 barrels per day. In 2013, the Government issued PMK 70 in order to reduce the tax obligations of oil and gas contractors and subsequently boost exploration and production (see section 3.4.7). With few significant oil discoveries in Western Indonesia in the last 10 years, the Government continues to encourage contractors to consider developing oil reserves in Eastern Indonesia's frontier and deep-sea areas.

## 1. Industry Overview

### Key Indicators - Indonesia's oil and gas industry

Indicator	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
<b>Reserves</b>											
Oil (Million Barrels)	8,610	8,630	8,930	8,400	8,220	8,000	7,760	7,730	7,262	N/A	N/A
Proven	4,300	4,190	4,370	3,990	3,750	4,300	4,230	4,040	3,740	4,000	3,600*
Potential	4,310	4,440	4,560	4,410	4,470	3,700	3,530	3,690	3,660	N/A	N/A
Gas (TCF)	188.34	185.80	187.10	165.00	170.10	159.63	157.14	152.89	150.70	N/A	N/A
Proven	97.81	97.26	94.00	106.00	112.50	107.34	108.40	104.71	103.35	108.4	104*
Potential	90.53	88.54	93.10	59.00	57.60	52.29	48.74	48.18	47.35	N/A	N/A
<b>Production</b>											
Crude oil (BOPD)	1,130	1,096	1,018	972	1,006	994	1,003	952	918	826	798**
Natural gas (MMSCFD)	7,986	7,823	7,660	7,283	7,460	7,962	8,857	8,415	7,110	6,825	7,229**
New contract signed	17	23	5	28	34	34	21	31	25	14	7

#### Source:

2004-2012 Oil Proven and Potential Reserves: ESDM

2004-2012 Gas Proven and Potential Reserves: ESDM

2013-2014 Oil and Gas Proven Reserves: EIA, US Government

2004-2012 Crude Oil and Natural Gas Production: BP Statistical Review of World Energy

2013-2014 Crude Oil and Natural Gas Production: SKK Migas - IPA Technical Division

presentation, 30 April 2014

New contracts: ESDM

MBOPD: Thousand Barrels per Day

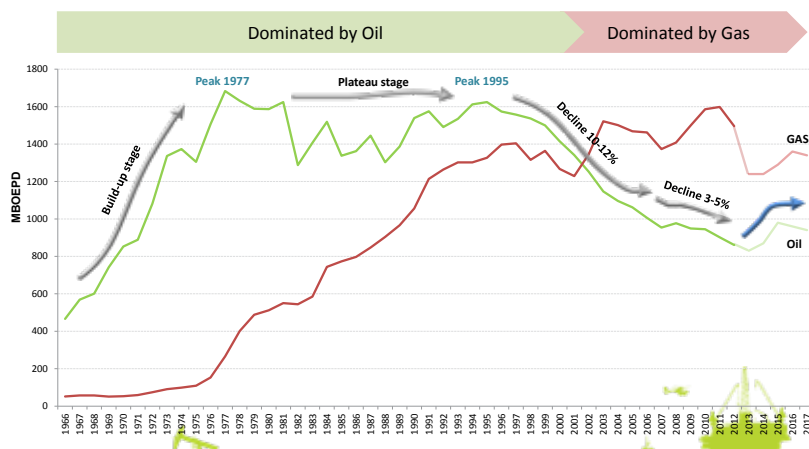
MMSCFD: Million Standard Cubic Feet per Day

\* estimate

\*\* target



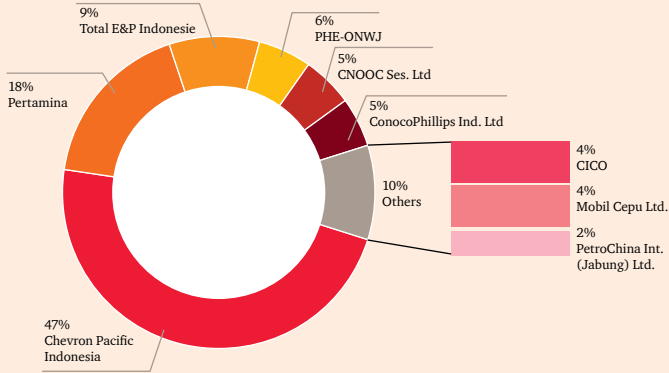
### Indonesia's Oil and Gas Production Profile



Source: SKK Migas – IPA Technical Division presentation, 30 April 2014

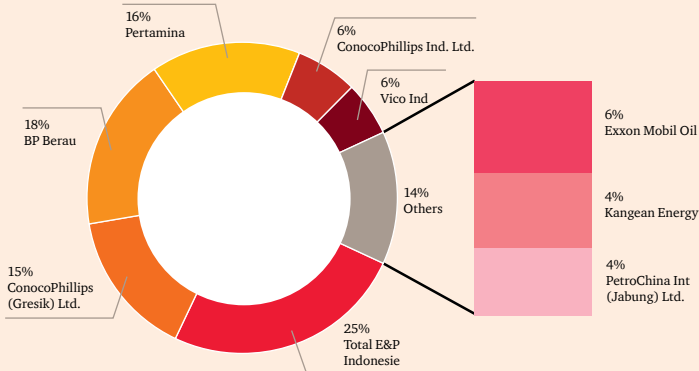
Most oil and gas production is carried out by foreign contractors under production sharing contracts (PSC) arrangements. The major crude oil and natural gas producers (as PSC operators) as of January 2013 were as follows:

#### Major Indonesian Oil Producers as of January 2013



Source: SKK Migas – IPA Technical Division presentation, 13 February 2013

#### Major Indonesian Gas Producers as of January 2013

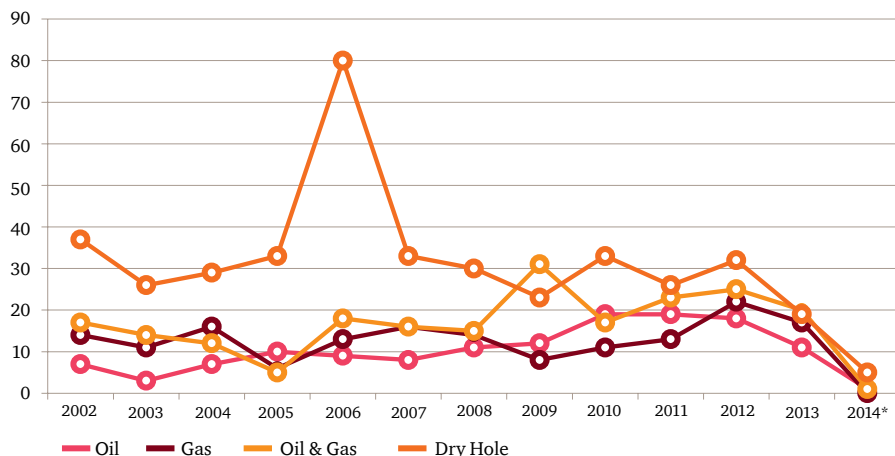


Source: SKK Migas – IPA Technical Division presentation, 13 February 2013

## 1. Industry Overview

The number of wells completed in Indonesia dropped substantially in 2013 and there has been only two productive wells completed (in addition to five dry holes) up until the end of April 2014.

### Wells Completed



#### Source:

SKK Migas - IPA Technical Division presentation, 30 April 2014

\* 2014 data is as of 25 April 2014

Indonesia's coal bed methane (CBM) reserves are estimated to be 453 Tcf which is larger than Indonesia's estimated natural gas resource and ranks 6th in the world. This would make Indonesia's CBM resources potentially one of the largest in the world. The first CBM contract was signed in 2008 and by the end of 2012 there were 54 CBM cooperation contracts in place. In 2013, four CBM production pilots began selling gas to independent power producers. The Government has set daily production targets of 500 mmcf by 2015 rising to 1,000 mmcf by the year 2020 and 1,500 by the year 2025. Indonesia's shale gas reserves are estimated to be 574 Tcf, which is even greater than its CBM reserves.

### 1.4 Downstream sector

Although the downstream market was formally liberalised in 2001, progress has been slow and the state-owned oil and gas company PT Pertamina (Persero) still dominates the sector. Whilst Pertamina's retail monopoly for petroleum products ended in July 2004 when the first licence for the retail sale of petroleum products



was granted to Shell and Petronas of Malaysia, Pertamina remains the dominant distributor of subsidised fuel products (although a recent tender round also allowed PT Aneka Kimia Raya Corporindo (AKR) and PT Surya Parna Niaga entry to the market).

Pertamina also owns and operates eight of the country's nine oil refineries (the ninth is owned by the Research and Development Agency of the Department of Energy and Mineral Resources). The refineries' combined installed capacity is only 1.05 million barrels per day which means that Indonesia imports significant amounts of refined products to meet demand. Whilst the sector has continued to attract interest from foreign investors, at the time of writing none had moved beyond the discussion stage – investors were seeking incentives which, to date, have not been forthcoming.

### 1.5 Contribution to the Economy

Indonesia's oil and gas industry continues to be a vital part of the Indonesian economy. It is an important contributor to Government export revenues and foreign exchange and contributes a substantial amount to state revenue. Revenue from the oil and gas industry increased between 2009 and 2012, then dropped to Rp181 trillion in 2013 to around 12% of all state revenues. It is budgeted to increase to Rp197 trillion in 2014.

Oil and Gas Contribution to Domestic Revenues

Year	Domestic Revenue	Oil/Gas Revenue	% of contribution
	Rp Trillion		
2004	403	85	21.09 %
2005	494	104	21.05 %
2006	636	158	24.84 %
2007	706	125	17.71 %
2008	979	212	21.65 %
2009	847	126	14.88 %
2010	992	153	15.42 %
2011	1205	193	16.02 %
2012	1338	206	15.38 %
2013*	1502	181	12.02 %
2014*	1667	197	11.79 %

Source: Ministry of Finance (MoF)

\* Budget

## 1. Industry Overview

Investment levels in the industry increased by 20% from US\$16,113 billion dollars in 2012 to US\$19,342 billion dollars in 2013 and are forecast to increase by an additional 33% to US\$25,640 in 2014. This is partly due to the higher cost of production from mature wells. The Government signed 25 PSCs in 2012, 14 in 2013 and seven in February 2014.

The Government is attempting to improve incentives to stimulate investment. It now accepts proposals for blocks through a direct bidding process in addition to the previous practice of awarding oil and gas concessions through an official tender. The Government has also improved production sharing splits in recent bid rounds to increase their attractiveness (the targeted “after-tax” returns for oil have increased from 15% to 25% and for gas have increased from 30-35% to 40%) but certain commercial terms have arguably become less competitive (e.g ring-fencing by field/project).

### Upstream Oil & Gas Investment

(in million USD)

Type of operation	2006	2007	2008	2009	2010	2011	2012	2013	2014*
Exploration	431	474	532	633	670	719	1,439	1,877	3,840
Administration	636	869	981	730	833	958	1,016	1,199	1,600
Development	1,876	2,088	2,523	2,671	2,495	3,149	3,288	4,306	5,300
Production	4,639	5,711	6,579	6,391	7,033	9,196	10,370	11,960	14,900
<b>Total Expenditure</b>	<b>7,582</b>	<b>9,142</b>	<b>10,615</b>	<b>10,425</b>	<b>11,031</b>	<b>14,022</b>	<b>16,113</b>	<b>19,342</b>	<b>25,640</b>

**Source:** BP Migas/SKK Migas annual reports (until 2012), SKK Migas website

\* target



## ***Regulatory Framework***



*“All the natural wealth on land and in the waters falls under the jurisdiction of the State and should be used for the greatest benefit and welfare of the people.”*

- Article 33, Constitution of the Republic of Indonesia, 1945

### 2.1 Oil and Gas Law No.22/2001

The law regulating oil and gas activities is Law No. 22/2001 dated 23 November 2001 (Law No. 22). Its stated objective (Article 3) is to ensure that Indonesia's oil and gas related activities:

- a. guarantee effective, efficient, highly competitive and sustainable exploration and exploitation;
- b. assure accountable processing, transport, storage and commercial businesses through fair and transparent business competition;
- c. guarantee the efficient and effective supply of oil and gas as a source of energy and for domestic needs;
- d. promote national capacity;
- e. increase state income; and
- f. enhance public welfare and prosperity equitably as well as maintaining the conservation of the environment.

#### 2.1.1 Control of Upstream and Downstream Activities (Articles 4-10 and Articles 38-43)

Oil and gas contained within Indonesia's jurisdiction is controlled by the Government (generally via a Production Sharing Contract (PSC)) as holder of the relevant concession. Law No.22 differentiates between upstream business activities (exploration and exploitation) and downstream business activities (processing, transport, storage and commerce) and stipulates that upstream activities are controlled through “Joint Cooperation Contracts” (which are predominantly PSCs) between the business entity/permanent establishment and the executing agency (BP Migas, since replaced by SKK Migas – see below) (Article 6) and downstream activities are controlled by business licenses issued by the regulatory agency (BPH Migas) (Article 7).

SKK Migas and BPH Migas supervise upstream and downstream activities respectively to ensure:

- a. conservation of resources and reserves;
- b. management of oil and gas data;
- c. application of good technical norms;
- d. quality of processed products;

- e. work place safety and security;
- f. environmental management such as preventing pollution and restoring environmental damage;
- g. prioritisation of local manpower, goods and services and domestic engineering capacities;
- h. development of local communities; and
- i. development and application of oil and gas technology.

Upstream and downstream business activities may be carried out by state-owned enterprises, regional administration-owned companies, cooperatives, small-scale businesses or private-business entities. For upstream business activities only, this can include branches of foreign incorporated enterprises where they are as a permanent establishment (PE). Upstream entities are prohibited from engaging in downstream activities, and vice versa (Article 10) except where an upstream entity must build transport, storage or processing facilities, or other downstream activities that are integral to supporting its exploitation activities (Article 1).

### Dissolution of BP Migas and Creation of SKK Migas

On 13 November 2012 the Constitutional Court of Indonesia issued a decision which cancelled certain articles within Law No.22 on the basis that BP Migas violated Article 33 of the 1945 Constitution. The Constitutional Court's decision effectively dissolved BP Migas with immediate effect. On the same day the President issued Presidential Regulation No.95/2012 transferring the roles and responsibilities of BP Migas to the Ministry of Energy and Mineral Resources (MoEMR) and MoEMR issued two decrees, MoEMR Decree No.3135K/08/MEM/2012 and No.3136K/73/MEM/2012, to establish Satuan Kerja Sementara (the SKS or Temporary Working Unit) under the MoEMR.

The new regulation and decrees provided short-term clarity on the following:

- That all duties, functions and responsibilities of BP Migas were assumed by the SKS;
- That all employees and key management of BP Migas were transferred to the SKS with the exception that the SKS was headed by the Minister of Energy and Mineral Resources; and
- That all PSCs awarded by BP Migas to oil and gas contractors remained in effect.

On 10 January 2013, the President issued Presidential Regulation No. 9/2013 establishing the Special Working Unit on Upstream Oil and Gas Activities (SKK

Migas) to replace the SKS. The personnel originally employed by BP Migas and subsequently by the SKS have now been transferred to SKK Migas. According to the Presidential Regulation, the role and management of the upstream oil and gas sector by SKK Migas will be overseen by a supervisory body consisting of the Minister and the Deputy Minister of Energy and Mineral Resources, the Deputy Minister of Finance and the Head of the Investment Coordinating Board (BKPM).

We do not expect the switch from the temporary working unit to the special working unit to bring about significant changes in the management of the upstream oil and gas sector by the Indonesian Government in the short term. However it is clearly stated that the authority of SKK Migas will be in place up until the issuance of a new Oil and Gas Law. At the time of writing a draft of the new Oil and Gas Law had been proposed by Parliament prior to the 2014 parliamentary elections. Therefore it appears any regulations as part of plans to change the Oil and Gas Law will also need to revisit the appointment and role of the oil and gas regulatory body.

It should be noted that the pre-November 2012 PSCs are yet to be amended to reflect the lack of status of the now dissolved BP Migas. New PSCs for the 2013 bid round did however substitute SKK Migas.

### 2.1.2 GR 79 on Cost Recovery and Income Tax for the Oil and Gas Sector

After a two year discussion period, the landmark Government Regulation 79 was issued on 20 December 2010 (GR 79) and contains the first ever over-arching framework and amending provisions on cost recovery and tax in the upstream space. Numerous implementing regulations have now been issued which have partially clarified the scope of GR 79. There remains, however, a number of implementing regulations which are still to be issued. Therefore the precise operation and impact of GR 79 is still unclear. For more on this please read section 3.4.

### 2.1.3 Restrictions on Foreign Workers

On 24 October 2013 the MoEMR issued Decree No.31/2013 on Expatriate Utilisation and the Development of Indonesian Employees in the Oil and Gas Business (Decree 31/2013), which covers employees in the upstream and downstream sectors as well as support services companies, with the aim of encouraging both the employment of Indonesian workers and the transfer of knowledge, skills and expertise from expatriates to the local workforce.

## 2. Regulatory Framework

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Under Decree 31/2013, expatriates cannot be employed in the following positions:

- a. human resources;
- b. legal;
- c. environmental health and safety;
- d. supply chain management;
- e. quality control; and
- f. exploration and exploitation functions below superintendent or equivalent levels.

Expatriates can be employed in the following functions on approval of the DG of Oil and Gas as long as they meet a specific set of requirements, including working experience (minimum 5 years), age (30 – 55 years), Indonesian language skills and a willingness to transfer their knowledge and skills to Indonesian workers:

- a. directors;
- b. commissioners;
- c. expatriates in international labour exchange programs; and
- d. expatriates with specialist skills.

Decree 31/2013 includes a reporting requirement and sanctions for non-compliance.

These restrictions on foreign workers are likely to tighten the market for qualified local and international employees.

## 2.2 Other Relevant Law

### 2.2.1 The Energy Law No.30/2007

The Energy Law No.30 /2007 dated 10 August, 2007 provides a renewed legal framework for the overall energy sector, with emphasis on economic sustainability, energy security and environmental conservation (Article 3). Under this Law, the National Energy Council (DEN) was established in June 2009 with the task of formulating and implementing a House of Representative-approved National Energy Policy, determining the National Energy General Plan and planning steps to overcome any energy crisis or emergency.

### National Energy Policy

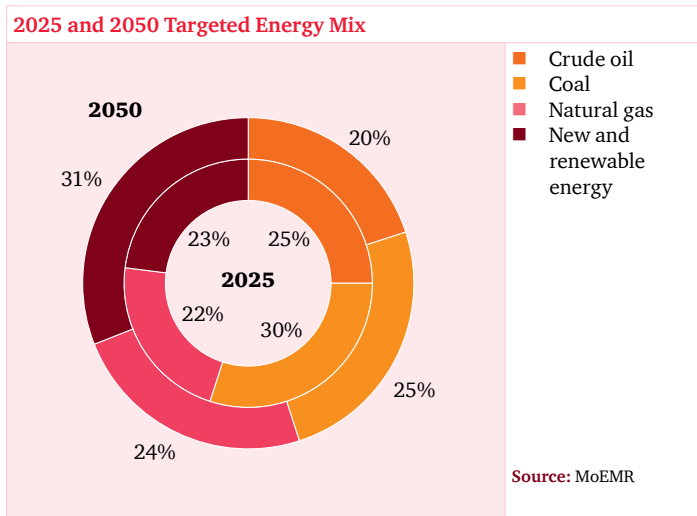
The draft of the National Energy Policy, which was formulated by DEN, was passed by the House of Representatives on 28 January 2014 but, at the time of writing, it had not been signed by the President.



The National Energy Policy is for the overall management of energy and will address issues such as:

- a. the availability of energy to meet the nation's requirements;
- b. energy development priorities;
- c. utilisation of national energy resources; and
- d. national energy buffer reserves.

The National Energy Policy aims to achieve an optimal energy resources mix by 2025 and 2050 as follows:



DEN is chaired by the President and Vice-President with the Energy Minister as Executive Chairman. DEN has 15 members which include the Minister and Government officials responsible for the provision, transportation, distribution and utilisation of energy; and other stakeholders (2 from academia; 2 from industry; 1 technology representative; 1 environment representative; and 2 from consumer groups).

### 2.2.2 The Investment Law No.25/2007 and Company Law No.40/2007

#### Mode of Business

The permitted mode of entry for foreign investors in the oil and gas sector is by way of a branch of a foreign company (i.e. as a Permanent Establishment or PE). Incorporation as a limited liability company under Company Law

No.40/2007 and domiciled in Indonesia (i.e. as a business entity or PT) is available for Indonesian investors only.

Due to the “ring fencing” principle (Article 13 of Law No.22), where only one PSC can be granted for each PE or PT, separate bodies must be set up for each work area. This was confirmed in GR 79. For example, after the passing of Law No.22, Pertamina was required to establish subsidiaries and enter into PSCs with BP Migas (now SKK Migas) for each of its work areas.

Investment Law No.25/2007 (Law No.25) dated 26 April 2007 applies only to those PTs operating in the downstream sector. Law No.25 allows investors, amongst other things, to transfer and repatriate profits (see section 2.4 on developments in Bank Indonesia regulation on the repatriation of funds), bank interest and dividends in foreign currency (Articles 6, 7 & 8) and provides for capital investment facilities. These facilities include the exemption or relief of import duty on the import of capital goods, machines or equipment for production needs; and/ or the exemption or postponement of Value Added Tax (VAT) on the import of capital goods or machines or equipment needed for production (Article 18).

### The Negative Investment List

On 24 April 2014 a new negative investment list was issued as Presidential Decree No. 39/2014, which replaces Presidential Decree No. 36/2010. This restricts foreign investment companies (PMA entities) involved in both offshore and onshore drilling and oilfield services as follows:

- PMA entities can no longer engage in onshore drilling (this is now restricted to domestic companies only). Previously the maximum foreign shareholding was 95%.
- The maximum foreign shareholding for PMA entities which engage in offshore drilling is 75%. Previously wholly owned foreign companies could engage in offshore drilling in eastern Indonesia, and the maximum foreign shareholding was 95% for all other offshore drilling.
- PMA entities can no longer engage in oil and gas construction services for the onshore pipe installations, production installations for upstream onshore oil and gas, horizontal/vertical tanks and storage installations; the maximum foreign shareholding for PMA entities which engage in oil and gas construction services for offshore pipe installations and spherical tanks is 49%; and the maximum foreign shareholding for PMA entities which engage in construction of oil and gas platforms is 75%. Previously, all engineering, procurement and construction services were open to a maximum foreign shareholding of 95%.
- PMA entities can no longer engage in the operation and maintenance of wells, design and engineering support services, or technical inspections. Previously, all operations and maintenance services were open to a maximum foreign shareholding of 95%.

- The maximum foreign shareholding for PMA entities which engage in oil and gas survey services is 49%. Previously, there were no mention of this service in the Negative Investment List.

The 2014 Negative Investment List does not apply to investments approved prior to its issue unless the terms are more favourable to the relevant investor. The List also does not apply to indirect investments, or portfolio investments transacting through domestic capital markets.

### **Legislative Responsibilities: Environment and Others**

The Company Law No.40/2007 dated 16 August, 2007 legislates the social and environmental obligations of companies undertaking business activities in the natural resource field and/or related to natural resources – the costs of such obligations to be borne by the company and budgeted in their expenditure (Article 74). Sanctions for non-compliance are covered in all related legislation. As at April 2014, the Government Regulation providing details of these social and environmental responsibilities had not been issued.

Obligations for PT companies are set out in the Investment Law No.25 and include: prioritising the use of Indonesian citizen manpower (Article 10), creating a safe and healthy working environment (Article 16), implementing corporate social responsibility programs (Article 15), and preserving environmental conservation (Article 16). Investors exploiting non-renewable natural resources must allocate funds to site restoration that fulfill the standards of an environmental feasibility (Article 17). Sanctions for non-compliance with Article 15 of the Investment Law (which includes corporate social responsibility) include restriction of business activities; and freezing or revocation of business activities (Article 34 of the Investment Law).

### **2.2.3 The Environment Law No.32/2009 and Forestry Law No.41/1999**

In October 2009, the Indonesian Parliament passed the Environment Law No.32/2009 (Law No.32). Law No.32 provides for environmental disincentives such as taxes and also requires entities to comply with standard environmental quality requirements and to secure environmental permits before beginning operations. Sanctions can include the cancellation of operating permits, fines, and/or imprisonment. The environmental quality requirements (which concern emissions and waste water temperature levels) have been the subject of recent industry concerns due to the time lag required in implementing new process technologies and increased production costs. After initially being postponed,

## 2. Regulatory Framework

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Law No.32 is now operative. Industry has been working with regulators on the new Hazardous & Toxic Material, Waste and Dumping (RPP-B3) regulations which are now on hold pending further discussions.

Other environmental management responsibilities include consideration of certified emission reductions as part of the Indonesian Government's commitment to its ratification of the 1997 Kyoto Protocol (i.e. as the Clean Development Mechanism).

### Forestry Law

The Forestry Law No.41/1999 (and its amendments 1/2004 and 19/2004) prohibit oil and gas activities in protected forest areas except where a Government permit is obtained. Government Regulation No.10/2010 allows projects, including oil and gas activities, power plants, mining, transport and renewable energy projects, to take place in protected forests where they are deemed strategically important.

Under GR No.24/2010 (as amended by GR No.61/2012) the utilisation of forestry areas for non-forestry activities is permitted in both production forests and protected forests subject to obtaining a "borrow-and-use" permit (IPKH) from the Ministry of Forestry. The "borrow-and-use" permit holder will be required to pay various non-tax State Revenues pursuant to these activities and will need to undertake reforestation activities upon ceasing its use of the land. The issuance and validity of the "borrow-and-use" permit depends entirely on the spatial zoning of the relevant forest area.

Use of a forestry area will often also require the making of land compensation transfers or compensation payments to local land owners.

### Forestry Moratorium Extended

A two year moratorium on permits for forest and peatland clearing (Presidential Instruction No.10/2011) was extended by Presidential Instruction No.6/2013 on 13 May 2013. The moratorium allows exceptions for vital national development such as geothermal, oil and gas, power plants, rice and sugar cane fields.

#### 2.2.4 Regulating Export Proceeds and Foreign Exchange

On 31 September 2011, Bank Indonesia (BI) simultaneously issued three regulations which are PBI No.13/20/PBI/2011, PBI No.13/21/PBI/2011, and PBI

No.13/22/PBI/2011 (together PBI No.13). The purpose of these regulations was to regulate export proceeds and foreign exchange.

Broadly, PBI No.13 stipulated three main requirements:

- a. All export revenue must be allocated through accounts with Indonesian banks, including Indonesian branches of offshore banks (“onshore accounts”) with reports/supporting documentation issued to the bank once the revenue has been allocated through the onshore account;
- b. Any discrepancy arising between the amount received through the onshore account and the export value stated in the Export Goods Notification (PEB) must be explained by the exporter in written form and to be supported by related evidence; and
- c. If foreign currency from external debt is to be withdrawn through onshore accounts the debtor must report the withdrawal to BI.

As an acknowledgement from the Bank of Indonesia (BI) that PBI No.13 raised questions amongst exporters, in December 2012 the BI issued replacement regulation PBI No.14/25/PBI/2012 (PBI 14). Through PBI No.14 the BI also supervises export revenue and the withdrawal of foreign debt in order to optimise the benefit of export proceeds in the domestic market.

The regulation states that all Indonesian export revenue received in a foreign currency must be reported to the BI and all non-cash amounts must be deposited in a bank which is licensed by the BI to conduct foreign currency business, known as a foreign exchange bank or *Bank Devisa*. When repaying foreign currency debts, companies must similarly use a *Bank Devisa* and report transactions to the BI.

PBI No.14 seems to provide more clarity and flexibility in respect to the reporting timeframe and increases the maximum discrepancy allowed between the export revenue received and the customs documentation (PEB) to IDR50 million. Discrepancies greater than IDR50 million require a written explanation and supporting documentation.

As a transitional provision, export revenue received in 2012 (based on the PEB date) should be repatriated back through a *Bank Devisa* within six months. This means that the latest date on which to repatriate revenue for PEBs issued in 2012 will be 30 June 2013. PBI 14 also requires that export revenue paid through an offshore trustee must be similarly repatriated by 30 June 2013. Such trustee arrangements typically apply for piped gas sales and LNG exports.

Particularly within the oil and gas sector, there are concerns that the request for compliance with PBI No.14:

- breaches the “contract sanctity” of PSCs which state that Contractors have the right to freely lift and export their production share and to retain the proceeds of any sale abroad;
- could potentially reduce cash liquidity for PSC and thus affect or slow new development activities (e.g. capex commitments);
- could affect the trustee paying agent mechanism for gas/LNG sales and any associated financial covenants; and
- could be subject to subsequent “refinements” or requirements on the minimum period of deposits and/or mandatory conversion of deposits to rupiah.

While non-compliance could result in the suspension of export activity, there has been no further clarification provided by the BI or other authorities (i.e. SKK Migas or the MoEMR) on matters surrounding the requirement to use a *Bank Devisa* (although there have been statements in the media that keeping export revenue in a *Bank Devisa* for one day would satisfy the regulation). In the midst of this, some PSC companies have been reported as cooperating and complying with PBI No.14.

## 2.3 Stakeholders

### 2.3.1 The Ministry of Energy and Mineral Resources (MoEMR)

The Ministry of Energy and Mineral Resources (MoEMR) is charged, amongst other duties, with creating and implementing Indonesia’s energy policy, ensuring that related business activities are in accordance with the relevant laws and regulations, and awarding contracts. It is also responsible for the National Master Plan for the transmission and distribution of natural gas. The MoEMR is divided into directorates with the Directorate General of Oil and Gas (DGOG) responsible for:

- a. the lifting calculation formula and its division between the local and central government;
- b. the policy on the gradual reduction of the fuel subsidy;
- c. the offering of new exploration and production blocks; and
- d. preparing other policies on the oil and gas industry.

An organisation chart and summary of roles and responsibilities of the MoEMR is provided at Appendix B.

### **2.3.2 BP Migas/SKK Migas**

The implementing/executing agency BP Migas (now dissolved and replaced by SKK Migas, see 2.1.1 above), a non-profit state owned legal entity established on 16 July 2002, controls upstream activities and manages oil and gas contractors on behalf of the Government through Joint Cooperation Contracts. Under Law No.22 (Articles 44 and 45) all of Pertamina's rights and obligations arising from existing Cooperation Contracts were transferred to BP Migas.

SKK Migas has the following (unchanged) role:

- a. providing advice to the MoEMR with regard to the preparation and offering of work areas and Joint Cooperation Contracts;
- b. acting as a party to Joint Cooperation Contracts;
- c. assessing plans of development<sup>3</sup> (or "field development plans") that are to produce for the first time in a given work area and submitting that evaluation to the MoEMR for its approval;
- d. approving plans of development (other than those mentioned in point c.);
- e. approving work plans and budgets;
- f. reporting to the MoEMR on the implementation of joint cooperation contracts; and
- g. appointing sellers of the State portion of petroleum and/or natural gas to the Government's best advantage.

The MoEMR and the Head of SKK Migas may further stipulate provisions regarding the scope and supervision of upstream business activities. If necessary, the MoEMR and the Head of SKK Migas may jointly supervise upstream business activities. The Head of SKK Migas is appointed by the President after consultation with the Parliament and is responsible to the President. SKK Migas' organisation chart is provided at Appendix C.

### **2.3.3 BPH Migas**

The regulatory agency BPH Migas was established on 30 December 2002 to assume state oil and gas company Pertamina's regulatory roles in relation to downstream activities (Articles 46 and 47 of Law No.22). BPH Migas is charged with assuring sufficient natural gas and domestic fuel supplies and

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3 In assessing and approving plans of development, SKK Migas considers the estimated reserves and production of Oil and Gas, cost estimates, plans for the use of the oil and gas, the oil and gas exploitation process, state revenue estimates, use of manpower and domestically produced goods and services, and environment and community issues.

2. Regulatory Framework

the safe operation of refining, storage, transportation and distribution of gas and petroleum products via business licences.

BPH Migas is managed by one chairman and eight members. The chairman and members of the Regulatory Body are responsible to the President who appoints them after consultation with the Parliament. BPH Migas’ organisation chart is provided at Appendix D.

BPH Migas’ regulatory, development and supervisory roles in downstream activities are set out in the following table:

Regulatory and Development Areas under BPH Migas	Supervisory Areas under the MoEMR
<ul style="list-style-type: none"><li>• Business licences</li><li>• Type, standard and quality of fuels</li><li>• Utilisation of oil fuel transportation and storage facilities</li><li>• Exploitation of gas for domestic needs</li><li>• Strategic oil reserves</li><li>• National fuel oil reserves</li><li>• Master plan for a national gas transmission and distribution network</li><li>• Occupational safety, health, environment and community development</li><li>• Price formulation including the gas selling price for households and small-scale customers</li><li>• Utilisation of local resources</li></ul>	<ul style="list-style-type: none"><li>• Business licences</li><li>• Type, standard and quality of fuels</li><li>• Occupational safety, health, environment and community development</li><li>• Employment</li><li>• Utilisation of local resources</li><li>• Oil and gas technology</li><li>• Technical rules</li><li>• Utilisation of measuring tools</li></ul>

Source: PP No. 36/2004

BPH Migas is also responsible for the supervision of fuel oil distribution and transportation of gas through pipelines operated by PT companies.



Supervision and Distribution of Fuel Oil	Transportation of Gas by
<ul style="list-style-type: none"> <li>• Supply and distribution of fuel oil</li> <li>• Supply of fuel oil in remote areas</li> <li>• Allocation of fuel oil reserves</li> <li>• Market share &amp; trading volumes</li> <li>• Settling of disputes</li> </ul>	<ul style="list-style-type: none"> <li>• Development of transmission segment and distribution network area</li> <li>• Determination of natural gas pipeline transmission tariff and prices</li> <li>• Market share of transportation and distribution</li> <li>• Settling of disputes</li> </ul>

### Open Access to Gas Pipelines

The Government of Indonesia recognises the need to expand its pipeline network to raise gas penetration rates and cut oil dependency.

BPH Migas have said that they will auction the construction of gas pipeline infrastructure in the distribution lines of Lampung, Semarang, Pasuruan, and Jambi in 2014 on the basis of open (third party) access. Although there have been BPH Migas rules supporting open access since 2008 (Rule No.12/BPH Migas/II/2008 on Special Right Auction of Gas Pipeline, Rule No. 16/P/BPH Migas/VII/2008 on Toll Fee (Tariff) of Gas Pipeline, Rule No.15/P/BPH Migas/VII/2008 on Open Access of Gas Pipeline) and a MoEMR regulation (10/2009 on Piped Natural Gas Business Activities) stipulating that owners of gas pipes in the country must allow their lines to be accessed by third parties, PGN has been reluctant to open the access to its pipelines.

PGN has said that it opposes open access to its gas pipelines because it will threaten the country's future pipeline projects as other companies will gain access to PGN's network and not have any incentive to build their own pipelines. PGN has also said that the company has built its own pipelines dedicated to its customers. The company has invested heavily in these pipelines and spends \$70 million annually to maintain them.

By auctioning new open access gas pipelines, BPH Migas hopes to pave the way for the entire distribution pipelines to adopt open access in due course.

Separately, PGN has plans to build a distribution pipeline in order to integrate with the Lampung Floating Storage and Regasification Unit and build another distribution pipeline to get integrated with the Central Java FSRU and the trans-Java gas transmission pipeline in Semarang.

PGN has targeted Lampung FSRU to start distributing gas generated from regasification of liquefied natural gas (LNG) to consumers in early 2015.

### 2.3.4 House of Representatives (DPR) and Regional Governments

Commission VII of the House of Representatives (DPR)'s 11 Commissions is charged with energy, mineral resources, research and technology, and environmental matters. This includes oversight of all oil and gas activities. It is responsible for drafting oil and gas related legislation, control (including the State Budget and regulations, Re-implementation of the laws & results from State Audits) and control of related Government policy. It also provides suggestions to Government in relation to the oil and gas sector's contributions to the State Budget (APBN). A chart explaining Commission VII's function and role within Government is provided at Appendix E.

Regional Governments are involved in the approval of Plans of Development (PoD) (also known as "field development plans") through the issuance of local permits and land rights.

### 2.3.5 PT Pertamina

On 18 June 2003, PT Pertamina (Persero) was officially transformed from a state-owned oil and gas enterprise governed by its own law into a state-owned limited liability company. Pertamina still retains authority from the Government to supply fuel oil for domestic consumption, with a subsidy provided by the Government. Pertamina is laying the groundwork for full privatisation to take place at some point in the future. In recent years Pertamina has expanded its scope of operations to include gas, renewable and new energy and upstream operations both within Indonesia and abroad. It now has upstream operations in Vietnam, Malaysia, Sudan, Qatar and Libya and serves aviation fuel charging in ten international airports. Pertamina has also entered into several joint operations within Indonesia.

### **2.3.6 PT Perusahaan Gas Negara (PGN)**

Perusahaan Gas Negara was originally a Dutch-based gas company called Firma L.I. Eindhoven & Co. In 1958, the firm was nationalised and became Perusahaan Negara Gas, changing its name to PT. Perusahaan Gas Negara (PGN) effective May 13, 1965. In 2003, PGN began trading on the Jakarta and Surabaya Stock Exchanges. PGN is 57% owned by the Government of Indonesia.

PGN operates a natural gas distribution pipeline network and a natural gas transmission pipeline network. Its subsidiaries and affiliated companies include upstream activities (Saka Energi Indonesia currently has interests in three PSC: Bangkanai; Kepapang; and Pangkah), downstream activities, telecommunications, construction and a floating storage and regasification terminal..

### **2.3.7 Industry Associations**

The Indonesian Petroleum Association (IPA) was established in 1971 in response to growing foreign interest in the Indonesian oil and gas sector. The IPA's objective is to use public information to promote the exploration, production, refining and marketing aspects of Indonesia's petroleum industry. Please see Appendix F for more information about the IPA.

The Indonesian Gas Association (IGA) was established in 1980 under the sponsorship of Pertamina and key gas producers. The main objective of the IGA is to provide a forum to discuss matters relating to natural gas and to advance knowledge, research and development in the areas of gas technology. The IGA also aims to promote the development of infrastructure and cooperation among the producing, transporting, consuming and regulatory segments of the gas industry. Please see Appendix F for more information about the IGA.

The Unconventional Gas Committee within the IPA represents the interests of participants in the coal bed methane, shale gas and other unconventional gas industries. In late 2013, the Committee participated in the HAGI-IAGI (Associations of Geophysicists and Geologists) Joint Convention and the Unconventional Hydrocarbon Symposium Indonesia.

## *Upstream Sector*



This chapter covers the following topics:

- 3.1 the regulations applicable to the upstream sector;
- 3.2 the commercial terms of a production sharing contract (PSC);
- 3.3 accounting issues in the upstream sector;
- 3.4 taxation and customs;
- 3.5 commercial and tax considerations; and
- 3.6 documentation for planning and reporting.

## 3.1 Upstream Regulations

Activities in the oil and gas upstream sector are regulated by Law No.22 and its implementing regulations GR 35/2004 and the amending GR 34/2005 and GR 55/2009, and GR 79. A summary of Law No.22's key sections are set out below.

### 3.1.1 Work Areas

Upstream business activities (i.e. exploration and exploitation) are conducted in regions known as “work areas”. Work areas are formalised upon approval from the Ministry for Energy and Mineral Resources (MoEMR) in consultation with SKK Migas and relevant local government authorities and then specified in a Joint Cooperation Contract.

A work area can be offered through either tenders (which consider the bidder’s work program, technical and financial capability, and degree of risk and efficiency), or direct offers (see below).

Every business entity or PE (Contractor) can hold only one work area (the “ring-fencing” principle) and must return it, in stages or in its entirety, as commitments are fulfilled in accordance with the Joint Cooperation Contract. Once a work area is returned it becomes an open area.

At the time of writing, just prior to the 2014 parliamentary elections, a draft bill for a new Oil and Gas Law was in existence. There were however no indications as to when and if this would be finalised by the new parliament.

3.1.2 Awarding of Contracts – direct offers or tenders for new acreage

Direct offers for new acreage

The MoEMR can award new acreage through a direct offer. In a direct offer, a company who performs a technical assessment through a joint study with the Directorate General of Oil and Gas will then receive the right to match the highest bidder of the tender round.

Pertamina can apply for a direct offer, with MoEMR approval, when the area is (1) an “open” area; (2) the Contractor is transferring its PSC participating interest to a non-affiliate; or (3) the PSC area has expired or been relinquished (and therefore reverts to an open area).

Tenders for new acreage

The majority of new acreage is awarded through a tendering process.

The tendering steps involved are as follows:

- a register as a tender participant by obtaining the official bid information package from the Directorate General of Oil and Gas (DGOG) at the MoEMR. The fee for the bid information package varies and is non-refundable;
- b purchase an official government data package for the particular block being tendered to support the technical evaluation and proposed exploration program to be submitted with the tender. The fee for the data package will vary depending on the nature of the block;
- c attend a clarification forum a few days prior to the tender date;
- d submit two identical copies of the completed bid documents by the tender closing date. The tender documents consist of:

Tender Document Checklist

No.	Subject	Remark
1.	Application Form	A completed application form.
2.	Work Program & Budget	A proposed work program & budget for six years of exploration. (A sample work program & budget for a tender is provided below).

**Tender Document Checklist**

No.	Subject	Remark
3.	Technical Report & Montage	The geological and technical justification for supporting the exploration program including a seismic survey commitment and completion of one exploration well.
4.	Financial Report	Annual financial statements for the past three years certified by a certified public accountant or other verification (as stipulated in the bid document) that demonstrate the participant's ability to finance all work program commitments for the first three years. (Increasingly the Government is requiring the successful bidder to submit a performance bond to cover the work program activity for the first three contract years).
5.	A statement regarding bonuses	A statement confirming the participant's ability to pay any required bonuses. (Increasingly the Government is requiring participant's to include evidence of a bid bond that provides 100% coverage of the signature bonus during the initial six month period).
6.	All Consortium Agreement	For a consortium bid, each agreement between and/or among the consortium members together with confirmation of which member of the consortium is the designated operator.

#### Tender Document Checklist

No.	Subject	Remark
7.	PSC Draft	A draft of the PSC agreement.
8.	A statement agreeing to the PSC Draft	A statement agreeing to the terms of the draft PSC agreement which will be signed by the winning bidder.
9.	Original receipt of payment	A copy of the payment receipt for the bid information document.
10.	Copy of data package payment	A copy of the proof of purchase of the official government data package.
11.	Copy of notarised deed/articles of establishment	A copy of the participant's notarised articles of incorporation.
12.	A compliance statement	A letter stating the participant's compliance with the results of the bidding process.

- e. The evaluation and grading of the tender bid document is carried out by the MoEMR Oil and Gas Technical Tender Team for New Acreage. Bids are evaluated on the basis of each bid's furtherance of Indonesia's national interests. Bid evaluations consider administrative compliance, financial and technical capability, and previous performance.
- f. The winner of the tender is determined by the DGOG after recommendation from the Tender Team.

A typical template for the Work Program and Budget for six years of exploration is as follows:



### PSC Work Program and Commitment

NO	CONTRACT YEARS	DESCRIPTION	COMMITMENT			
			ACTIVITY		BUDGET	
			UNIT	AMOUNT	UNIT	AMOUNT
A.	BONUS					
I		Signature			US.\$	
II		Equipment and/or Service Bonus			US.\$	
III		Production Bonus:				
		At Cumulative 25 MMBOE			US.\$	
		At Cumulative 50 MMBOE			US.\$	
		At Cumulative 75 MMBOE			US.\$	
B.	YEARLY COMMITMENT					
	FIRM EXPLORATION COMMITMENT					
I	First	G and G			US.\$	
		Seismic 2D Acquisition and processing	KM		US.\$	
		Seismic 3D Acquisition and processing	KM2		US.\$	
		Exploratory well	Well		US.\$	
II	Second	G and G			US.\$	
		Seismic 2D Acquisition and processing	KM		US.\$	
		Seismic 3D Acquisition and processing	KM2		US.\$	
		Exploratory well	Well		US.\$	
III	Third	G and G			US.\$	
		Seismic 2D Acquisition and processing	KM		US.\$	
		Seismic 3D Acquisition and processing	KM2		US.\$	
		Exploratory well	Well		US.\$	

THE SECOND 3 YEARS EXPLORATION COMMITMENT						
IV	Fourth	G and G			US.\$	
		Seismic 2D Acquisition and processing	KM		US.\$	
		Seismic 3D Acquisition and processing	KM2		US.\$	
		Exploratory well	Well		US.\$	
V	Fifth	G and G			US.\$	
		Seismic 2D Acquisition and processing	KM		US.\$	
		Seismic 3D Acquisition and processing	KM2		US.\$	
		Exploratory well	Well		US.\$	
VI	Sixth	G and G			US.\$	
		Seismic 2D Acquisition and processing	KM		US.\$	
		Seismic 3D Acquisition and processing	KM2		US.\$	
		Exploratory well	Well		US.\$	

#### 3.1.3 General Surveys and Oil and Gas Data

To support the preparation of work areas, a general survey (geological and geophysical) must be carried out, but any survey conducted by a business entity is done at its own expense and risk and only after receiving permission from the MoEMR.

General survey and exploration and exploitation data becomes the property of the State so that any utilisation, transmission, surrender and/or transfer of data inside or outside of Indonesia requires permission from the MoEMR. Data resulting from exploration and exploitation activities must be surrendered to the MoEMR (through SKK Migas) within three months of collection, processing and interpretation.

Prior to a work area being returned to the Government, its oil and gas data can be kept secret for four years (basic data) to eight years (interpreted data). But once the work area is returned, the data is no longer classified as secret.

### 3.1.4 Joint Cooperation Contracts

Upstream activities are executed via a Joint Cooperation Contract defined under Law No.22 to be a Production Sharing Contract (PSC) or other form of Joint Cooperation Contract (such as a Service Contract, Joint Operation Agreement, or Technical Assistance Contract) in exploration and exploitation activities that is signed by the business entity or Permanent Establishment (PE) with SKK Migas (the executing agency).

The JCC contains provisions that stipulate (Article 6):

- a. that ownership of the oil and gas remains with the Government until the delivery point;
- b. that ultimate operational management control remains with BP Migas (now SKK Migas); and
- c. that all capital and risks are borne by the Contractor.

The JCC also contains provisions that stipulate (Article 11):

- a. “State revenue” terms;
- b. work areas and their reversion;
- c. work programs;
- d. expenditure commitments;
- e. transfer of ownership of production results of oil and gas;
- f. period and conditions of the extension of the contract;
- g. settlement of any disputes;
- h. domestic supply obligations (a maximum 25% of production is given up to meet domestic supply)(Article 22)<sup>4</sup>;
- i. post-mining operation obligations;
- j. work place safety and security;
- k. environmental management;
- l. reporting requirements;
- m. plans for the development of the field;
- n. development of local communities; and
- o. priority on the use of Indonesian manpower.

Historically there were two categories of agreements and contracts for Indonesia’s petroleum industry. The first category referred to the bundle of rights and obligations granted to an investor to invest, in cooperation with the Government, in oil and gas exploration and exploitation (i.e. Production Sharing Contracts; Technical Assistance Contracts (TAC); and Enhanced Oil Recovery Contracts (EOR)). The second category referred to the separate

4 Now 25% of a contractor’s share of crude oil or natural gas per GR 79 Article 24 (8).

agreements that participants in the PSC, TAC or EOR entered into on how they would conduct the petroleum operations. These are known as Joint Operation Agreements (JOAs) and Joint Operation Bodies (JOBs). Since the passing of Law No.22, most new contracts have been in the form of PSCs.

#### 3.1.5 Activity, Expenditure and Bonus Commitments

Contractors are required to begin their activities within six months from the effective starting date of the JCC and to carry out the work program during the first three years of the exploration period.

The Contractor is responsible for all financing requirements of the operation and bear the full risk if exploration is not successful. This financing is expected to be in foreign currency, usually US dollars. Any costs incurred by SKK Migas are subject to a refund from the Contractor.

The PSC includes annual exploration expenditure requirements for both the initial six years and any four-year extension. While the overall annual commitment is established in the PSC, details must be approved by SKK Migas in the form of annual work programs and related budgets. The Government will typically require the Contractor to take out a performance bond to cover the first three contract years of activity commitment. Over-expenditures can be carried forward to the next year, but under-expenditures can only be made up with SKK Migas' consent. Failure to carry out the required obligation may lead to termination of the Joint Cooperation Contract and any under-expenditure may need to be paid to the Government along with the loss of any related performance bond.

The bid usually includes a commitment to pay certain bonuses to SKK Migas (and increasingly the Government is requesting a bond to cover the signing bonus as part of the bid). These bonuses are of two types:

- a. Signature Bonuses – payable within one month of the award of the contract. These bonuses generally range from between US\$1 million – US\$15 million.
- b. Production Bonuses – payable if production volumes exceed a specified number of barrels per day, e.g. US\$10 million when production exceeds 50,000 bbl/d, or cumulative production.

GR 79 stipulates that bonuses paid to the Government are not cost-recoverable (see comments below). Therefore, in accordance with the uniformity principle outlined in GR 79 bonuses paid to the government would also not be tax deductible.

The amount of bonuses to be paid and the amount of committed expenditures stated in a PSC are usually negotiated and agreed to by both the Contractor and SKK Migas before formally signing the PSC.

### **3.1.6 Contract Period**

JCCs remain valid for a maximum of thirty years from the date of approval (they must start activity within six months of signing). After this time, the Contractor can apply to the MoEMR for an extension for another (maximum) twenty years (Article 14). A request for extension can be submitted no earlier than ten years and no later than two years before the JCC expires; but if the contractor is party to a natural gas sale/purchase contract, the Contractor may request an extension before these stipulated time limits. At the time of writing, there were indications that the proposed new Oil and Gas Law would govern PSC extensions and the timing thereof.

The maximum thirty year period includes both the exploration and exploitation periods. The exploration period is for six years extendable for a further (maximum) four years (Article 15). If there are no commercial discoveries in the exploration period then the JCC terminates. After the contract period, the Contractor must return the work area to the MoEMR.

### **3.1.7 Amendments to a Joint Cooperation Contract**

A contractor, through SKK Migas, may propose amendments to the terms and conditions of a Joint Cooperation Contract. These may be approved or rejected by the Minister based on the considered opinions of SKK Migas and their benefit to the State.

### **3.1.8 Participating Interests - Transfers**

A contractor may transfer part or all of its participating interest to another party with prior approval of the MoEMR and SKK Migas. If the transfer is to a non-affiliated company, the MoEMR may ask the Contractor to first offer the interest to a national company. The transfer of a majority participating interest to a non-affiliate is not allowed during the first three years of the exploration period. The taxation issues associated with PSC transfers are discussed further at 3.5, including the changes arising under GR 79.

The Contractor is required to offer a 10% participating interest (at the NBV of expenditures incurred up to that date) to a regionally owned business entity

(BUMD) upon first commercial discovery, which the local company must accept within 60 days of the offer date. If the offer is not taken, the Contractor is required to offer the interest to a national company. The offer is declared closed if the national company does not accept the offer within a period of 60 days from the date of receiving the offer. In practice, these timeframes may not be observed strictly.

#### **3.1.9 Occupational Health and Safety, Environmental Management, and Community Development**

Contractors are required to comply with relevant laws and regulations on occupational health and safety, environmental management, and local Community Development (CD). For PSC contracts executed on or after 2008, the Contractor is explicitly responsible for conducting CD programs during the term of a PSC.

A Contractor's contribution to CD can be in kind, in the form of physical facilities and infrastructure, or through empowerment of local enterprises and workforce. CD activities must be conducted in consultation with the Local Government with priority given to those communities located nearest to the work area. Contractors are required to provide funds for undertaking any CD programs.

For PSCs executed prior to 2008 expenditures for CD are usually cost recoverable. However under Minister of Energy and Mineral Resources Regulation No.22/2008 CD expenditures during the exploitation phase are listed as being non-cost recoverable (and see comments on GR 79 at section 3.2.2). Unlike corporate social responsibility, CD is an operational cost and the Industry's view is that it should be cost recoverable given that it is generally part of an AMDAL (the Environmental Impact Assessment) which is important in maintaining the security of production facilities and long term stakeholder acceptance.

#### **3.1.10 Reservoir Extension and Unitisation**

A reservoir extension into another Contractor's work area, an open area, or the territory/continental shelf of another country must be reported to the MoEMR/SKK Migas. Unitisation arrangements must be formalised when a reservoir extends into another Contractor's work area. If the reservoir extends into an open area, a unitisation must be formalised if such open area later becomes a work area. However, if such open area does not become a work area within a period of five years, a proportionate extension of a contract's work area can be requested. All unitisations must be approved by the MoEMR.

**3.1.11 Non-profit oriented Downstream Activities Allowed**

The activities of field processing, transportation, storage, and sale of the Contractor's own production, are classified as upstream business activities. These should not be profit oriented. The use of facilities by a third party on a proportional cost sharing basis is allowed where there is excess capacity, SKK Migas approval has been obtained, and the activities are not aimed at making a profit. If such facilities are used jointly with another party with an objective of making a profit, these will represent downstream activities and require establishment of a separate business entity under a downstream business permit.

**3.1.12 Share of Production to Meet Domestic Needs**

The Contractor is responsible for meeting demand for crude oil and/or natural gas for domestic needs. Under GR No.35 the Contractor's share in meeting domestic needs is set at a maximum of 25% of the Contractor's share of production of crude oil and/or natural gas. GR 79 Article 24(8) indicates that DMO is now set at 25% of produced petroleum and/or natural gas.

**3.1.13 State Revenue (Articles 31-32 of Law No.22)**

Contractors are required to pay State revenues in the form of taxes and non-tax revenues. The taxes consist of Income Taxes, VAT, import duties and tariffs, regional taxes and other levies. For some PSC's import duties and tariffs, regional taxes and other levies are assumed and/or discharged by the Government. Non-tax State revenues consist of the State's share of fixed fees, exploration and exploitation fees and bonuses. The JCC will stipulate which taxation laws are applicable – either those in force when the JCC was signed, or those currently prevailing – although the exact operation of these alternatives is unclear.

Contractors shall be reimbursed for the costs they have incurred in exploration and exploitation in accordance with the work plan and budget and authorisations for financial expenditure as approved by SKK Migas after they have started commercial production.

Further discussion of this matter is provided below at section 3.4 Taxation and Customs.

#### 3.1.14 Land Title (Articles 33-37 of Law No.22 and Section VII of GR 35/2004)

Rights to working areas are a “right to use” and do not cover land surface rights, but land right acquisitions can be obtained after offering a settlement to owners and occupiers in accordance with the prevailing laws (Article 34). Consideration for land is based upon the prevailing market rate. Where a settlement is offered, land title holders are obliged to allow the Contractor to carry out their upstream activities (Article 35).

Upstream and downstream activities are not permitted in some areas unless consent is provided by the relevant parties (such as the relevant government and/or community). These restricted areas include cemeteries, public places and infrastructure, nature reserves, state defence fields and buildings, land owned by traditional communities, historic buildings, residences or factories. Resettlement might be involved as part of any consent. Section VII of GR 35/2004 sets out detailed provisions on the procedures for settlement.

A Contractor holding a right of way for a transmission pipeline must permit other Contractors to use it after consideration of safety and security matters. A Contractor that plans to use a right of way can directly negotiate with another Contractor/other party that holds the right of way, and if agreement between parties cannot be reached, the MoEMR/SKK Migas can be approached for settlement.

#### 3.1.15 Use of Domestic Goods, Services, Technology, and Engineering and Design Capabilities

All goods and equipment purchased by Contractors become the property of the Government. Any imports require appropriate approvals from the MoEMR, the MoF, and other minister(s) and can be imported only if they are not available domestically and meet requirements of quality/grade, efficiency, guaranteed delivery time and after sales service.

Management of goods and equipment rests with SKK Migas. Any excess supply of goods and equipment may be transferred to other Contractors with the appropriate government approval before any amounts can be charged to cost recovery. Any surplus inventory purchased due to bad planning is expressly mentioned in MoEMR No.22/2008 as not to be available for cost recovery. This position is now supported by GR 79, Article 13 (r).



SKK Migas is required to surrender excess goods and equipment to the MoF, if the equipment cannot be used by another Contractor. Any other use of such goods and equipment, including via donation, sale, exchange, use for capital participation by the State, destruction or rental, requires MoF approval on the recommendation of SKK Migas/ MoEMR.

All goods and equipment used for upstream activities must be surrendered to the Government upon termination of the Joint Cooperation Contract.

For greater detail on the treatment of inventory; property, plant, and equipment; and the tendering for goods and services, please refer to these respective titles at section 3.2.4 Other PSC Conditions and Considerations.

#### 3.1.16 Manpower and control of employee costs and benefits

Contractors should give preference to local manpower but may use foreign manpower for expertise that cannot be met by Indonesian personnel. SKK Migas controls the number of expatriate positions and these positions are reviewed annually. The current manpower laws and regulations applying to the employees of a Contractor are dealt with in section 2.1.4 above. Contractors are required to carry out development, education and training programs for Indonesian workers.

As part of the PSC annual work plan and budget review, SKK Migas reviews training programs/costs, salary and benefit costs and planned Indonesianisation of expatriate positions. Manpower or organisation charts for both nationals and expatriates (RPTK and RPTKA's) are to be submitted annually by Contractors for SKK Migas review and approval. SKK Migas controls the amount of national salaries and benefits which can be paid and cost recovered through salary caps. Due to these salary and benefit caps, PSC operators might be hindered in recruiting and retaining quality staff. In an effort to offset any inequity inherent in the salary caps, PSC operators may offer employee benefits such as housing loan assistance, car loan assistance, and long-service allowances etc, which are cost recoverable if approved by SKK Migas.

PSC operators, under the guidance of SKK Migas, provide a future pension liability upon employee retirement or severance payment upon termination whichever is applicable, referred to as *Tabel Besar* or the Big Table. A Big Table scheme is a form of defined benefit whereby an employee is given a certain number of months pay based on years of service.

Accordingly, some PSC operators have established defined contribution pension plans, which are managed by a separate trustee-administrated pension fund, that is an independent pension entity in which the PSC operator contributes a percentage of an employee's salary and the employee may contribute additional percentages. Any pension contributions paid or funded to the pension entity or insurance company are charged as cost recoverable. Some PSC operators also purchase annuity contracts from insurance companies to satisfy their pension obligations. Pension contribution accruals cannot be charged as cost recoverable until funded (i.e. paid).

Some PSC operators have opted to manage their pension plans by funding the pension obligations with bank time deposits. The interest earned on the time deposits is reinvested and used to reduce future funding. All of these pension schemes require PSC operators to prepare an actuarial assessment to evaluate the fair value of assets and the future pension liability whether it is fully funded or unfunded. Historically, any unfunded pension liability is maintained off balance sheet for PSC basis Financial Reporting.

#### 3.1.17 Jurisdiction and Reporting

Joint Cooperation Contracts are subject to Indonesian law. Contractors are obligated to report discoveries and the results of certification of oil and/or gas reserves to the MoEMR/SKK Migas. Contractors are required to perform their activities in line with good industry and engineering practices which include complying with provisions on occupational health and safety and environmental protection and using enhanced oil recovery technology as appropriate.

#### 3.1.18 Dispute Mechanism - Arbitration

Irrespective of the existing dispute mechanisms, SKK Migas has introduced a separate extra-PSC cost recovery dispute mechanism. PTK 051 provides guidelines to SKK Migas and the Contractor to be followed in the deferral of cost recovery as a result of audit findings, analysis and evaluation of the Financial Quarterly Report (FQR) submitted to SKK Migas, audit of AFE Close-outs, and/or expenditures for which SKK Migas questions the validity and fairness from legal, technical or operational points of view.

Prior to the deferral of cost recovery, discussions shall be held in stages and with successive tiers of management in SKK Migas and the Contractor (up to the top executive management) within a period of six months of the issuance of an audit report. Any deferred cost recovery shall be settled within 90 working days through

a maximum of three discussions. In the event that discussions fail to achieve an agreement, the Contractor may exercise its rights in accordance with the clauses stipulated in the PSC. There is no further explanation in the PTK 051 of what these rights may be.

## 3.2 Production Sharing Contracts (PSCs)

### 3.2.1 General Overview and Commercial Terms

PSCs have been the most common type of joint cooperation contracts used in Indonesia's upstream sector. Under a PSC the Government and the Contractor agree to take a split of the production measured in revenue based on PSC-agreed percentages. Operating costs are recovered from production through Contractor cost oil formulas as defined by the PSC; and the Contractor has the right to take and separately dispose of its share of oil and gas (title to the hydrocarbons passing at the export or delivery point).

#### Generations of PSCs

PSCs have evolved through five “generations”; the main variation between each being the production sharing split. The second and third generation PSCs issued after 1976 removed the earlier cost recovery cap of 40% of revenues and confirmed an after tax oil equity split of 85/15 for BP Migas (now SKK Migas) and the Contractor, respectively. The third generation model of the late 1980's introduced First Tranche Petroleum (FTP) and offered incentives for frontier, marginal and deep-sea areas. In 1994, to stimulate investment in remote and frontier areas (the Eastern Provinces), the Government introduced a 65/35 after-tax split on oil for contracts in the region (fourth generation). Since 2008, a fifth generation has been introduced. While the after tax equity split is negotiable, the latest model limits items available for cost recovery (listed on a “negative list” promulgated in GR 22/2008 and now GR 79) and offers incentives in other areas such as via investment credits. More details on cost recoverable items and the negative list are provided in section 3.2.2.

Key differences between the later generation PSCs and earlier generations are as follows:

- a. rather than a fixed production historical after tax share, there has been some flexibility with the production sharing percentage offered;
- b. PSCs now provide for a DMO for natural gas;
- c. BP Migas (now SKK Migas) and the Contractor are entitled to FTP of 20 % of the Petroleum production. The Contractor share is subject to tax;

- d. the profit sharing percentages appearing in the contract have been determined on the assumption that the Contractor is subject to dividend tax on after tax profits under Article 26(4) of the Indonesian Income Tax Law which is not reduced by any tax treaty;
- e. certain pre-signing costs (e.g. for seismic purchases) may be cost recoverable (although this is less clear in recent PSCs);
- f. SKK Migas must approve any changes to the direct or indirect control of the entity; and
- g. the transfer of the PSC participating interest to non-affiliates is only allowable:
  - with SKK Migas' approval; and
  - where the Contractor retains majority interest and operatorship; or
  - 3 years after signing of the PSC.

### Commercial Terms

The general concept of the PSC is that the contractor bears all risks and costs of exploration until commencement of commercial production. If production does not proceed, these costs are unrecoverable. If production does proceed, the contractors receive a share of production to meet cost recovery, an investment credit (where granted) and an after tax equity interest of the remaining production.

Terms of a PSC include:

- a. the Contractor is entitled to recover all allowable current costs, including production costs, amortised exploration costs and capital expenditures;
- b. recovery of exploration expenses is limited to production arising from the contracted work area that has an approved Plan Of Development (POD) – effectively quarantining cost recovery to the initial and then subsequent “fields” (earlier generation PSCs did not “ring fence” by POD and/or field);
- c. the Contractor is required to pay a range of bonuses including a signing, education (historically) and production bonus. The production bonus is determined on a cumulative quantity basis. These bonuses are not cost-recoverable and not tax deductible in the calculation of Income Tax;
- d. the Contractor agrees to a work program with a minimum amount of exploration expenditure over a certain number of years;
- e. all equipment, machinery, inventory, materials and supplies purchased by the Contractor becomes the property of SKK Migas once landed in Indonesia. The Contractor has a right to use and retain custody during operations. The Contractor has access to exploration, exploitation and geological and geophysical data, but the data remains the property of the MoEMR;

- f. each Contractor shares production less deductions for recovery of the Contractor's operating costs. Each Contractor must file and meet its tax obligations separately;
- g. the Contractor bears all risks of exploration;
- h. historically, each Contractor was entitled to FTP of 15% (for fields in Eastern Indonesia and some in Western Indonesia pursuant to the 1993 incentive package) or 20% (for other fields). This was calculated before considering any investment credit and cost recovery. Recent contracts now again provide for the sharing of FTP of 20% (for a period the entire FTP accrued to the Government);
- i. the Contractor is required to supply a share of crude oil production to satisfy a DMO. The quantity and price of the DMO oil is stipulated in the agreement. New contracts require a gas DMO;
- j. after commercial production, the Contractor may be entitled to recover an investment credit historically ranging from 17% to 55% (negotiated and agreed as part of the PoD approval process) of costs incurred in developing crude oil production facilities; and
- k. the Contractor is required to relinquish portions of the contract area per a schedule specified in the PSC.

#### Cost Recovery Principles

Basic cost-recovery principles include allowing the following items:

- a. current-year capital (being current-year depreciation charges) and non-capital costs;
- b. prior years' unrecovered capital and non-capital costs;
- c. inventory costs;
- d. home-office overheads charged to the operation; and
- e. insurance premiums and receipts from insurance claims.

Other relevant principles are not stated in the PSC but have been developed over time via SKK Migas/BP Migas/and formerly Pertamina and Indonesian Tax Office (ITO) regulations. For example, for oil, PSC contractors generally obtain an after-tax equity share of 15% (more for frontier areas, for gas and under new contracts). This is after cost recovery and any investment credits. However, DMO must be met out of this "equity" oil or gas. A foreign oil company having interests in several PSCs therefore typically earns a return of less than 15% of equity oil because there is no cost recovery or tax deductibility for unsuccessful PSCs and because of the DMO requirement. FTP arrangements have also separately enabled the Government to share in production before the contractor has fully recovered its costs.

### 3. Upstream Sector

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From 1995, PSCs indicated that site restoration was the responsibility of the contractor and their budgets need to provide for clearing, cleaning and restoring the site upon completion of work. Funds set aside for abandonment and site restoration are cost recoverable once spent or funded. Unused funds will be transferred to SKK Migas.

#### Accounting Standards

The PSC outlines the accounting to be applied by the contractor. Under this clause, operating, non-capital and capital costs are defined together with the related accounting method to be used for such costs. This differs from Generally Accepted Accounting Principles (GAAP). Most companies however, do not prepare Indonesian Financial Accounting Standards financial statements and instead prepare PSC statements that are adjusted in the respective parent company's home office to conform with GAAP.

#### Relinquishments

The PSC sets out the requirements for areas to be relinquished during the exploration period. Specific details are set out in the contract, but the parties must consult with SKK Migas and the areas must be large enough to enable others to conduct petroleum operations.

#### Pre-PSC Costs

The recipient of a PSC will typically incur expenditures before the PSC is signed. These pre-PSC expenditures cannot be transferred to the PSC and so become non-recoverable. Instead, these costs are recorded in the company's head office as leasehold costs along with any signing bonus paid to obtain the PSC.

#### 3.2.2 Equity Share - Oil

##### Sharing of Production - Oil

Crude production in excess of amounts received for FTP, cost recovery and investment credits is allocated to the Government and to the contractor before the consideration of tax (but adjusted by the DMO supply obligations).

Since a PSC involves the sharing of output, the production to be shared between the Government and contractor is made up of:

- a. cost oil;
- b. any investment credit; and
- c. equity oil.

#### Cost Oil

The contractor can recover certain costs of production. Expenses allowable for cost recovery (recoverable against a field or contract area depending on the generation of the PSC) are:

- a. Current-year operating costs from a particular field or fields with PoD approval, intangible drilling costs on exploratory and development wells, and the costs of inventory when landed in Indonesia (as distinct from when used - although this has changed in recent PSCs). The contractor can also recover a proportion of head office overheads (typically capped at a maximum of 2% of current year costs) provided the cost methodology is applied consistently, disclosed in quarterly reports and approved by SKK Migas (see further guidance below under Management and Head Office Overheads);
- b. Depreciation of capital costs is calculated at the beginning of the calendar year in which the asset is placed into service (although for recent PSCs only a monthly depreciation is allowed in the initial year). The method used is determined under the PSC as either the declining balance method or double declining balance method and is based on the individual asset multiplied by depreciating factors as stated in the PSC. Generally the factor depends on the useful life of the asset such as 50% for trucks and construction equipment; and 25% for production facilities and drilling and production equipment. Title to capital goods passes to the Government upon landing in Indonesia, but the contractor can claim depreciation; and
- c. Un-recouped operating and depreciation costs from previous years. If there is not enough production to recoup costs these may be carried forward to the following year with no time limit.

In December 2010, GR 79 increased a list of 17 non cost recoverable items (as previously stipulated in MoEMR No.22/2008) to 24 items. The costs specifically treated as non-recoverable are as follows:

- a. employees' personal expenses, e.g. personal Income Taxes, losses in selling private vehicles and houses;

- b. employee incentives such as for a Long-Term Incentive Plan (LTIP);
- c. costs of employing expatriates who have not complied with the Expatriate Manpower Utilisation Plan (RPTKA) or obtained a IKTA (work permit) from SKK Migas/BP Migas;
- d. legal consultancy fees not relating to PSC operations;
- e. tax consultancy fees;
- f. marketing costs resulting from “deliberate” mistakes;
- g. public relations costs;
- h. environmental and community development costs during exploitation stage;
- i. management costs and allowances for site abandonment and restoration funds (except where the fund is for field closure and restoration and is deposited in a joint account between SKK Migas and the contractor in an Indonesian bank);
- j. technical training costs for expatriates;
- k. merger and acquisition costs;
- l. interest expenses on loans for petroleum operations;
- m. third party Income Taxes;
- n. costs exceeding the approved Authorisation Financial Expenditure (AFE) by more than 10% without proper explanation;
- o. surplus material costs purchased due to bad planning;
- p. costs incurred due to negligently operating “Placed into Service” facilities;
- q. transactions with affiliated parties which cause losses to the State (e.g. sole sourcing; anti-monopoly practices; unfair business competition; or non-compliance with tax regulations).
- r. administrative sanctions such as interest, fines, surcharges and criminal sanctions;
- s. depreciation on assets not belonging to the Government;
- t. bonuses paid to the Government;
- u. costs incurred prior to the signing of the relevant cooperation contract;
- v. interest recovery incentives;
- w. commercial audit costs; and
- x. granted property.

#### Investment Credits

An investment credit is available on the direct development and production capital costs incurred on a project-by-project basis as negotiated and approved by SKK Migas.



In recognition of the delays in generating income inherent in the processes of exploration, a credit ranging from 17% to 55% of the capital cost of development, transport and production facilities was historically available. The second generation PSC allowed a rate of up to 20% for fields that became commercial after 1976.

The investment credit must be taken in oil or gas in the first year of production, but can generally be carried forward.

In earlier PSCs investment credits were capped in cases where the share of total production taken by the Government did not exceed 49%. This condition was eliminated in later generation PSCs.

Under GR 79 the Minister has authority to determine an investment incentive credit. The criteria for such a credit are not however provided in GR 79.

#### **Marginal Field Incentives**

The MoEMR issued Regulation No.008 Year 2005 (Regulation No.008/2005) on the Marginal Oil Field incentive program on 25 April 2005. The regulation provides contractors with an additional cost recovery of 20% meaning that the likely treatment of this incentive is similar to an investment credit (i.e. cost recoverable but taxable).

Oil fields entitled to the incentive must meet the following criteria:

- a. be located in the producing working area; and
- b. the estimated rate of return based on the terms and condition in the PSC and other prevailing incentive package regulations, is less than 15% .

Applications for the incentive can be submitted to SKK Migas with a copy to the Director General of Oil and Gas (DGOG). Within 30 days after the application received, SKK Migas has to issue its written approval or rejection to the contractor. The contractor must report to SKK Migas its actual realisation and year-to-date rate of return of the marginal oil field within 30 days of the year-end. If the rate of return is more than 30%, the incentive will be revoked. However, if the rate is below 15%, a similar incentive will be provided for the following year.

It is unclear what SKK Migas' position will be if the rate of return is between 15% and 30%. It is also unclear whether the incentive will be calculated on a monthly or annual basis.

### 3. Upstream Sector

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Regulation No.008/2005 stipulates that the contractor also has to maintain separate bookkeeping for the marginal oil field.

#### Management and Head Office Overheads

The contractor has exclusive authority to conduct oil and gas operations in its work area and is responsible to SKK Migas for the conduct of those operations. In practice, SKK Migas exercises considerable control through its approval of the contractor's annual work programs, budgets and manpower plans.

Some general and administrative costs (other than direct charges) related to head office overheads can be allocated to the PSC operation, based on a methodology approved by SKK Migas. Parent Company Overhead (PCO) Allocation Cap (PMK 256 dated 28 December 2011) was introduced in 2011 and seeks to govern the cost recoverability and tax deductibility of overhead costs. PMK 256 stipulates the cap for PCO allocations of a maximum of 2% of annual spending for cost recovery and tax deductibility purposes. PMK 256 confirms the cap of 2% per annum, however, the amount a PSC is able to actually recover will be dependent upon approval from SKK Migas which may be lower than 2%. This overhead allocation methodology must be applied consistently and is subject to periodic review and audit by SKK Migas. For producing PSCs, SKK Migas will often travel abroad to annually audit head office costs. Please refer to section 3.5 Commercial Considerations for further discussion.

#### Equity Share - Oil

Any oil that remains after investment credit and cost recovery is split between SKK Migas and the contractor. Second and third generation PSCs involve an oil after-tax split of 85/15 (65/35 for frontier regions) for SKK Migas and the contractor, respectively. This is an after-tax allocation being what the contractor is entitled to lift after taking taxation at the current rates (i.e. when the PSC was signed) into account. This is summarised as follows:

	New Contracts %	1995 Eastern Province PSC %	1995 PSC %	1985 - 1994 PSC %	Old PSC %
Tax rate	40*	44	44	48	56
Share of production after tax:					
Government	Varies	65	85	85	85
Contractor	Varies	35	15	15	15
Contractor's share of production before tax:	Ranges from 44.64 – 62.50				
35/(100-44)		62.50			
15/(100-44)			26.79		
15/(100-48)				28.85	
15/(100-56)					34.09

\* The general combined “C&D” tax rate fell to 42.4% in 2009 and 40% in 2010. The gross sharing rates were adjusted for in the 2013 PSCs.

### First Tranche Petroleum (FTP)

Under pre-2002 contracts, contractors and the Government were both entitled to take FTP and received each year a quantity of petroleum equal to 20% of the production before any deduction for the recovery of operating costs. FTP was then split according to their respective equity shares as stated in the contracts.

Under more recent PSCs, the Government is entitled to take the entire FTP (although at a lower 10%), with no sharing with the contractor group.

For recent PSCs only, the FTP of 20% is now again shared with the Contractor.

Although FTP is considered equity oil (and hence subject to Indonesian Income Tax laws), an industry issue has arisen over whether any Contractor's share of FTP is taxable if the Contractor has carried-forward un-recovered costs. See section 3.4 for a discussion of this tax issue.

#### Domestic Market Obligation (DMO)

According to the terms of the PSC, after commercial production commences, the contractor should fulfill its obligation to supply the domestic market in Indonesia. The DMO (for oil) for each year is calculated on the lesser of the following points:

- a. 25% of the Contractor's standard pre-tax share or its participating interest share of the total quantity of crude oil produced from the contract area; or
- b. the Contractor's standard share of crude oil produced from the contract area (either 62.50%, 26.79%, 28.85% or 34.09% - as described in the table above) multiplied by the total quantity of crude oil to be supplied and divided by the entire Indonesian production of crude oil from all petroleum companies for the PSC area.

In general, the Contractor is required to supply a maximum of 25% of total oil production from the contract area to the domestic market in Indonesia out of its equity share of production. It is understood that the oil DMO is satisfied from equity oil exclusive of FTP.

It is possible for oil DMO to absorb the entire Contractor's share of equity oil. Conversely, if there is not enough production to satisfy the oil DMO, there is no carry-forward of any shortfall to future periods. Generally, for the first five years after the contract area commences commercial production, the Contractor is paid by SKK Migas the full value for its oil DMO but this is reduced to 10% of that price for subsequent years. The price used is the weighted average price (WAP). Earlier generations of PSCs provided a price of only US\$ 0.20 per barrel.

Historically there was no DMO obligation associated with gas production. However, under the GR 35/2004 and recent PSC's a DMO on gas production has been introduced.

#### Valuation of oil

To determine the sharing of production, and for tax purposes, oil is valued on the basis of a basket of average Indonesian crude prices (ICP) published by RIM (50%) and Platt's (50%). The value is calculated monthly by SKK Migas. Under a PSC, the Contractor receives oil or in-kind product for settlement of its costs and share of equity. This makes it necessary to determine a price to convert oil to US dollars in order to calculate cost recovery, taxes and other fiscal items

such as under/over lifting. In the past, the ICP was determined monthly by BP Migas/Pertamina based on a moving average spot price of a basket of a number of internationally traded crudes, but its value did not properly account for significant fluctuations in movements in oil prices and was considered deficient for this reason.

Monthly tax calculations are based on ICP and actual Contractor liftings. The actual year-end annual PSC contractor entitlement (cost plus equity barrels) is based on the average ICP for the year. The average ICP during the respective year is known as weighted average price (WAP).

#### 3.2.3 Equity Share - Gas

##### Sharing of Production - Gas

The provisions for the sharing of gas production are similar to those for oil except for the equity splits and DMO. When a PSC produces both oil and gas, production costs will be allocated against each according to the proportion of production in value terms in the year or another means of allocation as approved by SKK Migas. The costs of each category that are not recouped can either be carried forward to the following year or taken against the production of the other category in the same year only.

The main difference between oil and gas production relates to the equity split. The majority of PSCs are based on an oil 85/15 after-tax split. For gas, the after-tax split is usually 70/30 for the Government and the Contractor, respectively, although some older PSCs are based on an after-tax split of 65/35. After the 1995 incentive package, Eastern Province gas contractors use an after-tax split of 60/40.

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These provisions result in the following entitlements:

	New Contracts %	1995 Eastern Province PSC %	1995 PSC %	1985 - 1994 PSC %	Old PSC %
Tax rate	40*	44	44	48	56
Share of production after tax:					
Government	Varies	60	70	70	70
Contractor	Varies	40	30	30	30
Contractor's share of production before tax:	Depends on the share of production – most are still at 71.43				
$40/(100-44)$		71.43			
$30/(100-44)$			53.57		
$30/(100-48)$				57.69	
$30/(100-56)$					68.18

\* The general combined “C&D” tax rate fell to 42.4% in 2009 and 40% in 2010. The gross sharing rates were adjusted for in the 2013 PSCs.

If the natural gas production does not permit full recovery of natural gas costs, the excess costs shall be recovered from crude oil production in the contract area. Likewise, if excess crude oil costs (crude oil costs less crude oil revenues) exist, this excess can be recovered from natural gas production.

#### Illustrative Calculation of Entitlements

An illustration of how the share between the Government and contractors is calculated is presented in the tables below.

**ILLUSTRATIVE CALCULATION OF ENTITLEMENT FOR OLD PSC**
**Assumptions:**

Contractor's Share before tax = 34.0909%  
Government's share before tax = 65.9091%  
WAP Per Barrel = US\$ 60  
Corporate & Dividend tax = 56%

DESCRIPTION	FORMULA USED	YEAR TO DATE	
		BBLs	US\$
<b>LIFTINGS :</b>			
- SKK MIGAS	US\$ [A1] = BBLs x WAP	2,500	150,000
- CONTRACTORS	US\$ [A2] = BBLs x WAP	4,500	270,000
<b>TOTAL LIFTINGS</b>	[A]	7,000	420,000
<b>LESS: FTP (20%)</b>	[B] = 20% x [A]	1,400	84,000
<b>TOTAL LIFTINGS AFTER FTP</b>	[C] = [A] - [B]	5,600	336,000
<b>LESS :</b>			
- COST RECOVERY	COST IN BBLs = COST IN US\$ : WAP	4,000	240,000
- INVESTMENT CREDIT	COST IN BBLs = COST IN US\$ : WAP	100	6,000
<b>TOTAL COST RECOVERY</b>	[D]	4,100	246,000
<b>EQUITY TO BE SPLIT</b>	[E] = [C] - [D]	1,500	90,000
<b>SKK MIGAS' SHARE :</b>			
- SKK MIGAS' SHARE ON FTP	65.9091% x [B]	923	55,380
- SKK MIGAS' SHARE ON EQUITY	65.9091% x [E]	989	59,340
- DMO	25% x 34.0909% x [A]	596	35,760
<b>SKK MIGAS' ENTITLEMENT</b>	[F]	2,508	150,480
<b>OVER/(UNDER) SKK MIGAS' LIFTING</b>	[G] = [A1] - [F]	(8)	(480)
<b>CONTRACTOR'S SHARE :</b>			
- CONTRACTOR'S SHARE ON FTP	34.0909% x [B]	477	28,620
- CONTRACTOR'S SHARE ON EQUITY	34.0909% x [E]	511	30,660
<b>LESS:</b>			
- DMO	25% x 34.0909% x [A]	(596)	(35,760)
<b>ADD:</b>			
- COST RECOVERY		4,000	240,000
- INVESTMENT CREDIT		100	6,000
<b>CONTRACTOR'S ENTITLEMENT</b>	[H]	4,492	269,520
<b>OVER/(UNDER) CONTRACTORS' LIFTING</b>	[I] = [A2] - [H]	8	480

**ILLUSTRATIVE CALCULATION OF CORPORATE AND DIVIDEND TAXES FOR CONTRACTOR'S ENTITLEMENT IN OLD PSC**

DESCRIPTION	US\$
<b>CONTRACTOR'S SHARE :</b>	
- CONTRACTOR'S SHARE ON FTP	28,620
- CONTRACTOR'S SHARE ON EQUITY	30,660
- COST RECOVERY	240,000
- INVESTMENT CREDIT	6,000
<b>LESS : DMO</b>	(35,760)
	269,520

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<b>LESS : LIFTING PRICE VARIANCE</b>	(26,949) **
<b>CONTRACTOR'S NET ENTITLEMENT :</b>	<u>242,571</u>
<b>LESS : - COST RECOVERY</b>	(240,000)
<b>ADD :</b>	
- ACTUAL PRICE RECEIVED FROM DMO	22,908 *
<b>CONTRACTOR'S TAXABLE INCOME</b>	<u>25,479</u>

<b>LESS :</b>	56%
- CORPORATE TAX (45%)	11,465
- DIVIDEND TAX (11%)	2,803
<b>CORPORATE AND DIVIDEND TAX (56%)</b>	<u>14,268</u>
<b>CONTRACTOR'S NET INCOME</b>	<u>11,211</u>

#### **Combined Effective Tax Rate :**

= Corporate and Dividend Tax/  
Contractor's Taxable Income  
= 14,268 / 25,479  
= 56%

<b>* DMO COMPRISED OF TWO ITEMS :</b>	<b>QUANTITY IN BARRELS</b>	<b>US\$</b>	<b>PRICE OF DMO</b>
- OLD OIL (40% of total DMO in barrels)	238	1,428	10% FROM WAP
- NEW OIL (60% of total DMO in barrels)	358	21,480	WAP
<b>ACTUAL PRICE RECEIVED FROM DMO</b>	<u>596</u>	<u>22,908</u>	

#### **\*\* CALCULATION OF LIFTING PRICE VARIANCE :**

US\$

ENTITLEMENT BY USING WAP	269,520
ENTITLEMENT BY USING ICP	<u>242,571</u>
<b>LIFTING PRICE VARIANCE</b>	<u>26,949</u>

@ The entitlement is calculated by using the monthly ICP during the respective year

#### **ILLUSTRATIVE PRESENTATION OF OLD PSC IN SKK MIGAS FINANCIAL QUARTERLY REPORT-FQR (FORMERLY KNOWN AS PERTAMINA QUARTERLY REPORT – PQR)**

DESCRIPTION	US\$
GROSS REVENUE / LIFTING	420,000
<b>LESS : FTP (20%)</b>	<u>84,000</u>
<b>GROSS REVENUE / LIFTING AFTER FTP</b>	<u>336,000</u>
<b>COST RECOVERY :</b>	
- COST RECOVERY	240,000
- INVESTMENT CREDIT	<u>6,000</u>
<b>TOTAL COST RECOVERY</b>	<u>246,000</u>
<b>EQUITY TO BE SPLIT</b>	<u>90,000</u>



<b>SKK MIGAS' SHARE :</b>	
- SKK MIGAS' SHARE ON FTP	55,380
- SKK MIGAS' SHARE ON EQUITY	59,340
- LIFTING PRICE VARIANCE	26,949
- GOVERNMENT TAX ENTITLEMENT	14,268
<b>ADD : DMO</b>	35,760
<b>LESS : DOMESTIC MARKET ADJUSTMENT</b>	(22,908)
<b>TOTAL SKK MIGAS' SHARE</b>	<b>168,789</b>
<b>CONTRACTORS' SHARE :</b>	
- CONTRACTOR'S SHARE ON FTP	28,620
- CONTRACTOR'S SHARE ON EQUITY	30,660
- LIFTING PRICE VARIANCE	(26,949)
<b>LESS : DMO</b>	(35,760)
<b>ADD : DOMESTIC MARKET ADJUSTMENT</b>	22,908
<b>LESS : GOVERNMENT TAX ENTITLEMENT</b>	(14,268)
<b>ADD : TOTAL RECOVERABLES</b>	<b>246,000</b>
<b>TOTAL CONTRACTORS' SHARE</b>	<b>251,211</b>

### Over/(under) lifting

Lifting variances will occur each year between the Contractor and the Government. These under/over lifts are settled in cash with the Government and can be considered to be sales/purchases of oil or gas respectively. The individual members of the PSC may in turn have under/over lifts between themselves which will be settled according to joint venture agreements but generally in cash or from production in the following year.

Under MoF Regulation No.139/PMK.2/2013 any under lift position between the Contractor and the Government should be settled in cash within 17 days (subject to the time taken for examination and processing of the request) after the DGB verifies the request from SKK Migas. There is no specified period for settlement of any over lift position. In practice though, the amount is most often settled when the year-end Financial Quarterly Report is finalised in March of the subsequent year.

#### Domestic Gas Pricing

Gas pricing in domestic supply contracts is reached through negotiations on a field-by-field basis among SKK Migas, buyers and individual producers based on the economics of a particular gas field development. Historically, all domestic gas had to be sold to Pertamina under a gas supply agreement. Pertamina then in turn sold the gas to the end-user (e.g. State Electricity Company (PLN) and PGN). Prices were fixed for a designated supply for the duration of the contract.

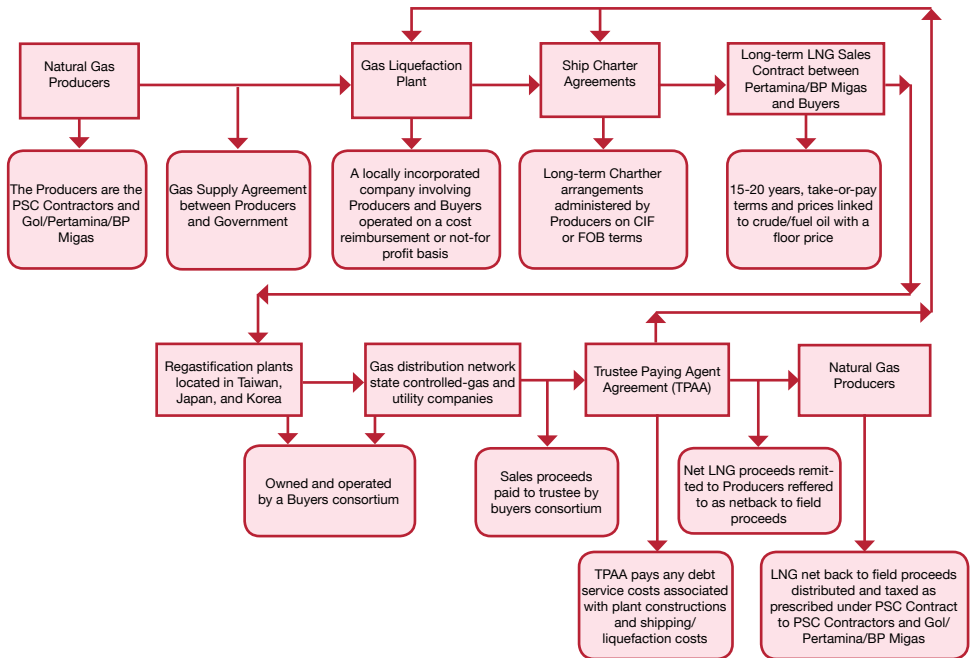
Under Law No.22, individual producers can sell directly to end users with contract terms and conditions negotiated directly between the producer and buyer (with assistance from SKK Migas). There continues however to be Government stakeholder involvement in steering contracts towards certain domestic buyers rather than the producers' preference to export due to favourable pricing and terms.

Take-or-pay arrangements have been negotiated in some circumstances. Although this concept has long been accepted the policy around its treatment from a tax, accounting (revenue recognition) and reporting perspective varies in practice. PSC contractors and potential investors should also consider the credit risk inherent in any domestic gas sales arrangements when negotiating contract terms and conditions, and how they might protect themselves.

#### Integrated LNG Supply Projects

Indonesia currently has three large LNG facilities: Arun located in North Sumatra; Bontang located in Northeast Kalimantan; and Tangguh (which made its first shipment in July 2009) located in Papua.

Historically, Indonesia has utilised a traditional integrated LNG seller/buyer supply chain structure. The Arun and Bontang LNG supply chains are generally structured as follows:



For both Arun and Bontang, locally incorporated special purpose O&M companies were established by the Producers and Buyers to process gas into LNG on a not-for-profit basis. A number of sales contracts were initially entered into under fixed long-term supply arrangements and minimum prices to augment risk for the Producers. The initial contracts carried CIF terms. From the late 1980s the shipping arrangements were changed to allow buyers and/or others to participate in long-term shipping charters on a Free on Board (FOB) basis.

These LNG projects were effectively project financed with an implied Government guarantee which allowed lower financing costs. A trustee paying agent arrangement was also established to service this debt and the O&M operating costs. These processing and financing costs are first netted against LNG proceeds with the net proceeds then released back to the PSC calculation (i.e. under the so-called “net back to field” approach). The Tangguh LNG facility employs a similar concept to Arun and Bontang and is operated by BP Indonesia on behalf of the gas producers.

#### Non-integrated LNG Projects

Non-integrated projects involve the legal/investor separation of the gas extraction and LNG production assets. Issues under this model focus on the gas offtake price to be struck between the PSC Contractors and LNG investors. In a non-integrated LNG model, the investors in the LNG plant separately require a designated rate of return on their investment to service project finance etc. (i.e. unlike the “net back to field” approach outlined above for integrated projects which effectively allow financiers to benefit from the value of the entire LNG project).

The non-integrated LNG structure is relatively new to Indonesia and, as such, it is difficult to assess the Indonesian tax implications. Withholding tax, VAT, tax rate differentials (and associated transfer pricing) and permanent establishment issues need to be considered. In addition any offshore project company would need to consider tax treaty entitlements.

An example of a non-integrated project is the Donggi Senoro LNG plant in Sulawesi. The Donggi Senoro LNG plant is owned by Medco, Mitsubishi Corp. Kogas and Pertamina but Mitsubishi does not have a participating interest in the two PSCs that will supply gas to the LNG plant by the end of 2014.

#### 3.2.4 Other PSC Conditions and Consideration

##### The procurement of goods and services

Procurement of goods and services by oil and gas contractors is regulated to give preference to Indonesian or domestic suppliers. For purchases in excess of defined values detailed procedures must be complied with including the calling of tenders and approval by SKK Migas.

The Government sets guidelines for the procurement of goods and services at Government institutions including state owned enterprises through Presidential Decrees, with the latest being Presidential Decree No.80/2003 (Keppres 80), which amends previous decrees on the subject. Keppres 80 BP Migas, through its Decision Letter No.KPTS.21/BP00000/2004-SO, issued Guidance No.007/PTK/VI/2004 on the Management Framework for the Supply Chain for Cooperation Contracts (*Pedoman Tata Kerja Pengelolaan Rantai Suplai Kontraktor Kontrak Kerja Sama*) and also provides guidance on asset management, customs and project management.

In general, all purchases of goods and services are done by either tender or direct selection/direct appointment (with certain requirements) and only vendors with Registered Vendor ID's (*Tanda Daftar Rekanan* or TDR) are considered qualified contractors (*Daftar Rekanan Mampu* or DRM) able to bid. A PSC contractor can write its own tenders but will require SKK Migas approval at the planning stage if the package is worth over Rp20 billion or US\$2 million and further approval to appoint the supplier when the package is over Rp50 billion or US\$5 million.

Changes in the scope or terms of contract which cause an increase in the contract value (from the initial contract value) with suppliers must also be approved by SKK Migas as follows:

- a. for contracts where the appointment of the supplier was through approval by BP Migas and where the overruns exceed 10% of the initial contract or above Rp50 billion or US\$5 million; and
- b. for contracts where the appointment of the supplier was made by the Contractors and where the cumulative amount of the initial contract plus overruns exceeds Rp50 billion or US\$5 million.

Bid documents provided by PSC contractors contain an invitation to bid and instructions to the bidder which consist of: general provisions; qualifications; and administrative, technical and commercial requirements.

The plans for procurement of goods/ services should be based on the WP&B and/ or AFE approved by SKK Migas/BP Migas. This AFE/ WP&B is used as the ceiling for the available funds. Procurement for activities that do not require an AFE can begin by using the WP&B as a reference according to the type of activity and the related budget. In 2009, and then again in 2011, the BP Migas procurement guidelines set out in PTK 007 were revised. PTK 007/2011 now replaces PTK 007/2009 and is effective 1 May 2011. Whilst the procurement method remains unchanged, the second revision provides a more stringent local content criteria, more supervision from SKK Migas with powers to sanction or reduce the authority of the PSC, and a 5% - 10% advance payment is required to local companies for drilling and construction contracts with a value of less than \$200 million. There was a third revision to PTK 007 issued on 3 April 2013, which focuses on domestic company preference in the pricing, bid bond and performance bond and more stringent requirements to be classified as a domestic company.

Tender awards are based on price, Indonesian content, technical advantage and reputation. Wholly foreign-owned Indonesian entities are allowed to participate and are considered to be a local Indonesian company. The tendering process

requires domestic goods or services to be used if available and if they meet the technical requirements. In general, Indonesian-made equipment must be purchased if it meets the requirements even if at a higher cost.

All equipment purchased by PSC contractors is considered the property of the Government when it enters Indonesia. Oil and gas equipment may enter duty free if it is used for operational purposes (however please see our further comments on this matter in section 3.4.8 Taxation – Import Taxes below). Imported equipment used by service companies on a permanent basis is assessed for import duty unless waived by the Foreign Investment Coordinating Board (BKPM). Import duties on oil and gas equipment range from 0% to 29%. The position for temporary imports of subcontractors' equipment is also covered in section 3.4.8 Import Taxes.

The Government issued Decision Letter KEP-0066/BP00000/2008/S0 (KEP 0066) with respect to payments for goods and services. KEP 0066 requires National General Banks to be used in performing payments to Goods/Services Providers in terms of both the payer's and receivers' accounts. BP Migas subsequently clarified that PSC Contractors can use any banks that are legally operating within Indonesia during the exploration stage but once the PSC enters into production the PSC should use a State-Owned Bank.

#### Inventory

Under the PSC, inventory is separated into two categories being capital and non-capital. Non-capital inventory is charged to cost recovery immediately upon landing in Indonesia. A contra account is usually maintained to track the physical movement and use of non-capital inventory. For later generation PSCs, inventory is however charged based on usage (i.e. charged to cost recovery as consumed).

All inventory items imported must pass through Batam Island under a PSC tax-free umbrella where it is inspected. A large number of PSC contractors maintain warehouse facilities in Batam solely for materials-in-transit.

Under SKK Migas guidelines, any excess or obsolete inventory must be circulated to other PSCs and receive BP Migas approval before any amounts (capital inventory) can be charged to cost recovery. And under MoEMR No.22/2008, any excess inventory purchase due to bad planning under PSCs signed from 2008 onwards is not cost recoverable.

If inventory is transferred or sold to another PSC the selling price must be at its carrying cost. Generally, the sale of inventory is not subject to VAT. If a PSC contractor cannot dispose of the inventory a write-off proposal (WOP) must be submitted to SKK Migas for approval. Once approved, the inventory is usually charged to cost recovery (if not yet charged) and transferred to a SKK Migas warehouse or facility.

### **Property, Plant and Equipment (PP&E)**

Under the terms of the PSC, PP&E (including land rights) purchased under the PSC becomes the property of the Government when landed in Indonesia. The Contractor continues to have use of such property until it is approved for abandonment by SKK Migas.

The net book value of such property, as reflected in the PSC financial statements, represents expenditures by the Contractor which have not yet been cost recovered. Tangible drilling costs of unsuccessful exploratory wells are charged to operating expenses as incurred. If commercial reserves are determined in the contract area and the exploratory wells subsequently become productive the associated tangible drilling costs are capitalised. Additionally, tangible costs of successful development wells are capitalised.

Depreciation is calculated at the beginning of the calendar year in which the asset is placed into service (PIS). Earlier generation PSCs allow a full year's depreciation in the initial year whereas later generation PSCs require a month by month approach so that an asset placed into service in December is only allowed one month depreciation in the initial year. Under PTK 033, PIS approval is required prior to commencement of depreciation of the assets. The PIS approval should be submitted with the AFE Close-out Report in order for the final depreciable project cost to be agreed.

The method used to calculate each year's allowable recovery of PP&E or capital costs is either the declining balance depreciation method or double declining balance method. The calculation of each year's allowable recovery of PP&E is based on the individual PP&E assets at the beginning of such year multiplied by the depreciation factors as stated in the PSC. In general, PP&E is categorised based on the useful life according to three groups: group 1, group 2 and group 3.

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The un-depreciated balance of assets taken out of service is not charged to recoverable costs but continues to be depreciated based upon the useful lives described above except where such assets have been subjected to unanticipated destruction.

#### Site restoration and abandonment provision

PSC contractors that signed contracts after 1995 must include in their budgets provisions for clearing, cleaning and restoring sites upon completion of work. For those PSCs signed from 2008 onwards any cash funds set aside in a non-refundable account for abandonment and site restoration should be cost recoverable. Any unused funds will be transferred to SKK Migas. For PSCs that do not progress to development any costs incurred are sunk costs and cannot be recovered from SKK Migas. Under PTK 040, cash funds must be placed into a State Owned Bank under a joint account between SKK Migas and the PSC Contractor. The PSC Contractor shall be liable if the funds are not sufficient to cover the cost of site restoration and abandonment.

It has been suggested that any abandonment and site restoration costs and liabilities related to PSCs signed before 1995 remain the Government's and SKK Migas's responsibility. However, consistent with PSCs signed since 1995, SKK Migas or the Government may, at some point in the future, require the Contractor to contribute to the cost of restoration and abandonment activities.

### 3.3 Upstream Accounting

The table below shows some of the key standards relating to upstream oil and gas companies under PSC accounting, United States Generally Accepted Accounting Principle (US GAAP) and International Financial Reporting Standards (IFRS).



## Accounting in Upstream Oil and Gas Business

## Key standards reference and comparison between PSC accounting and US GAAP and IFRS

Area	PSC	US GAAP	IFRS*
Amortisation of capital costs	Accelerated depreciation	Units of production	Method not specifically determined: to be allocated on a systematic basis over useful life, reflecting consumption of asset's benefits
Non-capital/controllable stores	Expensed upon receipt (except for later generation PSCs which are charged to cost recovery when consumed).	Expensed as consumed	Expensed as consumed
Obsolete stores or idle facilities	Written-off only when approved by SKK Migas	Expensed/impaired when identified	Expensed/impaired when identified
Deferred taxes	Not provided	SFAS 109 treatment	IAS 12 treatment
Contingent liabilities	Recognised when settled or approved by SKK Migas	SFAS 5 treatment	IAS 37 treatment
Severance and retirement benefits	Pay as you go basis	SFAS 87 treatment	IAS 19 (Revised) treatment
Decommissioning and restoration obligation	Recorded and recovered on cash basis	Provided for on a units of production basis; SFAS 143	Provision to be provided, under IAS 37
PSC license acquisition costs	Expense (generally not cost recoverable)	Capitalise	Capitalised as long as meeting IFRS asset recognition criteria

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#### Accounting in Upstream Oil and Gas Business

##### Key standards reference and comparison between PSC accounting and US GAAP and IFRS

Area	PSC	US GAAP	IFRS*
Exploration and evaluation - dry holes	Expense	Expense	Expense
Exploratory wells-successful: Tangible costs Intangible costs	Capitalise Expense	Capitalise Capitalise	Not specifically addressed; Capitalised as long as meeting IFRS asset recognition criteria
Development - dry holes	Expense	Capitalise	Not specifically addressed; capitalised as long as meeting IFRS asset recognition criteria under IAS 38 or IAS 16
Development wells-successful: Tangible costs Intangible costs	Capitalise Expense**	Capitalise Capitalise	Not specifically addressed; capitalised as long as meeting IFRS asset recognition criteria
Support equipment and facilities	Capitalise	Capitalise	Capitalise

\* Currently, Indonesia Financial Accounting Standards (IFAS) do not significantly differ from IFRS

\*\* New PSCs signed in 2011 capitalise intangible cost

### 3.4 Taxation and Customs

This section sets out the industry specific aspects of Indonesian taxation and customs law for upstream contractors and includes an analysis of some common industry issues. Taxation obligations common to ordinary taxpayers are not however addressed (please see our annual publication the PwC Pocket Tax Guide for discussion in this area).

### 3.4.1 Historical Perspective

#### “Net of Tax” to Gross of Tax

The modern regulatory era dealing with the framework of oil and gas activities in Indonesia began with the passage of the Oil and Gas Mining Law No.44/1960 on 26 October 1960. Pursuant to Law No.44, the right to mine Indonesian oil and gas resources was vested entirely in Indonesian State-owned Enterprises. Law No.44 did however, allow for State-owned Enterprises to appoint other parties as contractors.

Pursuant to GR No.27 of 4 September 1968, Pertamina was formed as a State Enterprise. Pursuant to Law No.8/1971 issued on 15 September 1971, Pertamina was granted exclusive powers in regard to the appointment of private enterprises, including those which are foreign incorporated, as contractors under oil and gas mining arrangements. This began the era of the PSC and similar contractual arrangements.

From the early 1960’s until the late 1970’s, PSC entities were entitled to take their share of production on a **“net of tax”** basis (i.e. with the payment of Indonesian Income Tax made on their behalf by the State/Pertamina).

In the late 1970’s this was changed to a “gross of tax” basis to accommodate US foreign tax credit rules. This change led, for the first time, to a calculation of taxable income being necessary and an actual payment of Income Tax by PSC entities. Notwithstanding this alteration, there was an understanding that a “net of tax” entitlement for PSC entities was to continue.

#### Uniformity Principle

As the change from a “net of tax” to a “gross of tax” basis was not meant to disturb the “desired” production sharing entitlements (i.e. the after-tax take), it became necessary to adopt the so-called “uniformity principle” in relation to the calculation of taxable income. This principle, as outlined in MoF Letter No.S-443A of 6 May 1982, provides that the treatment of income and expenditure items for cost recovery and tax deductibility purposes should be identical (with limited exceptions such as for signing/production bonuses). This long-standing principle has now been recognised (at least partially) in GR 79 which requires that there be a general “uniform treatment” between cost recovery and tax deductibility.

Uniformity therefore meant that the calculation of Income Tax for PSC entities differs to the calculation applying to other Indonesian taxpayers. Significant differences include:

- a. that the taxable value of oil “liftings” is to be referenced to a specific formula (currently ICP) as opposed to an actual sales amount (gas “liftings” generally reference the Contract price);
- b. that the classifications for intangible and capital costs are not necessarily consistent with the general Income Tax rules relating to capital spending;
- c. that the depreciation/amortisation rates applying to these intangible and capital costs are not necessarily consistent with the depreciation rates available under the general Income Tax rules;
- d. that there is a general denial of deductions for interest costs (except where specially approved) whereas interest is usually fully deductible under the general Income Tax rules;
- e. that there is an unlimited carry forward of prior year unrecovered costs as opposed to a 5 year restriction under the general Income Tax rules; and
- f. that no tax deductions will arise until there is commercial production as opposed to a deduction arising from the date of the spending being expensed or accrued under the general Income Tax rules.

#### 3.4.2 New Government Regulation No.79/2010 (GR 79)

After a discussion period of over two years, including for industry feedback, a landmark regulation dealing with cost recovery and tax in the upstream sector finally issued as GR 79 on 20 December 2010. GR 79 is the first dedicated regulation dealing with both the cost recovery and tax arrangements for this important industry. Since issuance a number of implementing regulations have issued for GR 79 however many issues remain (please refer to the table below for a summary of the issues which remain unclear and the respective regulation or guidance pending).

Article	Unclear Area	Regulation Pending	Guidance Pending	References to further clarification
Article 3, Article 5, Article 12	Definition of the principle of effectiveness and efficiency, fairness, as well as good business and engineering practices			Absent in: Articles 3(2), 11(1) Is Article 5(3) WPB approval by SKK Migas sufficient?

Article	Unclear Area	Regulation Pending	Guidance Pending	References to further clarification
Article 7	Ring fencing by field or well			Absent in Article 7(2)
Article 8	Minimum Government Share of a Work Area		Yes, Article 8(2) - from the Minister	
Article 10	FTP amount and share			Absent in Article 10(1)
	Investment incentives (form/ extent)			Absent in Article 10(2)
Article 12	Limitation on indirect charges from Head Office	See our comments on head office costs in 3.2.2		
Article 13	Negative lists - transactions procured without a tender process or cause loss to state			Insufficient detail in Article 13(t) elucidation.
Article 14	Income from by-products (sulfur/electricity)			Absent - consider condensates
Article 17	The use of reserve funds for abandonment and site restoration	Yes, Article 17(4)		
Article 18	Severance for permanent employees paid to the undertaker of employee severance fund	Yes, Article 18(2) - procedure for the administration of employees' severance	Yes, Article 18(1) Minister to determine	
Article 19 (See also Article 7)	Deferment of cost recovery until a field is produced - Ring fencing by field?			Absent in Article 19(1)
	Policy with regard to the plan of development to secure State Revenue		Yes, Article 19(2) – Minister to determine policy	

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Article	Unclear Area	Regulation Pending	Guidance Pending	References to further clarification
Article 22	Procedures to determine the methodology and formula of Indonesia's crude oil price	Yes, Article 22(2)		
Article 24	DMO fee for delivery of crude oil and gas	Issued as MoF Reg. No.137/2013	Yes, Article 24(9), to be determined by Minister	
Article 25	Tax assessment for foreign tax credit purposes	Issued as DGT Regulation No.29/PJ/2011 on Income Tax Payments		
Article 26	Maximum amount of deductions and fee/ compensation paid by the Government	Yes, Article 26(2) from Minister.		
Article 27	Guidance on the procedures for payment of income taxes on PSC transfer and uplift income	Issued as PMK 257 in 2011 (see section 3.5 )		
Article 31	Form and contents of annual income tax return	Issued as DGT regulation PER-05/2014 (see section 3.4.4)		
Article 32	Tax ID registration for PSC (so called "Joint Operation" tax ID number)		Yes, Article 32(1)	
Article 33	Procedures to calculate and deliver government share in the event of tax payment in kind	Yes, Article 33(3) PMK 79/2012 (see below)		
Article 34	Standard and norms of costs utilised in petroleum operations		Yes, Article 34(2)	
Article 36	Independent third party appointment to perform financial and technical verification			Elucidation in Article 36(1) appears to limit to natural disaster

Article	Unclear Area	Regulation Pending	Guidance Pending	References to further clarification
Article 38	Transitional rules and adjustment to the Government Regulation			Absent in Article 38(2)

### Effective Date

GR 79 stipulates that:

- a. it is effective from its date of signing. This means GR 79 operates from 20 December 2010 (but see below);
- b. it applies fully to JCCs, consisting of PSCs and Service Contracts, signed after 20 December 2010; and
- c. JCCs signed before 20 December 2010 continue to follow the rules relevant to these JCCs until expiration. This is except for areas on which pre-GR 79 JCCs are silent or not clearly regulated in which case Contractors should adopt the "transitional" areas covered in GR 79 within three months. This provision has caused considerable unrest amongst many holders of pre-GR 79 PSCs. This is primarily because the transitional provisions (at Article 38b) apply in respect of eight potentially significant areas being:-
  - i) government share;
  - ii) requirements for cost recovery and the norms for claiming operating costs;
  - iii) non-allowable costs;
  - iv) the appointment of independent third parties to carry out financial and technical verifications;
  - v) the issuance of an Income Tax assessments;
  - vi) the exemption of Customs Duty and Import Tax on the importation of goods used during exploitation and exploration activities;
  - vii) Contractor's Income Tax in the form of oil and gas from the Contractor's share; and
  - viii) income from outside of the JCC in the form of uplifts and/or the transfer of JCC/PSC interests.

Whilst the exact scope of these transitional provisions remains unclear some holders of pre-GR 79 PSCs have been concerned that the operation of the transitional rules could result in the largely retroactive operation of GR 79. This was particularly noting that, at the time of writing, there was also uncertainty around how to determine what areas were "not yet regulated or not yet clearly regulated" and so were outside the operation of Article 38a.

Overall therefore GR 79 will be likely to operate generally from 20 March 2011 for both "new" JCCs and for the unregulated areas of pre-existing JCC's, noting that for pre-existing PSCs there may be scope for GR 79 to apply from 20 December 2010.

#### State Revenue and Payment of Tax

The Income Tax payments of a PSC entity are effectively counted by the Government as oil revenue rather than as an Income Tax receipt. The Income Tax is remitted to the Director General of Budget (DGB) as opposed to the ITO.

Under GR 79, a facility exists for a Tax "Assessment" letter evidencing the payment of Income Tax to be obtained by taxpayers after an audit. Prior to this the DGT may issue a Temporary Statement. Monthly Income Tax payments are due on each month's liftings. At year-end the actual lifting entitlement is determined and the final Income Tax liability is settled.

On 24 May 2012, the Minister of Finance issued PMK 79 as a further implementing regulation to GR 79. PMK 79 outlines updated procedures for remitting and reporting "State Revenue" arising from PSC activities. The following high level points are noted:

- a. most of the terms in PMK 79 are consistent with GR 79. New terms however cover "over-lifting" and "under-lifting";
- b. State Revenue is formally defined as Government Share and the Corporate and Branch Profit Tax (i.e. the so-called "C&D Tax");
- c. final liftings are to be calculated at year end with detailed procedures on how to settle over/under liftings to be separately regulated;
- d. income tax for PSC contractors consists of the monthly and annual C&D Tax;
- e. if requested, the C&D Tax must be paid "in-kind" based on the Indonesian Crude Price (for oil) or the weighted average price (for gas) of the month when the tax is due. The possibility of tax being paid in-kind is not altogether new although PMK79 may be the first record of a calculation/value mechanism;
- f. updated C&D Tax payment procedures are:

for cash payments

- i) tax is to be remitted in USD to MoF account #600.000411980 at Bank of Indonesia. This is the existing account for C&D remittances.
- ii) the monthly and annual C&D Tax payment deadlines are the 15th of the following month and the end of the 4th month following year



end, respectively. Where the payment deadline falls on a public holiday the deadline will be the following working day. The C&D Tax dates are unchanged. The C&D Tax due date seems to be determined by the date when cash is physically received into the MoF account which is different to the general tax rules (which is when the taxpayer initiates payment). This less conservative approach is however consistent with historical practice for PSC entities.

- iii) a tax payment slip (SSP Migas) for the C&D Tax is to be completed. The SSP obligation is new although Directorate General of Taxation (DGT) Regulation No.25/PJ/2011 already provides different tax payment codes for Petroleum Income Tax, Natural Gas Income Tax and Branch Profits Tax. This could mean that one C&D Tax payment will require three separate SSPs.

for in-kind payments

- i) the payment deadlines are the same as for cash payments.
  - ii) contractors and SKK Migas will record the in-kind payments in a “minutes of in-kind hand-over” (*berita acara serah terima*) form to be signed by both parties.
  - iii) The SSP shall be completed based on the minutes of in-kind hand-over including the hand-over date;
- g. where C&D Tax is overpaid the overpayment should be settled in accordance with the prevailing tax laws. This process is new and could mean that tax refunds would be subject to a tax audit. (The historical practice has been that PSC entities simply offset overpayments against future C&D Tax instalments.) This new process may result in delays in refunds and cash flow issues in the event of an overpayment. Note however that the instructions in Per-05 for completing the Annual Corporate Income Tax Return (CITR) do not result in disclosure of under or over payment in the main CITR form and hence it is unclear whether this negates the existence of an under or overpayment position;
- h. C&D Tax reporting procedures are:
- i) the operator ( and any non-operators) are to prepare monthly and annual State Revenue Reports using the template provided in Attachment II of PMK 79. The reports should be submitted to the Director General of Budgets (DGB and specifically the Directorate of Non-Tax State Revenue in this case), the DGT at the office where the operator and non-operators are registered (which will generally be Badora II, the Oil & Gas Tax Office), and SKK Migas. These

reports are new and appear to replace the traditional “Form 7.1 and 7.2” for monthly filings. PMK 79 is silent on reporting obligations during exploration (i.e. where no State Revenue obligation should exist). It would not seem however that exploration PSCs are exempted and so they would presumably file nil reports.

- ii) non-operators are required to complete the reports based on the operator’s data. Given the filing deadline for operators and on-operators is the same, this will require effective coordination between the parties to ensure timeliness.
- iii) the monthly and annual report filing deadlines are the 20th of the following month and the end of the 4th month following year end, respectively. Where the dates fall on a public holiday the deadline will be the following working day.
- iv) the reports should attached the relevant SSP and payment evidence. This will be the transfer evidence (for cash payments) or the minutes of in-kind hand-over (for in-kind payments);
- i. there will be coordination between the DGB and the DGT in monitoring the C&D Tax payments; and
- j. any late payment or reporting will be subject to administrative sanctions under prevailing tax laws. The reports also require the declaration of Government Share and (as outlined above) extend the reporting obligations to the DGB, the DGT and SKK Migas while historically filing obligations were (technically) to the DGT only. These enhanced obligations are obviously new and are arguably outside of a taxpayer’s ordinary obligations under the tax law. It remains to be seen if this will create a concern in practice.

Overall PMK 79 represents a significant revamp of the compliance obligations of PSC entities. The revamp is largely systematic but could have a cash flow impact as well (e.g. for tax overpayments).

#### Cost recovery/tax deductions

GR 79 requires that there be a “uniform treatment” between cost recovery and tax deductibility. This is pivotal as it appears to formally enshrine the long-standing “uniformity principle”. To satisfy uniformity the amount should still:

- a. be spent on income production activities;
- b. satisfy the arms’ length principle (for related party transactions);
- c. be consistent with good business and engineering practices (which is technically a new requirement); and
- d. be approved by SKK Migas and included in the relevant Work Program and Budget.

GR 79 also outlines 24 items of spending that are not allowed for cost recovery. For this list please refer to section 3.2.2.

#### **Indirect Taxes**

Indirect taxes, regional taxes, and regional levies are stated as cost recoverable. Indirect taxes include VAT, customs duty, land and building tax, regional taxes and regional levies. This is a significant change as these taxes have generally been reimbursable in the past. Investors have now started to see some changes in the standard PSC language post GR 79 around this point (i.e. the removal of the VAT reimbursement), as discussed below in 3.4.7.

Customs Duty and import taxes (such as VAT and Article 22 Income Tax) due on the importation of goods related to exploration and exploitation activities are to be exempted. This is a positive development as it should alleviate some of the recent tax concerns with rig and similar imports although detail on the exemption is still to issue.

#### **Update on Land and Buildings Tax for Post GR 79 PSCs**

On 12 April 2013, the Minister of Finance (MoF) issued Regulation No.76/PMK.03/2013 (PMK 76) on land and building tax (PBB) for the oil & gas and geothermal sectors replacing Regulation No. 15/PMK.03/2012 (PMK 15). The effective date of PMK 75 was 12 May 2013.

PMK 76 has led to a major change in the PBB regulatory framework for PSCs as outlined below.

#### ***General PBB regime***

Pursuant to Article 5 of Land and Building Tax Law No.12/1994 (Law 12) the PBB tax rate is 0.5% of a “deemed” tax base. The “deemed” tax base ranges from 20% up to 100% of the “object value” (being a statutory value called “NJOP”). The taxable event is the tax base of land and buildings “held” as at 1 January each year. PBB should be paid within 6 months of the receipt of an Official Tax Payable Notification (SPPT). Whilst an SPPT is not an assessment it is still a legal notice from the Tax Office against which taxpayers can object.

#### *PBB and PSCs*

On 20 December 2010 Government Regulation No.79/2010 (GR 79) was signed. Article 11(4)(f) of GR 79 indicates that indirect taxes (including PBB) should be cost recoverable. Post GR 79 PSCs accommodate this by requiring indirect taxes to be cost recovered (in earlier PSCs the Government bears all taxes except Income Tax). On 1 February 2012, the MoF issued PMK 15 updating the PBB procedures (including overbooking) applicable in the PSC (and geothermal) sector. The key features were:

- a. that PMK 15 was effective on 1 February 2012 and canceled all previous regulations relating to the PBB compliance for PSCs;
- b. that the Tax Office should issue the SPPT by the end of April of each fiscal year;
- c. that the PBB due should be settled through an overbooking made by the Directorate General of Budget (DGB) from the oil and gas revenue account into the Tax Office/DGT account (i.e. PBB is not paid by the PSC contractor);
- d. that the taxable base value will be covered by further regulations.

On 12 April 2013 the MoF replaced PMK 15 with PMK 76. PMK 76 specifically references GR 79 and differentiates the PBB treatment as follows:

- a. for pre GR 79 PSCs the overbooking process continues to apply; and
- b. for post GR 79 PSCs the overbooking does not apply and the PSCs are required to self-remit the PBB and claim it as cost recovery.

With the automatic overbooking entitlement for post GR 79 PSCs withdrawn, the DGT began to directly “assess” post GR 79 PSCs. “Assessments” during 2013 have been imposed (via SPPTs) for substantial PBB amounts (many millions of dollars). This has become a major industry concern as most post GR 79 PSCs are still in exploration phase. Many believe that the SPPTs are contrary to the spirit of the PSC arrangement in that a contractor’s financial risks should be protected until liftings have commenced. Any requirement to remit PBB (with no certainty of cost recovery) obviously impacts the overall economics of exploration PSCs.

Subsequently, on 30 September 2013, the DGT issued SE-46 to provide further clarification on completing the SPOPs (notification of PBB objects) for the “offshore” component of objects. Perhaps the most significant aspect of SE-46 was to clarify that the NJOP should only extend to area “utilised” etc. by the PSC interest holder. Whilst utilisation was not defined, the intent appeared to be to reduce PBB exposure for these PSCs on a go forward basis.

Furthermore on 20 December 2013, the DGT issued PER-45 to replace PER-11 on the compliance and calculation procedures for PSCs (and effectively therefore SE-46 which was subordinate to PER-11- see above). Key points outlined in PER-45 (which came into force in 1 January 2014) were as follows:

- a. definition of “Offshore Area”: whilst PER-45 followed the same approach as PER-11 the PER-45 definition did not refer to utilisation thereby raising a question over whether PER-45 revoked the utilisation interpretation of “Offshore Area” outlined in SE-46. This issue remains unclear although during the socialisation of PER-45 the DGT indicated that the “interpretation” set out under SE-46 should continue.
- b. the introduction of a “zone” concept: that the “zone” utilized for oil and gas activities can include areas outside of the PSC contract area.

#### Tax Calculation, Payment and Audit

For JCCs signed after GR 79, the Income Tax rate is that which prevailed at signing or that prevailing from time to time. This appears to breathe life into the Income Tax rate “election” which is in Law No.22 (see 3.3 below).

For JCCs signed before GR 79, the Income Tax rate is that which prevailed when the JCC was signed. This grandfathering is consistent with the retention of the uniformity principle.

If the Income Tax payment is reduced, including via a change in the domicile of the Head Office (say due to a favourable tax treaty), the after tax “government share” shall remain the same. This enshrines the recent trend in PSCs to counter tax treaty use.

Income Tax payments are subject to tax audit out by the DGT. The DGT will issue any assessments after audit. Whilst this is not new in practice guidance will be needed on the technical aspects of these new procedures. As a general remark, upstream investors will need to be prepared for the tight deadlines that apply in a tax audit context and any associated tax dispute proceedings. This includes a 30-day time limit to produce documents especially those that might be held at the Head office. Apart from providing documents on a timely basis, there are also obligations to provide (written) responses to DGT enquiries on a timely basis.

For contractors in exploration, unrecovered costs are subject to tax audit on an annual basis by the Government auditor (e.g. BPKP) on behalf of the DGT. This is effectively a new development as BPKP audits have historically not commenced until production.

#### Non Lifting's Income

Transfers of PSC/JCC interests will be taxed as follows:

- a. During the exploration stage, a final tax of 5% on gross proceeds will be levied. However the transfer will be exempted if it is undertaken for “risk sharing purposes” and the following criteria are met:
  - i) less than the entire interest is transferred;
  - ii) the interest has been held for more than three years;
  - iii) exploration activities have been conducted; and
  - iv) the transfer is not intended to generate a gain.
- b. During the exploitation stage, a 7% final tax on gross proceeds is due except for a transfer to a “national company” as stipulated in the JCC (i.e. a national participating interest).

For more on this, including the developments under PMK 257, please also see section 3.5 below.

#### Bookkeeping and Tax Registration

Through the PSC itself, a PSC entity is automatically entitled to maintain its books, and calculate its Income Tax liability, in English and using US dollars (this has recently been reconfirmed by MoF Regulation No.24/PMK.011/2012). However a PSC entity should still file a notification (three months before the start of the relevant accounting period) with the Tax Office for tax purposes (i.e. to calculate and report its Income Tax liability in US dollars). Transactions denominated in currencies others than US dollars are to be converted to US dollars using the prevailing exchange rate at the date of the transactions.

VAT and WHT continues to be calculated in Rupiah irrespective of an entity's US Dollar bookkeeping notification.

It is common for a PSC contractor to keep two sets of records: one set of accounting records under PSC principles in Indonesia, and one set under the PSC contractor's home office's GAAP, which may or may not be maintained in Indonesia. SKK Migas and the ITO require a complete set of PSC accounting records to be maintained in Indonesia.

GR 79 does not affect the bookkeeping requirements as set out above. However, GR 79 also indicates that:

- a contractors shall carry out their transactions in Indonesia and settle payment through the banking system in Indonesia; and

- b transactions and the settlement of payments (referred to in paragraph a) can only be conducted outside Indonesia if approval from the MoF is obtained.

All books, records, etc. should be kept in Indonesia until the relevant costs are recovered.

A JCC will be required to register for its own tax ID number. The registration will be carried out by the operator of the particular JCC. This is a new development similar to that applying in existing Joint Operating Body arrangements.

Operators are responsible for transactional taxes (including WHT and VAT), presumably meaning that the transactional taxes should continue to be reported under the Operator's tax ID number.

#### Head office costs

Head Office costs are recoverable subject to the following:

- a. the costs support activities in Indonesia;
- b. the Contractor provides consolidated audited financial statements of the head office and an outline of the method of cost allocation (noting that it is not a new requirement to have the selected methods approved by SKK Migas). It is not clear what conditions apply where the head office is a Special Purpose Vehicle; and
- c. the head office allocation does not exceed a ceiling determined by the MoF. The issuance of MoF Regulation No.256/PMK.011/2011 has clarified this cap as being a maximum of 2% of annual spending (subject to approval from SKK Migas) for cost recovery and tax deductibility purposes. However, it does not address the allocation calculation or methodology.

#### Post lifting costs

Certain post lifting costs, including for transporting natural gas (such as marketing costs approved by SKK Migas) and other post upstream activities, are recoverable.

#### Expatriate costs

Expatriate costs are recoverable but should not exceed a ceiling determined by the MoF (in coordination with the MoEMR). MoF Regulation No.258/PMK.011/2011 (PMK 258) has provided details on the applicable cap (effective from 1 January

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2012 and to be reconsidered within 2 years) which is dependent on the role and relevant region that the expatriate comes from, as per the table below. Please note that remuneration is not well defined, but seems to cover short-term compensation only.

Position classification	Rates for expatriates who hold a passport from			Remarks
	Asia, Africa, and Middle East	Europe, Australia, and South America	North America	
	USD	USD	USD	
Highest Executive	562,200	1,054,150	1,546,100	1 <sup>st</sup> Ranking position in Contractor of Oil and Gas Cooperation Contract (President, Country Head, General Manager)
Executive	449,700	843,200	1,236,700	2 <sup>nd</sup> Ranking position in Contractor of Oil and Gas Cooperation Contract (Senior Vice President, Vice President)
Managerial	359,700	674,450	989,200	3 <sup>rd</sup> Ranking position in Contractor of Oil and Gas Cooperation Contract (Senior Manager, Manager)
Professional	287,800	539,450	791,200	4 <sup>th</sup> Ranking position in Contractor of Oil and Gas Cooperation Contract (Specialist)

Although the cap applies for cost recovery and tax deductibility purposes, the Article 21/26 employee income tax withholding obligation of the PSC contractor is still subject to the prevailing income tax law. Therefore, Article 21/26 withholding tax should be based on the actual payment to expatriates.

An exception from the above maximum thresholds applies where a particular expatriate has highly specialised and very rare skills (subject to obtaining MoF approval).



### 3.4.3 Income Tax Rates

#### Various Eras

The introduction of the uniformity principle (and its maintenance in GR 79) necessitated that the Income Tax rate should be “grand-fathered” to the rate applying at the time that the PSC (or extension) was entered into. This is because the production sharing entitlements set out in the PSC are grossed-up to accommodate the Income Tax rate applying at the time. These rates then need to apply for the life of the PSC.

MoF Decree No.267 of 1 January 1978, and MoF Decree No.458 of 21 May 1984, provide “loose” implementing guidelines on the levying of Income Tax against PSC entities. Decrees No.267 and No.458 discuss taxable income in terms of a share in oil and gas production (or “liftings”). Deductions are discussed in terms of associated exploration, development and production costs.

Where the relevant entity holds an interest in a PSC signed before 1984, the Income Tax rate applying should be 45%. This rate was reduced to 35% in 1984, and then to 30% in 1995 up to 2008. This rate was further reduced to 28% in 2009 and 25% starting 2010 based on the new Income Tax Law No.36/2008 which was effective 1 January 2009.

The general assumption in the early years of PSC licensing was that PSC entities would be foreign incorporated. On this basis, the after tax profits of a PSC entity were subject to a further tax on Branch Profits Remittances (BPRs). This tax was due at the rate of 20% giving rise to a total Income Tax exposure of (say) 56% for pre-1984 PSCs (i.e. 45% plus  $(55\% \times 20\%)$ ). In the relevant PSC this was shown as a (gross of tax) production share of 0.3409 for oil (i.e.  $15\%/1-.56\%$ ) and 0.6818 for gas (i.e.  $30\%/1-.56\%$ ).

In order to ensure a constant after tax take this gross-of-tax share has altered over the years as Indonesia’s general Income Tax rate has been lowered. In addition, in the latest PSC bidding rounds the net-of-tax contractor take has been increased to (up to) 25% for oil and 40% for gas. This has also led to a variation in the gross production sharing rates.

These calculations can be summarised as follows:

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PSC Era	Income Tax - General	Income Tax – Branch Profits	Combined Tax Rate	Prod. Share (Oil)	After Tax	Production Share (Gas)	After Tax
Pre-1984	45%	20%	56%	.3409	15%	.6818	30%
1984-1994	35%	20%	48%	.2885	15%	.5769	30%
1995-2007	30%	20%	44%	.2679	15%	.5357	30%
2008	30%	20%	44%	.4464	25%	.7143	40%
2009	28%	20%	42.4%	.6250	36%	.714	41.142%
2010	25%	20%	40%	.6000	36%	.685	41.143%
2013	25%	20%	40%	.583	35%	.667	40%

#### BPR – Treaty Use

The Income Tax rate applying to BPRs can be reduced by a tax treaty. However, with the exception of a small number of treaties (most notably those with the Netherlands, the U.K., Malaysia, and Singapore – although there are others) the BPR reduction in a tax treaty does not apply to PSC activities.

Any reduction in the BPR tax rate may lead to an increase in a PSC entity's after-tax production share. Consequently the relevant Indonesian government authorities have historically disputed a PSC entity's entitlement to utilise treaty benefits. In the late 1990's this issue led to the cancellation of the Netherlands' treaty (although this has since been renegotiated) and the threatened cancellation of others including that with the U.K. In 1999, the MoF issued an instruction that the Government's production share should be increased to compensate for any PSC entity utilizing treaty concessions.

Recent PSCs have sought to contractually negate the use of treaties by including provisions seeking to amend the production shares (i.e. as per the MoF instruction above). Typical PSC language is now as follows:

*“**SKK MIGAS** and **CONTRACTOR** agree that all of the percentages appearing in Section VI of this **CONTRACT** have been determined on the assumption that **CONTRACTOR** is subject to final tax on profits after tax deduction under Article 26 (4) of the Indonesia Income Tax Law and is not sheltered by any tax treaty*

to which the Government of the Republic of Indonesia has become a party. In the event that, subsequently, **CONTRACTOR** or any of Participating Interest Holder(s) comprising **CONTRACTOR** under this **CONTRACT** becomes not subject to final tax deduction under Article 26 (4) of the Indonesia Income Tax Law and/ or subject to a tax treaty, all of the percentages appearing in Section VI of this **CONTRACT**, as applicable to the portions of **CONTRACTOR** and **SKK MIGAS** so affected by the non applicability of such final tax deduction or the applicability of a tax treaty, shall be adjusted accordingly in order to maintain the same net income after-tax for all **CONTRACTOR**'s portion of Petroleum produced and saved under this **CONTRACT**".

Given that this provision has only appeared in recent PSC's (which are not yet in production) the actual operation is not yet clear.

### Indonesian Entities – Special Issues

The "gross of tax" calculation included in the production share assumes a foreign incorporated PSC holder with a liability to Income Tax on BPRs at the rate of 20%. A PSC can however, be awarded to an Indonesian entity. In such a case, the production sharing formula will typically be unchanged and so assume a dividend (rather than BPR) withholding tax also at the rate of 20%.

Where a PSC is held by an Indonesian entity with Indonesian shareholders the taxation of dividends should follow the general taxation rules. Under these rules, for an Indonesian entity, dividend income is generally tax exempt where the recipient share holding entity holds no less than 25% of the dividend paying entity's paid in capital.

It is not clear however, that any PSC related Income Tax reduction can be achieved in practice.

### Oil and Gas Law Election – prevailing tax laws or those prevailing when contract signed

Article 31(4) of Law No.22 allows parties to a PSC signed from 2001 onwards to elect which tax laws are to apply:

*"The Co-operation Contract shall provide that the obligation to pay taxes referred to in paragraph (2) shall be made in accordance with:*

- a) *the provisions of tax laws and regulations on tax prevailing at the time the Co-operation Contract is signed; or*
- b) *the provisions of prevailing laws and regulations on tax"*

However, the exact nature of this election is not clear including whether the election could lock-in the uniformity principle. To avoid uncertainty, some PSCs often include the following language:

*“It is agreed further in this **CONTRACT** that in the event that a new prevailing Indonesia Income Tax Law comes into effect, or the Indonesia Income Tax Law is changed, and **CONTRACTOR** becomes subject to the provisions of such new or changed law, all the percentages appearing in Section VI of this **CONTRACT** as applicable to the portions of **CONTRACTOR** and **GOI**’s share so affected by such new or changed law shall be revised in order to maintain the same net income after tax for **CONTRACTOR** or all Participating Interest Holders in this **CONTRACT**.”*

#### 3.4.4 Administration

##### Regulation

A PSC entity (where foreign incorporated) is required to set up a branch office in Indonesia. This branch also gives rise to a permanent establishment (PE). This is the case for all foreign incorporated PSC interest holders (i.e. operators and non-operators).

A PSC branch, as a PE, should register for tax by filing an appropriate registration application form including the following attachments:

- a. a letter from the branch’s “head office” declaring the intention to establish a branch in Indonesia including information on the branch’s chief representative;
- b. a copy of all pages of the passport of the branch’s chief representative;
- c. a notification letter on the chief representative’s domicile (issued by a local government officer);
- d. a notification letter on the domicile/place of business of the branch (usually issued by a building management company where the branch is located in a commercial office building);
- e. a copy of the PSC;
- f. a copy of the Directorate of Oil and Gas letter which declares the entity the PSC holder; and
- g. a letter of appointment of the chief representative from the head office.

## Compliance

The registration obligation applies from the time of commencement of business activities. Therefore, this includes the exploration phase (i.e. there is no entitlement to defer registration until, say, commerciality is declared).

Ongoing tax obligations include:

- a. the filing of annual Income Tax returns for each interest holder (although see comments on GR 79 above);
- b. the filing of monthly reports on the Income Tax due on monthly liftings as well as the remittance of Income Tax payments (for each interest holder-but obviously only after production);
- c. the filing of monthly returns for withholding obligations (for the operator only);
- d. the filing of monthly and annual Employee Income Tax returns (for each interest holder – noting that generally for a non-operator this will be a nil return);
- e. the filing of monthly VAT reports (for the operator only);
- f. the maintaining of books and records (in Indonesia) supporting the tax calculations (for the operator only).

On 18 February 2014 the DGT issued Regulation No.5/2014 on the format and content of the annual income tax return for PSC taxpayers (DGT Regulation No.28 was revoked).

In addition to distinguishing liftings and non-liftings income, Contractors are now required to complete and attach (as appropriate) six special attachments concerning:

- a. Corporate Income Tax for PSC Contractors;
- b. Branch Profits Tax/dividend tax for PSC Contractors;
- c. Details of Costs in Exploration/Exploitation Stage for PSC Contractors;
- d. Depreciation Schedule for PSCs;
- e. Details of the Contractor's portion of their FTP share;
- f. Details of Changes in the Participating Interests.

From April 2012, the DGT sought to move all PSC Contractors to the Badora II Tax Office, which has a specific responsibility for the industry.

#### Ring Fencing

Pursuant to MoF Regulation No.SE-75/1990, an entity may hold an interest in only one PSC (i.e. the “ring-fencing” principle). There are also no grouping or similar consolidation arrangements available in Indonesia. This means that the costs incurred in respect of one PSC cannot be used to relieve the tax obligations of another.

As noted in GR 79, PSCs and relevant PoDs now book to ring fence by field.

#### Joint Audits

Pursuant to a Memorandum of Understanding (MoU) entered into between SKK Migas, BPKP (a Government auditing body) and the Directorate General of Taxes (DGT) Joint Audits by these bodies have been carried out on all operational PSCs and non-producing PSCs with an approved Plan of Development (PoD) since April 2012. A number of these audits have now extended beyond the initial audit timeframe and a number of draft and final Joint Audit Reports have now been issued.

This is the first systematic DGT audit of PSCs meaning that many PSCs are experiencing a DGT tax audit for the first time. Given the operation of the uniformity principle (i.e. where deductibility is driven by cost recovery administration) the DGT has been primarily focused on transactional taxes (e.g. withholding taxes (WHT) and VAT).

Common issues raised by the DGT to date include:

- a. General reconciliations between the financial reports and the monthly tax returns – the DGT is often requesting an explanation of discrepancies between the “accounts” and the tax objects disclosed in the monthly WHT and VAT returns. Whilst this type of request is common with general taxpayers, this can be challenging for PSC entities as their financial data may be limited to their financial quarterly reports. Completing these reconciliations can be very time consuming.
- b. “Head office” overhead allocations – since 1998 Article 26 WHT and Self-Assessed VAT on head office overhead allocations has (effectively) exempted via DGT Letter S-604. Although the DGT appears to be still accepting S-604, the challenge appears to have shifted to satisfying the DGT as to the nature of the charge and which entity(s) constitute the “head office”. This also seems to remain a point of difference between the DGT and SKK Migas.

- c. Benefits in Kind (BiK) – BPKP/SKK Migas often seem to have a different view on BiK costs. SKK Migas often allows cost recovery (meaning deductibility under the uniformity principle). However the DGT is of the view that deductibility, even via cost recovery, creates an Article 21 Employee WHT due on the grossed up value of the benefit.

The experience is that the DGT is being very thorough in its tax audits but its knowledge of PSC issues can impact the findings and the volume of data requested. This can lead to requests for information outside the scope of the PSC activities. PSCs should consider how they respond to information requests carefully. As with all tax audits taxpayers should still do as much as possible to eliminate audit findings during the draft/temporary findings stage. This can help avoid protracted Objection and Appeal procedures. Under GR 79 (please see above at 3.4.2) tax audits may now also take place during the exploration stage.

As noted, accounting records are subject to audit by SKK Migas and BPKP and occasionally BPK (*Badan Pemeriksa Keuangan* – another audit body established under the Constitution and independent to the Government).

### 3.4.5 Employee Income Taxes

For PSC entities (acting as the operator) the taxation arrangements for employees are largely identical to those for other employers. On this basis, there is an obligation for the operator to withhold and remit Income Tax, and to file monthly returns, in accordance with either Article 21 or 26 of the Income Tax law. The Article (and so the tax rate) varies according to residency of the employee (please refer to PwC Pocket Tax Guide for further details).

Industry tax issues in relation to employment activities include:

- a. the treatment of “rotators” or similar semi-permanent personnel. This mainly relates to ensuring that the correct tax rates are applied; and
- b. the treatment of non-cash “benefits in kind”. The treatment can vary according to the era of the PSC, whether the personnel are working in designated “remote areas” and whether the operator wishes to claim cost recovery for the relevant benefit.

Further, resident employees without an NPWP (tax payer identification number) are subject to a surcharge of 20% on Indonesian sourced income in addition to the standard WHT. On this basis, a PSC entity needs to ensure that all employees (including resident expatriates) obtain their individual NPWP especially if a PSC entity provides salaries on a net of tax basis. Please refer to our annual publication the PwC Pocket Tax Guide for more information.

#### 3.4.6 Withholding Taxes (WHT)

For PSC entities (where operator) the WHT obligations are largely identical to those for other taxpayers. On this basis, there is an obligation for the operator to withhold and remit Income Tax, and to file monthly WHT returns, in accordance with the various provisions of the Income Tax law (please refer to PwC Pocket Tax Guide for details).

For PSC entities the most common WHT obligations arise with regard to:

- a. land and building rental (i.e. Article 4(2) - a final tax);
- b. deemed Income Tax rates (i.e. Article 15, for international shipping at 1.2% and 2.64%);
- c. payments for the provision of services etc. by tax residents (Article 23 - at 2%); and
- d. payments for the provision of services etc. by non-residents (Article 26 - 20% before treaty relief).

#### 3.4.7 VAT

##### General

The sale of hydrocarbons taken directly from source is currently exempt from VAT. PSC entities have therefore never constituted taxable firms for VAT purposes and have never been registered for VAT purposes (although see VAT Collectors in section 5.4. 7).

VAT charged to/suffered by PSC entities is therefore not available as an input credit. Instead, and depending upon a number of factors, the VAT has historically either been:

- a. deferred (typically for in-country supplies); or
- b. exempted (typically for imports); or
- c. reimbursed (by SKK Migas).

On 28 December 2012 the Minister of Finance issued Regulation No. 52 (MoF No.252) exempting certain types of natural gas supplies from VAT. These include natural gas transported through pipelines, Liquefied Natural Gas (LNG) and Compressed Natural Gas (CNG). Liquefied Petroleum Gas (LPG) in cylinders and on sale direct to the public remains subject to 10% VAT.

Two weeks earlier, the Fiscal Policy Office published a policy on the MoF website recommending that natural gas (other than LPG) be formally made non-VATable.



The document explained that various VAT treatments on the delivery of natural gas had been adopted by taxpayers in the past. For instance, the supply of CNG and LPG was often treated at VATable while the delivery of LNG and natural gas through pipes by the State Gas Company (Perusahaan Gas Negara/PGN) was generally treated as non-VATable.

The Fiscal Policy Office stated that the policy would encourage the use of gas rather than oil. Moreover, if the LNG, CNG and natural gas transported through pipelines were VATable the result would be a significant VAT restitution to taxpayers because the majority of gas was exported.

MoF No.252 was subsequently issued and the content is consistent with the recommendation provided in the policy paper.

As natural gas is now exempt from VAT, taxpayers engaged in the production of processed natural gas, such as LNG and CNG, could bear an additional cost because the VAT paid on their supplies (including capital goods) will no longer be creditable. The treatment is different if the taxpayer is a PSC entity entitled to a VAT reimbursement.

This is problematic for non-integrated producers of LNG (see section 3.4.8 below).

#### **In-Country Supplies - VAT Deferment**

Pursuant to Presidential Decree No.22/1989 (PD 22) and its implementing regulations, VAT payments arising from oil, gas and geothermal exploration and drilling services were deferred until the time of Government Share (when the VAT was then reimbursed-see VAT Reimbursement). This arrangement effectively eliminated all but a small cash flow exposure on VAT charged in these scenarios.

In 1995 however, an amendment to the VAT Law sought to terminate all VAT deferments with effect from 31 December 1999. The Indonesian tax authorities took the view that this amendment ended the deferment available to PSC entities. In January 2000, assessments for all VAT deferred up to this date were issued. Around 30 taxpayers appealed these assessments through the Indonesian Court system. The outcome of these cases has been mixed.

New PSC entities should probably assume no entitlement to defer VAT payments. On this basis, the 10% VAT charged on “in-country” goods and services will need to be paid and will not be refunded unless Government share is achieved.

#### Imports-VAT Exemption

See Import Taxes below in section 3.4.8.

#### VAT Reimbursement

PSCs issued prior to GR 79 (see below) typically provided that Pertamina (now SKK Migas) is to:

*“assume and discharge all other Indonesian taxes [other than Income Tax including VAT, transfer tax, import and export duties on materials equipment and supplies brought into Indonesia by Contractor, its contractors and subcontractors.....*

*The obligations of Pertamina [now SKK Migas] hereunder shall be deemed to have been complied with by the delivery to Contractor within one hundred and twenty (120) days after the end of each Calendar Year, of documentary proof in accordance with the Indonesian fiscal laws that liability for the above mentioned taxes has been satisfied, except that with respect to any of such liabilities which Contractor may be obliged to pay directly, Pertamina [now SKK Migas] shall reimburse it only out of its share of production hereunder within sixty (60) days after receipt of invoice therefore. Pertamina [now SKK Migas] should be consulted prior to payment of such taxes by Contractor or by any other party on Contractor's behalf”.*

PSC protection from non-Income taxes has therefore historically fallen into two categories. Firstly, those taxes historically met directly by SKK Migas (e.g. Land and Building Tax) and secondly those taxes met by the contractor (e.g. VAT) which have then been reimbursed. Further, and depending upon the PSC era, the reimbursement shall be only from SKK Migas' share of production (i.e. there is no entitlement to reimbursement until the PSC goes into production and reaches Government share).

Reimbursement is, in practice, also subject to the PSC entity satisfying high standards of documentation (original VAT invoices, etc.). Where VAT is not reimbursed for a documentation related concern BP Migas had, on occasions, allowed VAT to be charged to cost recovery.

VAT borne by PSC entities during the exploration phase, who do not subsequently move into production, will never be reimbursed and so the VAT will become an absolute cost.

VAT reimbursements are denominated in rupiah at historical exchange rates and so the reimbursement mechanism also carries an exchange risk.

As noted at section 3.4.2 above, PSCs issued post GR 79 have seen the standard PSC language regarding VAT reimbursement removed in favour of an entitlement to include all indirect taxes as operating costs of the business.

#### **VAT Collectors**

While PSC contractors are not VATable firms they do constitute “collectors” for VAT purposes (except for the period January 2004 - January 2005). As a result, PSC entities remit the VAT that is charged on goods and services directly to the tax authorities (rather than to the suppliers). There is a monthly filing associated with the process. This remittance arrangement leaves suppliers to the upstream sector in a perpetual VAT refund position.

Due to SKK Migas’ bidding rules, these suppliers are often Indonesian entities acting as “agents” for, typically, foreign oil service multinationals. Historically, the VAT cashflow disadvantage that the VAT collector arrangements have created for local agents gave rise to the QQ system. This system effectively allowed the agent to pass the VAT cashflow burden onto the multinational oil service entity by allowing the VAT invoice to by-pass the agent (ie the invoicing was done on their behalf).

This QQ system was revoked by the ITO in August 2008 and this left the VAT cashflow disadvantage with any agents, interposed between the PSC client and the oil service provider.

#### **3.4.8 Import Taxes**

##### **Old PSCs**

As indicated in section 3.4.7 under VAT Reimbursement, PSCs signed prior to the Law No.22 (Old PSCs), typically provided that Pertamina (now SKK Migas) was to discharge, out of its share of production, all Indonesian taxes (other than Income Tax). These taxes included VAT, transfer tax, import and export duties on material equipment and supplies brought into Indonesia by the Contractor (subject to documentary proof).

The discharge of Import taxes (which includes Import Duty, VAT and Income Tax prepayment) has been historically accommodated via a Master List, which effectively led to an outright exemption of all import taxes and duties on import

### 3. Upstream Sector

of the approved capital items. This covered both “permanent” imports (i.e. where title transfers to the State) and “temporary” imports (i.e. where title remains with the importer).

However, under Law No.22, BP Migas (now SKK Migas) assumed Pertamina’s regulatory role, including that in relation to MLs. Further Law No.22 now requires contractors to pay import taxes, meaning that “protection” may only be available via reimbursement or some more limited method.

Finally, MoF Regulation No.20/PMK.010/2005 dated 3 March 2005 provides an import tax exemption for Old PSCs until the end of the contract term. This regulation was effective from 1 March 2005.

#### New PSCs

For PSCs signed post Law No.22 (referred to as New PSCs), the import taxes and duties facilities are no longer available under the Masterlist. However, limited facilities are continued to be provided by the Ministry of Finance since 2005, via a number of separate regulations. Further detail in respect of the in force regulations is set out below, whilst the next page summarises the import tax facility regulations since 2005 and the periods they relate to.

	Import Duty	VAT	Art. 22 Income Tax
Old PSC (Pre-2001 )	✓	✓	✓
New PSC	Exploration Stage	✓	✓
	Exploitation Stage	-	✓

Where a new PSC is unable to claim an exemption under the above regulation it may be able to apply for a general “tax exemption letter” on Article 22 Income Tax from the relevant tax office.

#### GR79

Pursuant to Article 25(10) of GR 79, prima facie the Contractor should be protected from import taxes and duties for goods used in petroleum operations during both exploration and exploitation. However, since GR 79 defers the

implementation of these facilities to “the statutory law and regulations”, PSC Contractor must look beyond GR 79 in order to obtain exemptions from import taxes and duties.

#### *Import Duty*

MoF Regulation No.177/PMK.011/2007 (PMK-177) provides an Import Duty exemption for New PSCs effective from 16 July 2007. In contrast to VAT (see below), the regulation arguably applies to both exploration and exploitation activities, although it restricts the facilities for goods that are yet produced, or not produced to the required specifications, or not produced in sufficient quantity in Indonesia.

In addition, MoF Regulation No.179/PMK.011/2007 (PMK-179) provides for a 0% Import Duty on the import of drilling platforms and floating or submarine production facilities.

#### *VAT*

On 8 February 2012, the MoF issued regulation No 27/PMK.011/2012 (PMK 27) which provided an exemption from import VAT on certain goods exempted from Import Duty. Under PMK 27, the import of goods used for upstream oil and gas exploration business activities, as well as temporarily imported goods, are among those that are explicitly exempted from Import Duty.

This marked an end to the previous “VAT borne by Government” mechanism provided via the annual State Budget, which required issuance of a MoF Regulation on annual basis.

As noted above, PMK 27 limited the facilities to “exploration stage” only, in contradiction to GR 79 (PMK 27 did not refer to GR 79). Therefore import VAT was an issue for Contractors during exploitation, although it may have represented a cash flow concern only if the PSC contract specifically allow for VAT reimbursement (post GR 79 VAT may only be recoverable/deductible as operating costs).

On the basis that PMK 179 provides a rate reduction on Import Duty (to 0%), rather than an exemption, the Contractor may not be able to make use of PMK 27 (or the amending Regulation PMK 70 – see below) in order to benefit from

a VAT exemption on the import of drilling platforms and floating or submarine production facilities. As a consequence of PMK 177, the VAT exemption will also be subject to the restrictions noted above regarding goods produced in Indonesia.

On 2 April 2013, MoF issued Regulation No.70/PMK.011/2013 (PMK 70) providing a general VAT “exemption” (i.e. VAT not collected) on the import of goods for upstream oil & gas and geothermal businesses. The exemption applies to imports carried-out during both exploration and exploitation phases and so answers the industry’s concern over the previous PMK 27 which limited the exemption facility to the exploration phase.

In summary:

- a the Regulation amends PMK 27, meaning that the import VAT exemption applies to PSCs signed after Law No.22 was issued and to the new Geothermal IUPs. “Old” PSCs still qualify for exemptions under PMK 20/2005. Meanwhile, geothermal activities under the old JOC framework should qualify for exemptions under MoF Decree No.766/1992 (as further stipulated under a Joint Decree);
- b PMK 70 inherits the “harmony” between the import VAT exemption and the import duty exemption provided under PMK 177. However, some issues have arisen:
  - i) PMK 177 provides an import duty exemption to both exploration and exploitation activities. It however restricts the facilities to three types of goods (i.e. goods that are not locally produced, or not locally produced to the required specifications or in sufficient quantity). For the import VAT facility, Article 4 of PMK 70 requires that the above three criteria applies for goods imported during the exploration phase only. It is silent on whether the same criteria apply for imported goods during exploitation.
  - ii) Similar to PMK 27, PMK 70 is unclear as to whether the facility applies to imported goods subject to 0% import duty (rather than an exemption) as stipulated under PMK 179/2007 (i.e. for drilling platforms and submarine production facilities).

#### *Article 22 Income Tax*

MoF Regulation No.154/PMK.03/2010 (PMK 154) dated 31 August 2010, provides an exemption from Article 22 Income Tax for “*goods used for upstream activities of Natural Oil and Gas, the importation of which is conducted by the Contractor*” that are exempted from Import Duty and/or VAT.

### 3.4.9 Tax Dispute Process

Taxpayers are entitled to object against unfavourable tax assessments. Requirements include that the objection:

- a. be prepared for each assessment;
- b. be in Bahasa Indonesia;
- c. indicate the correct tax amounts;
- d. include all relevant arguments; and
- e. be filed within 3 months of the assessment date.

The ITO is required to decide on an objection within twelve months. Failure to decide within this timeframe means that the objection is deemed accepted. A taxpayer should pay at least the amount agreed during the tax audit closing conference before filing the objection. If the objection is rejected any underpayment is subject to a surcharge of 50%. This underpaid tax and surcharge is not due if the taxpayer files an appeal to the Tax Court with respect to the objected decision.

### Appeals

Taxpayers are entitled to appeal to the Tax Court against unfavourable objection decisions. Requirements include that the appeal letter:

- a. be prepared for each decision;
- b. be in Bahasa Indonesia;
- c. indicate all relevant arguments;
- d. be filed within 3 months of the date of the objected decision; and
- e. attach a copy of the relevant decision that is being objected.

Based on the Tax Court law, at least 50% of the tax due on the underlying assessment should be settled before filing an Appeal. This payment requirement is however now different to the Tax Law meaning that there is a mismatch between the Tax Administration law and Tax Court law.

The Tax Court will typically decide on an Appeal within 12 months. Any underpaid tax resulting from the Tax Court decision is subject to a surcharge of 100%.

### Requests for Reconsideration

For Tax Court decisions delivered after 12 April 2002, taxpayers are entitled to file “reconsideration requests” to the Supreme Court. Again, a 3 month action period is

in place with the Supreme Court required to respond within 6 months. To date only a limited number of such requests have been filed.

Interest Penalties/Compensation

Late payments of tax are subject to interest penalties generally at the rate of 2% per month. Refunds of tax attract a similar 2% interest compensation.

Income Tax on Liftings

Income Tax due on oil and gas receipts/liftings is remitted directly to the DGB. This has historically meant that the collection and dispute resolution process for this category of Income Tax falls outside of those administered by the DGT and the Tax Court. This has to date made both the collection process and trial for dispute resolution problematic for both the Government and PSC Contractors. GR 79 may change this situation (see above).

3.5 Commercial Considerations

When reviewing a PSC, potential investors should consider the following issues:

Topics	Issues
Abandonment Costs	<ul style="list-style-type: none"><li>• SKK Migas and formerly BP Migas have included an abandonment clause in the PSC since 1995 which provides that contractors must include in their budgets provisions for clearing, cleaning and restoring the site upon completion of work. As any funds set aside for abandonment and site restoration are cost recoverable and tax deductible unused funds at the end of the contract are transferred to SKK Migas.</li><li>• For PSCs which do not progress to a development stage any costs incurred are considered sunk costs.</li></ul>
DMO Gas	<ul style="list-style-type: none"><li>• Historically, there was no DMO obligation associated with gas production.</li><li>• GR No. 35 introduced a DMO obligation on a contractor’s share of natural gas.</li><li>• Recent PSCs have included the DMO obligation requirement for gas but as most of these PSCs are still in exploration stage many practical issues are not yet resolved.</li></ul>



Topics	Issues
Carry arrangements (JOBs)	<ul style="list-style-type: none"> <li>Some PSCs (as JOBs), require private participants to match Pertamina's sunk costs and to finance Pertamina's participating share of expenditures until commercial production commences. These are known as carry arrangements.</li> <li>After commercial production commences, Pertamina is to repay the funds provided plus an uplift of 50%</li> <li>It is unclear whether the uplift should be taxable at the general rate or follow the PSC income tax rate (although there has been a number of recent assessments in this area).</li> </ul>
Head office costs	<ul style="list-style-type: none"> <li>The administrative costs of a "head office" can generally be allocated to a PSC for cost recovery purposes. PMK 256 stipulates a cap of 2% of annual cost recoverable spending.</li> <li>PMK 256 also indicates that the amount a PSC is able to recover will be dependent upon approval from BP Migas, which may be lower than 2%. The type of approval required depends on whether or not the PSC is in the Exploration or Exploitation as follows: <ul style="list-style-type: none"> <li><b>Exploration:</b> the approval is to be ascertained from the work program and budget (WP&amp;B), and monitoring of the allocation cap will be done over the exploration period (i.e. it would not be adjusted until the end of the exploration period); or</li> <li><b>Exploitation:</b> specific written approval must be obtained from BP Migas and the cap will be monitored each year (i.e. the WP&amp;B will not be sufficient evidence to support the allocation once exploitation has commenced).</li> </ul> </li> <li>Due to uniformity, a tax deduction is also available but allocations above the permitted cost recovery are not tax deductible. These allocations technically create WHT and VAT liabilities (i.e. as cross-border "payments"). Pursuant to MoF Letter No.S-604 of 24 November 1998, the Government indicated that it would implement arrangements to "bear" these taxes on behalf of PSC entities.</li> <li>However, MoF Letter No.S-604 was arguably never fully implemented and so has never actually provided a tax exemption. The ITO is known to have focused on head office costs in tax audits.</li> </ul>

Topics	Issues
Interest recovery	<ul style="list-style-type: none"><li>• A PSC entity is generally not allowed cost recovery for interest and associated financial costs.</li><li>• Subject to specific approval, contractors may be granted interest recovery for specific projects. This facility should be pre-approved and included in the Plan of Development (POD). However SKK Migas states that interest recovery is only granted for PODs that have been approved prior to the promulgation of GR 79.</li><li>• From a taxation point of view, where a contractor is entitled to cost recovery there is also an entitlement to tax deductibility.</li><li>• The interest recovery entitlement will generally reference the pool of approved but un-depreciated capital costs, at the end of an agreed “period” of time. The “loan” attracting the relevant interest is generally deemed to be equal to the capital spending on the project. Depreciation of the spending is treated as a repayment of the loan. Consequently, the “interest” in question may not be interest in a technical sense.</li><li>• Interest paid is subject to WHT with potential relief granted under various tax treaties. As a precaution, most Contractors gross up the interest charged to reflect any WHT implications.</li><li>• Pertamina typically allowed a gross up for Indonesian WHT at the rate of 20%. Some PSC entities have been successful in reducing this rate via a tax treaty. This is even though the “interest” may not satisfy the relevant treaty definition.</li></ul>

Topics	Issues
Investment credits	<ul style="list-style-type: none"> <li>• An investment credit is provided as an incentive for developing certain capital intensive facilities including pipelines and terminal facilities.</li> <li>• The credit entitles a PSC entity to take additional production without an associated cost. An investment credit has therefore traditionally been treated as taxable.</li> <li>• More difficult questions have arisen with regard to the timing of investment credit claims. For instance, an investment credit should generally be claimed in the first year of production and any balance should be carried forward (although there are sometimes restrictions on carry forward).</li> </ul>
Take or Pay	<ul style="list-style-type: none"> <li>• A gas supply agreement may include provisions for a minimum quantity of gas to be taken by buyers on a take-or-pay basis. If buyers take less than the committed quantity of gas they must still pay an amount (as per the agreement) in relation to the shortfall.</li> <li>• Take-or-pay liabilities may arise if buyers have taken less than the committed quantity of gas under the agreements. The shortfall in the gas taken by buyers, if any, results in a take-or-pay liability for make-up gas to be delivered to buyers in the future.</li> <li>• It is unclear whether the tax due should be calculated based on the payments (based on the committed quantity to be taken by the buyer) or based on the quantity of gas delivered to the buyer.</li> </ul>

Topics	Issues
Land rights	<ul style="list-style-type: none"><li>• Historically, BP Migas (formerly Pertamina) took a central role in acquiring surface rights for oil and gas development.</li><li>• Oil and Gas Law No.22/2001 requires the Contractor to obtain the relevant land rights in accordance with the applicable local land laws and regulations.</li><li>• The process of obtaining appropriate land rights can be time consuming and cumbersome although Law No.2/2012 on acquisition of land for development in the public interest (and its implementing regulation PR No.71/2012 and subsequent amendments in PR No.40/2014) seek to overcome some of the issues.</li><li>• Entitlement to the Contract Area under a PSC does not include any rights to land surface, nonetheless given the change in the treatment of indirect taxes (including VAT and Land &amp; Buildings Tax) under GR 79 this became a material exposure in 2013 for many PSC holders.</li></ul>
“Net Back to Field” Arrangements	<ul style="list-style-type: none"><li>• Contractor calculations for transactions involving Trustee or similar arrangements (e.g. for piped gas/ LNG, etc.) typically commence with a revenue figure which has been netted against certain post-lifting costs (e.g. trustee, shipping, pipeline transportation, etc.). Once again, this follows the uniformity principle which generally disallows cost recovery on spending past the point of the lifting.</li><li>• Net back to field costs are generally also treated as being outside of a PSC entity’s WHT and VAT obligations. With the growing involvement of the DGT in joint audits, this position may be subject to review.</li></ul>

Topics	Issues
Sole risk operations	<ul style="list-style-type: none"> <li>Typically all costs and liabilities of conducting an exclusive (“sole risk”) operation for drilling, completing and equipping sole risk wells are borne by “the Sole Risk Party”. The Sole Risk Party indemnifies the Non-Sole Risk Parties from all costs and liabilities related to the sole risk operation.</li> <li>Should the sole risk operation result in a commercial discovery the Non-Sole Risk Parties have historically been given the option to participate in the operation. If the Non-Sole Risk Parties agree to exercise their option the Non-Sole Risk Party pays to the Sole Risk Party a lump sum amount which typically can be paid either through “Cash Premium” or “In-Kind Premium” to cover past costs incurred as well as reward for risk taken.</li> <li>It is not clear whether these premiums should be treated as taxable liftings income, other non-liftings income under GR 79 or ordinary income, although under GR 79 they are more likely to be treated as other non-liftings income.</li> </ul>
Unitisations	<ul style="list-style-type: none"> <li>Unitisation is a concept whereby the parties to two or more PSCs agree to jointly undertake the E&amp;P operations on a defined acreage (which typically overlaps between the two PSCs) and share risks and rewards from such activity in an agreed proportion.</li> <li>Typical issues under a unitisation arrangement include: <ul style="list-style-type: none"> <li>Re-determination of costs and revenues;</li> <li>Maintenance of separate records;</li> <li>Ring-fencing;</li> <li>Audits; and</li> <li>Impact on overall PSC economics</li> </ul> </li> </ul>

Topics	Issues
Transfer of PSC interests	<ul style="list-style-type: none"><li>Historically, transfers of PSC interests have not generally been taxed. This has been irrespective of whether the transfer was:<ol style="list-style-type: none"><li>via a direct transfer of a PSC interest (i.e. as an “asset sale”);</li><li>as a partial assignment such as a farm-out; or</li><li>via a sale in the shares of a PSC holding entity (i.e. as a “share sale”).</li></ol></li><li>Whilst previous tax laws could probably tax many transfers, Law No. 36 (which became effective 1 January 2009) now specifically targets PSC transfers done as an asset sale.</li><li>In addition, an interest in an Indonesian PSC probably constitutes an intangible asset for Indonesian Income Tax purposes. Taxable income can include gains from the sale of intangible assets. A tax treaty will typically not prohibit this.</li><li>Indonesian Income Tax will only apply if there is a “sale of assets in Indonesia” within the meaning of the Income Tax Law. Pursuant to MoF Decree No. 434 of 24 August 1999 these “assets” were restricted to shares in Indonesia incorporated companies. However, since Law No. 36 (effective on 1 January 2009) the ITO has the right to treat a sale of shares in a “tax haven” entity, as a sale of shares in an Indonesian entity.</li><li>These changes could provide advantages in not holding PSC interests in “tax haven” entities. However, as a tax levied on such a share sale would actually be a tax on the relevant shareholder, an alternative strategy might be for the shareholder to be resident in a treaty country which provided protection from such tax.</li></ul>

Topics	Issues
	<ul style="list-style-type: none"> <li>GR79 now imposes a 5%/7% transfer tax according to whether the PSC is in exploration/exploitation stage. GR 79 still protects partial assignments such as farm-outs during the exploration stage if that interest has been held for more than three years and the transfer is not intended to generate a gain. However, where the transfer is for “non-risk sharing” purposes, the 5% final tax will be imposed on gross proceeds. GR 79 also imposes a 7% final tax on gross proceeds for transfers during the exploitation stage except where they are to a “national company”. Please see section 3.4.2 for more details.</li> <li>In addition PMK 257 stipulates that a Branch Profits Tax (BPT) also applies to a transfer of a direct or indirect interest in the PSC. The BPT is due at the rate of 20% of the “economic profit” less the 5% or 7% tax already paid on the transfer.</li> </ul>

It is now becoming clear that PMK 257 does not cater for deal structures arising in practice. We have seen a number of transactions where an interpretation beyond PMK 257 may be needed to work out the likely tax implication. For example, clarity is required in the following areas:

- a. **“Distant” PSC transfers:** what is the range of Indonesia’s ability to tax share transfers especially where the scope falls outside Indonesian natural tax coverage (essentially rules on GR 79’s tracing power)?
- b. Where Indonesia does have taxing rights, how should the BPT be accounted for and which treaties can be relied on (bearing in mind BPT is ultimately a tax cost for the vendor entity)?
- c. Is a group restructuring (i.e. with no change of control and therefore no requirement for SKK Migas approval) really meant to be taxed?
- d. **Domestic indirect PSC transfers:** if the seller of an indirect PSC interest makes a transfer via a sale in another Indonesian taxpayer, does PMK-257 override the normal income tax due on gains arising from the share sale?
- e. **Carry arrangements:** when does a carry provided by a buyer as part of the farm-out constitute compensation for the PSC transfer? Is this outcome subject to whether the carry is repaid? Is there consideration where the buyer simply takes an interest in an existing cost pool?
- f. **Contingent payments:** when is a contingent payment subject to tax? Is it when the deal is agreed (i.e. when the PSC is transferred) or when the contingent payment is realised?

- g. **Calculation of profits:** what is the cost base in calculating the profits for BPT purposes? Should it follow cost recovery rules under the PSC or normal taxation rules? Can finance costs be included?

## 3.6 Documentation for Planning and Reporting

### 3.6.1 Plan of Development (POD) (Articles 90-98 of GR 35/2004)

A Plan of Development (POD) (also known as a field development plan) represents development planning on one or more oil and gas fields in an integrated and optimal plan for the production of hydrocarbon reserves considering technical, economical and environmental aspects.

Prior to Law No.22, an initial POD only needed Pertamina Director approval. After Law No.22, an initial POD in a development area needs both SKK Migas and the Minister of Energy and Mineral Resources approval. Subsequent POD's in the same development area only need SKK Migas approval. Generally the time needed for POD approval is around 10 weeks although the process can take in excess of one year for very large projects.

A POD is typically a complex document that outlines the proposed development of a particular commercial discovery. The scope and scale of PODs will vary enormously depending on the size of the project but it will typically cover the following information:

- a. Executive summary
- b. Geological findings
- c. Development incentives
- d. Reservoir description
- e. EOR incentives
- f. Field development scenarios
- g. Drilling results
- h. Field development facilities
- i. Project schedule
- j. Production results
- k. HSE & community development
- l. Abandonment
- m. Project economics
- n. Conclusion



PODs that are presented to the Minister (and therefore those that are for the development of oil or gas discoveries in the first field, as opposed to subsequent fields) must contain:

- a. supporting data and evaluation of Exploration;
- b. evaluation of the reserves;
- c. methods for drilling development wells;
- d. number and location of production and/or injection wells;
- e. production testing/well testing;
- f. pattern of extraction;
- g. estimated production;
- h. methods for lifting the production;
- i. production facilities;
- j. plans for use of the Oil and Gas;
- k. plans following operations, economics and state and regional revenues.

A POD revision could be performed in the following conditions:

- a. changes in the development scenario;
- b. significant changes to the oil and gas reserves compared to the initial POD submitted; and
- c. changes in the investment cost.

### 3.6.2 Authorisation for Expenditure (AFE)

As part of the BP Migas supervision and control over the execution of the PSCs each of the projects in an exploration and development phase should prepare an Authorisation for Expenditure (“AFE”) for BP Migas approval. For other projects BP Migas approval is required if budgeted expenditure is equal or greater than US\$ 500,000.

An AFE should include the following Information:

- a. project information in sufficient detail to allow for BP Migas analysis and evaluation;
- b. total budgeted costs; and
- c. total costs that have been incurred.

The time required for AFE approval, AFE revision and AFE close out is around 10-15 days although the process is considerably longer for complex and large project AFEs.

An AFE can be revised:

- a. twice before the project commences or before the tender has been awarded.
- b. where the project has commenced prior to reaching 50% of total expenditures and prior to reaching 70% of physical completion. Revisions should be made if the total AFE costs are projected to be over/under-run 10% or more and/or the individual AFE cost component is projected to be over/under-run more than 30%.

A sample AFE is provided at Appendix J Documentation.

#### 3.6.3 Work Program and Budget (WP&B)

The work Program and Budget (WP&B) is the proposal of a detailed action plan and annual budget in consideration of the condition, commitment, effectiveness and efficiency of the contractor's operations in a contract area. The WP&B covers the following:

- a. exploration (seismic & geological survey, drilling and G&G study), lead & prospect, exploration commitment;
- b. production and an effort to maintain its continuity:
  1. plan of development;
  2. intermittent drilling;
  3. production operations and work-overs;
  4. maintaining production; and
  5. EOR projects (Secondary Recovery & Tertiary Recovery).
- c. The costs allocated for those programs are as:
  1. exploration;
  2. development drilling & production facilities;
  3. production and operations; and
  4. general administration, exploration administration & overheads
- d. An estimation of:
  1. entitlement share;
  2. Gross Revenue, Oil & Gas Price, Cost Recovery, Indonesia Share, Contractor Share;
  3. Unit cost (US\$/Bbl);
  4. Direct Production Cost;
  5. Total Production Cost;
  6. Cost Recovery; and
  7. Status of unrecovered cost.

WP&B generally includes the following schedules:

- a. Financial Status Report;
- b. Key Operating Statistic;
- c. Expenses/Expenditures Summary;
- d. Exploration & Development Summary;
- e. Exploratory Drilling Expenditures;
- f. Development Drilling Expenditures;
- g. Miscellaneous Capital Expenditures;
- h. Production Expenses Summary;
- i. Production Facilities Capital Expenditures;
- j. Miscellaneous Production Capital Expenditures;
- k. Administration Expenses Summary;
- l. Administration Capital Expenditures;
- m. Capital Assets P.I.S. Old/New;
- n. Depreciation Old/New;
- o. Detailed Program Support Listing;
- p. Production/Lifting Forecast; and
- q. Budget Year Expenditures.

The WP&B proposal should be submitted to SKK Migas for approval three months before the start of each calendar year. Before SKK Migas grants approval some changes to the WP&B proposal may be requested. In granting approval for WP&Bs, SKK Migas follows GR 25/2004 Article 98 guidance which lists certain mandatory considerations such as: long-term plans; success in achieving activity targets; efforts to increase oil and gas reserves and production; technical activities and the viability of cost units; efficiency; field development plans previously approved; and manpower and environmental management.

Once approved, the contractor may revise the WP&B provided there is reasonable cause such as:

- a. the annual work plan turns out to be unrealistic; or
- b. the estimated cost departs enormously from the budget.

The proposed WP&B revision must be accompanied with the reason for the change. For urgent changes to an original annual WP&B revisions may be submitted to SKK Migas before June.

Generally the WP&B approval process takes around 22 working days although the process is considerably longer for complex and large WP&B.

A typical front page summary of WP&B is provided at Appendix J Documentation.

#### 3.6.4 Financial Quarterly Report (FQR)

On a quarterly basis an operator of a PSC area should submit its Financial Quarterly Report (FQR) to SKK Migas. The FQR primarily consists of a comparison between budgeted and actual revenue and expenditures. The FQR should be submitted to SKK Migas within a month of the end of the relevant quarter. A typical FQR consists of a summary front page with supporting schedules attached. An example of the FQR summary page is provided at Appendix J Documentation.

#### 3.6.5 Foreign Currency Report (FCR)

Based on Bank Indonesia Regulation No 4/2/PBI/2002 and subsequent revisions including the latest revisions in Stipulation Letter No 5/24/DSM dated October 3, 2003, non-financial institution companies (including oil and gas companies) with minimum assets of Rp.100 billion or annual gross sales greater than Rp.100 billion are required to report to the Bank of Indonesia (BI) their foreign currency transactions made with:

- a. overseas banks or overseas financial organisations; and/or
- b. other companies or offices domiciled outside of Indonesia. Companies that have overseas financial assets and liabilities are also required to produce BI reports.

The BI report consists of:

- a. a monthly foreign exchange transaction report for all the company's financial assets and/or liabilities in foreign currency (to be submitted within a month following the month in which the transaction occurs); and
- b. a half yearly report of the foreign currency financial assets and/or liabilities position for the period ended.

The BI reports are used by the Government to prepare the Payment Statistic Balance Sheet and Indonesia's International Investment Position.

The Government also recently issued decision letter KEP-0066/BP00000/2008/SO (KEP 0066) which requires PSC contractors to use a state-owned bank for both the vendor and payer's accounts with respect to payments for goods and services. Please see section 3.2.4 above for further details.



## *Downstream Sector*



This chapter covers the following topics:

- 4.1 the key regulations applicable to the downstream sector;
- 4.2 accounting issues in the downstream sector;
- 4.3 the taxation and customs issues for the downstream sector; and
- 4.4 commercial considerations.

## **4.1 Downstream Regulations**

Law No.22 formally liberalised the downstream market by opening the sector (processing, transportation, storage and trading) to direct foreign investment and ending the former monopoly of state-owned oil and gas company PT Pertamina (Persero). Whilst the distribution of downstream products and blending of lubricants had previously been conducted by multinationals in Indonesia, since Law No.22 was enacted many domestic and multinational companies have established themselves in the more capital intensive areas of the downstream sector. These areas include:

- a. tank farms/storage facilities for bulk liquids and LPG;
- b. the distribution of gas by way of pipelines (Citigas and long distance pipelines);
- c. proposed refineries and downstream LNG;
- d. LNG regasification terminals; and
- e. the retailing of fuel (both subsidised<sup>5</sup> and non-subsidised).

A summary of the key section of the downstream regulations as provided for in Law No.22 and its implementing regulations GR 36/2004. Please see Appendix A for an English translation of GR 36/2004.

### **4.1.1 Operation and Supervision of Downstream Business**

Downstream businesses are required to operate through an Indonesian incorporated entity (hereafter referred to as a PT Company) and to have obtained a business licence (issued by the MoEMR/the Government, with input from BPH Migas). As indicated in chapter 2 Regulatory Framework, BPH Migas is responsible for regulating, developing and supervising the operation of the downstream industry.

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5 As at 2014 only a limited number of licences had been issued for this activity.

### 4.1.2 Business Licences

A separate business licence is required for each of the following downstream activities (except where the activity is the continuation of an upstream activity in which case a licence is not required):

- a. processing (excluding field processing);
- b. transportation;
- c. storage; and
- d. trading (two types of business licences are required – a wholesale trading business licence; and a trading business licence).

It is permissible for one PT Company to hold multiple business licences.

Each business licence, managed by MoEMR with input from BPH Migas, stipulates obligations and technical requirements that the licensee must abide by.

To obtain a business licence, a PT Company must submit an application to the MoEMR by enclosing administrative and technical requirements which contain, at a minimum, the:

- a. name of operator;
- b. line of business proposed;
- c. undertaking to comply with operational procedure; and
- d. detailed plan and technical requirements relating to the business.

The business licenses are issued in two stages:

- a. a temporary licence for a maximum period of five years whilst the PT Company prepares the facilities and infrastructure of the business; and
- b. a permanent operating licence once the PT Company is ready for operation.

### 4.1.3 Processing

A PT Company holding a processing business licence must submit to the MoEMR and BPH Migas operational reports, an annual plan, monthly realisations, and other reports.

The processing of oil, gas and/or processing output to produce lubricants and petrochemicals are to be stipulated and operated jointly by the MoEMR and the Ministry of Trade (MoT).



### **Non-integrated gas supply chain**

Processing of gas into Liquefied Natural Gas (LNG), Liquefied Petroleum Gas (LPG), and Gas To Liquids (GTL) is classified as a downstream business activity as long as it is intended to realise a profit and is not secondary to an upstream development.

This technically allows for a non-integrated LNG/LPG supply chain concept by virtue of:

- a. enabling PSC Contractors to be the appointed seller of gas (including Government share) to be further processed by a separate entity;
- b. shorter LNG supply arrangements; and
- c. the possible use of an onshore project company sponsored by a shareholder agreement which receives initial funds for the development and operation of a LNG processing plant.

In practice, downstream LNG and mini LNG refineries have been impacted by a multitude of regulatory issues, including a change in the VAT treatment of LNG, and concerns over the adequacy of domestic gas supply.

#### **4.1.4 Transportation**

Transportation of gas by pipelines via a transmission segment or a distribution network area is permitted only with the approval of BPH Migas with licences being granted only for specific pipelines/commercial regions.

A PT Company with a transportation business licence is required to:

- a. submit monthly operational reports to the MoEMR and BPH Migas;
- b. prioritise use of transportation facilities owned by cooperatives, small enterprises and national private enterprises when using land transportation;
- c. provide an opportunity to other parties to share utilisation of its pipelines and other facilities used for the transportation of gas; and
- d. comply with the Master Plan for a National Gas Transmission and Distribution Network.

BPH Migas has the authority to:

- a. regulate, designate, and supervise tariffs after considering the economic considerations of the PT Company, users and consumers; and
- b. grant permits for the transportation of gas by pipelines to a PT Company based on the Master Plan for a National Gas Transmission and Distribution Network.

A PT Company may increase the capacity of its facilities and means of transportation after obtaining special permission.

### 4.1.5 Storage

A PT Company is required to:

- a. submit its operational reports to the MoEMR each quarter or as and when requested by BPH Migas;
- b. provide an opportunity to another party to share in its storage facilities;
- c. share storage facilities in remote areas; and
- d. have a licence to store LNG.

A PT Company can increase the capacity of its storage and related facilities after obtaining permission from BPH Migas.

Transportation or storage activities that are intended to make a profit, or be used jointly with another party by collecting fees or lease rentals, are construed as downstream business activities and require the appropriate downstream business licence and permits.

### 4.1.6 Trading

A PT Company must guarantee the following when operating a trading business:

- a. the constant availability of fuels and processing output in its trade distribution network;
- b. the constant availability of gas through pipelines in its trade distribution network;
- c. the selling prices of fuels and processing output at a fair rate;
- d. the availability of adequate trade facilities;
- e. the standard and quality of fuels and processing output as determined by the MoEMR;
- f. the accuracy of the measurement system used; and
- g. the use of qualified technology.

A PT Company is required to:

- a. submit monthly operational reports to the MoEMR or at any time as required by BPH Migas;
- b. maintain facilities and means of storage and security of supply from domestic and foreign sources;
- c. distribute fuels through a distributor, to small-scale users under the Company's authorised trademark;

- d. prioritise cooperatives, small enterprises and national private enterprises when appointing a distributor; and
- e. submit operational reports to the MoEMR and BPH Migas regarding appointment of distributors.

A PT Company holding a wholesale trading licence can operate a trading business to serve certain consumers (e.g. large consumers). The MoEMR, along with BPH Migas, may determine the minimum capacity limit of a storage facility or facilities of a PT Company. The PT Company may start its trading business after fulfilling the required minimum capacity.

A direct user who has a seaport or receiving terminal may import fuel oil, gas, other fuels, and process the output directly for its own use, but not for re-sale, after obtaining specific approval from the MoEMR.

A PT Company operating an LPG trading business is required to:

- a. control facilities and means of storage and bottling of LPG;
- b. have a registered trademark; and
- c. be responsible for maintaining a high standard and quality of LPG, LPG bottling, and LPG facilities.

PT Companies operating in the business of gas trading may include those having a gas distribution network facility and those who do not. The former should operate after obtaining a licence to trade gas and special permission for a Distribution Network Area. The latter may only be implemented through a distribution network facility of a PT Company that has obtained access to a Distribution Network Area and after obtaining a licence to trade gas.

The MoEMR has the authority to determine and set technical standards of gas, and also minimum technical standards for distribution and facilities.

#### **4.1.7 National Fuel Oil Reserve**

The MoEMR is responsible for stipulating policy on the quantity and type of national fuel oil reserve and may appoint a PT Company to contribute to building this reserve. The national fuel oil reserve is determined and supervised by BPH Migas. The reserve can only be used when there is a scarcity of fuel oil, and once the scarcity is resolved, the reserve must be returned to its original position.

### 4.1.8 Standard and Quality

The MoEMR sets the type, standard and quality of fuel oil, gas, other fuels, and certain processed products that are marketed domestically. In determining the quality standards, the MoEMR reviews the technology to be applied, the capacity of the producer, the consumer's financial position, safety, health, and environmental standards.

A PT Company operating as a processing business must have an accredited laboratory to perform tests on the quality of the processing output. Likewise, a PT Company operating a storage business, which does blending to produce fuel oil, must provide a testing facility on the quality of the blending output. If the PT Company is unable to provide a self-owned laboratory, it is allowed to use an accredited laboratory facility owned by another party.

Fuel oil, gas, and processing output in the form of finished products, which are imported or directly marketed domestically, must comply with the quality standards determined by the MoEMR. For fuels and processing output that are exported, a producer may determine the standard and quality based on the buyer's request. Fuels and processing output specially requested must report their determined standard and quality to the MoEMR.

### 4.1.9 Availability and Distribution of Certain Types of Fuel Oil

To guarantee the availability and distribution of certain types of fuel oil, a trading business at the moment is unable to operate in a fully fair and transparent market.

The MoEMR has the authority to designate areas of trading certain types of fuel oil domestically. This may include trading fuel oil where:

- a. the market mechanism has been effective;
- b. the market mechanism has been ineffective; or
- c. the market is located in a remote area.

BPH Migas has the authority to:

- a. designate a trade distribution area for certain types of fuel oil for corporate bodies holding a trading business licence; and
- b. determine joint usage of transportation and storage facilities, particularly in areas where the market mechanism is not yet fully effective or remote areas.
- c. If necessary, the Government, with input from BPH Migas, may determine the retail price for certain types of fuel oil by calculating its economic value.

A PT Company holding a wholesale trading business licence that trades certain types of fuel oil to transportation users or trades kerosene for household and small enterprises, must provide the distributor it has appointed with opportunities. The distributor includes cooperatives, small enterprises, and/or national private enterprises contracted with the PT Company. The distributor may only distribute the trademark fuel oil of the corporate body. The PT Company must report to BPH Migas and the MoEMR the name of its distributor.

### **4.1.10 Occupational Health and Safety, Environmental Management, and Development of the Local Community**

PT Companies operating with a downstream business licence must comply with provisions relating to occupational health and safety, the environment, and the development of local communities. This responsibility includes developing and utilizing the local community through, amongst other things, local employment. Such development must be implemented in coordination with the regional government and priority given around the area of operation.

### **4.1.11 Utilisation of Local Goods, Services, Engineering and Design Capacity and Workforce**

PT Companies operating with a downstream business licence must prioritise the utilisation of local goods, tools, services, technology, and engineering and design capacity.

In fulfilling labour requirements, a downstream PT Company must prioritise the employment of Indonesian workers according to required competency standards. Where Indonesian workers do not meet the required standards of competence and occupational qualifications, the PT Company must arrange for training and development programs to improve those workers' capacity.

### **4.1.12 Sanctions**

BPH Migas has the power to determine and impose sanctions relating to a PT Company's breach of its business licence. Sanctions increase whilst the breach remains unremedied and include a written reminder, suspension of the business, freezing of the business, and finally, annulment of the business licence. All damages arising out of any sanction must be borne by the respective Corporate bodies.

Any person or company who operates a business without a licence will be penalised. Duplication or falsification of fuels or processing output; or any misuse of transportation or trading of subsidised fuel carries with it a maximum penalty of six years imprisonment and Rp60 billion fine.

4.2 Downstream Accounting

Unlike the upstream sector, there are not many specific accounting standards promulgated for downstream oil and gas businesses. Instead, generally accepted accounting standards usually apply. The table below shows some of the key standards and differences specifically relating to downstream oil and gas companies under US GAAP and IFRS. Currently, Indonesian Financial Accounting Standards does not significantly differ from IFRS.

Accounting in Downstream Oil and Gas

A general comparison between US GAAP and IFRS		
Area	US GAAP	IFRS
Property, Plant and Equipment	<p>US GAAP utilises historical cost and prohibits revaluations. US GAAP generally does not require the component approach for depreciation.</p> <p>While it would generally be expected that the appropriateness of significant assumptions within the financial statements would be reassessed each reporting period, there is no explicit requirement for an annual review of residual values.</p>	<p>Historical cost is the primary basis of accounting. However, IFRS permits the revaluation to fair value of property, plant and equipment.</p> <p>IFRS requires that separate significant components of property, plant, and equipment with different economic lives be recorded and depreciated separately.</p> <p>The guidance includes a requirement to review residual values and useful lives at each balance sheet date.</p>

## Accounting in Downstream Oil and Gas

A general comparison between US GAAP and IFRS		
Area	US GAAP	IFRS
Impairment of long-lived assets held for use.	Impairment is a two-step approach. Impairment is assessed on undiscounted cash flows. If less than carrying amount, measure impairment loss as the amount by which the carrying amount exceeds fair value. Reversals of losses prohibited.	Impairment is a one-step approach under IFRS and is assessed on the basis of the excess of the asset's carrying amount over its recoverable amount. If impairment indicated, write down assets to higher of fair value less costs to sell and value in use future cash flows discounted to present value. Reversals of losses required in certain circumstances, except for goodwill.
Base inventories/linefill – cushion gas and line pack gas	Similar to IFRS	The cost of cushion gas and line pack gas are capitalised and depreciated over the useful life of the PP&E, as they meet the definition of PP&E.
Inventory	Carry at the lower of cost or market. Market is the current replacement cost; however, the replacement cost cannot be greater than the net realizable value or less than net realizable value reduced by a normal sales margin. Use of LIFO is permitted.  Reversal of write-down is prohibited.	Carry at lower of cost and net realisable value. Use FIFO or weighted average method to determine cost. LIFO prohibited. Reversal is required for subsequent increase in value of previous write-downs limited to the amount of the original write-downs.

Accounting in Downstream Oil and Gas

A general comparison between US GAAP and IFRS		
Area	US GAAP	IFRS
Revenue recognition - General	<p>Revenue recognition guidance is extensive and includes a significant volume of literature issued by various US standard setters.</p> <p>Generally, the guidance focuses on revenue being (1) either realized or realizable and (2) earned. Revenue recognition is considered to involve an exchange transaction; that is, revenue should not be recognized until an exchange transaction has occurred.</p>	<p>Two primary revenue standards capture all revenue transactions within one of fourbroad categories:</p> <ul style="list-style-type: none"><li>• Sale of goods</li><li>• Rendering of services</li><li>• Others' use of an entity's assets (yielding interest, royalties, etc.)</li><li>• Construction contracts</li></ul> <p>Revenue recognition criteria for each of these categories include the probability that the economic benefits associated with the transaction will flow to the entity and that the revenue and costs can be measured reliably. Additional recognition criteria apply within each broad category. The principles laid out within each of the categories are generally to be applied without significant further rules and/or exceptions.</p>
Producer gas imbalances	US GAAP permits a choice of the sales/liftings method or the entitlement methods for revenue recognition	Revenue is recognised in imbalances situation on an entitlement basis.



## Accounting in Downstream Oil and Gas

A general comparison between US GAAP and IFRS		
Area	US GAAP	IFRS
Buy-sell arrangement	Similar to IFRS	<p>These arrangements are often entered to save transportation costs by exchanging a quantity of product A in location X for a quantity of product A in location Y.</p> <p>The nature of the exchange will determine if it is a like-for-like exchange or an exchange of dissimilar goods. A like-for-like exchange does not give rise to revenue recognition or gains. An exchange of dissimilar goods results in revenue recognition and gains or losses.</p>
Derivatives	Similar to IFRS, however, differences can arise in the detailed application.	<p>Derivatives not qualifying for hedge accounting are measured at fair value with changes in fair value recognised in the income statement.</p> <p>Hedge accounting is permitted provided that certain stringent qualifying criteria are met.</p>

Accounting in Downstream Oil and Gas

A general comparison between US GAAP and IFRS		
Area	US GAAP	IFRS
Determin-ation of functional currency	There is no hierarchy of indicators to determine the functional currency of an entity. In those instances in which the indicators are mixed and the functional currency is not obvious, management’s judgment is required so as to determine the currency that most faithfully portrays the primary economic environment of the entity’s operations.	Primary and secondary indicators should be considered in the determination of the functional currency of an entity. If indicators are mixed and the functional currency is not obvious, management should use its judgment to determine the functional currency that most faithfully represents the economic results of the entity’s operations by focusing on the currency of the economy that determines the pricing of transactions (not the currency in which transactions are denominated).
Joint Arrange-ment/ Joint Venture	Equity method is required except in specific circumstances. Proportionate consolidation is generally not permitted except for unincorporated entities operating in certain industries.	IFRS reduces the types of joint arrangements to joint operations and joint ventures, and prohibits the use of proportional consolidation.

## Accounting in Downstream Oil and Gas

A general comparison between US GAAP and IFRS		
Area	US GAAP	IFRS
Costs of a major overhaul	Multiple accounting models have evolved in practice, including: expense costs as incurred, capitalise costs and amortise over the period benefited from the overhaul, or follow the IFRS approach.	<p>Costs related to major inspection and overhaul are recognised as part of the carrying amount of PP&amp;E if they meet the asset recognition criteria in IAS 16. The major overhaul component will then be depreciated over its useful life (i.e., over the period to the next overhaul) and any remaining carrying amount will be derecognised when the next overhaul is performed. The replaced components are derecognised. No accrual of future overhaul costs is allowed.</p> <p>Costs of the day-to-day servicing of the asset (i.e., routine maintenance) are expensed as incurred.</p>

Accounting in Downstream Oil and Gas

A general comparison between US GAAP and IFRS		
Area	US GAAP	IFRS
Asset retirement obligations (ARO)	ARO is recorded at fair value, and is based upon the legal obligation that arises as a result of an acquisition, construction, or development of a long-lived asset.	IFRS requires that management's best estimate of the costs of dismantling and removing the item or restoring the site on which it is located be recorded when an obligation exists. The estimate is to be based on a present obligation (legal or constructive) that arises as a result of the acquisition, construction or development of a long-lived asset.

## Accounting in Downstream Oil and Gas

A general comparison between US GAAP and IFRS		
Area	US GAAP	IFRS
Asset retirement obligations (ARO) <i>continued</i>	<p>The use of a credit-adjusted, risk-free rate is required for discounting purposes when an expected present-value technique is used for estimating the fair value of the liability. The guidance also requires an entity to measure changes in the liability for an ARO due to passage of time by applying an interest method of allocation to the amount of the liability at the beginning of the period. The interest rate used for measuring that change would be the credit-adjusted, risk-free rate that existed when the liability, or portion thereof, was initially measured.</p> <p>In addition, changes to the undiscounted cash flows are recognised as an increase or a decrease in both the liability for an ARO and the related asset retirement cost.</p>	<p>If it is not clear whether a present obligation exists, the entity may evaluate the evidence under a more-likely-than-not threshold. This threshold is evaluated in relation to the likelihood of settling the obligation.</p> <p>The guidance uses a pretax discount rate that reflects current market assessments of the time value of money and the risks specific to the liability.</p> <p>Changes in the measurement of an existing decommissioning, restoration or similar liability that result from changes in the estimated timing or amount of the cash outflows or other resources or a change in the discount rate adjust the carrying value of the related asset under the cost model. Adjustments may not increase the carrying amount of an asset beyond its recoverable amount or reduce it to a negative value. The periodic unwinding of the discount is recognised in profit or loss as a finance cost as it occurs.</p>

Accounting in Downstream Oil and Gas

A general comparison between US GAAP and IFRS		
Area	US GAAP	IFRS
Asset retirement obligations (ARO) <i>continued</i>	Upward revisions are discounted by using the current credit-adjusted, risk-free rate. Downward revisions are discounted by using the credit-adjusted, risk-free rate that existed when the original liability was recognised. If an entity cannot identify the prior period to which the downward revision relates, it may use a weighted-average, credit-adjusted, risk-free rate to discount the downward revision to estimated future cash flows.	
Take-or-pay arrangement	Similar to IFRS	Where take-or-pay payments are received which provide a right for the payer to take additional volumes at some point in the future, the receipt is accounted for as a liability rather than as revenue until such time as the delivery of obligation is fulfilled, or lapses.

## 4.3 Taxation and Customs

### 4.3.1 General Overview

Goods and services supplied by downstream operators, contractors and their businesses are generally subject to taxes under the general tax law. Please see our annual publication, the PwC Pocket Tax Guide, which can be found at <http://www.pwc.com/id>, for more detail. Most downstream entities pay taxes in accordance with the prevailing law, although some activities can be subject to different withholding tax arrangements and a final tax arrangement.

Practical tax issues to be considered before making any significant investment include:

- a. any potential tax incentives available for the proposed investment;
- b. whether a PE exists in Indonesia (in addition to the establishment of a subsidiary) either as part of the proposed investment or prior to the new investment;
- c. the import taxes and duties obligations, especially within the transportation and storage industry;
- d. the corporate income tax treatment on the revenue stream noting that there could be a different income tax treatment according to the nature of the transaction;
- e. ensuring that contracts specifically cater for the imposition of WHT and VAT, i.e. the use of net versus gross contracts;
- f. structuring inter-group transactions and agreements to accommodate the WHT and VAT implications and any transfer pricing issues that may arise (for example, inventory supplies and/or offtake, management fees, financing, etc.); and
- g. structuring certain contracts to minimise VAT and WHT implications.

From a customs perspective the risks in structuring investments include:

- a. royalties – Customs (the DGoCE) pursuing duty on royalty payments during customs' audits;
- b. transfer pricing adjustments - multi-nationals making year-end adjustments. The DGoCE could charge duty on any additional payments, and ignore any credits received by the importer;
- c. arrangements with no sale to the importer – examples include leased goods, warranty replacement, imports by branches, ship to A / sell to B. At best, there is a compliance burden in determining the alternative basis of customs value. At worst, the duty liability may increase significantly;

- d. inventory control in Customs Facilities - Companies using customs facilities may have problems in accounting for the physical inventory as compared to the bookkeeping records; and
- e. transfer of fixed assets under Customs Facilities - the exempted duties may have to be paid, where the company does not follow the proper procedures.

#### 4.3.2 Tax Incentives

Tax incentives are available within the downstream sector in the following areas:

##### Tax holiday for pioneer investors

GR No.94/2010 provides an Income Tax exemption (of 5-10 years from the start of production) and 50% rate reduction (for the period of two years after the end of the Income Tax exemption period) to companies in pioneer industries. These are defined as being “industries that have extensive links, give additional value and high externality, introduce new technologies and have strategic value for the country’s economy.” Within the energy sector the MoF has stated that oil refineries and/or base organic chemicals sourced from oil and gas constitute such industries.

In order to be eligible, the corporate taxpayer (Indonesian legal entity established after 15 August 2011) should also have a legalised new capital investment plan of a minimum of Rp 1 trillion (approximately USD 120m) and deposit a minimum of 10% of their planned investment value in banks located in Indonesia. This is subject to the provision that the deposit will not be withdrawn prior to the realisation of the investment plan.

Notwithstanding the above, the MoF may grant the tax facilities for a period longer than the determined timeline based on similar considerations to those for determining pioneer industries.

Note that this concession effectively expires on 14 August 2014 as applications must be lodged within three years of the GR being issued (under implementing regulation PMK 130/2011). At the time of writing the GoI was believed to be reconsidering the above incentive.



### Integrated Development Economic Zones (KAPET)

Companies conducting business in an Integrated Economic Development Zone (*Kawasan Pengembangan Ekonomi Terpadu*/KAPET) may enjoy tax facilities. The designation of an area as a KAPET is set out in a specific presidential decree. Currently there are 13 areas designated as KAPETs.

The tax facilities are as follows:

- Non-collection of VAT and LST on certain luxury goods transactions;
- Exemption from prepaid income tax on the importation of capital goods and other equipment (Article 22) directly related to production activities;
- Postponement of import duty on capital goods and equipment, and goods and materials for processing;
- Exemption from import duty for four years on machinery and certain spare parts.

### **Investment Law No.25/2007; GR 1/2007 (GR No.1); GR 62/2008 (GR No.62, as amended by GR No.52): Capital investment in certain business sectors and/or in certain regions.**

Investment Law No.25/2007 introduced tax and customs facilities for certain qualifying investments. For example, investments in an oil refinery, mini LNG refinery, or manufacturing organic-based chemical substances coming from petroleum and natural gas.

Government Regulation No.1/2007 (GR No.1) provides the tax incentives proposed by Law No.25. They are identical to the predecessor KAPET rules, but the GR No.1 incentives are not entirely limited according to geography. As with the KAPET rules, GR No.1 provides for an “investment credit” (i.e. at 30% of qualifying spending), accelerated depreciation/amortisation, reduced withholding tax rates and an extended tax loss carried forward period. The incentives must be applied for through the Investment Coordination Board (BKPM) and will involve Tax Office recommendations.

GR 62/2008 (effective 23 September 2008) amended GR No.1 by expanding the number of qualifying industries to now include coal gasification, the “conversion” of geothermal energy into electric power, certain gas to LNG/LPG processing activities, and hydrocarbon refining activities.

#### 4. Downstream Sector

GR 52/2011 further provides that incentives will be available in the key sectors of electric power generation (for new and renewable energy), LNG regasification using a Floating, Storage and Regasification Unit (FSRU) and certain metal refining activities and water distribution, amongst others.

The following tables are an extract of the energy sectors identified in GR 52 which are eligible for the Income Tax facilities pursuant to GR 52 (and GR 1).

##### Industries previously included in GR1, as amended by GR 62 and repeated in GR 52

Business Field	Scope of Products	Requirements
Natural Oil Refinery Industry	Refinery of natural oil which produces gas/LPG, avtur, avigas, naphtha, diesel fuel, kerosene, diesel oil, fuel oil, lubricant, waz, solvent, residue and asphalt	Priority to meet local demands
Natural Gas Refinery and Processing Industry	Refinery and processing of natural gas into LNG and LPG	

##### Industries previously included in GR 1 with new additional requirements stipulated under GR 52

Business Field	Scope of Products	Requirements
Lubricant Manufacturing Industry	All scope of products included within the relevant Lubricants business code (KBLI)	Investment $\geq$ Rp600 billion  Employees $\geq$ 100 people
Oil, Natural Gas and Coal Originated Organic Base Chemical Industry	<ul style="list-style-type: none"><li>- Olefin upstream group: ethylene, propylene, butadiene, butane, raffinate</li><li>- Aromatic upstream group: paraxylene, benzene, toluene, orthoxylene</li><li>- C1 upstream group: methanol, ammonia</li><li>- Others: black carbon</li></ul>	Investment $\geq$ Rp 900 billion  Employees $\geq$ 100 people

### New industries included under GR 52 without regional limitation

Business Field	Scope of Products	Requirements
Electric Power Generation	Conversion of new energy (hydrogen, CBM, liquefied coal or gasified coal) and renewable energy (hydropower and energy of falling water; solar energy, wind energy or ocean current energy) into electricity.	None
Natural and Artificial Gas Supply	Regasification of LNG into gas using a Floating Storage Regasification Unit (FSRU Coalbed Methane (Non PSC), shale gas, tight gas sand and methane hydrate.	None

### Bonded Zones

Bonded zone (*Kawasan Berikat*/KB) facility is provided to companies producing finished goods which are mainly for export, with a domestic sales quota of 50% of the previous year export realisation value and/or sales value to other Bonded Zones.

The facility essentially exempts imported capital equipment and raw materials from import duty and other import taxes (i.e., VAT, LST and Article 22 Income Tax).

### Free Trade Zone (FTZ) in Batam, Bintan and Karimun

Goods entered into and goods delivered amongst companies inside Free Trade Zone/FTZ (*Kawasan Perdagangan Bebas*/KPB) may enjoy tax facility.

Some administrative requirements in FTZ are:

- business license from the Management Board of FTZ (*Badan Pengusahaan Kawasan*/BPK);
- the imported goods must be in line with the business license;
- customs procedure (including customs audit, customs penalties) are applicable in FTZ;
- no requirement to be registered as a Taxable Enterprise (*Pengusaha Kena Pajak*/PKP) for VAT purposes.

The goods entered into and delivered amongst companies inside FTZ are exempted from import duty and excise. In addition, the import taxes (i.e., VAT, LST and Article 22 Income Tax) are not collected.

Transactions of intangible goods and taxable services are exempted from VAT, except for those delivered to other Indonesia Customs area and Bonded Zone companies.

When goods exit from FTZ to other Indonesia Customs area the liable import duty and import taxes should be paid.

#### 4.3.3 Taxation on Downstream Investments with Pertamina

Some investments in cooperation with Pertamina or its affiliates occur by way of a joint operation (JO). Typically a JO does not involve an incorporated entity. Invoicing and the day-to-day operations of the JO will be governed by the associated JOA.

From a tax perspective, a JO does not constitute a tax subject. Therefore, joint operations are not obliged to submit tax returns or pay Article 25 or Article 29 income tax. The only obligations are as withholders/collectors of Article 21 (employee WHT), Article 23 and Article 26 Income Taxes (i.e. WHT on the fees of service providers). Taxable entrepreneurs must also levy VAT.

Article 22 Income Tax that has been collected by another party can be credited against income tax owed by the individual members of a JO by way of an overbooking.

JO's are not a commonly used investment vehicle and in recent joint investments with Pertamina most are as incorporated joint ventures.

#### 4.3.4 Taxation on the Sale of Fuel, Gas and Lubricants by Importers and Manufacturers

The taxation on the sale of fuel, gas and lubricants by importers and manufacturers are regulated under MoF Regulation No. 154/PMK.03/2010 as lastly amended by MoF Regulation No. 175/PMK.011/2013 (PMK-154). PMK-154 requires importers and manufacturers to collect Article 22 WHT from the sale of fuel, gas and lubricants. Below are Article 22 WHT tariffs for such sales:

Definition	Rate	Sale to	
		Agent/ Distributor	Non-Agent/ Non- Distributor
<b>Fuel</b>			
Sale to Pertamina Gas Station	0.25%	Final	Non-Final
Sale to non - Pertamina Gas Station	0.3%	Final	Non-Final
Sale other than the above	0.3%	Final	Non-Final
<b>Gas</b>	0.3%	Final	Non-Final
<b>Lubricants</b>	0.3%	Final	Non-Final

### VAT on Commercial Sales

The producer/importer is regarded as a taxable entrepreneur with general VAT rules applying. The sale is therefore subject to a 10% VAT. Generally, the producer/importer adds VAT to its sales which are then creditable to the purchaser. Onward sales would be subject to VAT.

#### 4.3.5 Import Duties

### Import Duty on Petroleum

Crude oils are classified under HS 27.09 (which covers *Petroleum oils and oils obtained from bituminous minerals, crude*). Both the general import duty rate and the ASEAN Trade in Goods Agreement (ATIGA) rate (for goods of ASEAN origin) for crude oil are 0%.

Refined oil products are potentially classifiable under HS 27.10, which covers

*“Petroleum oils and oils obtained from bituminous minerals, other than crude; preparations not elsewhere specified or included, containing by weight 70% or more of petroleum oils or of oils obtained from bituminous minerals, these oils being the basic constituents of the preparations; waste oils”.*

## 4. Downstream Sector

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The general import duty rate ranges from 0% to 5%, depending on the specific product. The ATIGA duty rate is 0%.

Natural gas is classifiable under HS 27.11, which covers “*Petroleum gases and other gaseous hydrocarbons*”. The general import duty rate ranges from 0% to 5%. The ATIGA rate is 0%.

### Import Duty on Fuel

For input duty on fuel, regard should be had to the 2012 Indonesian Customs tariff book under MoF Regulation No.213/PMK/OI/2011. The HS codes have been changed to:

- 2710.12, which has 0% import duty in general and for the ATIGA duty rate;
- 2710.19, which has general import duty rate in the range of 0% to 5% and 0% for ATIGA.

In addition, importation of fuel is subject to a 2.5% or 7.5% Article 22 Income tax (treated as a prepaid tax to be credited against the annual corporate Income Tax) and a 10% Import VAT (which is creditable against Output VAT).

#### 4.3.6 VAT Facility on Bio-Fuel

VAT on the domestic sale of bio-fuels is borne by the Government. This facility is budgeted up to a VAT amount of Rp180 billion. The seller (including the producers, distributors, agents or retailers) are still required to issue a VAT invoice stamped with “VALUE ADDED TAX BORNE BY THE GOVERNMENT .....

#### 4.3.7 Royalty on Fuel Oil Supply and Distribution and Transmission of Natural Gas through Pipelines.

##### General

A PT Company must pay a royalty to BPH Migas where it:

- a. carries out the supply and distribution of fuel oil and/or transmission of natural gas through pipeline; and
- b. owns a Natural Gas Distribution network facilities operating at the Distribution Network Area and/or Transmission Section.

The Natural Gas Distribution Area/Transmission Section is defined as an area/section of the Natural Gas Distribution Network/Transmission Pipeline which is part of the Master Plan of the National Natural Gas Transmission and Distribution Network.

Companies that must pay a royalty on the supply and distribution of fuel oil are:

- a. PT Companies holding a fuel oil wholesale trading business licence;
- b. PT Companies holding a fuel oil limited trading business licence; and
- c. PT Companies holding a processing business licence that produces the fuel oil and supplies and distributes the fuel oil and/or trades fuel oil as an extension of the processing business.

Companies that must pay a royalty on transmitting Natural Gas are:

- a. PT Companies holding the Natural Gas Transmission through Pipeline business licence at the Transmission Section and/or Distribution Network Area that has owned the special right; and
- b. PT Companies holding the Natural Gas Trading business licence that own the special right and distribution network facilities at the distribution network area.

### Tariff

The royalty must be settled on a monthly basis and is calculated as follows:

Volume Level per Annum	Percentage Amount
<b>Fuel Oil Sales</b>	
- Up to 25 million kilolitres	0.3% of the selling price
- 25 million - 50 million kilolitres	0.2% of the selling price
- > 50 million kilolitres	0.1% of the selling price
<b>Gas Transmission</b>	
- Up to 100 billion Standard Cubic Feet	3% transmission tariff per one thousand Standard Cubic Feet
- > 100 billion Standard Cubic Feet	2% transmission tariff per one thousand Standard Cubic Feet

### Sanctions

Any late payment of royalties is subject to a 2% penalty.

BPH Migas will issue a warning letter if the late payment reaches 3 months and if the royalty is not paid within 30 days of this letter, BPH Migas may ultimately revoke the right over the Trade Distribution Area for Fuel Oil or the Special Right of the company.

4.4 Commercial Considerations

When reviewing a potential downstream asset, investors should consider the following issues:

Topics	Issues
Land rights	<ul style="list-style-type: none"><li>• The land where a pipeline is located may not be acquired/ owned.</li><li>• The process of land registration is time consuming and subject to Government regulation.</li><li>• Land ownership may be disputed and/or overlap with Government protected forest area or with other businesses' concession rights (e.g. timber, plantation or mining).</li><li>• Any land and building right transfer attracts a duty of 5% of the land value.</li></ul>
Valuation of underlying fixed assets and inventory	<ul style="list-style-type: none"><li>• Asset costs may be subject to mark-up.</li><li>• Equipment may not be in good condition; hence the net book value may not reflect its market value.</li><li>• The underlying assets may not have been formally verified. Lack of fixed asset and physical inventory verification increases the risk of non-existence.</li><li>• Special accounting rules apply for turnaround costs.</li><li>• There could be contractual or legal obligations for Asset Retirement.</li><li>• Asset validity (including any assets pledged as collateral) may need to be verified.</li><li>• The deductibility of shareholders' expenditure (e.g. feasibility study, etc.) incurred before the establishment of the project company may be scrutinised by the DGT.</li><li>• Unutilised tax depreciation expenses for fixed assets may exist if the project life is less than the tax useful life.</li></ul>



Topics	Issues
Underlying regulations and permits	<ul style="list-style-type: none"> <li>• Some of the downstream related regulations, especially those in relation to the right of access, taxation and tariff structure, are in a transition stage.</li> <li>• There are no customs regulations supporting storage activities. There could be import taxes and duties leakage especially for liquid products.</li> <li>• The requirement to share storage facilities needs to be defined in more detail.</li> <li>• The guarantee by a trading business to have a product constantly available for the distribution network needs to be defined to ensure optimal inventory management.</li> <li>• The requirement to supply to remote areas needs to be clarified.</li> </ul>
Stand-by Letters of Credit	<ul style="list-style-type: none"> <li>• There is a potential exposure to non-payment by a customer if there are no stand-by letters of credit or other credit protection in place.</li> </ul>
Contractual Commitments	<ul style="list-style-type: none"> <li>• Investors need to assess the impact of the following on their deals: <ul style="list-style-type: none"> <li>- Gas Sales and Supply Agreements.</li> <li>- Gas Transportation Agreements.</li> <li>- Take-or-Pay obligations.</li> <li>- Ship-or-Pay Arrangements (including the deferred revenue impact and the correct taxation treatment).</li> <li>- Potential liquidated damages and other exposures (upsides and downsides).</li> <li>- The cash waterfall mechanism.</li> <li>- Avenues for recourse against Contractors.</li> <li>- Line-pack gas - treatment, exposures and accounting.</li> <li>- Make-up gas - treatment, exposures and accounting.</li> <li>- Guaranteed product supply (contract, other arrangements, etc.).</li> <li>- Related party transactions.</li> </ul> </li> </ul>

Topics	Issues
Government relationship	<ul style="list-style-type: none"> <li>• The Government may intend to control refineries as in the past.</li> <li>• Restrictions on the further issue of capital/transfers of shares for a certain period of time may be applicable.</li> <li>• The Government usually keeps the right for first refusal, as well as a “tag along” right, on any future sale.</li> <li>• The requirement to pledge shareholding to the Government to secure performance may need to be considered.</li> <li>• The form and content of reports to be filed with the MoEMR and regulatory body needs to be understood.</li> <li>• Further guidance is needed on how private investors will work with the Government in maintaining national strategic oil and fuel oil reserves.</li> <li>• Further guidance is required on how investors may set pricing and how any subsidy will be paid to investors until such time that the Government fuel subsidy is fully removed.</li> <li>• The designation of trading areas and the requirement to market product in remote areas needs further elaboration.</li> <li>• The requirement to distribute to remote areas needs to be further defined.</li> <li>• Expectations of the Regulator’s and the Government’s role in the short, medium and long term needs to be understood.</li> <li>• Product pricing restrictions may be applicable in some areas based on prevailing GRs.</li> </ul>
Associated Products	<ul style="list-style-type: none"> <li>• Later generation PSCs promote Contractors developing associated products from its petroleum operations. Questions remain on whether earnings from the sale of the associated products will be creditable to operating costs (treated as by products under GR 79 and credited against cost recovery) or treated as profit oil and gas. Commercial feasibility and profitability of additional product development is subject to a proper review and analysis.</li> </ul>

Topics	Issues
Profitability	<ul style="list-style-type: none"> <li>• Future operations could be subject to volatility in the supply and price of key inputs (other than feed stock), e.g. electricity, water, etc.</li> <li>• There may be significant volatility in storage and transportation costs of feed stock and finished product.</li> <li>• Exposures to commodity price movements need to be considered.</li> <li>• Counter party performance assessment needs to be undertaken.</li> <li>• Demand forecasting must be considered.</li> <li>• Operational performance assessment may be needed.</li> <li>• Distortion of trading performance through related party transactions and other undisclosed arrangements is possible.</li> <li>• Controls and reporting processes need to be undertaken.</li> <li>• A review of the cost structure and impact on overall economics may be required.</li> </ul>
Technology	<ul style="list-style-type: none"> <li>• The licensing arrangements for technology may not have been formalised.</li> <li>• The operators' technical expertise/ credit strength may be questionable.</li> <li>• There is a general restriction on the tax deductibility of research and development (R&amp;D) expenditure when the R&amp;D is not conducted in Indonesia.</li> <li>• Royalty payments to offshore counterparts may attract Duty.</li> </ul>
Product mix	<ul style="list-style-type: none"> <li>• The ability to change product mix and associated costs may be limited.</li> <li>• The contractual commitments associated with the product mix may be significant.</li> </ul>
Supply Chain	<ul style="list-style-type: none"> <li>• The continuity of feed stock to the refining process is sometimes not secure.</li> </ul>

Topics	Issues
Environmental Issues	<ul style="list-style-type: none"> <li>Compliance with existing and future environmental regulations (including remediation/abandonment exposures) may be lacking.</li> <li>Remediation costs for the previous activities of the refinery may be significant.</li> <li>The environmental impact may need to be considered.</li> </ul>
Strategic Value enhancement opportunities	<ul style="list-style-type: none"> <li>There may be opportunities to improve crude procurement and inbound logistics costs.</li> <li>There may be opportunities to improve refinery utilisation.</li> <li>There may be opportunities to enhance retail outlet throughput may be limited.</li> <li>Branding and value capture opportunities need to be identified.</li> </ul>
Competition	<ul style="list-style-type: none"> <li>Prioritisation of cooperatives, small enterprises and national companies to own/operate transportation and distribution facilities may hinder development in the short-term due to lack of operational experience and understanding of the industry as well as potential capital or financing constraints.</li> <li>Overall market growth and product specific demand supply need to be considered.</li> <li>Emerging competition in retail market due to liberalisation needs to be assessed.</li> </ul>
Other potential taxation issues	<ul style="list-style-type: none"> <li>The imposition of WHT on the hire of pipelines.</li> <li>The imposition of WHT on the hire of oil/gas tanking.</li> <li>The adoption of split contract for EPC contracts is still untested.</li> <li>The VATable status of LNG – now clarified in chapter 3.</li> <li>Any related party transactions (where transactions with a counterparty exceed Rp10 billion in a year) should be supported by transfer pricing documentation which includes an explanation of the nature of transactions, pricing policy, characteristic of the property/services, functional analysis, pricing methodology applied and the rationale for the methodology selected, and benchmarking.</li> </ul>



## ***Service Providers to the Upstream Oil and Gas Industry***



## 5.1 Equipment and Services – General

As discussed in chapters 2, 3 and 4, the Government and SKK Migas set the guidelines and make the final decision on large purchases of most equipment and services provided to the upstream sector.

Purchases by JCCs are effectively Government expenditure and generally must be provided from a local limited liability company. Foreign companies wishing to sell upstream equipment or services therefore must comply with the strict procurement rules set out under BP Migas Guidance No.007/PTK as revised in 2011, and oil and gas services activities guidance under the MoEMR Regulation 27/2008 (MoEMR Reg 27).

MoEMR Reg 27 revoked an older Decree of 1972 regarding licensing of foreign companies engaged in oil and gas services, which allowed a foreign company with a licence from the Director General of Oil and Gas (DGOG) to provide oil and gas support services direct.

Under MoEMR Reg 27, a foreign company cannot provide oil and gas support services directly to a PSC entity. A foreign company must instead provide its services through an Indonesian legal entity which has obtained a license (*Surat Keterangan Terdaftar dan Surat Kemampuan Usaha Penunjang Migas*) from the Director-General of Oil and Gas.

## 5.2 Tax Considerations – General

Goods and services supplied to PSC contractors are subject to taxes identical to those under the general Indonesian tax law (please refer to the PwC Pocket Tax Guide published annually and available at <http://www.pwc.com/id>). There have been some exceptions for oilfield service providers with regard to import taxes (Article 22 Income Tax, VAT and import duty). Historically, the service providers were able to take advantage of a PSC client's Master List (ML) facility. Please refer to our comments in section 3.4.8 Import Taxes for details of the ML Facility.

There has been increased tax audit activity in relation to service providers in the last few years, culminating in the creation of Oil & Gas tax service office in the Badora II tax office. This is where PSC taxpayers and many oilfield service providers are to be registered.

Transfer pricing is also becoming an area of close scrutiny for the oilfield service providers, resulting in regular annual tax audits.

### 5.3 Taxation of Drilling Services

On 24 April 2014 a new negative investment list was issued as Presidential Decree No. 39/2014, which replaces Presidential Decree No. 36/2010. This restricts foreign investment companies (PMA entities) involved in both offshore and onshore drilling as follows:

- PMA entities can no longer engage in onshore drilling (this is now restricted to domestic companies only). Previously the maximum foreign shareholding was 95%.
- The maximum foreign shareholding for PMA entities which engage in offshore drilling is 75%. Previously wholly owned foreign companies could engage in offshore drilling in eastern Indonesia, and the maximum foreign shareholding was 95% for all other offshore drilling.

The 2014 Negative Investment List does not apply to investments approved prior to its issue unless the terms are more favourable to the relevant investor. The List also does not apply to indirect investments, or portfolio investments transacting through domestic capital markets.

For further investment restrictions in the oil and gas industry, see section 2.2.2.

#### 5.3.1 Foreign-owned drilling companies

Foreign-owned drilling companies (FDCs) engaged on a back-to-back basis, historically carried out their drilling activities in Indonesia via a branch or PE for Indonesian tax purposes. The taxation regime that applies to FDC PEs is outlined below:

- a. A FDC's PE is subject to a general Corporate Income Tax rate based on a deemed profit percentage of 15% of drilling income (hence an effective corporate income tax rate of 4.5% assuming a 30% tax rate), plus a 20% WHT on branch profit remittance (BPRs).
- b. With the reduction of the Income Tax rate to 28% for 2009 and 25% for 2010, the effective Income Tax rates should be 4.2% and 3.75% respectively. Whilst the DGT has not formally challenged the use of a reduced income tax rate, no regulations have been issued to determine the appropriate rate at the time of writing.
- c. The 20% tax rate on BPRs may be reduced under a relevant tax treaty. A Certificate of Domicile ("CoD") is required to claim the benefit of any tax treaty (refer to the new CoD form and requirement under DGT Regulation No. 61/62)
- d. Drilling income is generally accepted as the FDCs "day rate" income received. Reimbursements and handling charges (including mobilisation and demobilisation) may not be taxable income, depending on whether a *de minimis* threshold test is exceeded. The test is generally applied on an annual rather than contractual basis.
- e. Other non-drilling income, for example interest, is subject to tax at normal rates.



Since MoEMR Reg 27, it is unclear how FDCs can continue to provide drilling services once any existing licence expires.

### 5.3.2 Indonesian drilling companies

Unlike a FDC, Indonesian and PMA drilling companies are taxed on actual revenues and costs, and are subject to an Income Tax rate of 25% for 2010 onward. The drilling services they provide also attract WHT currently at 2% which represents a prepayment of their tax. Any imports of consumables or equipment by the drilling companies will generally attract Article 22 tax at 2.5%, which represents a further prepayment of their annual income tax bill.

### 5.3.3 VAT and WHT

The provision of drilling services is subject to VAT with PSC companies acting as the VAT collectors (i.e. with the output VAT of the drilling service entity remitted directly to the Tax Office). This means that many service providers will be in a perpetual VAT refund position. This VAT is technically refundable but only after a Tax Office audit.

### 5.3.4 Labour taxes

Foreign nationals (who become residents for tax purposes) of an FDC are generally subject to Article 21 – employer WHT on a deemed salary basis as published by the ITO (at least for a branch). Individual tax returns should still however be filed on the basis of an individual's actual earnings.

For rotators or non-resident expatriate staff it may be possible to file an Article 26 WHT return (i.e. as a non-resident of Indonesia) in relation to tax withheld from their salary. This would effectively result in a tax rate of 20%.

The lodging of a monthly Article 21 Tax Return with respect to staff does not remove the individual's obligation to register for an Indonesian NPWP (tax payer identification number) and to file an Indonesian individual tax return.

## 5.4 Shipping / FPSO & FSO Services

Large crude carriers/tankers are engaged to ship oil from Indonesian territorial waters to overseas markets. Similarly, LNG carriers carry LNG cargos from the Bontang, Arun and Tangguh plants. Converted tankers are also used as Floating Production Storage & Offload (FPSO) or Floating Storage Offload (FSO) vessels.

The shipping industry is heavily regulated. Both local and international shipping are open to foreign investment through a PMA company in joint venture with a maximum foreign shareholding of 49% (this has been confirmed in the latest

Negative Investment List issued on 24 April 2014). A PMA entity can only own an Indonesian flagged vessel with a gross tonnage of at least 5,000.

Ministry of Transportation Regulation No.71/2005 of 18 November 2005 stipulates cabotage principles which oblige the use of Indonesian flagged vessels by 1 January 2011 for local shipping. However in May 2011, the Ministry of Transport extended a cabotage waiver for some specialised vessels servicing the upstream oil and gas industry to 2012 and beyond. Offshore drilling rigs including jack-up, semi-submersible, drill ship, tender assist, and swamp barge rigs have been granted an extension until December 2015. Geophysical and geotechnical survey vessels have been extended until December 2014.

SKK Migas has said that the oil and gas industry is still lacking the capability of producing several types of vessels in the oil and gas industry, including seismic vessels, drilling ships and cable-pipe laying ships mainly used for exploration.

Shipping Law No.17/2008 of 7 May 2008 requires foreign shipping companies, conducting marine transportation within Indonesia to appoint an Indonesian agent. The agent will fulfil a number of roles including acting as a point of registration contact for the ITO.

BKPM rules allow a PMA company running FPSO/FSO operations to be considered as oil and gas support activities with a maximum foreign shareholding of 95%. The Department of Sea Communications however views this as a shipping activity which requires a shipping licence. In this regard, licensing as a shipping company creates investment and ownership issues. Note that the Shipping Law No.17/2008 stipulates that only a company majority owned by an Indonesian party can register for an Indonesian flagged vessel. Therefore, a holding of 95% interest by a foreign shareholder would not allow the company to register as an owner of an Indonesian flagged vessel and consequently to obtain a shipping license to operate the FPSO/FSO.

### 5.4.1 Taxation of Shipping / FPSO / FSO Service Providers

#### *Export cargos*

Typically export shipping involves the provision of services and is subject to a WHT on the fees generated. The relevant WHT rates are generally:

- a. domestic (Indonesian incorporated) shipping companies – taxed at 1.2% of gross revenue.
- b. foreign shipping companies - taxed (final) at 2.64% of gross revenue.

In this regard, please note that:

- a. the above WHT rates are only applicable to gross revenue from the “transportation of passengers and/or cargo” loaded from one port to another and, in the case of a foreign shipping company, from the Indonesian port to a foreign port (not vice versa);
- b. the 2.64% regime presumes that the foreign shipping company has a PE in Indonesia;
- c. it may not be possible to take advantage of a tax treaty to reduce BPR rates;
- d. it is unclear whether this (final) WHT rate can be reduced to reflect the recently reduced corporate tax rate (i.e. 28% for 2009, 25% for 2010);
- e. tax treaties have specific shipping articles – which may be relevant;
- f. bare-boat charter (“BBC”) rentals (i.e. with no service component) might instead be subject to 20% WHT, (before tax treaty relief); and
- g. BBC payments may alternatively be characterised as royalties.

With regard to the VAT please note that:

- a. shipping services which include an element of Indonesian “performance” (i.e. within the Indonesian Customs Area) are technically subject to VAT. This is the case irrespective of whether the shipping company has a PE, and irrespective of whether the client is an Indonesian based entity, or an offshore entity;
- b. a VAT exemption may be available if it can be argued that the services involve only a small proportion of Indonesian presence/performance and so should be viewed as entirely ex-Indonesia (i.e. as entirely International); and
- c. shipping services provided entirely outside of Indonesia (say under a separate international contract) may avoid VAT on a “performance” basis. However, VAT could still arise on a self-assessment basis where the services are “utilised” within Indonesia. Whilst “utilised” is not well defined, in practice the ITO deems this to occur where the shipping cost is charged into Indonesia.

#### *FPSO/FSO services*

Traditionally many PSC entities treated their FPSO/FSO service providers as shipping companies (i.e. and so fitting into the 1.2%/2.64% tax regime). The current and better view is that such services do not constitute transportation or shipping services and regard should be paid to the general tax law provisions.

## ***Unconventional gas: Coal Bed Methane and Shale Gas***



## 6.1 Background

Unconventional oil and gas is defined as oil and gas procured from reservoirs with low permeability though the use of specific technology (e.g. fracturing), including Shale Oil, Shale Gas, Tight Sand Gas, Coal Bed Methane (CBM) and Methane-Hydrate.

### 6.1.1 Coal Bed Methane

Indonesia's coal bed methane (CBM) reserves are estimated to be 453 Tcf which is larger than Indonesia's estimated natural gas resource and ranks 6th in the world. Its CBM reserves are spread across the archipelago but are predominantly located in South Sumatra, South Kalimantan, and East Kalimantan. The first CBM contract was signed in 2008 and by the end of 2012 there were 54 CBM cooperation contracts in place. In 2013, four CBM production pilots began selling gas to independent power producers. The Government has set daily production targets of 500 mmcf by 2015 rising to 1,000 mmcf by the year 2020 and 1,500 by the year 2025.

To increase CBM development, the government promulgated MoEMR Regulation 36/2008 to attract new investors whilst encouraging existing contractors to accelerate production within their existing work areas. GR 36/2008 (summarised below) imposes clarity around issues of work areas overlapping with mining or oil and gas work areas by imposing a "first priority principle".

There are two generations of CBM PSC based on differences in the provisions of the PSC. First generation PSCs were entered into between 2008 and May 2009, the remainder are second generation PSCs.

For first generation PSCs, production before POD is Government-owned with a maximum of 90% cost recovery. For second generation PSCs, production before PoD may be sold with the distribution of results according to the split in the Contract but the cost has yet to be recovered. Cost recovery is 100% without ceiling cost.

### 6.1.2 Shale Gas

Indonesia's shale gas reserves are estimated to be 574 Tcf, which is even greater than its CBM reserves.

As at the end of 2013, the Government had received 75 proposals spread across Sumatra, Sulawesi, Kalimantan and Papua and five, including Pertamina, had completed a Joint Study. Pertamina signed the first unconventional oil & gas (MNK) PSC for a work area in North Sumatra (Sumbagut).

Shale Gas is administered under MoEMR Regulation No.5/2012.

## 6.2 Regulatory Framework

Government Regulation No.35/2004 (GR35) authorised the Minister of Energy and Mineral Resources (MoEMR) to issue a specific regulation on CBM – which it did on 22 May 2006 when the MoEMR issued Regulation No.33/2006 (Reg-33) and later on 12 November 2008 when the MoEMR issued Regulation No.36/2008 (Reg-36) (revoking Reg-33).

The key provisions of Reg-36 are summarised below:

Offering Process	<ul style="list-style-type: none"><li>- Direct Offer, Tender Offer and Joint Study and Joint Evaluation process introduced in line with MoEMR Regulation No.35/2008 (Reg-35) on the offering of Oil and Gas (O&amp;G) Working Areas procedures.</li></ul>
Cooperation Contract provisions	<ul style="list-style-type: none"><li>- GR-35 extended to include provisions for Dewatering and Pilot Project.</li><li>- A PSC contract should include the “cost recovery” arrangement.</li></ul>
Areas for CBM Operation and Working Areas size	<ul style="list-style-type: none"><li>- In CBM Open Areas, O&amp;G Working Areas, Coal Contract of Work (CCoW) Areas, and/or Kuasa Pertambangan (KP) Areas</li><li>- Maximum area of 3,000 km<sup>2</sup> (300,000 Ha)</li></ul>

<p>Privilege right and offering process</p>	<p>Joint Study</p> <ul style="list-style-type: none"><li>- Investors can apply by Direct Offer through Joint Study for the CBM prospects found in Open Areas or Available Working Areas (i.e. not in the existing O&amp;G, CCoW or KP areas)</li></ul> <p>Joint Evaluation</p> <ul style="list-style-type: none"><li>- Qualified O&amp;G company, CCoW company or KP company is given the first priority to apply Direct Offer through a Joint Evaluation for the CBM prospects located within each respective concession area.</li><li>- For overlapping areas, O&amp;G companies, being the first priority party, can apply by Direct Offer through Joint Evaluation on the CBM prospect.</li><li>- Again, for overlapping areas, CCoW/KP company can only apply by Direct Offer through Joint Evaluation for the CBM prospect after the O&amp;G company rejects to engage the CBM prospect (i.e. give away its priority privilege).</li><li>- The Government of Indonesia can carry out Tender Offer for the CBM to the public for CBM prospects located in the Open Areas, Non-overlapping areas and Overlapping areas (which are not of interest to the existing concession holders).</li></ul>
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	<ul style="list-style-type: none"> <li>- Before the Joint Evaluation is commercialised, the Direct Offer will be tendered to the public. A party who undertakes the Joint Evaluation has the “right to match”.</li> <li>- Each investor should deposit US\$1 million as part of the Joint Evaluation process. The deposit is not refundable if the investor withdraws from the Joint Evaluation process or fails to meet the requirements of the Direct Offer.</li> </ul>
Joint Evaluation timeframe.	The joint evaluation should be carried out within 6 months and is extendable for another period of 4 months.
Cost and risk in the execution of the Joint Evaluation	All costs (and risks) related to the joint evaluation shall be borne by the investor and should not be charged as operational costs under the cooperation contract.
DMO	Supply to domestic market should be prioritised.
Confidentiality of data resulted from Joint Evaluation	Regulated.

MoEMR has subsequently issued Regulation No. 05/2012 covering the procedures for the determination and tender of unconventional oil and gas operational areas. The key provisions are summarised below:

GR79	The regulation references GR 79 as being relevant. See section 3.4.2 above for further details.
Terms and conditions	Unconventional PSCs should contain similar terms and conditions as stipulated in Art. 26 of Presidential Regulation 35/2004.
Profit sharing contracts	Reg. 05/2012 imposes conditions for PSCs in the form of profit sharing contracts.



Use of facilities and infrastructure.	Unconventional oil and gas contractors are able to use the facilities and infrastructure owned by Oil and Gas and CBM contractors. However, these are not to be used for profit or gain.
---------------------------------------	--

## 6.3 Direct Offers

### 6.3.1 First priority rules

A new feature of Reg-36 is the “first priority principle” provided to certain companies holding existing oil and gas or coal concession areas.

In this case, the first priority for Direct Offer would be given to:

- a. a PSC company: if the CBM prospect is located within the PSC working area of the particular PSC company and provided the PSC company has met the first 3 years exploration commitment;
- b. a PSC company: if the CBM prospect is located in overlapping areas within PSC working area and CCoW or KP area; and
- c. a CCoW company or KP company: if the CBM prospect is located within the CCoW or KP areas and these companies have met the first 3 years coal exploitation.

The above first priority right of the PSC company might be withdrawn in the following cases:

- a. the cooperation contract is signed after the Joint Study is performed (by other investors);
- b. the Oil and Gas (O&G) working area is determined after a Joint Evaluation has been carried out by CCoW or KP company;
- c. the first 3 years exploration commitments have not been met;
- d. the company does not commence CBM undertakings within 6 months after notification from the Director General of Oil and Gas (DG) on the CBM undertaking plan by CCoW or KP company; and
- e. the company does not propose Direct Offer (through Joint Evaluation) within 60 days after DG notification on the Government plan to develop CBM in the non-overlapping areas and overlapping areas.

Please note that for a CCoW or KP company, the first priority right might also be withdrawn if the company fails to meet the 3 years coal exploitation period.

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## **About the PwC network**

### **Why PwC?**

As the world's largest professional services network and one of the big four accountancy firms, the PwC network provides Industry-focused assurance, tax and advisory services for public and private companies. Close to 184,000 people in 157 countries connect their thinking, experience and solutions to build trust and enhance value for clients and their stakeholders.

### **A globally integrated firm**

Being part of a global network means we can invest in priority clients, sectors and markets and deliver leading edge ideas, products and services more quickly and effectively than our competitors. We work across borders without the constraints of geographic considerations and we work to a global standard and quality. Our global network structure enables quick decision-making and worldwide delivery of the best resources.

We are organised into industry groups, of which the oil and gas industry group is one of the largest. Our industry focus ensures our people have both a broad overview of the marketplace and a deep understanding of the industries and markets in which they specialise.

Our oil and gas industry group has priority status in terms of investment and resources in all key markets including Indonesia, reflecting our worldwide dominance in this market.

Our strength in the oil and gas industry is one of which we are proud. This means we are the most committed firm to achieving oil and gas client's needs and actively participate in the industry in all countries in which the industry is active. We work closely with our oil and gas clients, offering the benefits of our experience to help achieve their goals.

## **PwC Indonesia**

PwC Indonesia's (PwC or we) oil and gas team brings together local knowledge and experience with international oil and gas expertise. Our strength in serving the oil and gas industry comes from our skills, our experience and our network of partners and managers who focus 100% of their time on understanding the oil and gas industry and working on solutions to oil and gas industry issues. Detailed

oil and gas knowledge and experience ensures that we have the background and understanding of industry issues and can provide sharper, more sophisticated solutions.

PwC is organised into four Lines of Services, each staffed by highly qualified experienced professionals who are leaders in their fields. The lines of service are:

- Assurance Services which provide innovative, high quality, and cost-effective services related to an organisations' financial controls, regulatory reporting, shareholder value and technology needs.
- Tax Services which provide a range of specialist tax services in three main areas: tax consulting, tax dispute resolution, and compliance. Some of our value-driven tax services include:
  - International tax restructuring
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  - Tax process reviews
- Advisory services which provide comprehensive advice and assistance relating to transactions, performance improvement and crisis management, based on long-term relationships with clients and our financial analysis and business process skills.
- Consulting Services help you to improve your financial and operational procedures and internal controls in a wide variety of areas within your organisation. Our Consulting practice has the following sub-divisions:
  - Financial Effectiveness
  - Forensics
  - Operations
  - People & Change
  - Sustainability
  - Technology

For companies operating in the Indonesian oil and gas sector, there are some compelling reasons to choose PwC as your professional services firm:

- We are the leading advisor in the industry, both globally and in Indonesia, working with more explorers, producers and related service providers than any other professional services firm. In particular, PwC audits over 60% (in terms of production) of the oil and gas producers in Indonesia under Production Sharing Contract agreements, and provides other professional services such as taxation and advisory services to oil and gas producers in all stages of their development.
- We have operated in Indonesia since 1971 and have over 1,600 professional staff, including over 40 Indonesian national partners and expatriate technical advisors, trained in providing assurance, advisory, tax and consulting services to Indonesian and international companies, and the Government of Indonesia.
- Our Energy, Utilities and Mining (EUM) practice in Indonesia comprises over 300 dedicated professionals across our four Lines of Service. This body of professionals brings deep local industry knowledge and experience with international oil and gas expertise and provides us with the largest group of industry specialists in the Indonesian professional market. We can also draw on the PwC global EUM network which includes more than 3,400 qualified industry experts.
- Our commitment to the oil and gas industry is unmatched and demonstrated by our active participation in industry associations in Indonesia and around the world, and our thought leadership on the issues affecting the industry. Through our involvement with the Indonesian Petroleum Association (IPA) we help shape the future of the industry.
- Our client service approach involves learning about the company's issues and seeking ways to add value to every task we perform. Detailed oil and gas knowledge and experience ensures that we have the background and understanding of industry issues and can provide sharper, more sophisticated solutions that help clients accomplish their strategic objectives.

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# *Appendices*



## **A. Key Legislation**

### **Law No. 22/2001**

#### **LAW NO. 22/2001 DATED NOVEMBER 23, 2001 PETROLEUM AND NATURAL GAS**

#### **BY GRACE OF THE GOD ALMIGHTY THE PRESIDENT OF THE REPUBLIC OF INDONESIA**

Considering :

- a. that the national development must be directed to creation of people's welfare by reforming all aspects of national and state life on the basis of the state ideology Pancasila and the Constitution of 1945;
- b. that since petroleum and natural gas are non-renewable strategic natural-resources controlled by the state and vital commodities controlling life of public at large and play important role in the national economy, the exploitation of petroleum and natural gas must be capable of contributing maximally to the people's prosperity and welfare;
- c. that petroleum and natural gas related business activities play important role in proving real added value for the national economic growth which is increasing and sustainable;
- d. that Law No. 44 Prp./1960 on petroleum and natural gas mining, Law No. 15/1962 on the stipulation of Government Regulation in lieu of Law No. 2/1962 on the obligation of oil companies to meet the domestic need and Law No. 8/1971 on state-owned oil and gas mining companies are no longer suitable to developments of petroleum and natural gas mining businesses;
- e. that by continuously observing national and international developments, it is necessary to amend legislation on petroleum and natural gas mining so as to be capable of creating independent, reliable, transparent, competitive, efficient and environmental friendly petroleum and natural gas business activities as well as boosting the growth of national potential and role;
- f. that base on the considerations as meant in letters a, b, c, d and e as well as to provide legal basis for steps of renewal and arrangement of petroleum and natural gas exploitation, it is necessary to promulgate a law on petroleum and natural gas;

In view of :

1. Article 5 paragraph (1), Article 20 paragraphs (1), (2), (4) and (5), Article 33 paragraphs (2) and (3) of the Constitution of 1945 as already amended by the Second Amendment to the Constitution of 1945;
2. Stipulation of the People's Consultative Assembly of the Republic of Indonesia No. XV/MPR/1998 on the realization of regional autonomy;

regulation, sharing and exploitation of national resources on the basis of the principle of justice; as well as financial equilibrium between the central government and regional governments in the framework of the Unitary State of the Republic of Indonesia.

With the collective approval of  
**THE HOUSE OF REPRESENTATIVES OF THE REPUBLIC OF INDONESIA DECIDES :**

To stipulate :  
**LAW ON PETROLEUM AND NATURAL GAS.**

**CHAPTER I**  
**GENERAL PROVISION**

Article 1

1. Petroleum shall be a result of the natural process in the form hydrocarbon in a pressure condition and at atmosphere temperature which constitutes liquid or solid material, including asphalt, mineral candle or ozokerit and bitumen obtained from a mining process, excluding coal and sediments of other hydrocarbon in the form of solid material obtained from activities not connected with petroleum and natural gas-related business activities.
2. Natural gas is shall a produce of the natural process in form of hydrocarbon in a pressure condition and at an atmosphere temperature that in the form of gas, which is obtained from a petroleum and natural gas mining process.
3. Petroleum and natural gas shall be natural oil and gas.
4. Fuel oil shall be fuel derived and/or processed from petroleum.
5. Mining concession shall be the authority delegated by the state to the government to manage exploration and exploitation activities.
6. General survey shall field activities covering the collection, analysis and presentation of data connected with information on geological condition to predict the location and potential of petroleum and natural gas resources outside the working area.
7. Upstream business activities shall be business activities focused or based on exploration and exploitation business activities.
8. Exploration shall be activities aimed at obtaining information on geological condition to find and obtain the estimated reserves of petroleum and natural gas in the working area stipulated.
9. Exploitation shall be a series of activities aimed at producing petroleum and natural gas from the working area stipulated, consisting of drilling and completion of wells, the building of transport, storage and processing facilities to separate and purify petroleum and natural gas in the field as well as other activities supporting the exploitation.
10. Downstream business activities shall be business activities focused or based on processing, transport, storage and/or commercial business activities.
11. Processing shall be activities to purify, obtain parts, increase the quality and added value of petroleum and/or natural gas, excluding on-sight processing.
12. Transport shall be activities to move petroleum, natural gas and/or their processed products from the working area or storage and processing places, including the transport of natural gas through transmission and distribution pipeline.

13. Storage shall be activities to receive, collect, store and release petroleum and/or natural gas.
14. Commerce shall be activities to purchase, sell, export and import petroleum, natural gas and/or their processed products, including commerce of natural gas through pipeline.
15. The Indonesian mining jurisdiction shall be all Indonesian mainland, waters and continental shelf territories.
16. Working area shall be a certain region within the Indonesian mining jurisdiction used for the exploration and exploitation.
17. Business entities shall be companies in the form of statutory body which undertake businesses permanently, continuously and are established in accordance with laws in force as well as operate and are domiciled in the territory of the Unitary State of the Republic of Indonesia.
18. Permanent establishments shall be business entities established and being in the form of statutory body outside the territory of the Unitary State of the Republic of Indonesia that undertake activities in the territory of the Unitary State of the Republic of Indonesia and are obliged to comply with legislation in force in the territory of the Unitary State of the Republic of Indonesia.
19. Joint cooperation contract shall be a production sharing contract or other models of joint cooperation contract in exploration and exploitation activities, which is better in favor of the state and whose output is maximally used for improving people's welfare.
20. Business license shall be a license granted to a business entity to process, transport, store and/or trade for obtaining a benefit and/or profit.
21. The central government hereinafter called the government shall be the element of the Unitary State of the Republic of Indonesia consisting of the President and ministers.
22. The regional government shall be the head of the region along with other elements of autonomous region as the regional executive board.
23. Executing agency shall be an agency established to control upstream business activities in the petroleum and natural gas sector.
24. Regulatory board shall be a board established to regulate and supervise the supply and distribution of fuel oil and natural gas as well as the transport of natural gas through pipeline in the downstream business activities.
25. Minister shall be the minister in charge of petroleum and natural gas business activities.

## **CHAPTER II PRINCIPLE AND OBJECTIVE**

### **Article 2**

The implementation of petroleum and natural gas-related business activities stipulated in this law shall be based on the principles of populist economy, integration, benefit, balance, equitable distribution, collective prosperity and public welfare, security, safety and legal certainty as well as the environmentally friendly principle.

### **Article 3**

The implementation of petroleum and natural gas-related business activities shall aim at :

- a. guaranteeing the effective implementation and control over business activities of effective, efficient, highly competitive and sustainable exploration and exploitation of state-owned

- petroleum and natural gas which are strategic and not renewable through an open and transparent mechanism;
- b. assuring the effective implementation and control over the accountable processing, transport, storage and commercial businesses executed through a mechanism of reasonable, fair and transparent business competition;
  - c. guaranteeing the efficient and effective supply of petroleum and natural gas as both a source of energy and material for the domestic need;
  - d. supporting and promoting the national capacity so as to be more capable of competing nationally, regionally and internationally;
  - e. increasing state income to contribute maximally to the national economy and developing as well as strengthening the position of Indonesian industry and trade;
  - f. creating job opportunities, enhancing the public welfare and prosperity fairly and equitably as well as continuously maintaining the conservation of the environment.

### **CHAPTER III CONTROL AND CONCESSION**

#### **Article 4**

- (1) Petroleum and natural gas as non-renewable strategic natural-resources contained in the Indonesian mining jurisdiction shall constitute national assets controlled by the state.
- (2) The control by the state as meant in paragraph (1) shall be executed by the government as the holder of mining concession.
- (3) The government as the holder of mining concession shall establish the executing agency as meant in Article 1 point 23.

#### **Article 5**

Petroleum and natural gas-related business activities shall consist of :

- 1. Upstream business activities composed of :
  - a. exploration;
  - b. exploitation.
- 2. Downstream business activities comprising :
  - a. processing;
  - b. transport;
  - c. storage;
  - d. commerce.

#### **Article 6**

- (1) The upstream business activities as meant in Article 5 point 1 shall be executed and controlled through the joint cooperation contracts as meant in Article 1 point 19.
- (2) The joint cooperation contracts as meant in paragraph (1) shall at least contain the following requirements :
  - a. the ownership of natural resources is still on the hand of the government up to the delivery point;
  - b. the control over the operational management lies on the executing agency;
  - c. capital and risks are wholly borne by business entities or permanent establishments.

**Article 7**

- (1) The downstream business activities as meant in Article 5 point 2 shall be executed by the business licenses as meant in Article 1 point 20.
- (2) The downstream business activities as meant in Article 5 point 2 shall be realized through a mechanism of reasonable, fair and transparent business competition.

**Article 8**

- (1) The government shall prioritize to the exploitation of natural gas for the domestic need and have the task of preparing strategic petroleum reserves to support the supply of fuel oil in the country, which is further stipulated by a government regulation.
- (2) The government shall guarantee the availability and smooth distribution of fuel oil being a vital commodity and controlling the life of public at large throughout the territory of the Unitary State of the Republic of Indonesia.
- (1) The implementation of transport business activities of natural gas through pipeline connected with public interests shall be regulated so that its utilization is open for all users.
- (2) The government in this case a regulating agency shall be responsible for the regulation and supervision over the business activities as meant in paragraphs (2) and (3).

**Article 9**

- (1) The upstream and downstream business activities as meant in Article 5 point 1 and 2 shall be executed by :
  - a. state-owned enterprises;
  - b. regional administration-owned companies;
  - c. cooperatives, small-scale businesses;
  - d. private business entities.
- (2) Permanent establishments shall only be allowed to undertake upstream business activities.

**Article 10**

- (1) Business entities or permanent establishments undertaking upstream business activities shall be prohibited from executing downstream business activities.
- (2) Business entities undertaking downstream business activities shall be disallowed to execute upstream business activities.

**CHAPTER IV  
UPSTREAM BUSINESS ACTIVITIES**

**Article 11**

- (1) The upstream business activities as meant in Article 5 point 1 shall be executed by business entities or permanent establishments on the basis of joint cooperation contracts with the executing agency.
- (2) Every joint cooperation contract already signed shall contain at least the following principal provisions :
  - a. state revenue;
  - b. working area and reversion;
  - c. obligation to disburse funds;

- d. transfer of ownership of production results of petroleum and natural gas;
- e. period and conditions of the extension of contract;
- f. settlement of any dispute;
- g. obligation to supply petroleum and/or natural gas to meet the domestic need;
- h. expiration of contract;
- i. post-mining operation obligations;
- j. working safety and security;
- k. environmental management;
- l. transfer of right and obligation;
- m. necessary reporting;
- n. plan for the development of field;
- o. prioritization of the use of domestic goods and services;
- p. development of surrounding communities and guarantee for rights of communal society;
- q. prioritization of recruitment of Indonesian workers.

#### Article 12

- (1) The working area to be offered to business entities or permanent establishments shall be stipulated by the minister after consulting with the regional government.
- (2) The offering of the working area as meant in paragraph (1) shall be done by the minister.
- (3) The minister shall stipulate business entities and permanent establishments authorized to undertake exploration and exploitation business activities in the working area as meant in paragraph (2).

#### Article 13

- (1) Every business entity or permanent establishment shall be given only one working area.
- (2) In the case of a business entity or permanent establishment managing more than one working areas, separate statutory body shall be established in every working area.

#### Article 14

- (1) The validity period of the joint cooperation contracts as meant in Article 11 paragraph (1) shall be 30 (thirty) years at the maximum.
- (2) Business entities or permanent establishments can apply for the extension of the validity period of the joint cooperation contracts as meant in paragraph (1) to another term of 20 (twenty) years at the maximum.

#### Article 15

- (1) The validity period of the joint cooperation contracts as meant in Article 14 paragraph (1) shall consist of the period of exploration and period of exploitation.
- (2) The period of exploration as meant in paragraph (1) shall be 6 (six) years and extendible to only another term of 4 (four) years at the maximum.

#### Article 16

Business entities or permanent establishments shall be obliged to revert gradually part or all of their working areas to the minister.



**Article 17**

Business entities or permanent establishments already securing the first approval of development of field in a working area but not realizing their activities for the maximum period of 5 (five) years as from the date of expiration of the exploration period shall be obliged to return their working areas wholly to the minister.

**Article 18**

Guidances, procedures and requirements for the joint cooperation contracts, stipulation and offering of working areas, alteration and extension of joint cooperation contracts as well as the reversion of the working areas as meant in Articles 11, 12, 13, 14, 15, 16 and 17 shall be further stipulated in a government regulation.

**Article 19**

- (1) General survey executed by or under a license of the government shall be done to support the preparation for the working area as meant in Article 12 paragraph (1).
- (2) Procedures and requirements for the implementation of the general survey as meant in paragraph (1) shall be further stipulated by a government regulation.

**Article 20**

- (1) Data obtained from the general survey and/or exploration and exploitation shall be the state property controlled by the government.
- (2) Data obtained by business entities or permanent establishments in their working areas can be used by the relevant business entities or permanent establishments for the validity period of the joint cooperation contracts.
- (3) In the case of the joint cooperation contracts expiring, business entities or permanent establishments shall be obliged to give up the whole data obtained during the period of the joint cooperation contracts to the minister through the executing agency.
- (4) The secrecy of the data obtained by business entities or permanent establishments in their working areas shall be effective for a specified period.
- (5) The government shall regulate, manage and utilize the data as meant in paragraphs (1) and (2) to plan the preparation for the opening of working areas.
- (6) The implementation of the provisions on ownership, period of the use, secrecy, management and utilization of the data as meant in paragraphs (1), (2), (3), (4) and (5) shall be further stipulated by a government regulation.

**Article 21**

- (1) The plan for the first time development of field to be used for production activities in a working area shall secure the approval of the minister on the basis of considerations of the executing agency after consulting with the relevant provincial government.
- (2) In developing and producing petroleum and natural gas fields, business entities or permanent establishments shall be obliged to optimize and utilize them or on accordance with good technical norms.



(3) Provisions on the development of field, production of petroleum and natural gas reserves and provisions on the technical norms as meant in paragraphs (1) and (2) shall be further stipulated by a government regulation.

**Article 22**

- (1) Business entities or permanent establishments shall give up maximally 25% (twenty five percent) of their portion resulting from the production of petroleum and natural gas to meet the domestic need.
- (2) The implementation of the provisions as meant in paragraph (1) shall be further stipulated by a government regulation.

**CHAPTER V  
DOWNSTREAM BUSINESS ACTIVITIES**

**Article 23**

- (1) The downstream business activities as meant in Article 5 paragraph (2) can be executed by business activities after securing business licenses from the government.
- (2) The business licenses needed for the implementation of the petroleum and/or natural gas-related business activities as meant in paragraph (1) shall be distinguished by :
  - a. processing business license;
  - b. transport business license;
  - c. storage business license;
  - d. commercial business license.
- (3) Every business entity can be given more than one business licenses as long as the licensing does not contravene provisions of laws in force.

**Article 24**

- (1) The business licenses as meant in Article 23 shall at least contain :
  - a. name of operator;
  - b. kind of business granted;
  - c. obligations in the implementation of the operation;
  - d. technical requirements.
- (2) Every business license already granted as meant in paragraph (1) only can be used in accordance with its designation.

**Article 25**

- (1) The government can issue a written warning, suspend activities, freeze activities or revoke the business licenses as meant in Article 23 on the basis of :
  - a. violation against any of the requirements mentioned in business licenses;
  - b. repetition of violation against requirements for business licenses;
  - c. failure to meet the requirements stipulated on the basis of this law.
- (2) Before revoking the business licenses as meant in paragraph (1), the government shall firstly open opportunity for business entities to abolish the violation already committed of fulfill the stipulated requirements in a specified period.

**Article 26**

Activities of field processing, transport and sales of production as the continuation of exploration and exploitation executed by business entities or permanent establishment shall not need the separate business licenses as meant in Article 23.

**Article 27**

- (1) The minister shall stipulate the national master plan for transmission and distribution of natural gas.
- (2) Only certain transport segments can be granted to business entities holding business licenses to transport natural gas through pipeline.
- (3) Only certain commercial regions can be granted to business entities holding business licenses to transport natural gas through pipeline.

**Article 28**

- (1) Fuel oil and certain processed products marketed in the country to meet the public need shall comply with the standards and quality stipulated by the government.
- (2) Prices of fuel oil and natural gas shall be entrusted to the mechanism of fair and reasonable business competition.
- (3) The implementation of the pricing policy as meant in paragraph (2) shall not reduce the social responsibility of the government for certain groups of communities.

**Article 29**

- (1) In regions facing scarcity of fuel oil and remote areas, the transport and storage facilities, including their supporting facilities can be utilized in cooperation with other parties.
- (2) The utilization of the facilities as meant in paragraph (1) shall be regulated by the executing agency by continuously observing technical and economic aspects.

**Article 30**

Provisions on the processing, transport, storage and commercial businesses as meant in Article 23, 24, 25, 26, 27, 28 and 29 shall be further stipulated by a government regulation.

**CHAPTER VI  
STATE REVENUE**

**Article 31**

- (1) Business entities or permanent establishments undertaking the upstream business activities as meant in Article 11 paragraph (1) shall pay state revenue in the form of taxes and non-tax state receipts.
- (2) The state revenue in the form of taxes as meant in paragraph (1) shall consist of :
  - a. taxes;
  - b. import duty, and other levies on the import and excise;
  - c. regional taxes and levies.
- (3) The non-tax state receipts as meant in paragraph (1) shall consist of :
  - a. state portion;
  - b. state levies in the form of permanent contribution and exploration and exploitation contributions;
  - c. bonuses.

- (4) Joint cooperation contracts shall mention that the obligation to pay the taxes as meant in paragraph (2) is executed in accordance with :
  - a. provisions of taxation laws effective upon the signing of the joint cooperation contracts;
  - b. provisions of taxation laws in force.
- (5) Provisions on the stipulation of amounts of the state portion, state levies and bonuses as meant in paragraph (3) as well as procedures for remitting them shall be further stipulated by a government regulation.
- (6) The non-tax state receipts as meant in paragraph (3) shall be the revenue of the central government and regional governments, which is shared in accordance with provisions of laws in force.

**Article 32**

Business entities undertaking the downstream business activities as meant in Article 22 shall pay taxes, import duty and other levies on the import, excise, regional taxes and regional levies as well as other liabilities in accordance with laws in force.

**CHAPTER VII  
RELATIONS BETWEEN PETROLEUM AND NATURAL GAS-RELATED  
BUSINESS ACTIVITIES AND LAND TITLE**

**Article 33**

- (1) The petroleum and natural gas-related business activities as meant in Article 5 shall be executed in the Indonesian mining jurisdiction.
- (2) Rights to working areas shall not cover rights to land being earth surface
- (3) Petroleum and natural gas-related business activities cannot be executed in :
  - a. cemeteries, places considered sacred, public places, public facilities and infrastructures, nature preserve, cultural preserve as well as land belonging to communal society;
  - b. state defense fields and buildings as well as surrounding land;
  - c. historic building and state symbols;
  - d. buildings, residences or factories along surrounding yard land, except under a license from government institutions, approval of communities and individuals with regard to the said matter.
- (4) Business entities or permanent establishments planning to undertake their activities can remove the buildings, public places, public facilities and infrastructures as meant in paragraph (3) letters a and b after securing prior licenses from the authorized government institutions.

**Article 34**

- (1) In the case of business entities or permanent establishments planning to use land attached to a right or state land in their working areas, the relevant business entities or permanent establishments shall firstly make a kind of settlement with the right holder or users of the state land in accordance with the right holder or users of the state land in accordance with laws in force.

- (2) The settlement as meant in paragraph (1) shall be done under a way of deliberation to reach a consensus by means of transactions, granting a reasonable compensation, recognition or other forms of compensation to the right holder or users of the state land.

**Article 35**

Holders of land title shall be obliged to allow business entities or permanent establishments to carry out exploration and exploitation on the relevant land if :

- a. before activities start, business entities or permanent establishments firstly show joint cooperation contracts or their legitimate copies as well as notify the objective and place of activities to be executed;
- b. business entities or permanent establishments firstly make the settlement or a guarantee for the settlement approved by the right holder or users of the state land as meant in Article 34.

**Article 36**

- (1) Business entities or permanent establishments being already given working areas shall be granted a right to use land plots used directly for petroleum and natural gas-related business activities and their safety areas in accordance with the provisions of laws in force and be obliged to maintain and keep the land plots.
- (2) In the case of the granted working areas as meant in paragraph (1) covering a wide area on the state land, land plot not used for petroleum and natural gas-related business activities can be given to other parties by the minister in charge of the agrarian affairs or land affairs by prioritizing local communities after securing recommendation from the minister.

**Article 37**

Provisions or procedures for the settlement of the use of land title or state land as meant in Article 35 shall be further regulated by a government regulation.

**CHAPTER VIII  
FOSTERING AND SUPERVISION**

**Part One  
Fostering**

**Article 38**

The government shall foster petroleum and natural gas-related business activities.

**Article 39**

- (1) The fostering as meant in Article 38 shall cover :
  - a. the implementation of government affairs in the field of petroleum and natural gas-related business activities;
  - b. the stipulation of policies on petroleum and natural gas-related business activities on the basis of reserves and potentials of petroleum and natural gas which are owned, production capacity, domestic need for fuel oil and natural gas, technology mastery, environmental aspect and conservation of the environment, national capacity and development policies.

- (2) The fostering as meant in paragraph (1) shall be applied carefully, transparently and fairly to the implementation of petroleum and natural gas-related business activities.

#### Article 40

- (1) Business entities or permanent establishments shall guarantee the effective standard and quality in accordance with provisions of laws in force as well as apply good technical norms.
- (2) Business entities or permanent establishments shall guarantee working safety and security as well as the environmental management and abide by provisions of laws in force in the petroleum and natural gas-related business activities.
- (3) The environmental management as meant in paragraph (2) shall be in the form of obligations to prevent and overcome pollution as well as to restore the environmental damages, including obligation of post-mining operation.
- (4) Business entities or permanent establishments undertaking the petroleum and natural gas-related business activities as meant in Article 5 shall prioritize to the use of local manpower, goods and services as well as domestic design and engineering capacities transparently and competitively.
- (5) Business entities or permanent establishments undertaking the petroleum and natural gas-related business activities as meant in Article 5 shall be responsible for the development of the environmental and local communities.
- (6) Provisions on working safety and security as well as the environmental management as meant in paragraphs (1) and (2) shall be further stipulated by a government regulation.

### **Part Two Supervision**

#### Article 41

- (1) Responsibility for activities of supervision over jobs and the implementation of petroleum and natural gas-related business activities with regard to the compliance to provisions of laws in force shall be at the ministry whose tasks and authority cover petroleum and natural gas-related business activities and other ministries concerned.
- (2) The supervision over the implementation of upstream business activities based on joint cooperation contracts shall be executed by the executing agency.
- (3) The supervision over the implementation of downstream business activities based on business licenses shall be executed by the executing agency.

#### Article 42

The supervisions as meant in Article 41 paragraph (1) shall include :

- a. conservation of resources and petroleum and natural gas reserves;
- b. management of data on petroleum and natural gas;
- c. application of good technical norms;
- d. kind and quality of processed products of petroleum and natural gas;
- e. allocation and distribution of fuel oil and raw materials;
- f. working safety and security;
- g. environmental management;
- h. utilization of domestic goods, services and design and engineering capacities;
- i. development of Indonesian manpower;

- j. development of the environmental and local communities;
- k. mastery, development and application of petroleum and natural gas technology;
- l. other activities in the field of petroleum and natural gas related business activities as long as they are connected with public interests.

**Article 43**

Provisions on the fostering and supervision as meant in Articles 38, 39, 41 and 42 shall be further stipulated by a government regulation.

**CHAPTER IX  
EXECUTING AGENCY AND REGULATING AGENCY**

**Article 44**

- (1) The supervision over the implementation of joint operation contracts of the upstream business activities as meant in Article 5 point 1 shall be executed by the executing agency as meant in Article 4 paragraph (3).
- (2) The executing agency as meant in paragraph (1) shall have the function of supervising the upstream business activities so that the exploitation of petroleum and natural gas resources belonging to the state can give a maximal benefit and revenue to the state for increasing the public welfare maximally.
- (3) The executing agency as meant in paragraph (1) shall have the following tasks :
  - a. giving considerations to the minister with regard to the minister's policies on the preparation and offering of working areas as well as joint cooperation contracts;
  - b. signing joint cooperation contracts;
  - c. assessing and conveying plans for the development of fields for the first time to be used for production activities in a working area to the minister for securing approval;
  - d. approving plans for the development of fields other than those mentioned in letter c;
  - e. approving working plans and budgets;
  - f. monitoring and reporting the implementation of joint cooperation contracts to the minister;
  - g. appointing sellers of petroleum and/or natural gas being the state portion which can produce a maximum profit to the state.

**Article 45**

- (1) The executing agency as meant in Article 4 paragraph (3) shall constitute a state-owned statutory body.
- (2) The executing agency shall consists of managerial elements, experts, technical personnel and administrative personnel.
- (3) The head of the executing agency shall be appointed and relieved by the President after consulting with the House of Representatives of the Republic of Indonesia and be responsible to the President in executing his/her tasks.

**Article 46**

- (1) The regulating agency as meant in Article 8 paragraph (4) shall supervise the supply and distribution of fuel oil and transport of natural gas through pipeline.
- (2) The regulating agency as meant in paragraph (1) shall function to regulate so that the supply and distribution of fuel oil and natural gas stipulated by the government can be guaranteed throughout the territory of the Unitary State of the Republic of Indonesia as well as the domestic use of natural gas increases.

- (3) The regulating agency as meant in paragraph (1) shall have the tasks of regulating and stipulating the following matters :
  - a. supply and distribution of fuel oil;
  - b. national fuel oil reserves;
  - c. utilization of fuel oil transport and storage facilities;
  - d. tariff of transport of natural gas through pipeline;
  - e. selling price of natural gas to households and small-scale customers;
  - f. operation of natural gas transmission and distribution.
- (4) The tasks of the executing agency as meant in paragraph (1) shall also cover the supervision over the fields as meant in paragraph (3).

#### Article 47

- (1) The structure of the regulating agency as meant in Article 8 paragraph (4) shall consist of a committee and a division.
- (2) The committee as meant in paragraph (1) shall comprise one chairman concurrently member and 8 (eight) members, originating from professionals.
- (3) The chairman and members of the committee of the regulating agency as meant in paragraph (1) shall be appointed and relieved by the President after securing the approval of the House of Representative of the Republic of Indonesia.
- (4) The regulating agency as meant in Article 8 paragraph (4) shall be responsible to the President.
- (5) The establishment of the regulating agency as meant in Article 8 paragraph (4) shall be stipulated by a presidential decree.

#### Article 48

- (1) The budget of operational costs of the executing agency as meant in Article 45 shall be based on the fee of the government in accordance with laws in force.
- (2) The budget of operational costs of the regulating agency as meant in Article 46 shall be based on the State Budget of Revenue and Expenditure and contributions from business entities which are regulated in accordance with laws in force.

#### Article 49

Provisions on organizational structures, status, function, tasks, personnel, authority and responsibility as well as working mechanism of the executing agency and the regulating agency as meant in Article 41, 42, 43, 44, 45, 46, 47 and 48 shall be further stipulated by a government regulation.

### **CHAPTER X INVESTIGATION**

#### Article 50

- (1) In addition to investigators of the Police of the Republic of Indonesia, certain civil servant officials within the ministry in charge of petroleum and natural gas-related business activities shall be authorized specially to act as the investigators as meant in Law No. 8/1981 on the criminal code to investigate crimes in petroleum and natural gas-related business activities.

- (2) Civil servant investigators shall be authorized to :
  - a. examine the truth of reports and information on crimes in petroleum and natural gas related business activities;
  - b. investigate persons or statutory bodies allegedly committed crimes in petroleum and natural gas-related business activities;
  - c. summon persons for testifying and investigating as witnesses or suspects in petroleum and natural gas-related business activities;
  - d. raid place and/or facilities allegedly used for committing crimes in petroleum and natural gas-related business activities;
  - e. inspect facilities and infrastructures of petroleum and natural gas-related business activities and stop the use of equipment allegedly used for committing crimes;
  - f. sealing and/or confiscating equipment of petroleum and natural gas-related business activities used for committing crimes as evidences;
  - g. invite necessary experts in connection with the investigation of crimes in petroleum and natural gas-related business activities;
  - h. stop investigating crimes in petroleum and natural gas-related business activities.
- (3) The civil servant investigators shall notify the commencement if investigation into crimes to police officials of the Republic of Indonesia in accordance with the provisions of laws in force.
- (4) The investigators as meant in paragraph (1) shall be obliged to stop the investigation in the case of the events as meant in paragraph (2) letter a having no sufficient evidence and/or the events being not a crime.
- (5) The exercise of the authority as meant in paragraph (2) shall be done in accordance with provisions of laws in force.

## **CHAPTER XI CRIMINAL PROVISION**

### **Article 51**

- (1) Everyone who undertakes the general survey as meant in Article 19 paragraph (1) without right shall be subjected to one-year imprisonment or a fine of Rp. 10,000,000,000.00 (ten billion rupiahs) at the maximum.
- (2) Everyone who sends or gives up or transfers the data as meant in Article 20 without right in whatever from shall be subjected to one-year imprisonment or a fine of Rp. 10,000,000,000.00 (ten billion rupiahs) at the maximum.

### **Article 52**

Everyone who undertake exploration and/or exploitation without the joint cooperation contracts as meant in Article 11 paragraph (1) shall be subjected to 6 (six)-year imprisonment or a fine of Rp. 60,000,000,000.00 (sixty billion rupiahs) at the maximum.

### **Article 53**

Everyone who undertakes :

- a. the processing as meant in Article 23 without a processing business license shall be subjected to 5 (five)-year imprisonment or a fine of Rp. 50,000,000,000.00 (fifty billion rupiahs) at the maximum.



- b. the transport as meant in Article 23 without a transport business license shall be subjected to 4 (four)-year imprisonment or a fine of Rp. 40,000,000,000.00 (forty billion rupiahs) at the maximum.
- c. the storage as meant in Article 23 without a storage business license shall be subjected to 3 (three)-year imprisonment or a fine of Rp. 30,000,000,000.00 (thirty billion rupiahs) at the maximum.
- d. the commerce as meant in Article 23 without a commerce business license shall be subjected to 3 (three)-year imprisonment or a fine of Rp. 30,000,000,000.00 (thirty billion rupiahs) at the maximum.

**Article 54**

Everyone who imitates or falsify fuel oil and natural gas and the processed products as meant in Article 28 paragraph (1) shall be subjected to 6 (six)-year imprisonment or a fine of Rp. 60,000,000,000.00 (sixty billion rupiahs) at the maximum.

**Article 55**

Everyone who abuses the transport and/or commerce of fuel oil subsidized by the government shall be subjected to 6 (six)-year imprisonment or a fine of Rp. 60,000,000,000.00 (sixty billion rupiahs) at the maximum.

**Article 56**

- (1) In the case of the crimes as meant in this chapter being committed for and on behalf of business entities or permanent establishments, charges and sentence shall be imposed on the business entities or permanent establishments and/or their executives.
- (2) In the case of the crimes being committed by business entities or permanent establishments, sentence imposed on the said business entities or permanent establishments shall be a fine as high as the maximum fine of the crimes plus one thirds of the fine.

**Article 57**

- (1) The crimes as meant in Article 51 shall be violations.
- (2) The crimes as meant in Articles 52, 53, 54 and 55 shall be crimes.

**Article 58**

In addition to the criminal provisions as meant in this Chapter, the additional sentence shall be the revocation of right or seizure of goods used for and obtained from crimes in petroleum and natural gas-related business activities.

**CHAPTER XI  
TRANSITIONAL PROVISION**

**Article 59**

With the enforcement of this law :

- a. the executing agency shall be established not later than one year;
- b. the regulating agency shall be established not later than one year

**Article 60**

With the enforcement of this law :

- a. the status of Pertamina shall be changed into a state limited liability company (Persero) by a government regulation not later than 2 (two) years;
- b. as long as the state limited liability company as meant in paragraph (1) is not established yet, Pertamina which was established on the basis of Law No. 8/1971 (Statute Book of 1971 No. 76, Supplement to Statute Book No. 2971) shall be obliged to undertake petroleum and natural gas-related business activities as well as regulate and manage assets, personnel and other important matters needed;
- c. upon the establishment of the new state limited liability company, the obligation of Pertamina as meant in letter b shall be transferred to the relevant company.

**Article 61**

With the enforcement of this law :

- a. Pertamina shall continue executing the task and function of supervision over the operation of exploration and exploitation contractors, including production sharing contractors up to the establishment of the executing agency;
- b. upon the establishment of Persero as the substitute to Pertamina, the state-owned enterprise shall be obliged to make a production sharing contract with the executing agency to continue exploration and exploitation in ex-mining concession areas of Pertamina and be considered already securing the business licenses as meant in Article 24, needed for the implementation of processing, transport, storage and commercial businesses.

**Article 62**

Upon the enforcement of this law, Pertamina shall continue executing the task of supplying and serving fuel oil for the domestic need for a period of no later than 4 (four) years.

**Article 63**

With the enforcement of this law :

- a. following the establishment of the executing agency, all rights, obligations and consequences resulting from the production sharing contracts between Pertamina and other parties shall transfer to the executing agency.
- b. following the establishment of the executing agency, other contracts connected with the contracts as meant in latter a between Pertamina and other parties shall shift to the executing agency.
- c. all contracts as meant in letters a and b shall be declared to remain effective up to the expiration of the relevant contracts;
- d. rights, obligations and consequences resulting from the contracts, agreements or commitments other than those mentioned in letters a and b shall continue to be exercised by Pertamina up to the establishment of Persero set up for the purpose and shift to Persero afterwards;
- e. the implementation of dealings or negotiations between Pertamina and other parties in the framework of joint cooperation in exploration and exploitation shall shift to the minister.

**Article 64**

With the enforcement of this law :

- a. state-owned enterprises other than Pertamina, which undertake petroleum and natural gas-related businesses shall be considered already securing the business licenses as meant in Article 23;
- b. the development which is being executed by the state-owned enterprises as meant in latter a upon the enforcement of this law shall continue to be executed by the state-owned enterprises;
- c. not later than one year, the state-owned enterprises as meant in letter a shall be obliged to establish business entities set up for undertaking their business activities in accordance with the provisions of laws in force;
- d. contracts or agreements between the state-owned enterprises as meant in letter a and other parties shall continue to remain effective up to the expiration of the period of the relevant contracts or agreements.

**CHAPTER XIII  
MISCELLANEOUS**

**Article 65**

This law shall apply to petroleum and natural gas-related business activities other than those mentioned in Article 1 points 1 and 2, as long as they are not yet or are not regulated by other laws.

**CHAPTER XIV  
CONCLUSION**

**Article 66**

- (1) With the enforcement of this law, the following laws :
  - a. Law No. 44 Prp/1960 on petroleum and natural gas mining (Statute Book of 1960 No. 133, Supplement to Statute Book No. 2070);
  - b. Law No. 15/1962 on the stipulation of government regulation in lieu of a law No. 2/1962 concerning the obligation of oil companies to meet the domestic need (Statute Book of 1962 No. 80, Supplement to Statute Book No. 2505);
  - c. Law No. 8/1971 on state-owned oil and gas mining company (Statute Book of 1971 No. 76, Supplement to Statute Book No. 2971) as well as the whole amendments, amended the latest by Law No. 10/1974 (Statute Book of 1974 No. 3045);
- (2) All technical directives for Law No. 44 Prp/1960 on petroleum and natural gas mining (Statute Book of 1960 No. 133, Supplement to Statute Book No. 2070) and Law No. 8/1971 on state-owned oil and gas mining company (Statute Book of 1971 No. 76, Supplement to Statute Book No. 2971) shall remain effective as long as they do not contravene or are not yet replaced by new regulations on the basis of this law.

**Article 67**

This law shall come into force as from the date of promulgation.

For public cognizance, this law shall be promulgated by placing it in Statute Book of the Republic of Indonesia.

Ratified in Jakarta On November 23, 2001

THE PRESIDENT OF THE REPUBLIC OF INDONESIA  
sgd.  
MEGAWATI SOEKARNOPUTRI

Promulgated in Jakarta  
On November 23, 2001

THE SECRETARY OF STATE  
sgd.  
BAMBANG KESOWO

STATUTE BOOK OF THE REPUBLIC OF INDONESIA OF 2001 NUMBER 136

**ELUCIDATION ON LAW NO. 22/2001  
CONCERNING  
PETROLEUM AND NATURAL GAS**

**GENERAL**

Article 33 paragraphs (2) and (3) of the Constitution of 1945 affirms that the state controls production branches important for the state and dominating the life of public at large. The state also controls the earth and water as well as natural resources contained inside the earth and water and uses them maximally for increasing the people's prosperity and welfare. In view of the fact that petroleum and natural gas are non-renewable strategic natural resources controlled by the state and vital commodities playing important role in the provision of raw materials for industries, fulfillment of the domestic need for energy as well as a important source of foreign exchange earnings, they must be managed optimally so that they can be used maximally for the people's prosperity and welfare.

In the framework of complying with the provisions of the Constitution of 1945, and following the enforcement of law No 44/Prp/1960 on petroleum and natural gas mining and law No 8 /1971 on state-owned oil and natural gas mining company over four decades, various obstacles are found in the implementation of the laws because their materials substances are no longer suitable to the current and future developments.

In order to face the global need and challenges in the future, petroleum and natural gas-related business activities are demanded to be more capable of supporting the sustainability of the national development in the framework of improving the people's prosperity and welfare.

Based on the above mentioned matters, it is necessary to formulate a law on petroleum and natural gas to provided the legal foundation for steps of renewal and rearrangement of petroleum and natural gas-related business activities.  
The formulation of law aims at :

1. exploiting and controlling petroleum and natural gas as natural and development resources which are strategic and vital;
2. supporting and driving up national capacity so as to be more competitive;
3. in creasing the state revenue and contributing maximally to the national economy, developing and strengthening Indonesia's industries and trade;
4. creating job opportunities, improving the environment and increasing the people's prosperity and welfare.

This law makes out a principal substance of the provision that petroleum and natural gas as strategic natural resources contained in the Indonesian mining jurisdiction constitute national assets controlled by the state and the control is executed by the government as the holder of mining concession in the upstream business activities, while the downstream business activities are executed after securing business licenses from the government.

In order to ensure the more efficient execution of the function of the government as the regulator, fostering agency and supervisor, the executing agency is established in the upstream business activities, while in the downstream business activities, the regulatory board is set up.

#### **ARTICLE BY ARTICLE**

Article 1 up to Article 3  
Sufficiently clear

Article 4

Paragraph (1)

Based on the gist of Article 33 paragraph (3) of the Constitution of 1945, petroleum and natural gas as strategic natural resources deposited in the earth of the Indonesian mining jurisdiction constitute national assets controlled by the state. The above mentioned control by the state is meant to ensure that the state assets can be utilized maximally for the welfare of the whole Indonesian people. Therefore, individuals, communities and business people having a right to a land plot on the surface have not right to control or own petroleum and natural gas contained inside the land.

Paragraph (2) and (3)  
Sufficiently clear

Article 5

Point 1

Sufficiently clear

Point 2

Referred to in this provision as commerce includes natural gas commerce through both transmission and distribution pipelines.

**Article 6**

**Paragraph (1)**

Besides fulfilling the laws in force, business entities or permanent establishments also must abide by certain obligation in executing their business activities.

**Paragraph (2)**

The model of the joint cooperation contracts in this provision is production sharing contracts and other exploration and exploitation contracts more beneficial to the state. Hereinafter referred to as :

1. The delivery point is the selling point of petroleum and natural gas.
2. The control over the operational management is the approval of working plans and budget, field development plans as well as supervision over the realization of the said plans.
3. The capital and risks wholly borne by business entities or permanent establishment is that in the joint cooperation contracts, the government through the executing agency on the basis of this law is not allowed to invest in bear financial risks of joint cooperation contracts.

**Article 7**

**Paragraph (1)**

Sufficiently clear

**Paragraph (2)**

The realization through a mechanism of reasonable, fair and transparent business competition does not mean that the social responsibility of the government is ignored.

**Article 8**

**Paragraph (1)**

The government regulation as the implementation of this provision contains, among others, principal substances : priority of natural gas exploitation, quantity, kind and locations of strategic petroleum reserves.

**Paragraph (2)**

The government is obliged to ensure the sufficient supply of fuel oil throughout the country, including remote areas, the availability of a national stock at a sufficient quantity for as certain period.

**Paragraph (3)**

Since the petroleum pipeline networks constitute naturally monopolistic facilities, their utilization needs to be regulated and supervised in the framework of guaranteeing the equal treatment of services for all users. Referred to public interest in this provision is interests of producers, consumers and other communities connected with the transport of natural gas.

**Paragraph (4)**

Sufficiently clear

**Article 9**

**Paragraph (1)**

This provision is meant to open wider opportunities for large, medium and small-scale business entities to undertake the upstream business activities with the operational scale on the financial and technical capacity of the relevant business entities.

**Paragraph (2)**

Most of the highly-risky upstream business-activities (2) are executed by international companies having a broad range of international networks . In order to create an investment climate conducive to investments, including foreign investment, the opportunities to not establish business entities is provided.

**Article 10**

**Paragraph (1)**

Since the upstream business activities are activities of exploration of non-renewable natural resources being the state assets, the state must obtain the maximal benefit for the people's prosperity in the said activities.

The downstream business activities constitute activities of the business characteristics in general, in which the production costs and possible risks cannot be charged (consolidated) to the costs of upstream business activities. The prohibition of consolidation of the cost of upstream and downstream business activities also aims at ensuring the clear sharing of revenue between the central government and regional government as meant in Article 31 paragraph (6)

In the case of business entities undertaking upstream and downstream activities at the same time, they must establish separate statutory bodies, among others, by holding company.

**Paragraph (2)**

Sufficiently clear

**Article 11**

**Paragraph (1)**

The government mentions obligations in joint cooperation contracts so that the government can control the joint cooperation contracts through requirements for the said contracts and the legislation in force as meant in Article 6 paragraph (1)

**Paragraph (2)**

The copy of every joint cooperation contract already approved collectively and signed by the two parties must be sent to the commission of the house of Representatives of the Republic of Indonesia in charge of petroleum and natural gas affairs.

**Paragraph (3)**

This provision is meant to provide legal certainty for parties committed themselves to joint cooperation contracts.

**Article 12**

**Paragraph (1)**

Consultation with the regional government is done to give explanations and obtain information on plans for the offering of certain regions deemed potential to contain petroleum and natural gas resources to become working areas.

The consultation with the regional government is done with the governor leading the administration of the regional government in accordance with provisions of the regional administration laws.

**Paragraph (2)**

In its implementation, the minister coordinates with the executing agency.

**Paragraph (3)**

In its implementation, the minister coordinates with the executing agency

**Article 13**

**Paragraph (1)**

Sufficiently clear

**Paragraph (2)**

This provision is meant to avoid the consolidation of encumbrance and/or return of costs of exploration and exploitation of a working area by other working area.

This provision also aims at preventing the unclear sharing of revenue between the central government and the respective regional governments connected with the said working areas.

**Article 14**

Sufficiently clear

**Article 15**

**Paragraph (1)**

Sufficiently clear

**Paragraph (2)**

If business entities or permanent establishments found no petroleum and/or natural gas reserves which can be produced during the exploration period, they must return their working areas wholly.

**Article 16**

This provision is meant to ensure that part and/or the whole of working areas not used can be offered to other parties as new working areas.

Therefore, the government can obtain optimal results from the utilization of potentials of natural resources in a working area.

**Article 17**

Sufficiently clear



**Article 18**

The government regulation as technical directives for this provision contains, among others, principal substances: provisions and requirements for joint cooperation contracts, requirements and procedures for stipulation and offering of working areas, extension of joint cooperations contracts and stipulation and intake of working areas.

**Article 19**

**Paragraph (1)**

Sufficiently clear

**Paragraph (2)**

The government regulation on the general survey contains, among others, principal substances: the execution of general survey, kinds of activities, timetable of implementation, procedures for implementation and processing of data resulting from the survey.

**Article 20**

**Paragraph (1) up to paragraph (3)**

Sufficiently clear

**Paragraph (4)**

Data or information on the underground condition resulting from investments made by business entities or permanent establishments cannot be opened directly for the public to protect their investment interests.

Data can be declared opened after a certain period and interesting parties can use the said data.

The period of secrecy of data is dependent on kinds and classifications of data.

**Paragraph (5)**

Sufficiently clear

**Paragraph (6)**

The government regulation as technical directives for this provision contains, among others, principal substances: authority and responsibility of the government, kinds of data, classifications and periods of secrecy, administration and maintenance of data as well as periods of utilization and re-delivery of the data.

**Article 21**

**Paragraph (1)**

The approval of the minister in this provision is needed because the development of the first field in a working area determines whether the operation of the working area is returned or continued by the executing agency or permanent establishments. The approval of plans for the development of the subsequent fields in the working area will be granted by the executing agency.

The consultation with regional governments as meant in this provisions is needed for ensuring that the proposed plans for development of fields can be coordinated with regional governments of provinces especially for regional lay-out plans and plans for regional revenue from petroleum and natural gas in the regions in accordance with laws in force.

**Paragraph (2)**

This provision is meant to ensure that business entities or permanent establishments in exploiting petroleum and natural resources observe optimalization and conservation of petroleum and natural gas resources and implement them in accordance of good technical norms.

**Paragraph (3)**

The government regulation as technical directives for this provision contains, among others, principal substances :

Kinds and plans for developments of fields, technical norms, reporting obligations as well as procedures for the approval of plans for developments of fields.

**Article 22**

**Paragraph (1)**

This provision is meant to provide a guarantee for the availability of supply of petroleum and natural gas resulting from the Indonesia mining jurisdiction to meet the domestic need for fuel. The delivery as high as 25% (twenty five percent) at the maximum of their portion resulting from the production of petroleum and/or natural gas in this provision is meant to ensure that if a working area produces petroleum and natural gas, business entity or permanent establishment is obliged to give up maximally 25% (twenty five percent) of its portion from the petroleum production and maximally 25% (twenty five percent) of its portion from the natural gas production.

**Paragraph (2)**

The government regulation as meant in this provision contains, among others, principal substances :

condition of the domestic need, mechanism of implementation and provision of price as well policies on the granting of incentives connected with the exercise of obligation of the delivery of petroleum and/or natural gas being portion of business entities or permanents establishments from their production.

**Article 23**

**Paragraph (1)**

Business licenses are licenses granted by the go vernment to business entities in accordance with their respective scopes of authority to undertake processing, transport storage and/ or commercial business activities after fulfilling the necessary requirements. In the case of matters being connected with regional interests, the government issues business licenses after the said business entities secure recommendations from the regional governments.

Paragraph (2)

This provision is meant to ensure the more effective supervision and control over business entities operating in processing, transport, storage and / or commercial fields. The government is obliged to approve or reject applications for business licenses submitted by business entities in a certain period in accordance with laws in force.

Paragraph (3)

Sufficiently clear

Article 24

Sufficiently clear

Article 25

Paragraph (1)

Sufficiently clear

Paragraph (2)

Based on considerations, among others that the downstream business activities deal with commodities controlling the life of public at large and huge investment, the central government and regional government according to their respective scopes of authority can open opportunity for business entities to eliminate the violations committed before their business licenses are revoked . In addition to the violations, business licenses also can be revoked based on requests of holders of the business licenses.

Article 26.

In view of the fact that in activities of fields processing, transport and sales of petroleum and natural gas in the framework of the continuation of exploration and exploitation , facilities which are built are not destined to obtain benefits and /or profits from the activities, business licenses are not needed.

This provisions is not effective if facilities owned by business entities or permanent establishments are used collectively with other parties by collecting a cost or rental fee so as to obtain benefits and / or profits, so that the business entities or permanent establishment must secure business licenses.

Article 27

Paragraph (1)

The master plan stipulated by the government will be used as an investment reference to the development and building of natural gas transmission and distribution network by the interesting business entities.

Paragraph (2)

This provision is meant to encourage fair business competition and enhance efficiency in the use of infrastructure as well as the quality of service.

The segments of transport businesses are distributed by considering technical, economic, security and safety aspects.

Paragraph (3)

This provision is meant to encourage fair business competition and enhance efficiency in the use of infrastructures as well as the quality of service.

Article 28

Paragraph (1)

This provision is meant to protect interests of consumers, health of communities and the environment.

Paragraph (2)

Sufficiently clear

Paragraph (3)

The government can grant special aid as the substitute to subsidy to certain consumers for certain kinds of fuel oil. The government stipulates the natural gas pricing policy for the need of households and small-scale consumers as well as other certain users.

Article 29

Paragraph (1)

This provision is meant to open opportunity for other parties to use collectives facilities belonging to a business entity on the basis of a joint agreement in the framework of ensuring the optimal use of the facilities and the efficient operation to reduce distribution costs, particularly in the case of the shortage of supply of fuel oil in a region and relatively isolated area.

Paragraph (2)

Sufficiently clear

Article 30

The government regulation as technical directives for this provision contains, among other, principal substances : kinds of business activities, procedures for submission of applications and implementation of business licenses, standards and quality, obligations of business entities, classifications of violations, procedures for warning, cancellation, freezing and revocation of business licenses and the authority of regional governments connected with business licensing.

Article 31

Paragraph (1)

Since the provision as meant in this article is based on the understanding that upstream business activities in the form of exploration and exploitation are activities of intake of non-renewable natural resources being the state assets, business entities or permanent establishments are obliged to give up non tax state revenue consisting of the portion of the state, state levies and bonuses, besides paying taxes, import duty and other liabilities.

Paragraph (2)

Letters a and b

Sufficiently clear

Letter c

Besides paying regional taxes, business entities or permanent establishments are also obliged to pay regional levies.

Paragraph (3)

Letter a

The state portion of production given up by business entities or permanent establishments to the state as the owner of petroleum and natural gas resources.

Letter b

This provision is based on the understanding that business entities or permanent establishments are obliged to pay a regular contribution in accordance with the size of working areas as a compensation for the opportunity to undertake exploration and exploitation activities.

The exploration and exploitation contributions are imposed on business entities or permanent establishments as a compensation for the intake of non renewable petroleum and natural gas resources.

State levies being a revenue of the central government constitute non-tax state revenue (PNBP) in accordance with the provisions of law in force.

Letter c

Referred to in this provision as bonuses are data, signature and production bonuses based on the accomplishment of a certain cumulative production level.

Paragraph 4

The provision article is meant to enable business entities or permanent establishment to alternatives for taxation regulations which will be enforced to joint cooperation contracts.

The opening of the opportunity constitutes freedom of business entities of permanent establishments to choose taxation provisions in accordance the feasibility of their business because exploration and exploitation are long – term businesses, need huge capital and are highly risky.

Paragraph (5)

The government regulation as technical directives for this provision contains, among other, principal substances : regulation of amount of the state portion based on net production percentage, and state levies consisting of regular contribution per unit of working area, exploration and exploitation levies per production volume, bonuses and regulation of certain requirements for joint cooperation contracts.

Paragraph (6)

Referred to in this provision as “which is shared in accordance with provisions of law in force” is in accordance with provisions on the financial equilibrium between the central government and regional administration.

Article 32

Given the downstream business activities in the form of the processing, transport, storage and commerce are not business activities directly connected with the intake of non-renewable natural resources, the obligations to pay taxes, import duty and other liabilities to the state as like industrial and/or trading business activities in general apply.

Article 33

Paragraph (1) and (2)

Sufficiently clear

Paragraph (3)

Principally, all petroleum and natural gas related business activities executed in a location need a license from the government institution.

Yet, in certain places before securing license from the government institution, the businesses must secure prior approval from communities and/ or individuals

Letter a

Referred to as public places, public facilities and infrastructures are facilities provided by the government for interests for the public at large and having social functions, such as road, market, cemetery, park and worship places.

Letter b up to letter d

Sufficiently clear

Paragraph (4)

Since public places, facilities and infrastructures, defense fields and buildings constitute facilities built by the government for the public or defense interests, licenses from the government institutions concerned are needed, by observing suggestions of communities.

Article 34

Paragraph (1)

Sufficiently clear

Paragraph (2)

Referred to in this provision as recognition is the recognition to communal rights of traditional communities in a region so that their settlement can be done through deliberation and consensus on the basis of the relevant communal law.

Article 35

Sufficiently clear

Article 36

Paragraph (1)

In view of the fact that a right to working area does not cover a right to land surface, business entities or permanent establishments do not automatically have a right to use land plots in the working area. In the case of business entities directly using the land plots, the right to use the land must be exercised in accordance with provisions of law in force.

Paragraph (2)

Sufficiently clear

Article 37

The government regulations as technical directives for this provision contains, among other, principal substances : procedures for the settlement or negotiation rights and obligations of the respective parties, guidances on the amount of compensations and technical; provisions on the settlement pattern of land use.

Article 38

The fostering executed by the government in petroleum and natural gas- related business activities is based on the state control over natural resources and production fields controlling the life of public at large.

Article 39

Paragraph (1)

Letter a

The implementation of government affairs in the field of petroleum and natural gas-related business activities include, among others, the dissemination of information, education, training, technological research and development, enhancement of added value of products, application of standardization, accreditation, fostering of supporting industrial/business activities, fostering of small/medium-scale businesses, the utilization of domestic goods and services, maintenance of working security and health, environmental conservation, creation of a conducive business climate as well as maintenance of security and orderliness.

Letter b

Sufficiently clear

Paragraph (2)

Sufficiently clear

Article 40

Paragraph (1) up to paragraph (3)

Sufficiently clear

Paragraph (4)

This provision is meant to support and drive up the national capacity so as to be more capable of competing.

**Paragraph (5)**

Referred to in this provision as being responsible for the development of the environment and local communities is the involvement of business entities or permanent establishment in the development and utilization of potentials and capacities of local communities, among others by means of employing workers in certain quantity and quality as well as improving the resettlement of communities to create the harmony between business entities or permanent establishments and surrounding communities.

**Paragraph (6)**

The government regulations as technical directives for this provision contains, among others, principal substances covering the following obligations of business entities or permanent establishments :

- a. in the field of working safety and security, which covers safety and health of workers, conditions and requirements for working places and environment and standards of installation and equipment;
- b. in the field of the environmental management which covers prevention and overcoming of environmental pollution and restoration of environmental damages during and after joint cooperation contracts.

**Article 41**

Sufficiently clear

**Article 42**

Letter a up to letter g

Sufficiently clear

Letter h

In its implementation, the utilization continues to observe economic values in the respective projects or activities.

Letter i

In the use of foreign manpower, procedures in force and requirements in accordance with the need must be observed.

Letter j up to letter m

Sufficiently clear

**Article 43**

The government regulation as technical directives for this provision contains, among others, the principal substances as mentioned in elucidation on article 39 paragraph (1) letter a

**Article 44**

Sufficiently clear



Article 45

Paragraph (1)

The state-owned statutory body as meant in this provision has the status of a civil law subject and constitutes a non profit institution and is managed professionally.

Paragraph (2)

Referred to in this provision as the managerial elements are the head and vice head as well as deputies. technical personnel are functional personnel having expertise in their fields.

Paragraph (3)

The consultation aims at testing the capability and feasibility of prospective head of the executing agency by the House of Representatives of the Republic of Indonesia in this case the commission in charge of petroleum and natural gas affairs.

Article 46

Paragraph (1)

This provision is meant to protect interests of consumers in the continuous supply and distribution of fuel oil throughout Indonesia.

The supervision over the transport of natural gas through pipeline is done to optimize and prevent monopoly in the utilization of transmission, distribution and storage pipe facilities by certain business entities.

Paragraph (2)

The government is responsible for the sustainability of stocks and service as well as avoiding the scarcity of fuel oil throughout Indonesia.

Paragraph (3)

Referred to in this provision as the utilization of fuel oil transport and storage facilities is prioritized to certain regions or remote areas whose market mechanism cannot run so that the existing transport and storage facilities need to be regulated to be usable for achieving an optimal result and a lowest price.

Household is every consumer utilizing natural gas for the household purpose.

The operation of gas transmission and distribution is regulated by the regulatory board connected with business aspects of the said natural gas distribution and distribution activities.

Paragraph (4)

Sufficiently clear

Article 47

Paragraph (1)

Sufficiently clear

Paragraph (2)

Referred to in this provision as professionals are parties having necessary expertise, experience and knowledge in the oil , environmental, law, economies and social fields as well as having high integrity in executing their tasks and obligations.

Paragraph (3)

The regulatory board is independent and since its tasks and functions deal with interests of the public at large, the appointment and relief of its personnel need to secure the approval of the House of Representatives of the Republic of Indonesia.

Paragraph (4)

In view of the fact that the tasks and functions of the regulatory board is directly connected with commodities badly needed by the public at large so as to be very influential to the national economy and able to cause a board impact of vulnerability in the society as well as having inter-sectoral regulation, the regulatory board is responsible to the President.

Paragraph (5)

Sufficiently clear

Article 48

Paragraph (1)

Every state revenue resulting from business entities or permanent establishments which undertake upstream business activities is directly remitted to the state cash. In controlling joint cooperation contracts with business entities or permanent establishments, the regulatory board earns a fee as the managerial wage received from the government for activities which are executed.

Paragraph (2)

The operational cost of the regulatory board originating from the State Budget of revenue and Expenditure (APBN) is meant as the authorized capital of the regularity board. Subsequently, the operational cost of the regulatory board are obtained from contributions of business entities that the board regulates.

Article 49 up to article 54

Sufficiently clear

Article 55

Referred to in this provision as the abuse is activities intended to obtain benefits of individuals or business entities by means harmful to interests of the public at large and the state, such as illegal mixing of fuel, deviation from the allocation of fuel oil. Transport and sales of fuel oil to other countries.

Article 56 up to article 59

Sufficiently clear

Article 60

Letter a

The status of limited liability company as meant in this provision is the status of company mentioned in law on state-owned enterprises.

Letter b and c

Sufficiently clear

Article 61

Letter a

Sufficiently clear

Letter b

The joint cooperation contracts as meant in this provision contain payment liabilities to the state whose amount is in accordance with provisions in force in Pertamina's mining concession areas so far by including CHAPTER V.

Article 62

Sufficiently clear

Article 63

In order to implement this provision, joint cooperation contracts connected with parties making contracts are changed/amended without altering conditions and requirements for the contracts.

Letter b and c

Sufficiently clear

Letter d

Referred to in this provision as contracts, agreements or commitments include selling contracts of liquefied natural gas.

Letter e

Sufficiently clear

Article 64

Letter a

State-owned enterprises other than Pertamina, which undertake petroleum and natural gas-related businesses include PT Perusahaan Gas Negara (Persero) established on the basis of Government Regulation No 37/1994.

Letter b and c

Sufficiently clear

Article 65

Referred to in this provision as petroleum or natural gas is oil and gas resulting from artificial process (instead of results of natural process)

Article 66 and 67

Sufficiently clear

SUPPLEMENT TO STATUTE BOOK OF THE REPUBLIC OF INDONESIA NO 4152

GR 35/2004

**REPUBLIC OF INDONESIA GOVERNMENT REGULATION  
NUMBER 35 OF 2004  
ON  
UPSTREAM OIL AND GAS BUSINESS ACTIVITIES  
THE PRESIDENT OF THE REPUBLIC OF INDONESIA,**

Considering: that to implement the provisions of Article 8, Article 18, Article 19 Clause (2), Article 20 Clause (6), Article 21 Clause (3), Article 22 (2), Article 31 (5), Article 37, and Article 43 of Law Number 22 of 2001 on Oil and Gas, it is necessary to establish a Government Regulation on Upstream Oil and Gas Business Activities;

Bearing in mind:

1. Article 5 Clause (2) of the 1945 Constitution, as revised through the Fourth Amendment to the 1945 Constitution;
2. Law Number 22 of 2001 on Oil and Gas (State Records of the Republic of Indonesia for 2001 Number 136, Supplement to State Records Number 4152);
3. Government Regulation Number 42 of 2002 on the Implementing Body for Upstream Oil and Gas Business Activities (State Records of the Republic of Indonesia for 2002 Number 81, Supplement to State Records Number 4216);
4. Government Regulation Number 31 of 2003 on Change of Status of the State Oil and Gas Mining Company (Pertamina) into a Limited Liability Company (Persero) (State Records of the Republic of Indonesia for 2003 Number 69);

**HAS DECIDED:**

To promulgate this: GOVERNMENT REGULATION ON UPSTREAM OIL AND GAS BUSINESS ACTIVITIES.

**CHAPTER I  
GENERAL PROVISIONS**

Article 1

In this Government Regulation, the following terms are defined as follows:

1. "Crude Oil," "Natural Gas," "Oil and Gas," "Mining Authority," General Survey," "Upstream Business Activities," "Exploration," "Exploitation," "Legal Mining Zone of Indonesia," "Work Area," "Business Entity," "Permanent Establishment," "Cooperation Contract," "Central Government" (hereinafter referred to as the "Government"), "Regional Government," "Implementing Body," and "Minister" are defined as mentioned in Law Number 22 of 2001.
2. "Coalbed Methane" is a natural gas (hydrocarbon), in which methane gas is the main component, that occurs naturally in the process of formation of coal (coalification) in trapped and absorbed conditions within coal and/or coal layers.

3. An “Open Area” is a part of the Legal Mining Zone of Indonesia that has not yet been designated as a Work Area.
4. A “Production Sharing Contract” is a form of Cooperation Contract in Upstream Business Activities based on the principle of sharing the proceeds of production.
5. A “Service Contract” is a form of Cooperation Contract for the execution of Exploitation of Oil and Gas based on the principle of granting compensation for services for the production that is produced.
6. A “Contractor” is a Business Entity or Permanent Establishment that is granted the authority to carry out Exploration and/or Exploitation in a Work Area on the basis of a Cooperation Contract with the Implementing Body.
7. “Data” are all facts, indicators, indications, and information, whether in written form (characters), numerical form (digital), figures (analog), magnetic media, documents, samples of rocks or fluids, or other form, that are obtained from General Surveys, Exploration, and Exploitation of Oil and Gas.
8. The “Department” is the department whose area of duties and authority includes Oil and Gas business activities.
9. “Pertamina” is the State Oil and Gas Mining Company established on the basis of Law Number 8 of 1971 on the State Oil and Gas Mining Company in conjunction with Law Number 22 of 2001 on Oil and Gas.
10. P.T. Pertamina (persero) is a “Limited Liability Company (Persero) established on the basis of Government Regulation Number 31 of 2003 regarding Change of Status of the State Oil and Gas Mining Company (PERTAMINA) to that of a Limited Liability Company (Persero).

## **CHAPTER II WORK AREAS**

### **Article 2**

- (1) An Upstream Business Activity shall be conducted in a certain Work Area.
- (2) Work Areas as mentioned in Clause (1) shall be planned and prepared by the Minister with attention to considered opinions from the Implementing Body.

### **Article 3**

- (1) The Minister shall determine and announce the Work Areas that are to be offered to Business Entities and Permanent Establishments.
- (2) In determining Work Areas as mentioned in Clause (1), the Minister shall consult with the Governor whose administrative area includes the Work Area that is to be offered.
- (3) The consultation as mentioned in Clause (2) is intended to provide explanations and obtain information regarding the plans to offer certain areas that are believed to potentially contain Oil and Gas resources as Work Areas.

**Article 4**

- (1) The Minister shall determine policy on offers of Work Areas based on considerations of technical aspects, economics, degree of risk, and efficiency, and on the basis of openness, fairness, accountability, and competition.
- (2) The policy on offers of Work Areas as mentioned in Clause (1) may be in the form of offers through tender or through direct offers.

**Article 5**

- (1) Offers of Work Areas to Business Entities and Permanent Establishments shall be made by the Minister.
- (2) In executing offers of Work Areas as mentioned in Clause (1), the Minister shall coordinate with the Implementing Body.
- (3) A Business Entity or Permanent Establishment may submit a request to the Minister to obtain a Work Area.
- (4) In the case that PT Pertamina (Persero) submits a request to the Minister to obtain a given open Work Area, the Minister may approve the request, considering the work program and technical and financial capability of PT Pertamina (Persero) and as long as 100% (one hundred percent) of the shares of PT Pertamina (Persero) are owned by the State.
- (5) PT Pertamina (Persero) as mentioned in Clause (4) may not submit a request for an Open Area that has already been offered.

**Article 6**

- (1) The Minister shall determine the Business Entities and Permanent Establishments as the Contractors that are granted the authority to conduct Upstream Business Activities in Work Areas as mentioned in Article 2 Clause (1).
- (2) In carrying out the determination of Business Entities or Permanent Establishments as mentioned in Clause (1), the Minister shall coordinate with the Implementing Body.
- (3) Every Business Entity or Permanent Establishment as mentioned in Clause (1) shall be granted only one Work Area.

**Article 7**

- (1) A Contractor is required to return parts of its Work Area in stages, or all of it, to the Minister through the Implementing Body, in accordance with its Cooperation Contract.
- (2) Other than as mentioned in Clause (1), a Contractor may return part or all of its Work Area to the Minister through the Implementing Body before the term of its Cooperation Contract ends.
- (3) A Contractor is required to return its entire Work Area to the Minister through the Implementing Body, once the term of its Cooperation Contract has ended.

**Article 8**

In the case that a Contractor returns its entire Work Area as mentioned in Article 7 Clause (2), it is required first to fulfill all of its definite commitments for Exploration and other obligations under its Cooperation Contract.

**Article 9**

A Work Area that is returned by a Business Entity or Permanent Establishment as mentioned in Article 7 shall become an Open Area.

**Article 10**

Regarding parts of Work Areas that are not being used by the Contractor, the Minister may request these parts of Work Areas and determine policy on enterprises in them, based on considerations of optimizing the utilization of Oil and Gas resources, after receiving the considered opinions of the Implementing Body.

**CHAPTER III  
GENERAL SURVEYS AND OIL AND GAS DATA**

**Article 11**

- (1) To support the preparation of Work Areas, the Minister shall carry out General Survey activities.
- (2) General Survey activities as mentioned in Clause (1) shall be conducted in Open Areas within the Legal Mining Zone of Indonesia.
- (3) The activities of a General Survey shall include, among other matters, geological surveys, geophysical surveys, and geochemical surveys.

**Article 12**

Other than as specified in Article 11 Clause (2), a General Survey may be conducted across the borders of a Work Area after prior coordination with the Implementing Body to notify the Contractor concerned.

**Article 13**

- (1) In the conduct of General Survey as mentioned in Article 12, the Minister may grant a permit to a Business Entity as the executor of a General Survey.
- (2) Performance of a General Survey by a Business Entity as mentioned in Clause (1) shall be done at its own expense and risk.
- (3) Before conducting a General Survey, a Business Entity as mentioned in Clause (1) is first required to submit to the Minister the schedule and procedure for the conduct of the General Survey.

**Article 14**

A Business Entity that conducts a General Survey as mentioned in Article 13 Clause (1) may retain and make use of the Data resulting from the General Survey until the end of its permit as mentioned in Article 13 Clause (1).

**Article 15**

- (1) Data obtained through General Surveys and Exploration and Exploitation are the property of the state and shall be controlled by the Government.
- (2) The Minister shall determine arrangements for the management and utilization of Data obtained through General Surveys and Exploration and Exploitation as mentioned in Clause (1).

Article 16

The management of Data as mentioned in Article 15 shall include the collection, administration, processing, organization, storage, maintenance, and destruction of Data.

Article 17

- (1) For the transmission, surrender, and/or transfer of Data as mentioned in Article 15, permission must be obtained from the Minister.
- (2) The Minister shall determine the types of Data for which permits must be obtained as mentioned in Clause (1).

Article 18

- (1) A Contractor may manage Data resulting from Exploration and Exploitation activities in its Work Area during the period of its Cooperation Contract as mentioned in Article 16, except for destruction of Data.
- (2) If, in managing its Data as mentioned in Clause (1), a Contractor appoints another party, it must obtain the approval of the Minister.
- (3) Another party that is appointed to manage Data as mentioned in Clause (2) must fulfill requirements in accordance with the applicable laws and regulations.
- (4) Contractors are obliged to store the Data that are used as mentioned in Clause (1) within the Legal Mining Zone of Indonesia.
- (5) Contractors may keep copies of Data outside the Legal Mining Zone of Indonesia, after obtaining permission from the Minister.

Article 19

- (1) A Business Entity as the executor of a General Survey is required to surrender all Data obtained as mentioned in Article 14 to the Minister once the permit that was granted has ended.
- (2) When a Cooperation Contract ends as mentioned in Article 7 Clause (3), the Contractor is obliged to surrender all Data obtained from the results of its Exploration and Exploitation to the Minister through the Implementing Body.
- (3) Contractors, through the Implementing Body, are required to surrender to the Minister all Data obtained from the results of their Exploration and Exploitation in their Work Areas when the Work Areas are returned/ relinquished as mentioned in Article 7.
- (4) A Contractor whose Cooperation Contract has ended, or that transfers its entire interest to another Business Entity or Permanent Establishment, may submit to the Minister a request for permission to retain and use copies of the data from its Work Area.
- (5) Data as mentioned in Clause (4) may not be transferred to another party without the permission of the Minister.

Article 20

A Contractor, through the Implementing Body, is required to surrender the Data resulting from its Exploration and Exploitation activities to the Minister no later than three (3) months after the end of the collection, processing, and interpretation of the Data.

Article 21

Exchanges of Data between domestic Contractors, or between domestic Contractors and other parties outside the country, may be done after obtaining the permission of the Minister.



**Article 22**

In terms of secrecy, Data are classified into:

- a. General Data: data regarding identification, geographical location, potential, reserves, and wells of Oil and Gas, and Oil and Gas production.
- b. Basic Data: descriptions or amounts from the results of recording or notation of geological, geophysical, or geochemical investigations or drilling and production activities.
- c. Processed Data: Data obtained from the results of analysis and evaluation of Basic Data.
- d. Interpreted Data: Data obtained from the results of interpretation of Basic Data and/or Processed Data.

**Article 23**

- (1) Basic Data, Processed Data, and Interpreted Data as mentioned in Article 22 shall be kept secret for certain periods of time.
- (2) The periods of secrecy of Data as mentioned in Clause (1) shall be:
  - a. For Basic Data, set at four (4) years;
  - b. For Processed Data, set at six (6) years;
  - c. For Interpreted Data, set at eight (8) years.
- (3) When a Work Area is returned to the Government as mentioned in Article 7, all Data from the Work Area concerned shall no longer be classified as secret Data.

**CHAPTER IV  
EXECUTION OF UPSTREAM BUSINESS ACTIVITIES**

**Article 24**

- (1) Upstream Business Activities shall be conducted by Business Entities and Permanent Establishments on the basis of Cooperation Contracts with the Implementing Body.
- (2) Cooperation Contracts as mentioned in Clause (1) shall contain at least the following terms and conditions:
  - a. ownership of Oil and Gas natural resources shall remain in the hands of the Government until the point of delivery;
  - b. management control of operations conducted by the Contractor shall lie with the Implementing Body;
  - c. all capital and risks shall be borne by the Contractor.

**Article 25**

- (1) The Minister shall determine the forms and the basic provisions of Cooperation Contracts that are to be put into effect for particular Work Areas, with consideration to the level of risk, the greatest possible benefit to the State, and the provisions of prevailing laws and regulations.
- (2) The Minister shall determine the forms and the basic provisions of Cooperation Contracts as mentioned in Clause (1) after receiving the considered opinions of the Head of the Implementing Body.

#### Article 26

Cooperation Contracts are required to contain at least the following basic provisions:

- a. State revenues;
- b. Work Areas and their return;
- c. obligations to expend funds;
- d. transfer of ownership of the proceeds of production of Oil and Gas;
- e. time periods and conditions for extension of contracts;
- f. resolution of disputes;
- g. obligations to supply Crude Oil and/or Natural Gas for domestic needs;
- h. ending of contracts;
- i. obligations following mining operations;
- j. occupational safety and health;
- k. management of the natural environment;
- l. transfer of rights and responsibilities;
- m. required reporting;
- n. field development plans;
- o. priority on use of domestic goods and services;
- p. development of local communities and guarantees of the rights of traditional communities;
- q. priority on use of Indonesian manpower.

#### Article 27

- (1) The term of a Cooperation Contract as mentioned in Article 24 shall be not more than thirty (30) years.
- (2) The term of a Cooperation Contract as mentioned in Clause (1) shall consist of the Exploration period and the Exploitation period.
- (3) The Exploration period as mentioned in Clause (2) shall be six (6) years, and may be extended only one (1) time for not more than four (4) years on the basis of a request from the Contractor, provided that the Contractor has fulfilled its minimum obligations under the Cooperation Contract, with the approval to be granted by the Implementing Body.
- (4) If, within the Exploration period as mentioned in Clause (3), the Contractor does not discover Oil and/or Gas reserves that can be commercially produced, the Contractor shall be required to return the entire Work Area.

#### Article 28

- (1) A Cooperation Contract as mentioned in Article 27 Clause (1) may be extended for a renewal period of not more than twenty (20) years for each extension.
- (2) The provisions or forms of Cooperation Contracts in extensions of Cooperation Contracts as mentioned in Clause (1) must continue to be advantageous to the State.
- (3) A Contractor, through the Implementing Body, must submit a request for extension of its Cooperation Contract as mentioned in Clause (1) to the Minister.
- (4) The Implementing Body shall conduct an evaluation of requests for extensions of Cooperation Contracts as material for the Minister's consideration in granting approval or rejection of a Contractor's request.
- (5) A request for extension of a Cooperation Contract as mentioned in Clause (3) may be submitted no sooner than ten (10) years and no later than two (2) years before the Cooperation Contract is to expire.

- (6) Notwithstanding the provisions as stipulated in Clause (5), if the Contractor has been bound in a Natural Gas sales/purchase contract, the Contractor may request extension of the Cooperation Contract before the time limit specified in Clause (5).
- (7) In granting approval for extensions of Cooperation Contracts as mentioned in Clause (1), the Minister shall consider factors including potential reserves of Oil and/or Gas from the Work Area concerned, potential or certainty of market/ needs, and technical/ economic feasibility.
- (8) Based on the results of the study and considerations as mentioned in Clause (4) and Clause (7), the Minister may reject or approve the request for extension of the Cooperation Contract as mentioned in Clause (1) with a certain time period, form, and provisions of the Cooperation Contract.
- (9) PT Pertamina (Persero) may submit a request to the Minister for a Work Area whose contract period has ended.
- (10) The Minister may approve a request as mentioned in Clause (9), considering the work program and technical and financial capability of PT Pertamina (Persero), as long as 100% (one hundred percent) of the shares of PT Pertamina (Persero) are owned by the State, and other matters related to the Cooperation Contract concerned.

#### Article 29

- (1) A Contractor, through the Implementing Body, may propose to the Minister amendments to the provisions and terms and conditions of a Cooperation Contract.
- (2) The Minister may approve or reject proposals as mentioned in Clause (2) on the basis of the considered opinions of the Implementing Body and of optimum benefit to the State.

#### Article 30

- (1) Within not more than 180 (one hundred eighty) days from the effective starting date of a Cooperation Contract, the Contractor is required to begin its activities.
- (2) In the case that a Contractor is unable to carry out its responsibilities as mentioned in Clause (1), the Implementing Body may propose to the Minister to receive approval for termination of the Cooperation Contract.

#### Article 31

- (1) During the first three (3) years of the Exploration period as mentioned in Article 27 Clause (3), a Contractor is required to carry out a definite work program with the estimated total expenditure as specified in the Cooperation Contract.
- (2) If, in the implementation, it is technically and economically not possible to execute the definite work program as mentioned in Clause (1), the Contractor may, through the Implementing Body, propose changes to the Minister to obtain his approval.
- (3) The Minister may approve or reject a definite work program proposal as mentioned in Clause (2) based on the considered opinions of the Implementing Body.
- (4) In the case that a Contractor finishes a Cooperation Contract and is unable to perform part or all of the definite work program as mentioned in Clause (2), the Contractor shall be required to pay to the Government through the Implementing Body the amount of the expenses related to the definite work program that it was unable to perform.

#### Article 32

In the case that a Contractor is unable to carry out its obligations in accordance with its Cooperation Contract and the prevailing laws and regulations, the Implementing Body may propose to the Minister to end the Cooperation Contract.

Article 33

- (1) A Contractor may shift, surrender, or transfer part or all of its rights and responsibilities (participating interest) to another party after obtaining approval of the Minister based on the considered opinions of the Implementing Body.
- (2) In the implementation of the shift, surrender, or transfer of part or all of a Contractor's participating interest as mentioned in Clause (1) to a non-affiliated company or to a company other than a working partner in the same work area, the Minister may ask the Contractor to first offer it to a national company.
- (3) For disclosure of Data as part of the shift, surrender, or transfer of part or all of a Contractor's participating interest to another party as mentioned in Clause (1), the permission of the Minister must be obtained through the Implementing Body.
- (4) A Contractor may not transfer a majority of its participating interest to another party that is not its affiliate within the first three (3) years of the Exploration period.

Article 34

After the development plan has been approved for a field that is to produce for the first time within a given Work Area, the Contractor is required to offer a participating interest of 10% (ten percent) to a Regionally-Owned Business Entity.

Article 35

- (1) The statement of intent and willingness to take up a participating interest as mentioned in Article 33 shall be submitted by the Regionally-Owned Business Entity within not more than 60 (sixty) days from the date of the offer by the Contractor.
- (2) In the case that the Regionally-Owned Business Entity does not provide a statement of intent within the period mentioned in Clause (1), the Contractor is required to offer it to a national company.
- (3) In the case that the national company does not provide a statement of intent and willingness within a period of not more than 60 (sixty) days from the date of the offer by the Contractor to the national company, the offer shall be declared closed.

Article 36

- (1) Contractors are required to allocate funds to pay for activities following Upstream Business Activity operations.
- (2) The obligation as mentioned in Clause (1) shall be carried out from the start of the exploration period and shall be done through the work plan and budget.
- (3) Placement of allocations of funds as mentioned in Clauses (1) and (2) shall be agreed between the Contractor and the Implementing Body and shall function as special reserve funds for activities following Upstream Business Activities in the Work Area concerned.
- (4) Procedures for use of the special post-operations reserve funds as mentioned in Clause (3) shall be stipulated in the Cooperation Contract.

Article 37

- (1) Cooperation Contracts shall be made in the Indonesian language and/or the English language.
- (2) If a Cooperation Contract is made in both Indonesian and English and there is a difference of interpretation between the two, the interpretation to be used shall be the interpretation in Indonesian or the one in English, as agreed by the parties.

**Article 38**

Cooperation Contracts shall submit to and be subject to Indonesian law.

**Article 39**

- (1) Contractors are obliged to report their discoveries and the results of certification of Oil and/or Gas reserves to the Minister through the Implementing Body.
- (2) In developing and producing from Oil and Gas fields, Contractors are required to carry out conservation and to perform their activities in line with good Engineering Practices.
- (3) Conservation as mentioned in Clause (2) shall be done through efforts toward optimization of exploitation and efficiency in the utilization of Oil and Gas.
- (4) Good Engineering Practices as mentioned in Clause (1) include:
  - a. complying with the provisions on occupational safety and health and environmental protection;
  - b. producing Oil and Gas in line with the practices of good Reservoir Management;
  - c. producing from Oil and Gas wells using appropriate methods;
  - d. using enhanced oil recovery (EOR) technology as appropriate;
  - e. increasing efforts to increase reservoir capability to flow fluids using appropriate technology;
  - f. complying with the provisions of required standards for equipment.

**Article 40**

A Contractor must report, through the Implementing Body, to the Minister if it is discovered, and evidence has been obtained, that an Oil and/or Gas reservoir extends into another Contractor's Work Area, an Open Area, or the territory/ continental shelf of another country.

**Article 41**

- (1) A Contractor is required to conduct unitization if it is proven that its reservoir extends into another Contractor's Work Area.
- (2) For a reservoir extension that enters an Open Area, the Contractor is required to conduct unitization if said Open Area later becomes a Work Area.
- (3) In the case that within a period of no longer than five (5) years an Open Area as mentioned in Clause (2) has not become a Work Area, the Contractor concerned, through the Implementing Body, may request a proportionate extension of its Work Area.
- (4) For unitization as mentioned in Clause (1) and Clause (2), the approval of the Minister must be obtained.

**Article 42**

The Minister shall determine the operator for the unitization based on the agreement between the Contractors conducting the unitization and the considered opinions of the Implementing Body.

**Article 43**

For a reservoir extension that enters the territory/ continental shelf of another country, the resolution shall be determined by the Minister based on the continental shelf agreement between the Government of the Republic of Indonesia and the Government of the other country concerned and on considerations of optimum benefit to the state.

**Article 44**

- (1) The activities of field processing, transportation, storage, and sale of its own production conducted by the Contractor concerned shall be Upstream Business Activities.
- (2) In the case that there is excess capacity at facilities for field processing, transportation, storage, and sale as mentioned in Clause (1), with the approval of the Implementing Body, the Contractor may make use of said excess capacity to be used by another party on the basis of proportional sharing of operating costs.

**Article 45**

- (1) Facilities constructed by a Contractor to carry out the activities of field processing, transportation, storage, and sale of its own production as mentioned in Article 44 shall not be aimed at obtaining a profit.
- (2) In the case that facilities as mentioned in Clause (1) are used jointly with another party, with fees or rent collected such as to obtain a profit, the Contractor is required to establish a separate Business Entity for Downstream Business Activities and is required to obtain a Business Permit.

**CHAPTER V**

**UTILIZATION OF CRUDE OIL AND NATURAL GAS TO FULFILL DOMESTIC NEEDS**

**Article 46**

- (1) Contractors are responsible for participating in meeting the demand for Crude Oil and/or Natural Gas for domestic needs.
- (2) The Contractor's share in meeting domestic needs as mentioned in Clause (1) shall be determined on the basis of a system of prorated production of Crude Oil and/or Natural Gas.
- (3) The amount of the Contractor's obligation as mentioned in Clause (2) shall be a maximum of 25% of its share of the production of Crude Oil and/or Natural Gas.
- (4) The Minister shall determine the amount of each Contractor's obligation in fulfilling the domestic demand for Crude Oil and/or Natural Gas as mentioned in Clause (3).

**Article 47**

The Minister shall determine policy on the demand for Crude Oil and/or Natural Gas for domestic purposes once each year.

**Article 48**

- (1) For Natural Gas reserves that have newly been discovered, the Contractor is required to first submit a report to the Minister to meet domestic needs as mentioned in Article 46.
- (2) In the case that the Natural Gas reserves as mentioned in Clause (1) are to be produced, the Minister shall first provide an opportunity within a period not to exceed one (1) year to domestic consumers to meet their needs.
- (3) Within a period no longer than three (3) months from the end of the one (1) year time limit for granting an opportunity to domestic consumers as mentioned in Clause (2), the Minister shall submit a notification to the Contractor regarding the condition of domestic needs.

**Article 49**

The mechanism for implementation of surrender of Crude Oil and/or Natural Gas by a Contractor as mentioned in Article 46 shall be specified in the Cooperation Contract.

**Article 50**

- (1) The Minister shall set policy on utilization of Natural Gas from Natural Gas reserves, endeavoring to ensure that domestic needs can be optimally met and giving due consideration to the public interest, the interests of the state, and the national energy policy.
- (2) In setting policy on the utilization of Natural Gas as mentioned in Clause (1), the Minister shall consider technical aspects including the reserves of and market opportunities for Natural Gas; infrastructure, both that which is available and that which is planned; and proposals from the Implementing Body.

**Article 51**

- (1) For Crude Oil or Natural Gas that is discovered, produced, or sold, quality evaluation must be conducted.
- (2) The costs incurred in conducted quality evaluation as mentioned in Clause (1) shall be charged as operating costs.
- (3) Further regulation regarding the procedures for evaluation of the quality of Crude Oil and Natural Gas as mentioned in Clause (1) shall be determined by the Minister.

**CHAPTER VI  
STATE REVENUES**

**Article 52**

- (1) Contractors that conduct Upstream Business Activities are required to surrender and pay State revenues in the form of taxes and of Non-Tax State Revenues.
- (2) The State revenues in the form of taxes as mentioned in Clause (1) shall consist of:
  - a. taxes;
  - b. import duties and other levies on imports and tariffs;
  - c. regional taxes and regional levies.
- (3) The Non-Tax State Revenues as mentioned in Clause (1) shall consist of:
  - a. the State's share;
  - b. State levies in the form of fixed fees and Exploration and Exploitation fees;
  - c. bonuses.

**Article 53**

Before a Cooperation Contracts is signed, the Contractor may choose the provisions regarding tax payment obligations as mentioned in Article 52 Clause (2) letter a from among the following options:

- a. to follow the provisions of the laws and regulations in the taxation sector that are in force at the time that the Cooperation Contract is signed; or
- b. to follow the provisions of the laws and regulations currently prevailing in the taxation sector.

**Article 54**

Provisions regarding determination of the amount of the state's share, state levies, and bonuses as mentioned in Article 52 Clause (3), and the procedures for their payment, shall be regulated through a separate Government Regulation.

**Article 55**

- (1) The division of the production of Oil and Gas from Production Sharing Contracts between the Government and the Contractor shall be done at the point of delivery.
- (2) In delivering Oil and Gas at the point of delivery as mentioned in Clause (1), a system of measurement devices must be used as determined by the Minister in accordance with the applicable laws and regulations.

**Article 56**

- (1) Expenditures of investment and operation costs in Production Sharing Contracts must receive the approval of the Implementing Body.
- (2) Contractors shall be reimbursed for the costs they have expended to conduct Exploration and Exploitation as mentioned in Clause (1) in accordance with the work plan and budget and Authorizations for Financial Expenditure approved by the Implementing Body after they have started commercial production.

**Article 57**

All production of Oil and Gas produced by a Contractor in a Service Contract shall be the property of the State and must be surrendered by the Contractor to the Government.

**Article 58**

- (1) A Contractor that conducts Exploitation of Oil and/or Gas on the basis of a Service Contract shall be given compensation for services (a fee).
- (2) The amount of the compensation for services as mentioned in Clause (1) shall be calculated based on the amount of production of Oil and/or Gas produced and shall be determined based on the offer from the Business Entity/ Permanent Establishment.
- (3) A Contractor that conducts Exploitation of Oil and/or Gas as mentioned in Clause (1) shall bear all the costs and risks of producing the Oil and/or Gas.
- (4) The compensation for services (fee) as mentioned in Clause (1) shall be provided after commercial production has begun.

**Article 59**

Provisions regarding Service Contracts shall be further regulated through Decree of the Minister.

**Article 60**

The non-tax State revenues as mentioned in Article 52 Clause (3) shall be revenues of the Government and the Regional Governments, the division of which shall be determined in accordance with the provisions of the applicable laws and regulations.

**Article 61**

Non-tax State revenues after the revenues of the Regional Governments have been deducted shall be non-tax State revenues from the Oil and Gas sector, part of which may be used by the Department in accordance with the provisions of prevailing laws and regulations.



**CHAPTER VII  
PROCEDURES FOR SETTLEMENT OF  
USE OF LAND UNDER RIGHTS OR STATE LAND**

**Article 62**

- (1) A Contractor that intends to use parcels of land under rights or state land within its work area is required first to make a settlement for the use of the land with the holder of rights to the land or the user of state land, in accordance with the provisions of the applicable laws and regulations.
- (2) The community holding the land rights or user of land located on state land is required to permit a Contractor that has shown the Cooperation Contract or a legalized copy of it, to conduct Exploration and Exploitation on the land concerned, if the Contractor concerned has achieved a settlement for the use of the land or provided the guarantee of a settlement, approved by the holder of the land rights or the user of the land located on state land.

**Article 63**

- (1) Settlements for use of land by Contractors shall be done through consultation and consensus with the holder of the land rights or the user of land located on state land, in accordance with the provisions of prevailing laws and regulations.
- (2) The consultation and consensus as mentioned in Clause (1) may be done directly with the holder of land rights or user of land located on state land through the methods of sale and purchase, exchange, suitable indemnification, recognition, or other form of compensation.
- (3) If the land concerned is collectively owned land of a traditional law community (tanah ulayat), the methods of consultation and consensus must pay due attention to the decision-making procedures of the local traditional law community.

**Article 64**

- (1) If the number of community members holding rights to the land or users of state land is so large as to make effective consultations impossible, the consultations may be done partially or with a representative appointed by and acting on behalf of the holders of the rights, with a power of attorney duly made in accordance with the provisions of the applicable laws and regulations.
- (2) In the case that consensus cannot be achieved through deliberations as mentioned in Article 63 Clause (1), the parties may appoint another party in accordance with the applicable laws and regulations.

**Article 65**

- (1) Determination of indemnification for land shall use as guidelines the results of consultations, with due attention to the most recent assessed property value.
- (2) Determination of indemnification for buildings, plants, and other things located on the land shall use as guidelines the relevant technical standards.

**Article 66**

- (1) Together with the granting of indemnification, a letter of statement of release or surrender of the rights to the land shall be produced, signed by the parties and witnessed by at least two (2) witnesses.
- (2) At the time of the making of the statement letter as mentioned in Clause (1), the holder of land rights shall surrender the certificate and/or original of the land documents concerned to the Contractor.

**Article 67**

- (1) Land for which settlement has been reached by a Contractor as mentioned in Article 62 shall become the property of the Government and shall be managed by the Implementing Body, except for rented land.
- (2) For land as mentioned in Clause (1), a certificate for rights to the land must be requested in accordance with the provisions of the applicable laws and regulations.

**Article 68**

- (1) A Contractor's Work Area that is not yet being used for Exploration and Exploitation may be used by another party for activities other than Exploration and Exploitation after a recommendation from the Minister and a use permit from the local Regional Government have been obtained.
- (2) The other party as mentioned in Clause (1), with a recommendation from the Minister, may request rights to the land in accordance with the provisions of the applicable laws and regulations.

**Article 69**

- (1) A Contractor may conduct Exploration and Exploitation activities other than the activities mentioned in Article 44 within the Work Area of the Contractor concerned in accordance with the Cooperation Contract.
- (2) A Contractor may construct facilities as mentioned in Article 44 upon parcels of land within and/or outside the Contractor's Work Area after conducting procurement in accordance with the provisions in this Chapter.
- (3) Ownership, registration of land rights, and bookkeeping for parcels of land used by a Contractor as mentioned in Clause (2) shall be subject to the provisions of Article 68.

**Article 70**

- (1) A Contractor that holds a Right of Way for an Oil and Gas transmission pipeline is required to permit another Contractor to use such Right of Way for construction and use of an Oil and Gas transmission pipeline.
- (2) The granting of permission as mentioned in Clause (1) shall be based on technical and economic considerations, as well as those of safety and security.
- (3) A Contractor that plans to use a Right of Way as mentioned in Clause (1) may negotiate directly with the Contractor/ other party that holds the Right of Way.
- (4) In the case that the negotiation as mentioned in Clause (3) is unable to achieve an agreement, the Contractors shall submit to the Minister through the Implementing Body to determine the further settlement.

Article 71

For land that is used for the Right of Way for an Oil and Gas transmission pipeline as mentioned in Article 69 [sic! should be 70 – tr.], land rights may be requested in accordance with the provisions of the applicable laws and regulations.

**CHAPTER VIII  
OCCUPATIONAL SAFETY AND HEALTH,  
ENVIRONMENTAL MANAGEMENT,  
AND COMMUNITY DEVELOPMENT**

Article 72

Contractors that conduct upstream business activities are required to ensure and abide by the provisions regarding occupational safety and health, management of the natural environment, and development of local communities.

Article 73

Provisions regarding occupational safety and health, environmental management, and community development as mentioned in Article 72 shall be in accordance with the applicable laws and regulations.

Article 74

- (1) Contractors, in conducting their activities, share responsibility for developing local communities.
- (2) The responsibilities of Contractors in developing local communities as mentioned in Clause (1) are participation in development and utilization of the potential capabilities of the local community, including by employing workforce in specified quantities and qualities in line with the required competencies, and upgrading the living environment of the community in order to achieve harmonious relations between the Contractor and the surrounding community.

Article 75

In participating in the development of local communities as mentioned in Article 74 Clause (1), Contractors shall allocate funds in the formulation of each year's annual work plan and budget.

Article 76

- (1) Contractors' community development activities shall be done in coordination with the Regional Government.
- (2) Priority in the activities for development of local communities as mentioned in Clause (1) shall be on communities near the areas where Exploitation is carried out.

Article 77

Implementation of a Contractor's participation in development of local communities as mentioned in Article 74 Clause (1) shall be provided in kind, in the form of physical facilities and infrastructure or of empowerment of local enterprises and workforce.

**CHAPTER IX  
UTILIZATION OF DOMESTIC GOODS, SERVICES, TECHNOLOGY,  
AND ENGINEERING AND DESIGN CAPABILITIES**

**Article 78**

- (1) All goods and equipment directly used in Upstream Business Activities that are purchased by Contractors shall become the property/assets of the state, under the guidance of the government and the management of the Implementing Body.
- (2) In the case that the goods and equipment as mentioned in Clause (1) come from outside the country, the procedures for the import of such goods and equipment shall be determined jointly by the Minister, the Minister of Finance, and the minister whose area of duties and responsibilities includes trade affairs.
- (3) Goods and equipment [used] by Contractors as mentioned in Clause (1) must fulfill the applicable standards in line with laws and regulations.
- (4) Contractors may use the goods and equipment as mentioned in Clause (1) throughout the terms of their Cooperation Contracts.

**Article 79**

- (1) Contractors are obliged to place priority on the use of domestic goods, services, technology, and engineering and design capabilities in a transparent and competitive manner.
- (2) The priority on use of domestic goods, services, technology, and engineering and design capabilities as mentioned in Clause (1) shall be implemented if said goods, services, technology, and engineering and design capabilities are already produced or available domestically and meet the requirements of quality/grade, delivery time, and price in accordance with the provisions for procurement of goods and services.

**Article 80**

Goods and equipment, services, technology, and engineering and design capabilities as mentioned in Article 79 may be imported as long as they are not yet produced domestically and as long as the goods and equipment, services, technology, or engineering and design capabilities that are to be imported fulfill the requirements of quality/grade, efficiency of operating costs, and guaranteed delivery time, and can provide guarantees of after-sales service.

**Article 81**

- (1) Management of goods and equipment used in Upstream Business Activities shall be done by the Implementing Body.
- (2) Excess supplies of goods and equipment as mentioned in Clause (1) may have their use transferred to other Contractors within the Legal Mining Zone of Indonesia with the approval of the Implementing Body and reported to the Minister and the Minister of Finance.
- (3) In the case that excess supplies of goods and equipment as mentioned in Clause (2) are not being used by another Contractor, the Implementing Body is required to surrender them to the Minister of Finance through the Minister for determination of policy on their use.
- (4) In the case that goods and equipment as mentioned in Clause (3) are to be donated, sold, exchanged, used for capital participation by the state, destroyed, or used by another party through rental or joint use, this must first receive the approval of the Minister of Finance on the recommendation of the Implementing Body through the Minister.

- (5) When a Cooperation Contract ends, the Contractor's goods and equipment must be surrendered to the government for determination of policy on their use in accordance with the applicable laws and regulations.

## **CHAPTER X MANPOWER AFFAIRS**

### **Article 82**

- (1) In meeting their manpower needs, Contractors are required to place priority on the use of Indonesian manpower, with due attention to the use of local manpower in accordance with the competency standards required.
- (2) Contractors may use foreign manpower for certain types of positions and expertise that cannot yet be fulfilled by Indonesian personnel, in line with the competence required for the positions.
- (3) Procedures for use of foreign manpower as mentioned in Clause (2) shall be done in accordance with the provisions of the applicable laws and regulations.

### **Article 83**

Provisions regarding labor relations, job protection, and job requirements and on surrendering part of the execution of work to other companies shall be stipulated in accordance with the laws and regulations in the manpower affairs sector.

### **Article 84**

To develop the capabilities of Indonesian workers to enable them to meet work competency standards and the qualifications of their positions, Contractors are required to carry out guidance and education and training programs for Indonesian workers.

### **Article 85**

The guidance and development of Indonesian workers shall be carried out in accordance with the provisions of the applicable laws and regulations.

## **CHAPTER XI GUIDANCE AND SUPERVISION OF UPSTREAM BUSINESS ACTIVITIES**

### **Article 86**

- (1) Guidance of upstream business activities shall be exercised by the Government and implemented by the Minister.
- (2) The guidance as mentioned in Clause (1) shall cover:
- conduct of Government affairs in the upstream business activity sector, and;
  - setting policy on upstream business activities on the basis of the oil and gas reserves and resource potential possessed, production capability, domestic demand for oil- and gas-based fuels, mastery of technology, aspects of the environment and environmental conservation, national capabilities, and development policy.
- (3) Responsibility for activities of supervision of work and implementation of upstream business activities with regard to compliance with the provisions of the applicable laws and regulations shall lie with the Minister.

- (4) Upstream Business Activities shall be executed and controlled through Cooperation Contracts between the Implementing Body and Business Entities or Permanent Establishments.
- (5) The Implementing Body shall exercise supervision and control over the execution of Cooperation Contracts as mentioned in Clause (4).
- (6) In exercising supervision and control over the execution of Cooperation Contracts as mentioned in Clause (5), the Implementing Body shall have the authority to sign other contracts related to Cooperation Contracts.
- (7) The exercise of supervision and control as mentioned in Clause (5) shall be done by the Implementing Body through management control of the execution of Cooperation Contracts.

**Article 87**

- 1. The conduct of Government affairs in the Upstream Business Activity sector as mentioned in Article 86 Clause (2) letter a shall include:
  - a. planning;
  - b. licensing, approvals, and recommendations;
  - c. management and utilization of Oil and Gas Data;
  - d. education and training;
  - e. technological research and development;
  - f. application of standardization;
  - g. granting of accreditation;
  - h. granting of certification
  - i. guidance of support industries/ business entities;
  - j. guidance of small/medium-scale enterprises;
  - k. use of domestically produced goods and services;
  - l. maintenance of occupational health and safety;
  - m. conservation of the natural environment;
  - n. creation of a conducive investment climate;
  - o. maintenance of security and order.
- 2. Determination of policy regarding upstream business activities as mentioned in Article 86 Clause (2) letter b shall include regulation of:
  - a. execution of General Surveys;
  - b. management and utilization of Oil and Gas Data;
  - c. preparation, determination, and offers and returns of Work Areas;
  - d. forms and terms and conditions of Cooperation Contracts;
  - e. extensions of Cooperation Contracts;
  - f. plans for first-time developments of fields;
  - g. development of fields and production of Oil and Gas reserves;
  - h. utilization of natural gas;
  - i. application of good engineering practices;
  - j. obligation to surrender a part of the Contractor's share of Oil and Gas to fulfill domestic needs (Domestic Market Obligation, DMO);
  - k. mastery, development, and application of Oil and Gas technology;
  - l. obligation to pay state revenues;
  - m. management of the natural environment;

- n. occupational health and safety;
- o. use of Foreign Manpower
- p. development of Indonesian Manpower;
- q. development of local communities;
- r. standardization;
- s. use of domestic goods, services, technology, and engineering and design capabilities;
- t. conservation of Oil and Gas resources and reserves;
- u. enterprises for coalbed methane;
- v. other activities in Oil and Gas business activity sector, insofar as they involve the public interest.

#### Article 88

The supervision as mentioned in Article 86 Clause (3) shall cover:

- a. conservation of Oil and Gas resources and reserves;
- b. management of Oil and Gas data;
- c. good engineering principles;
- d. occupational safety and health;
- e. management of the natural environment;
- f. use of domestic goods, services, technology, and engineering and design capabilities;
- g. use of foreign manpower;
- h. development of Indonesian manpower;
- i. development of local communities;
- j. mastery, development, and application of Oil and Gas technology;
- k. other activities in the Oil and Gas business activity sector insofar as they affect the public interest.

#### Article 89

- (1) The responsibility for guidance as mentioned in Article 87 shall lie with the Department and other relevant departments in line with their respective areas of duties and authority.
- (2) The responsibility for supervision as mentioned in Article 88 shall lie with the Department and other relevant departments in line with their respective areas of duties and authority.

#### Article 90

In the framework of control and supervision as mentioned in Article 86 Clause (5), the Implementing Body shall have the following duties:

- a. to provide considered opinions to the Minister on his policies on matters of preparation and offers of Work Areas and Cooperation Contracts;
- b. to conduct the signing of Cooperation Contracts;
- c. to evaluate plans for development of fields that are to produce for the first time in a given Work Area and to submit these to the Minister to obtain his approval;
- d. to grant approval for field development plans other than those mentioned in letter c;
- e. to grant approval for work plans and budgets;
- f. to conduct monitoring of, and report to the Minister on, the implementation of Cooperation Contracts;
- g. to appoint sellers of the State's share of Crude Oil and/or Natural Gas that can provide the greatest possible advantage to the state.

Article 91

The Implementing Body shall exercise control and supervision over the execution of the provisions of Cooperation Contracts.

Article 92

In exercising supervision over compliance with the execution of the provisions of Cooperation Contracts as mentioned in Article 91, the Implementing Body shall coordinate the Contractors in their relations with the Department and other relevant departments.

Article 93

- (1) Contractors are required to periodically submit written reports to the Minister regarding matters related to supervision as mentioned in Article 88.
- (2) Contractors are required to periodically submit written reports to the Implementing Body regarding matters related to supervision as mentioned in Article 91.

Article 94

- (1) In conducting the signing of Cooperation Contracts as mentioned in Article 90 letter b, the Implementing Body shall act as the party that enters into contracts with Business Entities and Permanent Establishments.
- (2) The signing of Cooperation Contracts with Business Entities and Permanent Establishment as mentioned in Clause (1) shall be done after obtaining the approval of the Minister on behalf of the Government.
- (3) The Implementing Body shall inform the People's Representative Assembly of the Republic of Indonesia in writing of every Cooperation Contract that is signed by attaching a copy of it.

Article 95

- (1) Plans for development of fields that are to produce for the first time in a given Work Area as mentioned in Article 90 letter c, including any changes to them, must receive the approval of the Minister on the basis of considered opinions from the Implementing Body.
- (2) In granting approval as mentioned in Clause (1), the Minister shall engage in consultation with the Governor whose administrative jurisdiction covers the field that is to be developed.
- (3) The consultation as mentioned in Clause (2) is intended to provide explanations and obtain information, especially in connection with land use planning and plans for regional revenues from Oil and Gas.

Article 96

- (1) In the case that a Contractor [that] has received approval as mentioned in Article 95 Clause (1) does not conduct activities in accordance with the field development plan within a period of not more than five (5) years from the approval of the first field development plan, the Contractor shall be obliged to return its entire Work Area to the Minister.
- (2) Notwithstanding the provision as mentioned in Clause (1), for development of Natural Gas fields, if within the period as mentioned in Clause (1) no binding Natural Gas sales agreement has been reached, the Minister may determine the policy on an extension of the time period as mentioned in Clause (1) for the Contractor concerned.



**Article 97**

In conducting studies as mentioned in Article 90 letter c and granting approval as mentioned in Article 90 letter d, the Implementing Body must give due consideration to matters including the following:

- a. estimated reserves and production of Oil and Gas;
- b. estimates of the costs required for field development and of the production costs of Oil and Gas;
- c. plans for the use of the Oil and Gas;
- d. the Oil and Gas exploitation process;
- e. estimates of the State revenues from the Oil and Gas;
- f. use of manpower, and use of domestically produced goods and services;
- g. occupational health and safety, management of the natural environment, and development of local communities.

**Article 98**

In granting approval for work plans and budgets as mentioned in Article 90 letter e, the Implementing Body must give due consideration to :

- a. long-term plans;
- b. success in achieving activity targets;
- c. efforts to increase oil and gas reserves and production;
- d. technical activities and viability of cost units for each activity to be performed;
- e. efficiency;
- f. field development plans previously approved;
- g. time allocation of activities and the end of the Cooperation Contract;
- h. operational safety, occupational health, and management of the environment;
- i. use and development of manpower;
- j. development of local communities.

**Article 99**

On the basis of the results of the monitoring as mentioned in Article 90 letter f, the Implementing Body is required to periodically submit reports to the Minister on matters including the following:

- a. each Contractor's work plan and budget, and its realization;
- b. estimates and realization of Oil and Gas production;
- c. estimates and realization of State revenues;
- d. estimates and realization of costs of investment in Exploration and Exploitation;
- e. realization of the operating costs of each Contractor;
- f. management of the use of assets and operational goods by Contractors.

**Article 100**

- (1) In implementing the appointment of sellers of the State's share of Crude Oil and/or Natural Gas as mentioned in Article 90 letter g, the Implementing Body may appoint the Business Entity or Contractor concerned.
- (2) A Business Entity or Contractor appointed as seller of the State's share of Crude Oil and/or Natural Gas is granted the authority to transfer the right to ownership of the state's share of Oil and/or Gas to the purchaser at the point of delivery based on the relevant Oil and/or Gas sales-purchase agreement.

- (3) The Implementing Body may appoint a Contractor to sell the State's share of the Oil and/or Gas that comes from its Work Area on the basis of a Cooperation Contract.
- (4) The Implementing Body may appoint a Contractor to sell the State's share of the Gas that comes from its Work Area on the basis of a Cooperation Contract and from other Work Areas.
- (5) Before appointing a Business Entity as a seller of the State's share of Oil and/or Gas as mentioned in Clause (1), the Implementing Body shall consult with the Contractor and shall be required to consider:
  - a. the smooth execution, continuity, and efficiency of sales of Oil and/or Gas;
  - b. the capability of the seller;
  - c. the selling price of Oil and/or Gas;
  - d. the rights and responsibilities of the seller.
  - e. that there is no conflict of interest between the Business Entity appointed as the seller and the Contractor.
- (6) The appointment of a Business Entity or Contractor as seller of the State's share of Oil and/or Gas as mentioned in Clause (1), together with its terms and conditions, shall be put into the form of a cooperation agreement.
- (7) In the case that the party appointed as the seller is the Contractor concerned, the costs incurred from the sale of Oil and/or Gas will be treated as operating costs as regulated in the Cooperation Contract with the Contractor concerned, except if such costs or consequences result from deliberate errors by the Contractor concerned.
- (8) In the case that the party appointed as the seller is not the Contractor concerned, the compensation provided to the seller shall be charged to the state's share of the revenues from the proceeds of sale of Oil and/or Gas.
- (9) The Implementing Body is required to present reports to the Minister on the realization of appointment of sellers of the State's share of Oil and/or Gas as mentioned in Clause (1), and on contracts as mentioned in Clause (2).

#### Article 101

- (1) A seller as mentioned in Article 100 Clause (1) shall be fully responsible to the purchaser for the smoothness and continuity of the sales of Oil and/or Gas.
- (2) A seller as mentioned in Clause (1) shall engage in marketing, negotiate with prospective buyers, and sign sales/purchase contracts and other related contracts.
- (3) The signing of contracts as mentioned in Clause (2) shall be done after obtaining the approval of the Implementing Body.
- (4) Signing of contracts as mentioned in Clause (2) by a seller other than the Contractor shall be done after obtaining the approval of the Contractor concerned.
- (5) The Implementing Body shall carry out supervision of the implementation of contracts as mentioned in Clause (3).
- (6) Further provisions regarding the appointment of sellers of the state's share of Oil and/or Gas shall be stipulated through Decree of the Head of the Implementing Body.

#### Article 102

- (1) The Minister may further stipulate the provisions regarding the scope of implementation of supervision of Upstream Business Activities by the Department as mentioned in Article 88.
- (2) The Head of the Implementing Body may further stipulate the provisions regarding the scope of implementation of supervision of Upstream Business Activities by the Implementing Body as mentioned in Article 91.
- (3) If necessary, the Minister and the Head of the Implementing Body may jointly regulate the scope of supervision of Upstream Business Activities.

## **CHAPTER XII OTHER PROVISIONS**

### **Article 103**

Provisions regarding enterprises for Coal Bed Methane, including the forms and terms and conditions of their Cooperation Contracts, shall be further regulated through Decree of the Minister.

## **CHAPTER XIII TRANSITIONAL PROVISIONS**

### **Article 104**

At the time that this Government Regulation comes into force:

- a. Production Sharing Contracts and other contracts related to Production Sharing Contracts between Pertamina and other parties shall remain in force until the end of the contracts concerned.
- b. Production Sharing Contracts and other contracts related to Production Sharing Contracts as mentioned in letter a shall be transferred to the Implementing Body.
- c. Contracts between Pertamina and other parties in the form of Joint Operating Agreements (JOA)/ Joint Operating Bodies (JOB) shall be transferred to the Implementing Body and shall remain in force until the end of the contracts concerned.
- d. Rights and responsibilities (participating interest) in JOAs and JOBs as mentioned in letter c shall be transferred from Pertamina to PT Pertamina (Persero).
- e. Contracts between Pertamina and other parties in the form of Technical Assistance Contracts (TAC) and Enhanced Oil Recovery (EOR) Contracts shall be transferred to PT Pertamina (Persero) and shall remain in force until the end of the contracts concerned.
- f. When the JOA/JOB EOR [contracts] as mentioned in letter c have ended, the Minister shall determine policy on the forms and provisions of cooperation in the former areas of such contracts.
- g. When the Technical Assistance Contracts (TAC) and Enhanced Oil Recovery (EOR) contracts as mentioned in letter e that are in the former Mining Concession Area of Pertamina have ended, said former contract areas shall continue to be part of the work areas of PT Pertamina (Persero).
- h. In the case that before the end of the term of a contract as mentioned in letter e an agreement has been reached between the parties, the Minister may determine policy on another form for the contract concerned.
- i. PT Pertamina (Persero) is required to enter into Cooperation Contracts with the Implementing Body to continue Exploration and Exploitation in the former Mining Concession Area Pertamina.
- j. Within a period of not more than two (2) years, PT Pertamina (Persero) as mentioned in letter i shall be required to establish subsidiaries and enter into Cooperation Contracts with the Implementing Body for each of its Work Areas, with a Cooperation Contract period of 30 (thirty) years, which may be extended in accordance with the prevailing laws and regulations.

- k. The amounts of payment obligations to the state of PT Pertamina (Persero) as mentioned in letter d, letter i, and letter j shall be in accordance with the provisions applying in the former Mining Concession Area of Pertamina.
- l. The Minister shall determine the forms and provisions of Cooperation Contracts for PT Pertamina (Persero) and its subsidiaries as mentioned in letter h, letter i, and letter j.
- m. The transfer of contracts as mentioned in letter b shall not alter the provisions of the contracts.
- n. The Implementing Body and PT Pertamina (Persero) shall settle amendments to contracts as mentioned in letter b to obtain the approval of the Minister.
- o. LNG sales and transportation contracts between Pertamina and other parties shall be transferred to PT Pertamina (Persero).

#### **CHAPTER XIV CONCLUSION**

##### **Article 105**

This Government Regulation shall come into force as of the date of its enactment.  
So that all persons may know of it, it is ordered that this Government Regulation be enacted by placing it in the State Gazette of the Republic of Indonesia.

Promulgated in Jakarta on 14 October 2004  
PRESIDENT OF THE REPUBLIC OF INDONESIA  
signed  
MEGAWATI SUKARNOPUTRI

Enacted in Jakarta  
on 14 October 2004  
STATE SECRETARY OF THE REPUBLIC OF INDONESIA  
signed  
BAMBANG KESOWO  
STATE GAZETTE OF THE REPUBLIC OF INDONESIA FOR 2004, NUMBER 123  
This copy is in accordance with the original,  
Deputy Cabinet Secretary  
Legal and Legislation Section  
[signed and sealed]  
Lambock V. Nahattands

#### **CLARIFICATION OF GOVERNMENT REGULATION OF THE REPUBLIC OF INDONESIA NUMBER 35 OF 2004 ON UPSTREAM OIL AND GAS BUSINESS ACTIVITIES**

##### **GENERAL**

Since the promulgation of Law Number 22 of 2001 on Crude Oil and Natural Gas, it has been stressed that Oil and Gas, as strategic and non-renewable resources contained within the Legal Mining Zone of Indonesia, are national assets controlled by the state. This control by the

state is executed by the Government as the holder of the Mining Authority. As strategic natural resources, Oil and Gas are a national asset and play an important role as a source of finances, as a source of energy, and as raw materials for the nation's economic development. As Oil and Gas are non-renewable natural resources, Upstream Oil and Gas Business Activities must be conducted in the best possible way, and the policies to regulate them must follow the guidelines of the spirit of Article 33 Clause (2) and Clause (3) of the 1945 Constitution.

The aims of Upstream Oil and Gas Business Activity enterprises include ensuring the effectiveness of the implementation and control of Exploration and Exploitation business activities for Oil and Gas in an efficient, effective, highly competitive, and sustainable way through open and transparent mechanisms.

Taking the need for a legal basis for Upstream Oil and Gas Business Activity enterprises as our starting point, regulation is needed in the form of a Government Regulation. This Government Regulation regulates Upstream Oil and Gas Business Activities, covering, among other matters, regulation of the execution of Upstream Business Activities including their guidance and supervision, the mechanism for granting of Work Areas, General Surveys, Data, Cooperation Contracts, use of Oil and Gas for domestic needs, state revenues, procurement and use of land, development of local communities, use of domestic goods, services, technology and engineering and design capabilities, and use of manpower in Upstream Oil and Gas Business Activities.

## **ARTICLE BY ARTICLE**

### **Article 1**

Sufficiently clear

### **Article 2**

Sufficiently clear

### **Article 3**

Sufficiently clear

### **Article 4**

#### **Clause (1)**

Sufficiently clear

#### **Clause (2)**

A direct offer of a Work Area may be an offer of a Work Area directly by the Minister to a Business Entity or Permanent Establishment, or an offer/request for a Work Area directly from a Business Entity or Permanent Establishment to the Minister. Direct offers of Work Areas shall be openly announced through the mass media. Determination of the Business Entity or Permanent Establishment that is granted the authority to carry out Exploration and Exploitation in said Work Area shall be based on the results of direct technical and economic evaluation by the Work Area Offer Team.

Article 5

Sufficiently clear

Article 6

Clause (1)

For offers of Work Areas through tender, determination by the Minister shall be based on results of evaluations by the Work Area tender team, while for direct offers to a Business Entity or Permanent Establishment, the determination by the Minister shall be based on results of evaluation by an evaluation team established by the Minister.

Clause (2)

The Implementing Body may provide input to the Minister regarding the performance of the Business Entity or Permanent Establishment concerned based on records of the operations that have been conducted.

Clause (3)

Sufficiently clear

Article 7

Clause (1)

Sufficiently clear

Clause (2)

This provision is intended to enable the Minister to appoint another Business Entity or Permanent Establishment to conduct operations in a part of a Work Area that has been relinquished by a Contractor so that Oil and Gas resources can be optimally utilized.

Clause (3)

Sufficiently clear

Article 8

Sufficiently clear

Article 9

Sufficiently clear

Article 10

The intention of this provision is that Oil and/or Gas fields that a Contractor considers non-economic (marginal) may be optimally utilized.

Article 11

Sufficiently clear

Article 12

The aim of conducting a General Survey across Work Area boundaries is to provide a thorough picture of the Geological surface conditions in one sediment basin system, the technical requirements for processing of one certain type of survey, and other aims in the sense of efficiency of operations in the field.

Article 13

Clause (1)

A Business Entity as mentioned in this provision is a Business Entity that has the expertise, experience, and financial capability to conduct a General Survey.

The granting of a General Survey Permit to one Business Entity for a particular location does

not eliminate the possibility of granting a permit to another business entity to conduct a General Survey in the same location.

Clause (2)

Sufficiently clear

Clause (3)

Sufficiently clear

Article 14

Sufficiently clear

Article 15

Clause (1)

Sufficiently clear

Clause (2)

Management and Use of Data is aimed at supporting the determination of Work Areas, formulation of technical policy, execution of Government affairs, and supervision in the sectors of Exploration and Exploitation, execution of Exploration and Exploitation, publication of Data to users, and exchanges of Data.

Article 16

Sufficiently clear

Article 17

Sufficiently clear

Article 18

Sufficiently clear

Article 19

Sufficiently clear

Article 20

Sufficiently clear

Article 21

Sufficiently clear

Article 22

Sufficiently clear

Article 23

Clause (1)

Sufficiently clear

Clause (2)

The secrecy periods for Data shall be calculated from when their status as Basic Data, Processed Data, or Interpreted Data is determined by the Government.

Clause (3)

The meaning of “no longer clarified [sic! still should read “classified” – tr.] as Data

of a secret nature” in this provision is that these Data may be accessed by all parties with an interest in Exploration and Exploitation.

Article 24

Clause (1)  
Sufficiently clear

Clause (2)

Letter a

The meaning of “point of transfer” in this provision is the point (location) where the Contractor is obliged to surrender the State’s share to the Government and is entitled to receive its share of the production. This point of transfer shall be agreed by the Implementing Body and the Contractor and specified in the Cooperation Agreement, and may be the same point as the point of transfer to the purchaser of the production.

Letter b

The meaning of “management control of operations” in this provision is the granting of approval for work plans and budgets and field development plans, and supervision of the realization of such plans.

Letter c

Sufficiently clear

Article 25

The forms of Cooperation Contracts are Production Sharing Contracts or other forms of Cooperation Contracts such as Service Contracts. The level of risk is based on the stage of activity, the location, and the availability of data and of infrastructure.

Article 26

Sufficiently clear

Article 27

Clause (1)  
Sufficiently clear

Clause (2)  
Sufficiently clear

Clause (3)  
Sufficiently clear

Clause (4)

The meaning of “commercial production” in this provision is production that is commercially profitable to both the State and the Contractor.

The obligation to return a Work Area in this provision shall be executed by the Contractor when the field development plan for said reserves (first field development) does not receive the approval of the Minister.



**Article 28**

Clause (1)

In the case that the extension of a Natural Gas Sales Purchase [agreement] exceeds the 20-year extension period, the Contractor appointed to continue Exploration and Exploitation in the Work Area is required to ensure the continuity of sales to the end of the sales purchase agreement.

Clause (2)

Sufficiently clear

Clause (3)

Sufficiently clear

Clause (4)

Sufficiently clear

Clause (5)

Sufficiently clear

Clause (6)

The meaning of “agreement” in this provision is a Letter of Intent (LoI) or Memorandum of Understanding (MoU) or Head of Agreement (HoA) or sales/purchase contract.

Clause (7)

The meaning of “technical feasibility” in this provision is based, among other matters, on production capability (deliverability), reservoir pressure, and the specifications of the Natural Gas, while “economic feasibility” is based, among other matters, on the amount of investment, costs (cost recovery), the price of Oil and/or Gas, and state revenues.

**Clause (8)**

Sufficiently clear

Clause (9)

Sufficiently clear

Clause (10)

Sufficiently clear

**Article 29**

Sufficiently clear

**Article 30**

Sufficiently clear

**Article 31**

Sufficiently clear

**Article 32**

The meaning of “Contractor is unable to carry out its obligations” in this provision is that the Contractor does not fulfill its obligations in accordance with its Cooperation Contract and the prevailing laws and regulations, whether deliberately or through negligence or through lack of good faith to carry out its obligations or as a result of incidents other than force majeure that make the Contractor unable to carry out its obligations.

Article 33

Clause (1)

Sufficiently clear

Clause (2)

The meaning of “national company” in this provision is a State-Owned Business Enterprise (BUMN), a Regionally-Owned Business Enterprise (BUMD), a cooperative, a small enterprise, or a private national company all of whose shares are owned by Indonesian Citizens. The offer shall be made between the Contractor and the national company in line with normal business practice.

In this provision, in the case that the Contractor has made an offer to national companies and none has expressed interest, the Contractor may offer it to another party.

Clause (3)

Sufficiently clear

Clause (4)

In this provision, the meaning of “affiliate” is a company or other entity that controls or is controlled by one of the parties, or a company or other entity that controls or is controlled by a company or other entity that controls one of the parties, with the understanding that “controlling” means ownership by one company or other entity of not less than 50% of the shares with voting rights or rights of control or profits, if the other entity is not a company.

Article 34

The meaning of “Regionally-Owned Business Enterprise (BUMD)” in this provision is a BUMD established by the Regional Government whose administrative area includes the field concerned. This BUMD must have sufficient financial capability to participate. The participating interest shall be made between the Contractor and the BUMD in line with normal business practices.

If in a given area there is more than one (1) BUMD, regulation of the allocation of interest shall be left to the discretion of the Governor.

Article 35

Clause (1)

Sufficiently clear

Clause (2)

The meaning of “national company” in this provision is a State-Owned Business Enterprise (BUMN) or private national company all of whose shares are owned by Indonesian citizens.

Clause (3)

Sufficiently clear

Article 36

Sufficiently clear

Article 37

Sufficiently clear

Article 38

Sufficiently clear

Article 39

Clause (1)

Sufficiently clear

Clause (2)

Sufficiently clear

Clause (3)

The meaning of “optimization of exploitation” in this provision is producing Oil and Gas over the longest possible time. The meaning of “efficiency in use” is reducing to the greatest possible extent waste and losses in the use of Oil and Gas and flaring of Natural Gas in the field.

Clause (4)

Sufficiently clear

Article 40

Sufficiently clear

Article 41

Clause (1)

Sufficiently clear

Clause (2)

Sufficiently clear

Clause (3)

The determination of a maximum period of five (5) years is meant to ensure that if development is needed for a field that must be done through unitization, it is not impeded, especially for development of Natural Gas to meet the needs of the market.

Clause (4)

Sufficiently clear

Article 42

Sufficiently clear

Article 43

Sufficiently clear

Article 44

Clause (1)

Sufficiently clear

Clause (2)

In the provisions of this Article, the granting of facilities to another party is an Upstream Business Activity and does not require a business permit from the Government.

Assessment of costs will be determined by calculating investment costs, operation costs, and maintenance costs.

Article 45  
Sufficiently clear

Article 46  
Clause (1)  
The meaning of “domestic needs” in this provision is the entire national requirement for Crude Oil and/or Natural Gas. The provision regarding the obligation to surrender Natural Gas in this provision shall apply to Cooperation Contracts with effective dates after Law Number 22 of 2001 came into force.  
Clause (2)  
The meaning of a pro-rata system in this provision is that the percentage amount of crude oil that must be surrendered by a Contractor is a maximum of 25% (twenty-five percent) of its share to meet domestic requirements as calculated on the basis of national needs.  
Clause (3)  
Sufficiently clear  
Clause (4)  
Sufficiently clear

Article 47  
Sufficiently clear

Article 48  
Sufficiently clear

Article 49  
Sufficiently clear

Article 50  
Clause (1)  
Sufficiently clear

Clause (2)  
The meaning of “considerations of reserves” in the provisions of this Clause covers amounts, specifications of the Natural Gas, and location. The meaning of “considerations of market opportunities” in the provisions of this Clause covers market demand (volume and specifications of the Natural Gas) and location of the market.

Article 51  
Sufficiently clear

Article 52  
Sufficiently clear

Article 53  
Sufficiently clear

Article 54  
Sufficiently clear

Article 55  
Sufficiently clear

Article 56  
Clause (1)  
Sufficiently clear  
Clause (2)  
Cost recovery shall be approved by the Implementing Body with reference to the relevant provisions in the Cooperation Contract concerned.

Article 57  
In a Service Contract, all production of Oil and Gas produced by the Contractor is the share of the State as stipulated in this Government Regulation.

Article 58  
Sufficiently clear

Article 59  
Sufficiently clear

Article 60  
Sufficiently clear

Article 61  
The use of part of Non-Tax State Revenues by the Department is part of the effort to support Exploration and Exploitation activities and efforts to attract investors to increase exploration for and discovery of new reserves. Furthermore, use of part of the Non-Tax State Revenues is also intended to permit conducive efforts to support upstream oil and gas business activities, execution of surveys, promotion of Work Areas, Consultation with Regional Governments, and so on.

Article 62  
Clause (1)  
The holder of land rights or user of land located on state land in this provision includes:  
a. holders of rights to land, whether with or without certificates;  
b. traditional law communities whose traditionally used land (tanah ulayat) is affected by construction;  
c. a party that controls land based on an agreement with the land's owner;  
d. the supervisor (nadzir), for religious endowment land;  
e. users of land located on state land;  
f. owners of buildings, plants, or other objects related to the land, or;

Clause (2)

The meaning of “Guarantee” in this provision includes a statement of willingness to reach a settlement for granting of indemnification by the Contractor that is agreed by the holder of land rights.

Article 63

Clause (1)

Sufficiently clear

Clause (2)

Settlements for use of land in the form of recognition or other compensation may be in the form of:

- a. Indemnification for traditional collectively owned land (tanah ulayat) shall be done on the basis of deliberations to achieve consensus in accordance with local traditional law;
- b. plots of land ready for building;
- c. replacement land;
- d. Basic or Very Basic housing, with Home Ownership Loan (KPR) facilities;
- e. apartments with KPR facilities;
- f. real estate with KPR facilities;
- g. relocation; or
- h. other form of compensation that may be undertaken by the Contractor and/or Regency/City Government.

Clause (3)

Compensation for a plot of land that is controlled by traditional land rights (hak ulayat) that is determined based on Regional Regulations (Qonun for the Province of Nanggroe Aceh Darussalam, and Provincial Regional Regulations for the Province of Papua) shall be given in the form of construction of public facilities or other form of benefit to the local community, and for religious endowment land (wakaf)/ other religious observance land, indemnification shall be given in the form of land, buildings, and facilities as necessary.

The criteria for existence of tanah ulayat shall be determined in accordance with the applicable laws and regulations.

Article 64

Clause (1)

Sufficiently clear

Clause (2)

The meaning of “other party” in this provision may be in the form of a team or committee established by an authorized official.

Article 65

Clause (1)

Sufficiently clear

Clause (2)

The meaning of “technical standards” in this provision is standards issued by an authorized official.

Article 66

Sufficiently clear

Article 67

Clause (1)

Sufficiently clear

Clause (2)

The Certificates mentioned in this provision shall be issued in the name of the Government.

Article 68

Sufficiently clear

Article 69

Sufficiently clear

Article 70

Sufficiently clear

Article 71

Sufficiently clear

Article 72

Sufficiently clear

Article 73

Sufficiently clear

Article 74

Clause (1)

Community development activities shall be conducted by Contractors to assist Government programs to increase the community's productivity and the people's social/economic capabilities to make efficient use of regional potential in a sustainable and self-reliant way.

Clause (2)

Sufficiently clear

Article 75

Sufficiently clear

Article 76

Sufficiently clear

Article 77

Sufficiently clear

**Article 78**

Clause (1)

The guidance exercised by the Government is a consequence of the status of goods as State Owned Goods such that they must follow the prevailing laws and regulations, and is not intended to stipulate guidance of the micro aspects of the use of State Owned Goods by Contractors as mentioned in Article 12 letter d of Government Regulation No. 42 of 2002 on the Implementing Body for Upstream Oil and Gas Business Activities.

Clause (2)

Sufficiently clear

Clause (3)

Sufficiently clear

Clause (4)

Sufficiently clear

**Article 79**

Clause (1)

Priority on the use of domestic goods and services in this provision must still give consideration to technical requirements, quality, promptness of delivery, and price.

Clause (2)

Sufficiently clear

**Article 80**

Sufficiently clear

**Article 81**

Clause (1)

Sufficiently clear

Clause (2)

Sufficiently clear

Clause (3)

Sufficiently clear

Clause (4)

In the case that goods and equipment are sold to another party, the proceeds from the sale must be deposited to the State Treasury.

Clause (5)

Sufficiently clear

**Article 82**

Sufficiently clear

**Article 83**

Sufficiently clear

**Article 84**

The meaning of Contractor in this provision includes support service companies.



Article 85

Sufficiently clear

Article 86

Clause (1)

Sufficiently clear

Clause (2)

Sufficiently clear

Clause (3)

Sufficiently clear

Clause (4)

Sufficiently clear

Clause (5)

Sufficiently clear

Clause (6)

The meaning of “other contracts” in this provision is contracts related to a contractor’s activities within the framework of a Production Sharing Contract, including contracts related to third-party financing, Offtake Agreements, Supply Agreements/ Seller Appointment Agreements, Producers Agreements, Processing Agreements, and Trustee Paying Agent [Agreements], all of which are parts of the contracts that support the sale of Oil and Gas.

Clause (7)

Sufficiently clear

Article 87

Sufficiently clear

Article 88

Sufficiently clear

Article 89

Sufficiently clear

Article 90

Letter a

In providing considered opinions to the Minister on his policies in preparing and offering Work Areas and Cooperation Contracts, the Implementing Body may, among other matters, recommend provisions and terms and conditions for Cooperation Contracts and locations of Work Areas to be offered, and present recent developments in the investment climate for Upstream Business Activities.

Letter b

The meaning of “Cooperation Contracts” in this definition includes extensions to and amendments of Cooperation Contracts.

Letter c

Sufficiently clear

Letter d

Sufficiently clear

Letter e

Sufficiently clear

Letter f

Sufficiently clear

Letter g

In executing the appointment of sellers of the state's share of Oil and/or Gas, the Implementing Body has the authority to transfer the rights to ownership of the state's share of Oil and/or Gas at the point of delivery to the Business Entity or Contractor that is appointed as the seller.

Article 91

The supervision of execution of Cooperation Contracts by the Implementing Body is based on its scope of authority, and does not reduce the authority of the Minister in supervising the execution of Cooperation Contracts.

Article 92

Sufficiently clear

Article 93

Sufficiently clear

Article 94

Clause (1)

As the party that enters into the contracts, in conducting the signing of Cooperation Contracts, the Government guarantees that the Implementing Body can carry out the provisions of Cooperation Contracts and of other Contracts related to Cooperation Contracts.

Clause (2)

Sufficiently clear

Clause (3)

Sufficiently clear

Article 95

Clause (1)

Field development plans that are presented to the Minister shall contain, at the least, supporting data and evaluation of Exploration, evaluation of the nature of the reservoir fluids and rocks, descriptive evaluation of the reservoir, calculation of reserves, methods for drilling development wells, number and location of production and/or injection wells, production testing/ well testing (including pilot injection tests), pattern of extraction, estimated production, methods for lifting the production, production facilities, plans for use of the Oil and Gas, plans following operations, economics, and state and regional revenues.

Clause (2)

Sufficiently clear

Clause (3)

The Regents/Mayors whose administrative areas include the fields to be developed must also be included in these consultations. These consultations are not to request permission from the Regional Governments.

Article 96

Clause (1)

In this provision, the meaning of “not carrying out activities in line with the field development plan” is not carrying out the activities through deliberate intent or through negligence of the Contractor, or lack of good faith in carrying out the activities, or other events, other than force majeure, that cause the activities not to be carried out.

Clause (2)

The meaning of “binding agreement” in this provision is a sales/purchase agreement between the seller and a buyer.

Article 97

Sufficiently clear

Article 98

Sufficiently clear

Article 99

Sufficiently clear

Article 100

Clause (1)

Sufficiently clear

Clause (2)

Sufficiently clear

Clause (3)

Sufficiently clear

Clause (4)

Sufficiently clear

Clause (5)

Sufficiently clear

Clause (6)

As the appointment of sellers of Oil and/or Gas involves rights and responsibilities of both parties (the Implementing Body and the seller that is appointed), to ensure legal certainty these rights and responsibilities shall be formally placed in the form of a cooperation agreement.

Clause (7)

Sufficiently clear

Clause (8)

Sufficiently clear

Clause (9)

Sufficiently clear

Clause (10)  
Sufficiently clear

Article 101

Clause (1)  
Sufficiently clear

Clause (2)  
In the case that the seller of Natural Gas appointed is not the Contractor, the seller, in conducting its negotiations with purchasers, shall base these on the provisions agreed jointly between the seller, the Contractor, and the Implementing Body.

In conducting these negotiations, the seller is required to pay due attention to the policy of the Minister in determining the price of Oil or Gas.

Clause (3)  
In the case that the seller of Natural Gas appointed is not the Contractor, the Implementing Body shall grant approval after coordinating with the Contractor.

Clause (4)  
Sufficiently clear

Clause (5)  
Sufficiently clear

Clause (6)  
Sufficiently clear

Article 102

Further regulation by the Minister and/or the Head of the Implementing Body is intended to ensure that the execution of supervision of Upstream Business Activities is done effectively and efficiently.

Article 103

Sufficiently clear

Article 104

Letter a

The meaning in this provision of “other contracts” is contracts related to a Contractor’s activities within the framework of the Cooperation Contract, including contracts related to third-party financing, Offtake Agreements, Exchange Agreements, Supply Agreements, Producers Agreements, Transportation Agreements, Plant Processing Agreements, and Plant Use Agreements, all of which are parts of the contracts that support the sales of Oil and Gas.

Letter b

Sufficiently clear

Letter c

Sufficiently clear

Letter d

Sufficiently clear

Letter e

Sufficiently clear

Letter f  
Sufficiently clear

Letter g  
Sufficiently clear

Letter h  
Sufficiently clear

Letter i  
Sufficiently clear

Letter j  
The subsidiary companies that have contracts with the Implementing Body are obliged to conduct separate bookkeeping for each Work Area.

Letter k  
The intent of this provision is that Pertamina, as a State-Owned Business Entity, can grow and develop as a competitive Business Entity. In the case that Pertamina desires that other parties participate as holders of participating interest, this needs to be regulated in Cooperation Contracts, which shall still use as their guidelines the aims as mentioned above.

Letter l  
Sufficiently clear

Letter m  
Sufficiently clear

Letter n  
Sufficiently clear

Letter o  
Sufficiently clear

Article 105  
Sufficiently clear

SUPPLEMENT TO STATE GAZETTE OF THE REPUBLIC OF INDONESIA NUMBER 4435

**GR 34/2005**

**Government Regulation of the Republic of Indonesia No34 of 2005  
Regarding  
Amendment of the Government Regulation No.35 of 2004  
Regarding  
Oil and Natural Gas Upstream Business Activity  
By the Grace of the One God Almighty  
The President of the Republic of Indonesia**

Considering : that in connection with the national interest to accelerate the increase of national Oil and Natural Gas production, it is deemed necessary to amend the Government Regulation Number 35 of 2004 regarding Oil and Natural Gas Upstream Business Activity.

In view of :

1. Article 5 sub-article (2) of the 1945 Constitution of the Republic of Indonesia;
2. Law No.22 of 2001 regarding Oil and Natural Gas (State Bulletin of the RI of 2001 No.136, State Bulletin Supplement of the RI No.4152);
3. Government Regulation No.35 of 2004 regarding Oil and Natural Gas Upstream Business Activity (State Bulletin of the RI of 2004 No.123, State Bulletin Supplement of the RI No.4435;

**Has Decided:**

To establish : The Government Regulation regarding the amendment of the Government Regulation No.35 of 2004 regarding Oil and Natural Gas Upstream Business Activity.

**Article 1**

Between Article 103 of Chapter XI1 on Other Provision and Article 104 of Chapter XI11 on Transitional Provision of the Government Regulation No.35 of 2004 regarding the Oil and Natural Gas Upstream Business Activity, is inserted 4 (four) Articles namely Article 103A, Article 103B, Article 103C and Article 103D, which state as follows:

**Article 103A**

- (1) In the case of urgent national interests, by remaining to consider the most beneficial to the state, exception may be done to a number of principal stipulations of a Cooperation Contract regarding:
- a. an offer of participating interest to Region-owned Company as referred to in Article 34;
  - b. reimbursement of investment and operational costs of a Production Sharing Contract referred to in Article 56;
  - c. the term of Cooperation Contract on the former Pertamina Mining Authority Area as referred to in Article 104 subh;
  - d. the amount of a sharing split as referred to in Article 104 sub k.
- (2) The urgent national interests as referred to in sub-article (1) is for accelerating the increase of national oil and natural gas production.

Article 103B

The exception as to a number of principal provisions of the Cooperation Contract as referred to in Article 103A may only be given if the following conditions are met:

- a. the availability of adequate Oil and Natural Gas reserves which could soon be exploited;
- b. applied to former Pertamina Mining Authority areas; and
- c. the participation of national capital in the undertaking.

Article 103C

The Minister puts forward an application for the exception of principal provisions of the Cooperation Contract for a certain work area based on the requirements as referred to in Article 103B to the President for consent.

Article 103D

Based on the President's consent, the Minister determines the form and the principal provision of the Cooperation Contract and determines the Business Entity or Permanent Business Entity to carry out Oil and Natural Gas Upstream Business Activity.

Article II

This Government Regulation becomes effective on the date of its promulgation. In order that it may be known to all, the promulgation of this Government Regulation is ordered to be published in the State Bulletin of the Republic of Indonesia.

Established in Jakarta, 10 September 2005

President of the Republic of Indonesia

signed

Dr. H. Susilo Bambang Yudhoyono

Promulgated in Jakarta, 10 September 2005

Minister of Law and Human Rights of the Republic of Indonesia

signed

Hamid Awaludin

State Bulletin of the Republic of Indonesia of 2005 Number 81

For Copy conform:

Deputy Minister State Secretary for Legal and Legislative Affairs

signed and stamped

Abdul Wahid

**MoEMR Reg 22/2008**

**THE MINISTER OF ENERGY AND MINERAL RESOURCES OF  
THE REPUBLIC OF INDONESIA**

**MINISTER OF ENERGY AND MINERAL RESOURCES REGULATION  
NO. 22 OF 2008**

**CONCERNING**

**TYPES OF OIL AND NATURAL GAS UPSTREAM BUSINESS ACTIVITY COSTS NON-  
RETURNABLE TO PRODUCTION SHARING CONTRACTORS**

**THE MINISTER OF ENERGY AND MINERAL RESOURCES**

- Considering:
- a. that the upstream oil and natural gas business activities should be carried out by means of effectiveness and efficiency principles to protect and enhance the state revenue to be optimally used for welfare of the people;
  - b. that in performing oil and natural gas upstream business activities, the Contractor shall bear all costs and risks, the cost repayment (Recovery of Operating Cost) of which needs to be limited to the activities that are directly related to the oil and natural gas upstream business activity operation;
  - c. that based on the above-mentioned consideration as mentioned in items a and b, and to implement the provisions of Article 56 of the Government Regulation No. 34 of 2007 concerning oil and natural gas upstream business activities as amended by Government Regulation No. 34 of 2005, it is necessary to stipulate types of oil and natural gas upstream business activities non-returnable to production sharing contractors by a Minister of Energy and Mineral Resources Regulation;

In view of:

- 1. Law Number 22 of 2001 on oil and natural gas (State Gazette No.136 of 2001, State Gazette Supplement of the Republic of Indonesia No.4152) as amended by the Constitutional Court Decision No. 002/PUU-I/2003 on 21 December 2004 (State Gazette of the Republic of Indonesia No. 1 of 2005);
- 2. Government Regulation No. 35 of 1994 concerning the terms and guideline of oil and natural gas production sharing contract (State Gazette of the Republic of Indonesia No. 64 of 1994; State Gazette Supplement of the Republic of Indonesia No. 3571);



3. Government Regulation No. 42 of 2002 concerning oil and natural gas upstream business activity executive agency (State Gazette of the Republic of Indonesia No. 81 of 2002, State Gazette Supplement of the Republic of Indonesia No. 4216);
4. Government Regulation No.35 of 2004 concerning oil and natural gas upstream business activities (State Gazette No. 23 of 2004, State Gazette Supplement No. 435) as amended by Government Regulation No. 34 of 2005 (State Gazette of the Republic of Indonesia No. 81 of 2005, State Gazette Supplement of the Republic of Indonesia No. 4530);
5. Presidential Decree No.187/M of 2004 of 20 October 2004 as several times and last amended by Presidential Decree No. 77/P of 2007 of 28 August 2007;
6. Minister of Energy and Mineral Resources Regulation Number 0030 of 2005 of 20 July 2005 concerning the organization and procedures of the Ministry of Energy and Mineral Resources;

**HAS DECIDED:**

To stipulate: MINISTER OF ENERGY AND MINERAL RESOURCES REGULATION  
CONCERNING OIL AND NATURAL GAS UPSTREAM BUSINESS ACTIVITY  
COSTS NON-RETURNABLE TO PRODUCTION SHARING CONTRACTORS

**Article 1**

- (1) Production sharing contract contractors shall redeem the cost (cost recovery) that has been spent in the exploration and exploitation execution of the said working area after making commercial production stipulated in the production sharing contract.
- (2) The cost recovery as mentioned in paragraph (1) shall be originated from the oil and/or natural gas production in the working area, unless otherwise stated in the production sharing contract.
- (3) The cost recovery in the exploration and exploitation execution as mentioned in paragraph (1) shall not apply to other costs as mentioned in the attachment to this Minister Regulation.

**Article 2**

In the event that working area as mentioned in Article 1 paragraph (1) does not make any commercial production, all costs that have been spent shall be borne completely by the production sharing contractor.

**Article 3**

The Head of the Oil and Natural Gas Upstream Business Activity Executive Agency shall supervise the execution of the production sharing contract as mentioned in Article 1 paragraph (1).

**Article 4**

This Minister Regulation shall take effect on the date of its promulgation.

Promulgated in Jakarta

On 30 June 2008

THE MINISTER OF ENERGY AND MINERAL RESOURCES

[signature]

PURNOMO YUSGIANTORO

ATTACHMENTS:

REGULATION OF THE MINISTER OF ENERGY AND MINERAL RESOURCES

NO. 22 OF 2008

DATED 30 JUNE 2008

**TYPES OF OIL AND NATURAL GAS UPSTREAM BUSINESS ACTIVITY COSTS  
NON-RETURNABLE TO PRODUCTION SHARING CONTRACTORS**

1. Charges related to the production sharing contractor's personal interest comprising among others: personal income tax, losses due to the sale of private cars and houses.
2. Incentives granted for the employees of production sharing contractors constituting Long-Term Incentive Plan (LTIP) or other similar incentives.
3. Employment of foreign employees/expatriates not in compliance with the Expatriate Manpower Utilization Plan procedures (RPTKA) and without being furnished with Expatriates Work Permit (IKTA) in oil and gas sector issued by the Upstream Oil and Gas Upstream Business Activity Executive Agency (BP MIGAS) and/or the Directorate General of Oil and Natural Gas.
4. Legal consulting fee that is not related to production sharing contractor's operation.
5. Tax consulting fee.
6. The charging of oil and natural gas marketing costs borne by the production sharing contractor that results from intended mistake, and related to oil and natural gas marketing activities.
7. The charging of Public Relations costs shall be made without limitation in the types and number excluding the nominative list of beneficiaries as governed in the tax provisions, comprising expenses of among others: golf, bowling, credit card, membership fee, family gathering, farewell party, contribution to production sharing contractor's educational institutions, production sharing contractor's anniversary, contribution to association of employees' wives, exercise, nutrition and fitness.

8. Environmental and community development costs during the exploitation stage.
9. The management and depositing of reserve fund for site abandonment and restoration in the production sharing contractor's account.
10. The charging of costs related to all types of technical training activities for foreign employees/expatriates.
11. The charging of costs related to merger and acquisition.
12. The charging of costs for loan interest of Petroleum Operation activities.
13. The charging of costs for third party income tax.
14. Procurement of goods and services as well as other activities that exceed the approval value of Authorization Financial Expenditure/AFE by more than 10% (ten percent) from the AFE rate and not completed by sufficient justification.
15. Excess material surplus due to mistaken planning and purchase.
16. Development and operation of Placed into Service (PIS) projects/facilities that are not operating in accordance with the economic life as a result of the production sharing contract contractor's negligence.
17. Transactions with affiliated parties that cause losses to the state, without tender, or contradictory to Law No. 5 of 1999 concerning Anti-monopoly Practice and Unfair Business Competition as well as tax statutory regulations.

THE MINISTER OF ENERGY AND MINERAL RESOURCES

PURNOMO YUSGIANTORO

**GR 36/2004**

**REGULATION OF GOVERNMENT OF THE REPUBLIC OF INDONESIA  
NO. 36/2004 ON  
OIL AND GAS DOWNSTREAM BUSINESS**

**PRESIDENT OF THE REPUBLIC OF INDONESIA**

Considering: that, to enforce the provisions of Articles 8 paragraph (1), 30, 43, and 49 of Law No. 22/2001 on Oil and Gas, it is necessary to stipulate Government Regulation on Oil and Gas Downstream Business.

In view of:

1. Article 5 paragraph (2) of the 1945 Constitution as amended by Fourth Amendment to the 1945 Constitution;
2. Law No. 22/2001 on Oil and Gas (Statute Book of 2001 No. 136, Supplement No. 4152);
3. Government Regulation No. 67/2002 on Agency for the Regulating of Oil Fuel Provision and Distribution and Transportation of Oil and Gas By Pipe (Statute Book of 2002 No. 141, Supplement No. 4253);

**DECIDES:**

To stipulate: **GOVERNMENT REGULATION ON NATURAL OIL AND GAS DOWNSTREAM BUSINESS**

**CHAPTER I  
GENERAL PROVISIONS**

**Article 1**

Hereinafter referred to as:

1. Oil, Gas, Oil and Gas, Oil Fuel, Upstream Business, Downstream Business, Processing, Transportation, Storage, Trade, Corporate Body, Permanent Establishment, Business License, Central Government (hereinafter is called "Government"), Regional Government, Regulating Agency, and Minister are as stipulated in Law No. 22/2001 on Oil and Gas.
2. Gas Fuel is fuel used in transportation originating from Gas and/or output of processing Oil and Gas.
3. Other Fuel is fuel in liquid or gas form originating from sources other than Oil, Gas, and Processing Output.
4. LPG is hydrocarbon gas liquefied by pressure to enable storage, transportation, and handling, which, basically consists of propane, butane, or a mix of propane and butane.
5. LNG is Gas consisting mainly of methane liquefied at a very low temperature (around minus 160°C) and maintained in liquid form to enable transportation and loading.
6. Processing Output is the output and/or product other than Oil and/or Gas Fuel acquired from Oil and Gas Processing business, either in the form of finished or intermediary products, except lubricant and petrochemical products.

7. Strategic Oil Deposit is a specific quantity of Oil as determined by the Government which must be available at any time for raw materials needed by domestic Processing to support availability and distribution of Oil Fuel domestically.
8. National Oil Fuel Reserve is a specific quantity of Oil Fuel to support the availability of Oil Fuel domestically.
9. Field Processing is the activity of processing of self production output as a continuation and/or a series of activities of exploration and exploitation of Oil and Gas as far as it is not intended to obtain gain and/or profit or for commercial purpose.
10. Transportation of Gas By Pipe is the activity of channelling of Gas by pipe which consists of transmission and/or transmission and distribution through channelling pipe and tools operated and/or managed as an integrated unit of system.
11. Mother Plan on National Gas Transmission and Distribution Network is a document on plan on development and construction of Gas transmission and distribution network in the Unitary State of the Republic of Indonesia adjustable every year.
12. Transmission Segment is a specific segment of Gas transmitting pipe network which is part of the Mother Plan on National Gas Transmission and Distribution Network.
13. Distribution Network Area is a certain area of Gas distribution network which is part of the Mother Plan on National Gas Transmission and Distribution Network.
14. Privilege is a right granted by the Regulating Agency to a Corporate Body to Transport Gas By Pipe on Transmission Segment and/or Distribution Network Area based on tender.
15. Tariff is the cost collected in relation to Transportation Gas By Pipe.
16. Wholesale Trading is the business of selling, purchasing, exporting, and importing of Oil Fuel, Gas Fuel, other Fuels and/or Processing Output in large quantity which controls or has storage facility and means and is entitled to distribute to all final users using a specific trademark.
17. Trading is the business of selling, purchasing, exporting, and importing of Oil Fuel, Gas Fuel, Other Fuels and/or Processing Output in large quantity, which does not control or have any storage facility and means and may only distribute to users having/controlling seaports and/or receiving terminals.
18. Oil Fuel Scarcity is a condition of unfulfilled need of the society for Oil Fuel in certain areas and at certain times.
19. Remote Area is an area which is difficult to be reached with limited transportation means/ infrastructure and which economy of the society has not been developed so that it requires high cost to distribute Oil Fuel.

## **CHAPTER II**

### **OPERATION OF DOWNSTREAM BUSINESS**

#### **Article 2**

Downstream Business shall be operated by a Corporate Body which has obtained Business License issued by the Minister based on a fair, healthy, and transparent competition.

#### **Article 3**

The Government shall do the regulating, development, and supervision over the operation of Downstream Business as referred to in Article 2.

**Article 4**

The regulating and development, as referred to in Article 3, implemented by the Minister consist of:

- a. Business Licenses granted to Corporate Bodies;
- b. Type, standard, and quality of Oil Fuel, Gas, Gas Fuel, Other Fuels, and Processing Output;
- c. Guarantee of availability and smooth distribution of Oil Fuel across the Unitary State of the Republic of Indonesia;
- d. Exploitation of Gas for domestic need;
- e. Strategic Oil Deposit to support the availability of Oil Fuel domestically;
- f. Policy on National Oil Fuel Reserve;
- g. Mother Plan on National Gas Transmission and Distribution Network;
- h. Techniques of work safety and health, environmental treatment, and development of the local society.
- i. Mechanism and/or formulation of prices of Gas Fuel and certain Oil Fuels before those prices are assigned to fair and healthy competition;
- j. Availability and distribution of certain types of Oil Fuel;
- k. Improvement of national capacity;
- l. Utilization of local commodities, services, technology, and engineering and design capacity;

**Article 5**

The provisions as set forth in Article 4 paragraphs c, d, f, h, and I shall be in accordance with inputs of the Regulating Agency and/or related institution.

**Article 6**

Supervision, as referred to in Article 3, implemented by the Minister, consists of:

- a. Type, standard, and quality of Oil Fuel, Gas, Gas Fuel, Other Fuels, and Processing Output;
- b. Work safety and health and environmental treatment;
- c. Employment of foreign workers and development of Indonesian workers;
- d. Utilization of local commodities, services, technology, and engineering and design capacity;
- e. Improvement of the environment and local society;
- f. Mastery, development, and application of Oil and Gas technology;
- g. Enforcement of Business License in addition to the supervision implemented by the Regulating Agency;
- h. Good technical rules;
- i. Utilization of measuring tools and system in Downstream Business.

**Article 7**

The Regulating Agency shall implement regulating and supervision over provision and distribution of Oil Fuel and transportation of Gas by Pipe operated by Corporate Bodies which have obtained Business License from the Minister.

**Article 8**

- (1) The regulating of the provision and distribution of Oil Fuel, as referred to in Article 7, includes:
- a. Determining of obligations of Corporate Bodies which will obtain or have obtained Business License from the Minister so that the availability and distribution of Oil Fuel as stipulated by the Government can be guaranteed across the Unitary State of the Republic of Indonesia;
  - b. Determining of obligations of the Corporate Bodies which will obtain or have obtained Business License from the Minister to provide and distribute Oil Fuel in areas which market mechanism has not been running well and in Remote Areas in the framework of regulating of availability of Oil Fuel across the Unitary State of the Republic of Indonesia;
  - c. Determining of allocation of Oil Fuel Reserve of each Corporate Body according to Business License to fulfil National Oil Fuel Reserve;
  - d. Determining of joint exploitation including mechanism of determining of tariff of Oil Fuel Transportation and Storage facilities including their supporting facilities owned by Corporate Bodies, especially in very necessary conditions where Oil Fuel is scarce and/or to support optimal provision and distribution of Oil Fuel in Remote Areas;
  - e. Calculating and determining of amount of contribution of Corporate Bodies organizing business in the provision and distribution of Oil Fuel according to the volume of Oil Fuel which is traded based on the formula as stipulated in Government Regulation;
  - f. Settling of disputes arising relating to Oil Fuel Trading.
- (2) In case that the dispute settlement conducted by the Regulating Agency, as referred to in paragraph (1) Clause f is unacceptable to the Corporate Body or the parties, the Corporate Bodies or the parties may file a petition to the Lower Court of Central Jakarta.

**Article 9**

- (1) The regulating of transportation of Gas by pipe, as referred to in Article 7, includes:
- a. Determining of Transmission Segment and Distribution Network Area based on technical and economic aspects to be sold in tender to Corporate Bodies having License to Transport Gas By Pipe;
  - b. Granting of privilege in transportation of Gas by pipe on Transmission Segment and in Distribution Network Area in a tender based on the Mother Plan on National Gas Transmission and Distribution Network;
  - c. Determining of tariff according to techno-economic principle;
  - d. Determining of prices of Gas for household and retail consumers according to the economic value of the Corporate Body and people's purchasing capacity and power;
  - e. Determining and applying of system of information of management and regulating account of Corporate Bodies transporting Gas by pipe;
  - f. Calculating and determining of the amount of contribution of Corporate Bodies operating Transportation of Gas by pipe according to the transported and distributed Gas based on the formula as stipulated in Government Regulation;
  - g. Settling of disputes arising against holders of privilege in and/or relating to transportation of Gas by pipe.
- (2) In case that the dispute settlement conducted by the Regulating Agency, as referred to in paragraph (1) Clause g, is unacceptable to the Corporate Bodies or the parties, the Corporate Bodies or the parties may file petition to the Lower Court of Central Jakarta.

**Article 10**

- (1) Supervision over the provision and distribution of Oil Fuel and transportation of Gas by pipe, as meant in Article 7, shall be done on Corporate Bodies.
- (2) The supervision performed by the Regulating Agency, as referred to in paragraph (1), includes:
  - a. Provision and distribution of Oil Fuel and/or transportation of Gas by pipe;
  - b. Joint exploitation of facilities of Oil Fuel transportation and storage and transportation of Gas by pipe and supporting facilities of the Corporate Bodies;
  - c. Enforcement of Privilege in transportation of Gas by pipe;
  - d. Prices of Gas for household and small consumers.
- (3) The supervision, as referred to in paragraph (2) Clauses a and b, includes giving of opinion to the Minister in determining sanctions on breaches against Business License committed by Corporate Bodies.

**Article 11**

Further provisions on enforcement of Articles 8, 9, and 10 will be stipulated in Decree and Guidelines of the Regulating Agency.

**CHAPTER III  
BUSINESS LICENSE**

**Article 12**

Downstream Business includes:

- a. Processing business, which consists of activities of purifying, acquiring of parts, improving of quality, and increasing of added value of Oil and Gas producing Oil Fuel, Gas Fuel, Processing Output, LPG and/or LNG (but not including Field Processing);
- b. Transportation business, which consists of activities of transporting of Oil, Gas, Oil Fuel, Gas Fuel and/or Processing Output, either by land, water and/or air, including Transportation of Gas by Pipe from one place to another for commercial purpose;
- c. Storage business, which consists of activities of receiving, collecting, accommodating, and releasing of Oil, Oil Fuel, Gas Fuel, and/or Processing Output at the location on top of and/or below land surface and/or water surface for commercial purpose;
- d. Trading business, which consists of activities of purchasing, selling, exporting, and importing of Oil, Oil Fuel, Gas Fuel, and/or Processing Output, including Gas transported by pipe.

**Article 13**

- (1) Downstream Business, as referred to in Article 12, shall be operated by Corporate Bodies after obtaining Business License from the Minister.
- (2) The Minister may assign the authority of grant of Business License for certain businesses, as referred to in paragraph (1) as will be further stipulated in Decree of the Minister.

**Article 14**

- (1) The submission and grant of Business License, as referred to in Article 13 paragraph (1), are decided as follows
  - a. Processing business producing Oil Fuel, Gas Fuel, and/or Processing Output shall be submitted to and granted by the Minister;



- b. Transportation of Oil, Oil Fuel, Gas Fuel, and/or Processing Output including transportation of Gas by pipe shall be submitted to and granted by the Minister;
  - c. Storage of Oil, Oil Fuel, Gas Fuel, and/or Processing Output shall be submitted to and granted by the Minister;
  - d. Trading of Oil, Gas, Oil Fuel, Gas Fuel, and/or processing Output shall be submitted to and granted by the Minister.
- (2) Carbon copies of the License to Process Oil Fuel, License to Transport Gas by Pipe, License to Store Oil Fuel, License to Trade Gas, and License to Trade Oil Fuel, as referred to in paragraph (1) Clauses a, b, c, and d shall be furnished to the Regulating Agency.
- (3) The Business License, as referred to in paragraph (1) Clause d, consists of Wholesale Trading Business License and Trading Business License.

#### Article 15

- (1) To obtain the Business Licenses, as referred to in Article 13, a Corporate Body must submit an application to the Minister by enclosing administrative and technical requirements, which, at least, contain:
- a. Name of operator;
  - b. Line of business proposed;
  - c. Obligation to comply with operational procedure;
  - d. Information regarding plan and technical requirements relating to the business.
- (2) The Minister will further stipulate terms and guidelines for the implementation of the Business Licenses, as meant in paragraph (1).

#### Article 16

- (1) In case that a Corporate Body operates Processing business with transportation, storage, and/or trading businesses secondary to its Processing business, the said Corporate Body shall only be obliged to have Processing Business License.
- (2) In case that the Corporate Body, as meant in paragraph (1), operates Wholesale Trading business, it must obtain a Wholesale Trading Business License, in advance.
- (3) In case that the Corporate Body operates Processing business with transportation, storage, and trading businesses not secondary to its Processing Business, the Corporate Body must obtain Processing Business License, Transportation Business License, Storage Business License, and Wholesale Trading Business License or Trading Business License.

#### Article 17

In case that the Corporate Body operates transportation Gas by pipe on Transmission Segment or Distribution Network Area, it must have Privilege from the Regulating Agency.

#### Article 18

- (1) In case that the Corporate Body operates Storage business with transportation business to support its Storage business, it will be given a Storage Business License, and Transportation Business License is not required.
- (2) In case that the Corporate Body operates Storage business with Transportation business not secondary to its Storage business, it must obtain Storage Business License and/or Transportation Business License.

**Article 19**

- (1) In case that the Corporate Body operates Trading Business with storage and/or transportation business secondary to its Trading business, it will be granted Trading Business License, and Storage Business License and/or Transportation Business License are not required.
- (2) In case that the Corporate Body operates Trading business with storage and/or transportation business not secondary to its Trading business, it must obtain Wholesale Trading Business License or Trading Business License, Storage Business License and/or Transportation Business License.

**CHAPTER IV  
PROCESSING**

**Article 20**

Corporate Body that will operate business of Processing of Oil, Gas, and/or Processing Output must have a Processing Business License from the Minister.

**Article 21**

In operating Processing business, the Corporate Body must guarantee work safety and health, environmental treatment, and development of local society and must guarantee that the finished products meet the standard of quality pursuant to the laws in force.

**Article 22**

A Corporate Body being holder of Processing Business License must submit report to the Minister and the Regulating Agency on annual plan, monthly realization, and cease of operation to maintain Processing facilities and means in the framework of maintaining of availability of Oil Fuel.

**Article 23**

- (1) In operating Processing business, the Corporate Body has to observe national interest relating to fulfilment of need for Oil Fuel and Gas Fuel domestically.
- (2) In case of shortage in the fulfilment of need for Oil Fuel, as referred to in paragraph (1), the Minister may appoint and assign a certain Corporate Body to increase production of Oil Fuel according to technical and economic aspects of the Corporate Body.

**Article 24**

- (1) Processing of Gas into LNG, LPG, and Gas to Liquefied (GTL) is classified as and/or construed as Downstream Business as long as it is intended to acquire gain and/or profit and is not secondary to Upstream Business.
- (2) The business of Processing of Gas, as referred to in paragraph (1), shall be operated by a Corporate Body after obtaining Business License from the Minister.

**Article 25**

The Processing of Oil, Gas, and/or Processing Output to produce lubricant and petrochemical products will be stipulated and operated jointly by the Minister and the minister of industry.

## **CHAPTER V TRANSPORTATION**

### **Article 26**

Corporate Body which will operate business of Transportation of Oil, Gas, Oil Fuel, Gas Fuel, and/or Processing Output must have a Transportation Business License from the Minister.

### **Article 27**

Transportation of Gas by pipe shall be operated by a Corporate Body after receiving a Privilege from the Regulating Agency.

### **Article 28**

In operating Transportation business, the Corporate Body must guarantee work safety and health, environmental treatment, and development of local society in accordance with the laws in force.

### **Article 29**

The Corporate Body, in operating Transportation business by means of land transportation in addition to pipes, shall prioritise the utilization of transports owned by cooperatives, small enterprises and/or national private enterprises through selection process.

### **Article 30**

A Corporate Body being holder of Transportation Business License must submit report to the Minister once a month regarding plan and realization of its business, which includes, type, quantity, and operation, or at any time if necessary, with a carbon copy to the Regulating Agency.

### **Article 31**

- (1) The Corporate Body must give an opportunity to another party to share the utilization of facilities and means of transportation of Gas by pipe owned by it according to technical and economic aspects.
- (2) In case of Scarcity of Oil Fuel, and in Remote Areas, to reduce cost of distribution, the Corporate Body must give an opportunity to another party to share the utilization of facilities and means of Transportation owned by it according to technical and economic aspects.
- (3) The joint utilization of facilities and means of Transportation, as meant in paragraphs (1) and (2) will be further stipulated, ruled, and supervised by the Regulating Agency in accordance with technical and economic aspects.

### **Article 32**

A Corporate Body being holder of Transportation Business License must submit report to the Regulating Agency on plan and realization of transportation of Gas by pipe including utilization of facilities and means of transportation of Gas by pipe every month, or if necessary with a carbon copy to the Minister.

**Article 33**

The regulating, designation, and supervision over Tariff shall be conducted by the Regulating Agency in accordance with economic calculation of the Corporate Body and users' and consumers' interests.

**Article 34**

- (1) In operating business of transportation of Gas By Pipe, the Corporate Body must comply with the Mother Plan on National Gas Transmission and Distribution Network.
- (2) The Mother Plan on National Gas Transmission and Distributions Network shall be stipulated by the Minister according to inputs of the Regulating Agency and the Corporate Body and in observance of Government's interest in enhancing the domestic market.
- (3) The Regulating Agency shall grant Privilege for the transportation of Gas By Pipe on Transmission Segment and Distribution Network Area to the Corporate Body based on the Mother Plan on National Gas Transmission and Distribution Network.

**Article 35**

A Corporate Body operating business of transportation of Gas by Pipe may increase the capacity of its facilities and means of transportation after obtaining Privilege adjustment.

**Article 36**

- (1) Transportation of gas which is not classified as Upstream Business and is used to transport gas produced by the contractor and is not construed as a business intended to acquire gain and/or profit, is construed as Upstream Business, and Business License is not required.
- (2) The business of transportation of gas intended to acquire gain and/or profit and/or used jointly with another party by collecting fee or lease or joint imposition of cost commercially, is construed as Downstream Business and must obtain Business License and Privilege.

**CHAPTER VI  
STORAGE**

**Article 37**

A Corporate Body operating business of Storage of Oil, Gas, Oil Fuel, Gas Fuel, and/or Processing Output must obtain Storage Business License from the Minister.

**Article 38**

In operating Storage business, the Corporate Body must guarantee work safety and health, environmental treatment, and development of local society in accordance with the laws in force.

**Article 39**

A Corporate Body being holder of Storage Business License must submit report to the Minister on plan and realization of Storage business including type, quantity, and/or quality of commodities stored once in every 3 (three) months or at any time required with a carbon copy to the Regulating Agency.

**Article 40**

- (1) The Corporate Body must give an opportunity to another party to share the utilization of Storage facility owned by the Corporate Body according to technical and economic aspects.
- (2) In areas where Oil Fuel is scarce and in Remote Areas, the Corporate Body must give an opportunity to another party to share the utilization of Storage facility owned by the Corporate Body according to technical and economic aspects.
- (3) The joint utilization of the Storage facility, as referred to in paragraphs (1) and (2), will be further ruled and stipulated by the Regulating Agency.

**Article 41**

- (1) A Corporate Body which operates Storage business may add and increase capacity of the facilities and means of Storage after obtaining adjustment of its Business License.
- (2) The adjustment of Business License, as referred to in paragraph (1), must obtain recommendation from the Regulating Agency, in advance.

**Article 42**

- (1) A Corporate Body operating business of Storage of LNG must have License to Store LNG.
- (2) The Minister shall determine terms and guidelines on grant of the Business License, as referred to in paragraph (1).

**CHAPTER VII  
TRADING**

**Article 43**

A Corporate Body which will Trade Oil, Gas, Oil Fuel, Gas Fuel, Other Fuels, and/or Processing Output must have a Trading Business License from the Minister.

**Article 44**

In operating Trading business, a Corporate Body must:

- a. Guarantee the availability of Oil Fuel, Gas Fuel, Other Fuels, and/or Processing Output constantly in its Trade distribution network;
- b. Guarantee the availability of Gas by pipe constantly in its Trade distribution network;
- c. Guarantee the selling prices of Oil Fuel, Gas Fuel, Other Fuels, and/or Processing Output at a fair rate;
- d. Guarantee the provision of adequate Trade facility;
- e. Guarantee the standard and quality of Oil Fuel, Gas Fuel, Other Fuels, and/or Processing Output as determined by the Minister;
- f. Guarantee and responsible for the accuracy of the measurement system used;
- g. Guarantee the utilization of qualified tools.

**Article 45**

A Corporate Body being holder of Trading Business License must submit report to the Minister on realization of Trading business once a month or at any time if required with a carbon copy to the Regulating Agency.

**Article 46**

- (1) To the Corporate Body operating business of Trading of Oil Fuel, Gas Fuel, Other Fuels, and/or Processing Output, as referred to in Article 43, may be granted a Wholesale Trading Business License or Trading Business License.
- (2) The Corporate Body being holder of Wholesale Trading Business License, as referred to in paragraph (1), may operate trading business to serve certain consumers (big consumers).

**Article 47**

- (1) A Corporate Body being holder of Wholesale Trading Business License must have and/or control facilities and means of storage and security of supply from domestic and/or foreign sources.
- (2) The Minister may determine the minimum capacity of storage facility, as referred to in paragraph (1), which must be realized by the Corporate Body.
- (3) The Regulating Agency shall give consideration to the Minister with regard to the determining of minimum capacity of storage facility, as meant in paragraph (2).
- (4) The Corporate Body, as referred to in paragraph (2), may start its Trading business after fulfilling the required minimum capacity for storage facility.

**Article 48**

- (1) A Corporate Body being holder of Wholesale Trading Business License, in distributing Oil Fuel, Gas Fuel, and LPG for small-scale users, small consumers, transportation, and household, must distribute those fuels through a distributor appointed by the Corporate Body through selection process.
- (2) The appointment of distributor, as referred to in paragraph (1), must prioritise cooperatives, small enterprises and/or national private enterprises integrated with the Corporate Body based on an association contract.
- (3) The distributor, as referred to in paragraph (1), may only market Oil Fuel, Gas Fuel, and LPG with the trademark used or possessed by the Corporate Body being holder of Wholesale Trading Business License.
- (4) The distributor, as referred to in paragraph (1), must possess the licenses in accordance with the laws in force.
- (5) The Corporate Body being holder of Wholesale Trading Business License shall be responsible for standard and quality up to distributor level.
- (6) The Corporate Body must submit report to the Minister and the Regulating Agency regarding appointment of distributor, as referred to in paragraphs (1), (2), and (3).

**Article 49**

- (1) A Corporate Body being holder of Wholesale Trading Business License of Oil Fuel may distribute directly to transportation users using the facilities and means managed and/or owned by the Corporate Body.
- (2) The direct distribution of the facilities and means owned by the Corporate Body, as referred to in paragraph (1), may only be done for not exceeding 20% (twenty percent) of total facilities and means of distribution managed and/or owned by the Corporate Body.
- (3) Distribution using the facilities and means managed and/or owned by the Corporate Body, in addition to that as set forth in paragraph (2), may only be operated by cooperatives, small enterprises and/or local corporate bodies.

- (4) Cooperatives, small enterprises, and/or local corporate bodies may own and operate facilities and means owned by self based on cooperation with the Corporate Body being holder of Wholesale Trading Business License.
- (5) Provisions on the enforcement of the provision of paragraph (2) will be stipulated by the Minister after obtaining consideration from the Regulating Agency.

Article 50

- (1) A direct user who have or control seaport and/or receiving terminal may import Oil Fuel, Gas Fuel, Other Fuels, and/or Processing Output directly for self-utility after obtaining recommendation from the Minister.
- (2) The direct user, as referred to in paragraph (1), shall not market and/or sell and purchase Oil Fuel, Gas Fuel, Other Fuels, and Processing Output.
- (3) On direct user who markets and/or sells & purchases Oil Fuel, Gas Fuel, Other Fuels, and/or Processing Output, as referred to in paragraph (2), will be imposed with penalty and monetary charge pursuant to the laws in force.

Article 51

- (1) A Corporate Body being holder of Trading Business License operating business of trading of LPG must have or control facilities and means of storage and bottling of LPG.
- (2) The Corporate Body being holder of the Trading Business License, as referred to in paragraph (1), must have and use a certain trademark.
- (3) The Corporate Body being holder of Trading Business License shall be responsible for the standard and quality of LPG, LPG bottle, and facilities and means of storage and bottling.

Article 52

- (1) Corporate Bodies operating business of Trading of Gas consist of those having Gas distribution network facility and those who do not.
- (2) The business of Trading of Gas operated by the Corporate Body having distribution network facility, as referred to in paragraph (1) shall be operated after obtaining License to Trade Gas and Privilege for Distribution Network Area.
- (3) The business of trading of Gas operated by a Corporate Body not having distribution network facility, as referred to in paragraph (1), may only be implemented through distribution network facility of Corporate Body that has obtained Privilege for Distribution Network Area and after obtaining License to Trade Gas.

Article 53

In operating Trading business, a Corporate Body must guarantee work safety and health, environmental treatment, and development of local society in accordance with the laws in force.

Article 54

- (1) The Minister shall determine technical standard for Gas Fuel and LPG bottles and Gas Fuel and LPG bottling facilities of Corporate Bodies being holders of License to Trade Gas Fuel and LPG.
- (2) The Minister shall determine minimum technical standard for facilities and means of distribution.

**Article 55**

On sale of Oil and Gas as production output which is classified or construed as Upstream Business, Trading Business License is not required.

**CHAPTER VIII  
STRATEGIC OIL DEPOSIT**

**Article 56**

- (1) Strategic Oil Deposit provided by the Government can be acquired from domestic production and/or imported.
- (2) The Government may assign a Corporate Body to provide Strategic Oil Deposit as referred to in paragraph (1).
- (3) The Minister shall rule and determine Strategic Oil Deposit in relation to quantity, type, and location of storage and exploitation of Strategic Oil Deposit.
- (4) The quantity of Strategic Oil Deposit shall be determined based on need for Oil Fuel and so forth adjusted to the configuration of domestic Processing facilities that will exploit Strategic Oil Deposit.

**Article 57**

The exploitation of Strategic Oil Deposit will be determined by the Minister upon disturbance of Oil supply to support the provision of Oil Fuel domestically.

**Article 58**

The regulating, implementation, and supervision over Strategic Oil Deposit will be further stipulated by the Minister.

**CHAPTER IX  
NATIONAL OIL FUEL RESERVE**

**Article 59**

- (1) The Minister shall stipulate policy on quantity and type of National Oil Fuel Reserve.
- (2) Type of the National Oil Fuel Reserve, as referred to in paragraph (1), must meet the standard and quality as determined by the Minister.
- (3) The Minister may appoint a Corporate Body being holder of Processing Business License, Corporate Body being holder of Storage Business License, and Corporate Body being holder of Trading Business License producing and/or yielding type of Oil Fuel, as referred to in paragraph (2), to provide National Oil Fuel Reserve.
- (4) The National Oil Fuel Reserve of each of the Corporate Bodies, as referred to in paragraph (3), will be ruled and stipulated by the Regulating Agency.
- (5) Supervision over the provision of National Oil Fuel Reserve, as referred to in paragraph (4), shall be executed by the Regulating Agency.

**Article 60**

- (1) The National Oil Fuel Reserve, as referred to in Article 59 paragraph (1), shall only be utilized upon Scarcity of Oil Fuel which will be regulated and stipulated by the Regulating Agency.



- (2) In case that Scarcity of Oil Fuel has been solved, the National Oil Fuel Reserve shall be returned to the original condition.

**Article 61**

- (1) The appointed Corporate Body, as referred to in Article 59 paragraph (3), must report the condition of Oil Fuel as part of the National Oil Fuel Reserve consisting of location, quantity, and type of which to the Regulating Agency with a carbon copy submitted to the Minister every month.
- (2) In case that the Corporate Body does not fulfil the National Oil Fuel Reserve when needed, as set forth in article 59 paragraph (3), the Minister may impose administrative sanction and/or monetary charge on the Corporate Body according to recommendation of the Regulating Agency.

**CHAPTER X  
STANDARD AND QUALITY**

**Article 62**

- (1) The Minister shall determine type, standard, and quality of Oil Fuel, Gas Fuel, Other Fuels, and/or Processing Output in the form of finished products that will be marketed domestically.
- (2) The standard and quality of Oil Fuel, Gas Fuel, and/or Processing Output marketed domestically must comply with the standard and quality as determined by the Minister as referred to in paragraph (1).
- (3) In determining the standard and quality, as referred to in paragraph (1), the Minister must observe technological development, capacity of producer, consumer's financial condition and need, work safety and health, and environmental treatment.

**Article 63**

- (1) A Corporate Body operating Processing business which produces Oil Fuel, Gas Fuel, and/or Processing Output must have an accredited laboratory to perform test into quality of processing output according to the standard and quality as determined by the Minister.
- (2) The Corporate Body operating Storage business which does blending to produce Oil Fuel and/or Processing Output shall provide facility of testing into quality of blending output according to the standard and quality as determined by the Minister.
- (3) In case that the Corporate Body, as referred to in paragraph (2), is unable to provide a self-owned laboratory, it may utilize the facility of an accredited laboratory owned by another party.

**Article 64**

- (1) Oil Fuel, Gas Fuel, and/or Processing Output in the form of finished products which are imported or directly marketed domestically must comply with the standard and quality as determined by the Minister.
- (2) On Oil Fuel, Gas Fuel, and/or Processing Output which will be exported, the standard and quality of which may be determined by producer at consumers' request.
- (3) On Oil Fuel, Gas Fuel, and/or Processing Output with special demand, the standard and quality of which may be determined and must be reported to the Minister.

**Article 65**

The Minister shall regulate and stipulate procedure of supervision over standard and quality of Oil Fuel, Gas Fuel, Other Fuels, and/or Processing Output marketed domestically as set forth in Article 62 paragraph (1).

**CHAPTER XI  
AVAILABILITY AND DISTRIBUTION OF CERTAIN TYPES OF OIL FUEL**

**Article 66**

- (1) To guarantee the availability and distribution of certain types of Oil Fuel, Trading Business shall be operated based on a fair, healthy, and transparent competition, which, in practice, is implemented gradually.
- (2) The gradual implementation, as referred to in paragraph (1), will be stipulated in a Presidential Decree.
- (3) The Presidential Decree, as referred to in paragraph (2), shall set forth provisions on certain types of Oil Fuel, selling plan, and export and import of Oil Fuel.
- (4) In case that the operation of the trading business, as meant in paragraph (1), has not achieved a fair, healthy, and transparent competition, rules on provision and distribution of certain types of Oil Fuel will be applied.
- (5) The rules, as meant in paragraph (4), shall only be applicable for Corporate Bodies being holders of Wholesale Trading Business License for Oil Fuel.

**Article 67**

- (1) The Minister shall designate Area of Trading of certain types of Oil Fuel domestically.
- (2) The Trading Area for certain types of Oil Fuel, as referred to in paragraph (1) includes Area of Trading of Oil Fuel which market mechanism has been effective, Area of Trading of Oil Fuel which market mechanism has not been effective, and Area of Trading of Oil Fuel in Remote Areas.
- (3) The Regulating Agency shall give consideration to the Minister in relation to the designation of Area of Trading of certain types of Oil Fuel, as meant in paragraph (1).

**Article 68**

- (1) The Regulating Agency shall designate Trade distribution area for certain types of Oil Fuel for Corporate Bodies being holders of Trading Business License including the procedure of which.
- (2) The Regulating Agency shall determine joint utilization of transportation and storage facilities including its supporting facilities in the provision and distribution of certain types of Oil Fuel, particularly in areas which market mechanism has not been effective and in Remote Areas.
- (3) If necessary, in Areas of Trading of certain types of Oil Fuel which have not been and/or are unable to establish fair, healthy, and transparent competition mechanism, the Government may determine the limit of retail prices for certain types of Oil Fuel.
- (4) The retail prices of certain types of Oil Fuel, as referred to in paragraph (3), consist of price at Wholesale level plus cost of distribution, retailer's margin, and tax.
- (5) The Government shall determine limit of the price, as referred to in paragraph (3), based on input of the Regulating Agency according to calculation of its economic value.

**Article 69**

- (1) A Corporate Body being holder of Wholesale Trading Business License which operates trading of certain types of Oil Fuel to transportation users, must give an opportunity to the distributor appointed by the Corporate Body through selection process.
- (2) The distributor, as referred to in paragraph (1) includes cooperatives, small enterprises, and/or national private enterprises integrated with the Corporate Body based on an association contract.
- (3) The distributor, as meant in paragraph (2), may only distribute certain types of Oil Fuel with the trademark used or owned by Corporate Body as holder of Wholesale Trading Business License.
- (4) The distributor, as meant in paragraph (2), must obtain the licenses in accordance with the laws in force.
- (5) The Corporate Body must submit report to the Regulating Agency with a carbon copy to the Minister regarding appointment of the distributor, as referred to in paragraphs (1), (2), and (3).

**Article 70**

- (1) A Corporate Body being holder of Wholesale Trading Business License which operates business of Trading of Oil Fuel in the form of kerosene for household and/or small enterprises must do it through a distributor appointed by the Corporate Body through selection process.
- (2) The distributor, as referred to in paragraph (1), includes cooperatives, small enterprise, and/or national private enterprise integrated with the Corporate Body based on an association contract.
- (3) The distributor, as referred to in paragraph (2), may only distribute Oil Fuel in the form of kerosene with trademark used or owned by the Corporate Body as holder of Wholesale Trading Business License.
- (4) The distributor, as referred to in paragraph (2), must obtain the licenses in accordance with the laws in force.
- (5) The distributor, as meant in paragraph (2), may only distribute to household users and/or small enterprises and may not distribute to other users.
- (6) The Corporate Body must submit report to the Regulating Agency with a carbon copy to the Minister regarding appointment of the distributor as referred to in paragraphs (1), (2), and (3).

**Article 71**

- (1) In the framework of supporting of business of Trading of certain types of Oil Fuel operated by distributor and Corporate Body being holder of Wholesale Trading Business License, the use of transportations owned by cooperatives, small enterprises, and/or national private enterprises through selection process, must be prioritised.
- (2) The transportation business, as referred to in paragraph (1), must be operated integrally with the Corporate Body pursuant to an association contract.
- (3) The transportation business, as referred to in paragraph (1), must obtain the licenses in accordance with the laws in force.

## **CHAPTER XII PRICES OF OIL FUEL AND GAS**

### **Article 72**

- (1) Prices of Oil Fuel and Gas, except Gas for household and small consumers, shall be assigned to a fair, healthy, and transparent competition.
- (2) Price of Gas for household and small consumers, as referred to in paragraph (1), shall be ruled and stipulated by the Regulating Agency according to technical and economic aspects of the provision of Gas and price policy determined by the Government.
- (3) The Regulating Agency shall perform supervision over prices of Oil Fuel and Gas, as referred to in paragraphs (1) and (2).

### **Article 73**

Retail price of Oil Fuel domestically consists of price at the level of Corporate Body being holder of Wholesale Trading Business License plus cost of distribution, retailer's margin, and tax.

### **Article 74**

Tax, as referred to in Article 73, shall be imposed pursuant to the laws in force.

## **CHAPTER XIII DISTRIBUTION OF OIL FUEL TO REMOTE AREAS**

### **Article 75**

The Minister shall issue policy for Remote Areas based on location, market establishment preparedness, and strategic value of the area concerned according to the consideration of the Regulating Agency.

### **Article 76**

- (1) The distribution of Oil Fuel to Remote Areas will be further ruled and stipulated by the Regulating Agency.
- (2) In the distribution of Oil Fuel to Remote Areas, as referred to in paragraph (1), the Corporate Body may cooperate with Regional Enterprises, cooperatives, small enterprises, and/or national corporate bodies, which have had distribution network in Remote Areas in accordance with technical and economic aspects.
- (3) Oil Fuel that must be distributed to Remote Areas, as referred to in paragraph (1), is in the form of gasoline, diesel fuel, and kerosene adjusted to the needs of the respective areas.

## **CHAPTER XIV WORK SAFETY AND HEALTH, ENVIRONMENTAL TREATMENT, AND DEVELOPMENT OF LOCAL SOCIETY**

### **Article 77**

Corporate Bodies operating Processing, Transportation, Storage, and Trading Businesses must guarantee and comply with provisions regarding work safety and health, environmental treatment, and development of local society.

**Article 78**

Provisions regarding work safety and health, environmental treatment, and development of local society, as referred to in Article 77, in Processing, Transportation, Storage, and Trading businesses will be ruled pursuant to the laws in force.

**Article 79**

- (1) Corporate Bodies, in operating Processing, Transportation, Storage, and Trading businesses shall be responsible for development of the environment and local society in the framework of entering into relationship with the surrounding society.
- (2) Responsibility of Corporate Bodies in developing the environment and local society, as referred to in paragraph (1), means participation in developing and utilizing potentiality of local society, among other things, by employing workers in certain quantity and quality in accordance with the required competence and improving residential environment of the society to create harmony between the Corporate Bodies and the surrounding society.

**Article 80**

- (1) Development of the environment and local society by the Corporate Body shall be implemented in coordination with the Regional Government.
- (2) Development of the environment and local society, as referred to in paragraph (1), shall be prioritised for society around area of operation.

**CHAPTER XV**

**UTILIZATION OF LOCAL GOODS, SERVICES, AND ENGINEERING AND DESIGN CAPACITY  
AND EMPLOYMENT OF WORKERS**

**Article 81**

The utilization of goods and tools in Downstream Business must fulfil the applicable standard pursuant to the laws in force.

**Article 82**

- (1) A Corporate Body operating Downstream Business must prioritise the utilization of local goods, tools, services, technology, and engineering and design capacity transparently and competitively.
- (2) The prioritising of utilization of local goods, tools, services, technology, and engineering and design capacity, as meant in paragraph (1), shall be implemented if those goods, tools, services, technology, and engineering and design capacity have been yielded or available domestically and have complied with quality, time of delivery, and competitive price.

**Article 83**

- (1) In fulfilling the need for workers, a Corporate Body operating Downstream Business must prioritise the employment of Indonesian workers in observation of utilization of local workers according to the required standard of competence.
- (2) A Corporate Body operating Downstream Business may employ foreign workers for certain occupations and expertise which have not been able to be fulfilled by Indonesian workers according to the required occupational competence.
- (3) Procedure on employment of foreign workers, as referred to in paragraph (2), shall be implemented pursuant to the laws in force.

**Article 84**

Provisions regarding employment relation, employment protection, and terms and delivery of part of work to another party will be ruled pursuant to the labor laws in force.

**Article 85**

To improve the capacity of Indonesian workers to be able to meet standard of competence and occupational qualifications, Corporate Bodies must arrange development and educational & training programs for Indonesian workers.

**Article 86**

The development and improvement of capacity of Indonesian workers shall be implemented pursuant to the laws in force.

**CHAPTER XVI  
DEVELOPMENT AND SUPERVISION**

**Article 87**

The Minister shall implement development and supervision over the operation of Processing, Transportation, Storage, and Trading businesses pursuant to this Government Regulation.

**Article 88**

Supervision relating to the provision and distribution of Oil Fuel and transportation of Gas By Pipe shall be executed by the Regulating Agency.

**Article 89**

- (1) Provisions on development and supervision, as referred to in Article 87, will be further stipulated by the Minister.
- (2) Provisions on supervision, as referred to in Article 88, will be further stipulated by the Regulating Agency.

**CHAPTER XVII  
SANCTIONS**

**Article 90**

- (1) The Minister shall deliver written reminder to a Corporate Body which breaches one of the terms of the Processing Business License, Transportation Business License, Storage Business License, and/or Trading Business License issued by the Minister.
- (2) In case that the Corporate Body, after receiving written reminder, as referred to in paragraph (1), still repeats such breaches, the Minister may postpone the Processing, Transportation, Storage, and/or Trading businesses.
- (3) In case that the Corporate Body does not comply with the requirements as stipulated by the Minister during the period of postponement, as referred to in paragraph (2), the Minister may freeze the Processing, Transportation, Storage, and/or Trading businesses.

- (4) The Regulating Agency shall determine and impose sanction relating to breaches of Privilege relating to the business of transportation of Gas by pipe.
- (5) The Regulating Agency shall determine and impose sanction relating to breaches of obligations of the Corporate Body in the provision and distribution of Oil Fuel.
- (6) The sanctions, as referred to in paragraphs (4) and (5), are in the form of written reminder, monetary charge, postponement, freeze, and annulment of Rights in the provision and distribution of Oil Fuel and annulment of Privilege in transportation of Gas by pipe.
- (7) Provisions regarding imposition of sanctions, as referred to in paragraph (6), will be further stipulated by the Regulating Agency.

#### Article 91

- (1) In case that after the imposition of written reminder, postponement, and freeze of business, as referred to in Article 90, the Corporate Body will be given an opportunity to recover the breaches or to fulfil the requirements within a period of not later than 60 (sixty) days since the decision on freeze of business.
- (2) In case that after expiration of the 60(sixty)-day period, as meant in paragraph (1), the Corporate Body has not recovered the breaches and has not fulfilled the requirements, the Minister may nullify the Business Licenses concerned.

#### Article 92

The Minister may impose written reminder, postponement, freeze of business, and nullification of Business Licenses to Corporate Bodies committing breaches, as set forth in Article 90.

#### Article 93

All damages arising as a result of delivery of written reminder, monetary charge, postponement, freeze of business, and nullification of Business Licenses, as set forth in Articles 90, 91, and 92, shall be borne by the respective Corporate Bodies.

#### Article 94

- (1) Every person or Corporate Body operating Processing, Transportation, Storage, and/or Trading Businesses without the Licenses, as meant in Article 12, will be penalized pursuant to laws on Oil and Gas.
- (2) Every person who duplicate or falsify Oil Fuel, Gas Fuel, Processing Output, and/or Other Fuels, will be penalized with imprisonment of maximum 6 (six) years and monetary charge of maximum Rp. 60.000.000.000,00 (sixty billion Rupiah).
- (3) Every person or Corporate Body misusing Transportation and/or Trading of Oil Fuel subsidized by the Government will be penalized with imprisonment of maximum 6 (six) years and monetary charge of maximum Rp. 60.000.000.000,00 (sixty billion Rupiah).

### **CHAPTER XVIII OTHER PROVISIONS**

#### Article 95

On Processing, Transportation, Storage, and Trading businesses related to Downstream Business, the Corporate Body must use the measurement system as determined by the Minister.

**Article 96**

- (1) In case of Scarcity of Oil Fuel resulting in security disturbance and/or Force Majeure, the Minister will take the necessary actions to solve this problem.
- (2) In times where prices of Oil Fuel and Gas Fuel (in the form of LPG) are unstable or fluctuate causing very heavy burden to consumers, the Government may take actions to stabilize prices in observance of interests of users, consumers, and Corporate Bodies.

**Article 97**

Every person or corporate body who has known the occurrence of or are properly assumed to know about breaches by Corporate Bodies in relation to the enforcement of the Licenses as meant in Article 7 may submit report, in writing, to the Regulating Agency.

**Article 98**

Procedure of submission of the report, as referred to in Article 97, will be further ruled and stipulated by the Regulating Agency.

**CHAPTER XIX  
CLOSING PROVISIONS**

**Article 99**

Upon the enforcement of this Government Regulations all enforcement regulations regarding Downstream Business shall be declared applicable as long as those regulations have not been amended and/or are not in contradiction with this Government Regulation.

**Article 100**

This Government Regulation shall come into force from the date of stipulation.

So that everybody is well advised, ordering the enactment of this Government Regulation by placing it in the Statute Book of the Republic of Indonesia.

Stipulated in Jakarta  
On 14 October 2004  
PRESIDENT OF THE REPUBLIC OF INDONESIA  
Signed  
MEGAWATI SOEKARNOPUTRI  
Enacted in Jakarta

On 14 October 2004  
STATE SECRETARY OF THE REPUBLIC OF INDONESIA  
signed  
BAMBANG KESOWO

STATUTE BOOK OF THE REPUBLIC OF INDONESIA OF 2004 NO. 124



This copy conforms to the original document  
Deputy Cabinet Secretary for Legal Affairs and the Laws  
signed and sealed  
Lambock V. Nahattands

**ELUCIDATION  
OF  
REGULATION OF GOVERNMENT OF THE REPUBLIC OF INDONESIA  
NO. 36/2004  
ON  
OIL AND GAS DOWNSTREAM BUSINESS**

**GENERAL**

Law No. 22/2001 on Oil and Gas which was ratified and enacted on 23 November 2001 is a historical point in giving a legal base for steps of renewal and re-arrangement of Oil and Gas Businesses consisting of Upstream and Downstream Businesses.

Downstream Business is demanded to be more capable to support the sustainability of national development in the framework of improvement of prosperity and welfare of the people. The operation of Oil and Gas Downstream Business is intended, among other things, to support and improve the national capacity to be more capable to compete, to create employment opportunities, to repair the environment, and to improve people's welfare and prosperity.

In the framework of creating of an independent, reliable, transparent, competitive, efficient Oil and Gas Downstream Business based on the point of view of environmental function conservation and encouraging of improvement of national potentiality and role, a legal base is necessary for the Downstream Business consisting of Processing, Transportation, Storage, and Trading businesses according to the mechanism of fair, healthy, and transparent competition.

Based on the need for legal base for the operation of Downstream Business, rules in a Government Regulation are required in observance of the impact that may possibly arise. This Government Regulation rules about Oil and Gas Downstream Business, which, among other things, includes regulations on development and supervision, grant of Business License, Processing, Transportation (including Transportation of Gas by Pipe), Storage and Trading, Strategic Oil Deposit, National Oil Fuel Reserve, Standard and Quality, Availability and Distribution of certain types of Oil Fuel, Prices of Oil

Fuel and Gas, Distribution of Oil Fuel to Remote Areas, Work Safety and Health, Environmental Treatment, Development of Local Society, Utilization of Local Goods and Services, Domestic Engineering & Design Capacity, Utilization of Workers, and Sanctions in relation to Downstream Business.

**ARTICLE BY ARTICLE**

Article 1  
Self-explanatory.

Article 2

Downstream Business shall be operated with Business License which shall only be granted to Corporate Bodies after meeting of the necessary administrative and technical requirements. Corporate Bodies operating Upstream Business shall not operate Downstream Business and Corporate Bodies managing Downstream Business shall not operate Upstream Business, except by establishing an independent corporate body or Holding Company.

Article 3

Self-explanatory.

Article 4

Paragraph a

Self-explanatory.

Paragraph b

Self-explanatory.

Paragraph c

Self-explanatory.

Paragraph d

Self-explanatory.

Paragraph e

Self-explanatory.

Paragraph f

Self-explanatory.

Paragraph g

Self-explanatory.

Paragraph h

Self-explanatory.

Paragraph i

“Certain Types of Oil Fuel” include, amongst others, Gasoline, Diesel Fuel, Kerosene, and/or other types of Oil Fuel.

Paragraph j

Self-explanatory.

Paragraph k

Self-explanatory.

Paragraph l

Self-explanatory.

Article 5

Self-explanatory.

Article 6

Self-explanatory.

Article 7

Self-explanatory.

**Article 8**

Paragraph (1)

Clause a

Self-explanatory

Clause b

Self-explanatory

Clause c

Self-explanatory.

Clause d

“The Regulating and Determining” are intended so that the Corporate Body will give an opportunity for joint utilization and the Regulating Agency must observe and consider technical and economic aspects so that the operation of the Corporate Body having and/or controlling facilities of storage and transportation of Oil Fuel will be undisturbed.

Clause e

“Contribution” means an amount that must be paid by the Corporate Bodies providing and distributing Oil Fuel.

Clause f

Self-explanatory.

Paragraph (2)

Decree issued by the Lower Court of Central Jakarta as an institution authorized to settle disputes handled by the Regulating Agency is because the Regulating Agency, at present, only exists in Jakarta.

**Article 9**

Paragraph (1)

Clause a

Self-explanatory.

Clause b

Self-explanatory.

Clause c

So that it will not harm and burden Corporate Bodies and consumers, in determining the Tariff, the Regulating Agency must observe the interests of Gas owners, pipe owners, and consumers.

Clause d

The designated price of Gas shall only be applicable for household and small consumers utilizing Gas with a certain scale of consumption.

Clause e

Self-explanatory.

Clause f

“Contribution” means an amount that must be paid by Corporate Bodies Transporting Gas by Pipe.

Clause g

Self-explanatory.

Paragraph (2)

Decree issued by the Lower Court of Central Jakarta as an institution authorized to settle disputes handled by the Regulating Agency is because the Regulating Agency, at present, only exists in Jakarta.

Article 10

Paragraph (1)

Self-explanatory.

Paragraph (2)

Self-explanatory.

Paragraph (3)

“The giving of opinion, in writing” includes, amongst others, breaches committed by the Corporate Body, impact/analysis from technical and economic points of view, and proposal on sanctions that will be imposed.

Article 11

Self-explanatory.

Article 12

Self-explanatory.

Article 13

Paragraph (1)

Self-explanatory.

Paragraph (2)

“The assignment of authority of grant of Business License for certain businesses” is intended to enable business performers and in the framework of efficiency to prevent high-cost economy and in observance with the capacity and capability of business performers including in observance of ownership of stocks by foreign parties and/or utilization of investment facility. This authority may be assigned to the Regional Government, related institution, and/or certain agency which duty and responsibility are in investment affairs.

Article 14

Paragraph (1)

Clause a

Self-explanatory.

Clause b

A Corporate Body operating Transportation of Gas by Pipe shall manage its business based on unbundling business system and may only be given a certain Transmission Segment and/or Distribution Network Area. This is to encourage a fair and healthy competition and to improve efficiency in the utilization of infrastructure and quality of service.

Clause c

Self-explanatory.

Clause d

A Corporate Body Trading Gas by Pipe shall manage its business based on unbundling business system and may only be given a certain Distribution Network Area. This is to encourage a fair and healthy competition and to improve efficiency in the utilization of infrastructure and quality of service. The division of Trading area shall be done according to technical, economic, security, and safety aspects.

Paragraph (2)

Self-explanatory.

Paragraph (3)

Self-explanatory.

Article 15

Paragraph (1)

Self-explanatory.

Paragraph (2)

The terms and guidelines for the implementation of Business License will be stipulated in a Ministerial Decree, which, among other things, contains:

- a. Deed of establishment and its amendments which have been ratified by the authorized institution;
- b. Company profile;
- c. Taxpayer's Register Number (NPWP);
- d. Company Registration Certificate (TDP);
- e. Certificate of domicile;
- f. Statement on Source of Funding;
- g. Written Statement on commitment to fulfil operational safety and health and environmental treatment;
- h. Written Statement on commitment to fulfil obligations pursuant to the laws in force;
- i. Approval from the Regional Government on location requiring construction of facilities and means.

Article 16

Paragraph (1)

"Secondary To Its Processing Business" means that the Corporate Body, in operating Transportation, Storage, and/or Trading businesses which are construed as secondary and directly related to its Processing business and is not intended to acquire gain and/or profit.

Paragraph (2)

Self-explanatory.

Paragraph (3)

Self-explanatory.

Article 17

Self-explanatory.

Article 18

Self-explanatory.

Article 19  
Self-explanatory.

Article 20  
Self-explanatory.

Article 21  
Self-explanatory.

Article 22  
Self-explanatory.

Article 23  
Paragraph (1)  
Self-explanatory.  
Paragraph (2)

“Technical Aspect” means that a Processing facility with exceeding capacity may be utilized by another party without disturbing the operation of the facility’s owner.  
And, “Economic Aspect” means that the other party who will utilize the Storage facility must consider economic interest of the facility owner, among other things, the rate of return.

Article 24  
Self-explanatory.

Article 25  
Based on this provision, for lubricant shall be applied the laws in force setting forth that the grant of license to blend lubricant and/or processing of used lubricant shall be granted by the minister for industrial affairs after obtaining written consideration from the Minister. And, the designation of standard and quality of lubricant and development and supervision of which shall be implemented by the Minister.

Article 26  
“Transportation Business License from the Minister” is a License granted by the Minister to a Corporate Body to transport, channel, and/or distribute Oil, Gas, Oil Fuel, Gas Fuel, other Fuels, and/or Processing Output by land, water, and/or air including Transportation of Gas by Pipe for commercial purpose considering that those commodities are strategic and vital and have a direct impact on the interest of the society at large. The respective Corporate Body is still obliged to complete its licenses pursuant to the laws on transportation affairs.

Article 27  
Self-explanatory.

Article 28  
Self-explanatory.

Article 29  
Transportation which may be operated by cooperatives, small enterprises, and or national private enterprises by means of land transportation, except train, with the purpose

to empower the capacity of cooperatives, small enterprises, and/or national private enterprises to take part in the transportation of Oil Fuel to retailers which appointment shall be done by the Corporate Body through selection process. The selection and the determining of criteria of national private enterprise shall be implemented based on national, local, or individual company with a total ownership of domestic capital or stocks of 100% (one hundred percent).

Article 30

Self-explanatory.

Article 31

Paragraph (1)

“Technical Aspect” means that facility of Transportation of Gas by Pipe with an exceeding capacity may be utilized by another party without disturbing the operation of the facility’s owner.

And, “Economic Aspect” means that the other party who will utilize the facility of Transportation of Gas by Pipe must consider economic interest of the facility’s owner, among other things, the rate of return.

Paragraph (2)

Self-explanatory.

Paragraph (3)

Self-explanatory.

Article 32

Self-explanatory.

Article 33

Self-explanatory.

Article 34

Self-explanatory.

Article 35

Self-explanatory.

Article 36

Self-explanatory.

Article 37

Self-explanatory.

Article 38

Self-explanatory.

Article 39

Self-explanatory.

**Article 40**

Paragraph (1)

“Technical Aspect” means that facility of Storage with an exceeding capacity may be utilized by another party without disturbing operation of the facility’s owner. And, “Economic Aspect” means that the other party who will utilize the Storage facility must consider economic interest of the facility’s owner, amongst others, the rate of return.

Paragraph (2)

Self-explanatory.

Paragraph (3)

Self-explanatory.

**Article 41**

Self-explanatory.

**Article 42**

Self-explanatory.

**Article 43**

The obligation to obtain Business License is also applicable for Corporate Bodies appointed to sell part of Oil and Gas owned by the Government which is not secondary to Upstream Business and is not related to Association Contract.

**Article 44**

Paragraph a

Self-explanatory.

Paragraph b

Self-explanatory.

Paragraph c

“Selling Price of Oil Fuel at a Fair Rate” means the selling price of Oil Fuel according to its economic value by considering fair gain for the Corporate Body and shall not burden consumers.

Paragraph d

Self-explanatory.

Paragraph e

Self-explanatory.

Paragraph f

Self-explanatory.

Paragraph g

Self-explanatory.

**Article 45**

Self-explanatory.



**Article 46**

Paragraph (1)

Business License must be possessed by a Corporate Body operating Trading Business and not having Trading facility and means. Requirements to obtain Trading Business License shall be differentiated with requirements to obtain Wholesale Trading Business License having Trading facility and means.

Paragraph (2)

Self-explanatory.

**Article 47**

Paragraph (1)

Self-explanatory.

Paragraph (2)

“Determine the Minimum Capacity” means the minimum storage facility that must be provided by the Corporate Body for its operation according to the required minimum capacity for facility of storage of Oil Fuel.

Paragraph (3)

Self-explanatory.

Paragraph (4)

Self-explanatory.

**Article 48**

Paragraph (1)

Self-explanatory.

Paragraph (2)

Self-explanatory.

Paragraph (3)

Self-explanatory.

Paragraph (4)

Self-explanatory.

Paragraph (5)

The Responsibility for Standard and Quality shall not only be imposed on Corporate Bodies being holders of Wholesale Trading Business License, but is the joint responsibility of distributor up to consumer level.

Paragraph (6)

Self-explanatory.

**Article 49**

Paragraph (1)

Self-explanatory.

Paragraph (2)

Self-explanatory.

Paragraph (3)

Self-explanatory.

Paragraph (4)

“Operation by Cooperatives, Small Enterprises, and/or National Private Enterprises” means that the operation shall be based on selection and shall be integrated with a Corporate Body operating Wholesale business and possessing Wholesale Trading Business License.

Paragraph (5)  
Self-explanatory.

Article 50  
Self-explanatory.

Article 51  
Self-explanatory.

Article 52  
Self-explanatory.

Article 53  
Self-explanatory.

Article 54  
Self-explanatory.

Article 55  
Self-explanatory.

Article 56  
Paragraph (1)  
Self-explanatory.

Paragraph (2)  
“The Obligation to Provide Strategic Oil Deposit” may only be assigned or obliged to Corporate Bodies operating Processing business and having and/or controlling facility and means of refinery.

Paragraph (3)  
Self-explanatory.

Paragraph (4)  
Self-explanatory.

Article 57  
Self-explanatory.

Article 58  
Self-explanatory.

Article 59  
Paragraph (1)  
“Type of National Oil Fuel” means Oil Fuel which is always available in certain quantity and type and may be utilized at any time, and, if it is unavailable and/or delayed to be utilized, will cause disturbance and very much affect the national economy. Paragraph (2)  
Self-explanatory.

Paragraph (3)  
Self-explanatory.

Paragraph (4)  
Self-explanatory.

Paragraph (5)  
Self-explanatory.

Article 60  
Self-explanatory.

Article 61  
Self-explanatory.

Article 62  
Self-explanatory.

Article 63  
Self-explanatory.

Article 64  
Self-explanatory.

Article 65  
According to society's need, work safety and health, environmental treatment, and protection of consumers of Oil Fuel, Gas Fuel, Other Fuels, and/or Processing Output, the Government, through the Minister, shall rule and determine the standard and quality of the foregoing including procedure of supervision of which. The Minister, in determining the standard and quality, shall also observe development of machine technology and international standard and quality.

Article 66  
Paragraph (1)  
Self-explanatory.  
Paragraph (2)  
"Gradual Implementation" means rules on arrangement of stages relating to the Trading of certain types of Oil Fuel which includes Corporate Body's selling plan based on yearly need of each Area of Trading of Oil Fuel and mechanism of assignment of right to sell to another Corporate Body and rules on procedure of export and import including recommendation of which in observance of interest of the consumers society.

Paragraph (3)  
"Selling Plan" means the quantity of certain types of Oil Fuel submitted to be managed by a Corporate Body in the provision and distribution of Oil Fuel in the Area of Trading of certain types of Oil Fuel and to obtain decree and approval of the Regulating Agency.

Paragraph (4)  
Self-explanatory.

Paragraph (5)  
Self-explanatory.

Article 67  
Paragraph (1)

“Area of Trading of Oil Fuel” means a specific area based on geographic borders given to a Corporate Body being holder of Wholesale Trading of Oil Fuel to provide and distribute certain types of Oil Fuel.

Paragraph (2)

The division of Area of Trading of certain types of Oil Fuel shall be determined based on need, location, market establishment preparedness and strategic value of the respective Area.

Paragraph (3)

Self-explanatory.

Article 68

Self-explanatory.

Article 69

Self-explanatory.

Article 70

Self-explanatory.

Article 71

Self-explanatory.

Article 72

Paragraph (1)

Prices of Gas Fuel in the form of LPG shall be assigned to market mechanism after the availability of competition/establishment in LPG market or there are at least 2 (two) Corporate Bodies/business performers Trading LPG.

Paragraph (2)

Self-explanatory.

Paragraph (3)

Supervision over selling prices of Oil Fuel and Gas shall be based on fair prices, prices according to economic value by considering fair gain for the Corporate Body and shall not burden consumers.

Article 73

Self-explanatory.

Article 74

Self-explanatory.

Article 75

Self-explanatory.

Article 76

Self-explanatory.

Article 77  
Self-explanatory.

Article 78  
Self-explanatory.

Article 79  
Self-explanatory.

Article 80  
Self-explanatory.

Article 81  
Self-explanatory.

Article 82  
Paragraph (1)  
In prioritising the utilization of local goods and services, technical requirements, quality, timely delivery, and price must be considered.  
Paragraph (2)  
Self-explanatory.

Article 83  
Self-explanatory.

Article 84  
Self-explanatory.

Article 85  
Self-explanatory.

Article 86  
Self-explanatory.

Article 87  
Self-explanatory.

Article 88  
Self-explanatory.

Article 89  
Self-explanatory.

Article 90  
Self-explanatory.

Article 91  
Self-explanatory.

Article 92  
Self-explanatory.

Article 93  
Self-explanatory.

Article 94  
Self-explanatory.

Article 95  
“Determined by the Minister” means provisions relating to planning, construction, operation, maintenance, and technical inspection of measurement system.

Article 96  
Paragraph (1)  
“Actions of the Minister” are methods and/or steps to solve Scarcity of Oil Fuel through release of National Oil Fuel Reserve of the Corporate Bodies or through increase of import of Oil Fuel by giving of facility and incentive which implementation is coordinated with the Regulating Agency.  
Paragraph (2)  
“Actions of the Government” means methods or steps to stabilize prices of Oil Fuel by determining of the highest selling price jointly by the Minister and the related minister after consultation with the President.

Article 97  
Self-explanatory.

Article 98  
Self-explanatory.

Article 99  
Self-explanatory.

Article 100  
Self-explanatory.

SUPPLEMENT TO STATUTE BOOK NO. 4436

**GR 79/2010**

**GOVERNMENT REGULATION OF THE REPUBLIC OF INDONESIA  
NUMBER 79 OF 2010  
CONCERNING  
COST RECOVERY AND INCOME TAX TREATMENT IN THE UPSTREAM OIL AND GAS  
BUSINESS  
IN THE NAME OF THE ONLY ONE GOD  
PRESIDENT OF THE REPUBLIC OF INDONESIA,**

Considering :

- a. that based on Article 6 paragraph (1) of Law Number 22 of 2001 regarding Oil and Gas, upstream business activities are carried out and controlled through Cooperation Contract (“CC”);
- b. that in implementing the CC as referred to point a above, capital borne by business entity or permanent establishment is recoverable by Government of Indonesia at the time of the upstream oil and gas business reaches production;
- c. that based on the consideration as referred to points a and b above, and to implement provisions under Article 31D of Law Number 7 of 1983 regarding Income Tax as lastly amended by Law Number 36 of 2008 regarding the fourth amendment to Law Number 7 of 1983 regarding Income Tax, there is a need to issue a Government Regulation regarding cost recovery and Income Tax treatment in the upstream oil and gas sector;

In view of :

- a. Article 5 paragraph (2) of the 1945 Constitution Law;
- b. Law Number 7 of 1983 regarding Income Tax (State Gazette of the Republic of Indonesia Number 50 of 1983, Supplement to the State Gazette Number 3263) as lastly amended by Law Number 36 of 2008 regarding the fourth amendment to Law Number 7 of 1983 regarding Income Tax (State Gazette of the Republic of Indonesia Number 133 of 2008, Supplement to the State Gazette Number 4893);
- c. Law Number 22 of 2001 regarding Oil and Gas (State Gazette of the Republic of Indonesia Number 136 of 2001, Supplement to the State Gazette Number 4152).

**HAS DECIDED:**

**To stipulate : GOVERNMENT REGULATION CONCERNING COST RECOVERY AND INCOME TAX TREATMENT IN THE UPSTREAM OIL AND GAS BUSINESS.**

**CHAPTER I  
GENERAL PROVISION**

**Article 1**

**In this Government Regulation, referred to as:**

- (1) Crude oil, natural gas, oil and natural gas, exploration, exploitation, CC, Executive Board (Badan Pelaksana), work area, Indonesia’s mining territory, and upstream business activities are as referred to in Law Number 22 of 2001 regarding Oil and Gas.

- (2) Contractor is a business entity or permanent establishment which is appointed to perform exploration and exploitation activities in a work area based on CC with Executive Board.
- (3) Operator is a Contractor or in the case that the Contractor consists of several Participating Interest holders, is one of the Participating Interest holder which is appointed as a representative by the other Participating Interest holders according to the CC.
- (4) Petroleum Operation is an activity which includes exploration, exploitation, transportation, plug and abandonment of wells, also restoration of oil and gas site.
- (5) Lifting is a quantity of crude oil and/or natural gas which is sold or distributed at custody transfer point.
- (6) First Tranche Petroleum, hereinafter abbreviated as FTP, is a certain quantity of crude oil and/or natural gas produced in a work area within one calendar year, which could be taken and received by Executive Board and/or Contractor in each calendar year, before cost recovery deduction and own use.
- (7) Investment Credit, hereinafter referred to as investment incentive is an additional of certain capital cost recovery directly related to the production facility, which is provided as an incentive for certain oil and/or gas production field development.
- (8) Equity to be Split is the production yields available to be distributed (lifting) between Executive Board and Contractor after deducted by FTP, investment incentive (if any), and cost recovery.
- (9) Non-capital cost is the cost spent on the current year operational activities with a useful life of less than a year including survey and intangible drilling cost.
- (10) Capital cost is the expenditure for equipment or goods with useful life of more than one year and which is charged in the current year through depreciation.
- (11) Work Plan and Budget is a yearly plan of activities and budget expenditures by a Contractor for upstream oil and gas business activities in a certain work area.
- (12) Production Sharing Contract ("PSC") is a form of cooperation contract in upstream oil and gas business activities based on production sharing scheme.
- (13) Service Contract is a form of cooperation contract to perform oil and gas exploitation based on compensation for services scheme for production yielded.
- (14) Participating Interest is the right and obligation as CC Contractor, either directly or indirectly in a work area.
- (15) Uplift is a income received by Contractor in relation to the provision of funds to finance the operation of a PSC which should have been part of the others Contractor's participation obligation in work areas, in the financing
- (16) Domestic Market Obligation, hereinafter abbreviated as DMO, is the obligation to surrender a part of Contractor's shares of Oil and Gas to meet domestic needs.
- (17) DMO fee is the compensation made by the Government to the Contractor for the oil and gas surrendered to meet domestic needs using a certain price as set by the Minister whose his/her area and responsibilities cover upstream oil and gas business activities.
- (18) Government is the Central Government.
- (19) Minister is the Minister who held Government affairs in upstream oil and gas business activities.

## **Article 2**

Provisions stipulated under this Government Regulation are applied to PSC and Service Contract in upstream oil and gas business.

## **Article 3**

- (1) Contractor shall bring capital and technology, and bear all risks in performing Petroleum Operation based on the CC in a certain work area.
- (2) The performance of Petroleum Operation referred to in paragraph (1) shall be conducted



based on the principles of effectiveness and efficiency, arm's length principle, and good business and engineering practice.

**Article 4**

- (1) All goods and equipments purchased by a Contractor for Petroleum Operation activities shall become the State property which is supervised by Government and managed by Executive Board.
- (2) Goods and equipments referred to in paragraph (1) cannot be revaluated for the purposes of cost recovery.

**Article 5**

- (1) In carrying out Petroleum Operation, Contractor shall prepare a Work Plan and Budget based on the good business and engineering practice as well as arm's length principle.
- (2) Work Plan and Budget as referred to in paragraph (1) consists of:
  - a. routine expenditures; and
  - b. project expenditures.
- (3) The Work Plan and Budget as referred to in paragraph (2) shall obtain approval from the Head of the Executive Board.
- (4) Approval from the Head of the Executive Board as referred to in paragraph (3) shall constitute as a guidance for Contractor in performing Petroleum Operation.

**Article 6**

For the project expenditures as referred to in Article 5 paragraph (2) point b, an authorisation for financial expenditure ("AFE") approval from Head of Executive Board should be obtained prior to be implemented.

**Article 7**

- (1) Contractor will recover the operating cost based on the Work Plan and Budget approved by the Head of the Executive Board, after the work area has reached commercial production.
- (2) The status of commercial production as referred to in paragraph (1) is determined by Minister approval on the first plan of development for the field to be produced.
- (3) In the event the work area as referred to in paragraph (1) does not yield any commercial production, all operating costs that have been incurred shall fully become the Contractor's risks and expenditures.

**Article 8**

- (1) The Minister shall determine the minimum amount of Government's share from a certain work area which is associated with lifting in the approved plan of development as referred to in Article 7 paragraph (2).
- (2) Determination on the minimum amount of Government's share as referred to in paragraph (1) is done based on a guidance stipulated by the Minister.

**CHAPTER II**  
**GROSS INCOME AND CONTRACTOR'S INCOME DEDUCTION**  
**First Part**  
**Contractor's Gross Income**

**Article 9**

- (1) Contractor's gross income consists of:
  - a. Income from PSC; or
  - b. Income from Service Contract; and
  - c. Other income outside the CC.
- (2) Income tax calculation on income from PSC as referred to in paragraph (1) point a is calculated based on the realisation value of Contractor's oil and/or gas from the Equity Share and FTP share, added with oil and/or gas from cost recovery, added any additional oil and/or gas from the granting of incentive or other, deducted with the realisation value of oil and/or gas DMO, added with DMO fee, and added lifting price variance.
- (3) Income tax calculation on income from Service Contract as referred to in paragraph (1) point b is calculated based on compensation received from the Government, added with the sales realisation of oil and/or gas from cost recovery.
- (4) Other income outside the CC as referred to in paragraph (1) point c consists of:
  - a. Uplift or other similar income; and/or
  - b. Income from the transfer of Participating Interest.

**Article 10**

- (1) To guarantee the State revenue, the Minister shall determine the amount and split of FTP.
- (2) To boost the development of work area, the Minister shall determine the form and amount of investment incentive.

**Second Part**  
**Operating Cost**

**Article 11**

- (1) Operating cost consists of:
  - a. exploration cost;
  - b. exploitation cost; and
  - c. other cost.
- (2) Exploration costs as referred to in paragraph (1) point a consist of:
  - a. drilling cost consists of:
    1. exploration drilling cost; and
    2. development drilling cost;
  - b. geology and geophysics cost consists of:
    1. geology study cost; and
    2. geophysics study cost.
  - c. general and administration cost for exploration activities; and
  - d. depreciation expenses.
- (3) Exploitation costs as referred to in paragraph (1) point b consist of:
  - a. direct production cost for:
    1. oil; and
    2. gas.

- b. gas processing cost;
  - c. utility cost consists of:
    - 1. cost of production equipment and maintenance of equipment; and
    - 2. cost of steam, water and electricity.
  - d. general and administration cost for exploitation activities; and
  - e. depreciation expenses.
- (4) General and administration cost for exploration and exploitation activities as referred to in paragraph (2) point c and paragraph (3) point d consists of:
- a. administration and finance cost;
  - b. employee cost;
  - c. material service cost;
  - d. transportation cost;
  - e. general office cost; and
  - f. indirect tax, regional tax and regional levy.
- (5) Other cost as referred to in paragraph (1) point c consists of:
- a. cost to transport the gas from point of production to point of delivery; and
  - b. post upstream activities operation cost.

#### **Article 12**

- (1) Operating cost that can be recovered in the calculation of production sharing and Income Tax shall meet the following requirements:
- a. incurred to obtain, collect and maintain income in accordance with the prevailing laws and regulations, and directly connected to petroleum operation activities in the concerned Contractor's work area in Indonesia;
  - b. using a arm's length price which is not influenced by a special relationship as meant in Income Tax Law;
  - c. the petroleum operation activities is conducted in accordance with good business and engineering practice;
  - d. the petroleum operation activities is in accordance with work plan and budget which has been approved by the Head of Executive Board as referred to in Article 5 and Article 6.
- (2) Direct costs in relation to petroleum operation as referred to in paragraph (1) point a shall meet the following requirements:
- a. depreciation expenses only for goods and equipment used for petroleum operation which belong to the Government;
  - b. head office direct cost from overseas charged to project in Indonesia only for the following activities that:
    - 1. can not be performed by domestic institution/body;
    - 2. can not be performed by Indonesian manpower; and
    - 3. not routine;
  - c. the granting of work-related compensations for the employees/ workers in the form of benefit in kinds shall be in line with the tax regulation;
  - d. donation for natural disaster on behalf of the Government shall be in line with the tax regulation;
  - e. community and environmental development expenses disbursed during the exploration period;
  - f. indirect head office's overhead allocation cost with the following requirements:
    - 1. use to support the business or activities in Indonesia;

2. Contractor submit the audited consolidated head office financial statements and the basis for cost allocation; and
  3. the amount does not exceed the limit determined with Minister of Finance Regulation upon receiving the Minister's consideration.
- (3) the maximum limit for costs related to expatriate remuneration shall be determined with Minister of Finance Regulation upon receiving the Minister's consideration.

### **Article 13**

Type of operating cost that can not be recovered in the calculation of production sharing and Income Tax including:

- a. expenses charged to or disbursed for personal interests of employees and/or family, and/or management, Participating Interest holders and shareholders;
- b. establishment or maintaining of reserve funds, except for mines abandonment and site restoration, kept in an escrow account of the Executive Board and Contractor in the Indonesian Government Banks account in Indonesia;
- c. granted estates;
- d. administrative sanctions such as interest, fine, surcharges and criminal sanctions in the form of a fine related to the enforcement of tax law and charge or fine imposed due to Contractor's fault either deliberately or not;
- e. depreciation expenses on the use of goods and equipment not belonging to the Government;
- f. incentives, payment of pension dues, and insurance premiums for personal interests and/or family members of foreign manpower/expatriates, management, and shareholders;
- g. costs for foreign manpower which do not comply with the procedures for Foreign Manpower Utilization Plan (RPTKA) or who do not have Foreign Manpower Work Permit (IKTA);
- h. cost for legal consultant not directly related to petroleum operation in a CC;
- i. cost for tax consultant;
- j. cost for marketing of Contractor's share of oil and gas, except for gas marketing cost approved by the Head of the Executive Board;
- k. representation cost, including entertainment cost in whatever name or form, except attached with nominative list and tax ID number of the beneficial recipient;
- l. cost for environmental and community development during the exploitation period;
- m. cost for technical training for foreign manpower/expatriates;
- n. costs related to the merger, acquisition or Participating Interest transfer;
- o. cost of loan interest;
- p. Employee Income Tax borne by the Contractor or paid as a tax allowance, Income Tax that must be deducted or collected on a third party's income borne by the Contractor or grossed-up;
- q. goods and service procurements and other activities not complying with the arm's length principle and good engineering practice, or which exceed the approved value of AFE i.e. above 10% (ten percent) of the AFE value;
- r. excessive material surplus due to planning and purchasing error;
- s. book value and asset operating cost which has been placed into service and can no longer be operated due to the negligence of Contractor;
- t. transactions which:
  1. bring loss to the country;
  2. is carried out not through tender according to the prevailing regulations except in certain cases; or
  3. contravene with the laws and regulations;

- u. bonus paid to the Government;
- v. costs incurred prior to the signing of contract;
- w. interest recovery incentive; and
- x. commercial audit cost.

**Article 14**

In the case there is additional income obtained from petroleum operation in the form of sales of by-products or in other forms shall be treated as a deduction of operating cost.

**Article 15**

- (1) Goods with useful life of less than 1 (one) year shall be charged as operating cost at the time the goods is being used.
- (2) The charging as referred to in paragraph (1) shall be conducted in average or by first in first out method.

**Article 16**

- (1) Depreciation for a tangible asset with useful life more than 1 (one) year shall be done in declining method during its useful life, calculated by applying the depreciation rate on the book value, and at the end of the useful life the remaining book value shall be depreciated at once.
- (2) Depreciation shall start in the month such asset is placed into service.
- (3) The depreciation calculation is done in accordance with the grouping, rate and useful life as provided in the attachment of this Government Regulation.
- (4) If the tangible asset as referred to in paragraph (1) that can no longer be used due to natural damage or force majeure, the book value of such asset shall continue to be depreciated based on its remaining useful life.

**Article 17**

- (1) The amount of reserve funds for mines abandonment and site restoration charged for 1 (one) tax year shall be calculated based on an estimated abandonment and site restoration cost based on the economic life.
- (2) Reserve funds referred to in paragraph (1) shall be kept in an escrow account of the Executive Board and Contractor in an Indonesian Government Banks account in Indonesia.
- (3) In the event the total realisation cost for abandonment and site restoration is less or more than the reserved amount, the difference shall be deduction or addition to the operating cost recovery from each of the relevant work area or field, upon obtaining approval from Head of Executive Board.
- (4) Procedures for utilising the reserve funds for mines abandonment and site restoration shall be stipulated by Minister.

**Article 18**

- (1) Contractor can charge the severance payment for the permanent employees which was paid to employee severance fund manager as determined by the Minister of Finance.
- (2) Procedures for severance payment management and the amount of severance shall be further stipulated by Minister of Finance Regulation.

**Article 19**

- (1) The charging of operating costs incurred shall be deferred until commercial production is reached in the field of the work area as referred to in Article 7 paragraph (1).
- (2) To secure the State revenue, other than cost deferment referred to in paragraph (1), the Minister can make policy regarding plan of development.

**Article 20**

- (1) Operating cost referred to in Article 12 that can be recovered in 1 (one) tax year consists of:
  - a. current year non-capital cost;
  - b. current year capital goods depreciation expenses; and
  - c. unrecovered operating cost from previous years;
- (2) The maximum operating cost that can be recovered for a Service Contract referred to in paragraph (1) is equal to the compensation received from the Government.
- (3) Operating cost referred to in paragraph (1) which cannot be recovered in 1 (one) tax year can be recovered in the following years.
- (4) Direct costs of oil shall be charged to oil production and direct costs of gas shall be charged to gas production.
- (5) In the case there is a joint cost of oil and gas, the joint cost shall be allocated proportionately to the relative value of production.
- (6) In the case where a field or work area has produced one type of oil or gas, while the other type yet to produce, the joint cost referred to in paragraph (5) shall be fairly allocated in accordance with the agreement between Executive Board and Contractor.
- (7) The recovery of operating cost for oil shall be made against oil lifting only, whereas the recovery of operating cost for gas shall only be made against the gas sales.
- (8) In the case the operating cost recovery of oil and gas is not met from the production or sales value, it is determined that:
  - a. Operating cost of gas which exceeds the production, the difference shall be charged to the production of oil;
  - b. Operating cost of oil which exceeds the production, the difference shall be charged to gas sales.

**CHAPTER III**

**RECOGNITION AND MEASUREMENT OF INCOME**

**Article 21**

Contractor's income from a PSC shall be recognised at the point of delivery.

**Article 22**

- (1) Income from a CC in the form of oil sales shall be valued using the Indonesian crude oil price.
- (2) Method and formula for Indonesian crude oil price referred to in paragraph (1) shall be jointly determined by the Minister together with Minister of Finance.
- (3) The procedure for setting the methodology and formula of Indonesian crude oil price referred to in paragraph (2) shall be determined in a Ministerial Regulation.

**Article 23**

- (1) Income from a CC in the form of gas sales contract shall be valued using the price agreed upon in a Gas Sales Agreement.
- (2) If gas sales as referred to in paragraph (1) occur after a further gas processing as approved by the Minister, the income should be calculated based on the sale price after deduction of marketing cost component.

**CHAPTER IV  
CALCULATION OF EQUITY SHARE**

**Article 24**

- (1) In the case there is no FTP and investment incentive, equity to be split shall be calculated based on lifting less operating cost recovery referred to in Article 20.
- (2) In the case there is FTP but there is no investment incentive, equity to be split shall be calculated based on lifting less FTP less operating cost recovery.
- (3) In the case there is FTP and investment incentive, equity to be split shall be calculated based on lifting less FTP less investment incentive less operating cost recovery.
- (4) In the case there is no FTP but there is investment incentive, equity to be split shall be calculated based on lifting less investment incentive less operating cost recovery.
- (5) Investment incentive and operating cost recovery in accordance with the prevailing laws and regulations shall be converted into:
  - a. oil, using weighted average of Indonesia crude oil price referred to in Article 22; or
  - b. gas, using price agreed upon in a Gas Sales Agreement.
- (6) Contractor's equity share in a CC is calculated based on the percentage of Contractor's equity share before Income Tax stated in the CC multiplied by equity to be split.
- (7) Government's equity share in a CC is calculated based on the percentage of Government's equity share as stated in the CC multiplied by equity to be split which excluded Income Tax payable by the Contractor.
- (8) Contractors shall fulfil its DMO by surrendering 25% (twenty five percent) of the Contractor's equity share of oil and gas produced to meet domestic needs.
- (9) Contractor shall receive a DMO fee for surrendering oil and/or gas referred to in paragraph (8) with the price as determined by the Minister.

**CHAPTER V  
INCOME TAX CALCULATION**

**Article 25**

- (1) Taxable income for 1 (one) tax year for a Contractor in a CC shall be calculated based on income in relation to CC referred to in Article 9 paragraph (2) less current year non-capital cost, less current year capital goods depreciation expenses less operating costs that have not been recovered in the previous years.
- (2) In case the amount of deduction referred to in paragraph (1) is greater than the income referred to in Article 9 paragraph (2), the balance shall be included in the following tax year until the expiration of the contract.
- (3) The amount of Income Tax payable for a Contractor is calculated based on the taxable income referred to in paragraph (1) multiplied with the tax rate determined in the Income Tax Law.
- (4) The amount of Income Tax payable for a Contractor which the contract was signed before the enactment of this Government Regulation is calculated based on the Income Tax rate based on Tax Ordinance or the Income Tax rate prevailed at the date the contract is signed.
- (5) The taxable income referred to in paragraph (1) after deducted by income tax referred to in paragraph (3) or paragraph (4) is subject to Income Tax in accordance with the provision in the law.
- (6) If a Contractor is an Indonesian legal entity, taxable income referred to in paragraph (1) after deduction of Income Tax referred to in paragraph (3) constitutes a dividend available to be distributed and subject to Income Tax according to the provision in the law.
- (7) Upon fulfilment of tax liabilities referred to in paragraphs (3), (4), (5) and (6), a tax assessment letter for income tax payment related to oil and gas will be issued after tax audit has been performed.
- (8) Before the income tax payment assessment letter is issued, a temporary income tax payment assessment letter may be issued.
- (9) The provision regarding the issuance of income tax payment assessment letter referred to in paragraph (7) and a temporary income tax payment assessment letter referred to in paragraph (8) shall be stipulated in a Directorate General of Taxation Regulation.
- (10) Contractors shall be exempted from import duty and tax on imported goods used in petroleum operation during exploration and exploitation activities.
- (11) Procedures for guidance on the exemption of import duty and tax on the imported goods referred to in paragraph (10) shall be regulated in accordance with the provision in the law.

**Article 26**

- (1) Taxable income for 1 (one) tax year for a Contractor of Service Contract is based on income referred to in Article 9 paragraph (3) less current year non-capital cost less current year capital goods depreciation expenses less all operating costs referred to in Article 12 that have not been recovered.
- (2) Maximum amount of deduction referred to in paragraph (1) plus compensation given to the Contractor by the Government shall be stipulated in a Ministerial Regulation.
- (3) If the amount of deduction referred to in paragraph (1) is greater than the income referred to in Article 9 paragraph (3), the balance shall be included in the following tax year until the expiration of the contract.
- (4) The Income Tax payable amount for a Contractor is based on taxable income referred to in paragraph (1) multiplied by the income tax rate referred to in the Income Tax Law.
- (5) Taxable income referred to in paragraph (1) after deducted with Income Tax referred to



in paragraph (4) constitutes dividend available to be distributed and Income Tax payable according to the provision in the law.

## **CHAPTER VI INCOME OUTSIDE CC**

### **Article 27**

- (1) Contractor's income from an uplift or the kind as referred to in Article 9 paragraph (4) point a shall be imposed a final income tax at 20% from the gross amount.
- (2) On Contractor's income from the transfer of Participating Interest as referred to in Article 9 paragraph (4) point b shall be imposed a final income tax at the following rate:
  - a. 5% from gross amount, for the transfer of Participating Interest during the exploration period;
  - b. 7% from gross amount, for the transfer of Participating Interest during the exploitation period.
- (3) Income tax imposition referred to in paragraph 2 point b will be exempted if the transfer is carried out to fulfil the transfer of Participating Interest under the CC to national company as stipulated in the CC.
- (4) Procedures for withholding and payment of income tax referred to in paragraphs (1), (2), and (3) shall be regulated in a Minister of Finance's Regulation.

### **Article 28**

Transfer of Participating Interest for risk sharing purpose during the exploration stage would not be considered as income referred to in Article 9 paragraph (4) point b if satisfying the following criteria:

- a. Not transferring all of its Participating Interest;
- b. The Participating Interest has been held for more than 3 (three) years;
- c. Exploration has been conducted in the work area (investment expenditure has been occurred); and
- d. The transfer of Participating Interest is not meant for gaining any profits.

## **CHAPTER VII CONTRACTOR'S BOOKKEEPING**

### **Article 29**

- (1) Bookkeeping or recording must be carried out with due attention to good will and it should reflect the true condition or business activities.
- (2) Bookkeeping or recording must be carried out in Indonesia using Latin, Arabic numbers, and prepared in Indonesian or foreign language as approved by the Minister of Finance.
- (3) Bookkeeping shall be carried out based on the principle of consistency, according to Financial Accounting Standard Statements adjusted with the principles as contained in the PSC.
- (4) Bookkeeping shall at least consist of records on assets, liabilities, capital, income and expenses, as well as sales and purchases so that the tax payable amount can be calculated.
- (5) Books, records, and documents as the basis for the bookkeeping or recording and other documents including data processing resulted from an electronic or on-line accounting

application program shall be provided in Indonesia as long as the costs referred to in Article 12 have not been recovered.

**Article 30**

- (1) For tax calculation purpose, Directorate General of Taxation shall determine the amount of exploration cost for each year in the upstream oil and gas business sector upon receiving recommendation from the Executive Board.
- (2) Before determining the amount of the cost referred to in paragraph (1), Government auditor on behalf of Directorate General of Taxation shall perform a tax audit.
- (3) In case the amount of cost recommended by Executive Board referred to in paragraph (1) differs from the amount as a result from audit by the Government Auditor referred to in paragraph (2), Government auditor and Executive Board shall settle the difference.

**CHAPTER VIII  
CONTRACTOR'S AND/OR OPERATOR'S OBLIGATIONS**

**Article 31**

- (1) Every Contractor in a work area shall:
  - a. register for a tax ID number;
  - b. maintain bookkeeping;
  - c. submit an Annual Income Tax Return (SPT PPh);
  - d. pay the monthly tax instalment for current year at the latest by 15<sup>th</sup> of the following month, and calculate based on the taxable income from actual lifting in a calendar month;
  - e. fulfil other requirement in accordance with the prevailing taxation laws and regulations.
- (2) In case there is transfer of Participating Interest or shares, the Contractor shall report the transaction amount to the Directorate General of Taxation.
- (3) In case of transfer of Participating Interest, the right and obligation related to tax shall transfer to the new Contractor.
- (4) The format and procedures for preparation of the SPT PPh referred to in paragraph (1) point c shall be regulated in Directorate General of Taxation Regulation.

**Article 32**

- (1) Every Operator in a work area shall:
  - a. register the CC for a different tax ID number from the tax ID number referred to in Article 31 paragraph (1) point a;
  - b. fulfil the withholding and/or collecting tax obligation;
  - c. prepare bookkeeping for petroleum operation activities for the respective work area.
- (2) In case there is a change of Operator, the obligation referred to in paragraph (1) shall transfer to the new Operator.

**Article 33**

- (1) Government's share of oil and/or gas from PSC referred to in Article 24 is calculated based on the volume of the oil and/or gas.
- (2) In a case where the Government is in need of oil and/or gas to meet domestic needs, Contractor's Income Tax from PSC can be in the form of oil and/or gas volume from the Contractor's share.
- (3) The provision on procedures for the calculation and delivery of Government's equity share referred to in paragraph (1) shall be stipulated in a Ministerial Regulation.
- (4) The provision on calculation and procedures for payment of Income Tax referred to in paragraph

(2) shall be stipulated in a Minister of Finance Regulation.

## **CHAPTER IX EXECUTIVE BOARD'S OBLIGATIONS**

### **Article 34**

- (1) The Executive Board shall issue a standard or norm, type, category and amount of costs used in the petroleum operation activities at the same time with the enactment of this Government Regulation.
- (2) The Executive Board shall submit bookkeeping report concerning the implementation of cost recovery to the Director General of Taxation and Director General of Oil and Gas periodically on annual basis or at any time as required.

## **CHAPTER X OTHER PROVISIONS**

### **Article 35**

- (1) Contractors shall carry out their transactions in Indonesia and settle the payment through the banking system in Indonesia.
- (2) Transactions and settlement of payment referred to in paragraph (1) can only be conducted outside Indonesia if an approval from Minister of Finance is obtained.

### **Article 36**

- (1) The Minister of Finance in certain circumstances may appoint an independent third party to carry out financial and technical verifications after coordination with the Ministry.
- (2) The appointment of a third party referred to in paragraph (1) is carried out in accordance with the laws and regulations applicable for the procurement of goods and services.

### **Article 37**

In case there is a change of legal form and/or country of domicile and/or transfer of Participating Interest or share ownership and/or something else from the Contractor that causes change in Income Tax calculation, the Government's share shall remain the same.

## **CHAPTER XI TRANSITIONAL PROVISIONS**

### **Article 38**

When this Government Regulation come into effect:

- a. CC signed before the enactment of this Government Regulation is valid until the expiration of the contract.
- b. For matters not yet regulated or not yet clearly regulated in the CC referred to in point a for the following provisions:
  1. Government's shares;
  2. requirements for cost recovery and the norm for claiming the operating cost;
  3. non allowable cost recovery;

4. appointment of independent third party to carry out financial and technical verification;
5. issuance of the income tax assessment;
6. the exemption of customs duty and import taxes for importation of goods used during exploitation and exploration activities;
7. Contractor's Income Tax in the form of oil and of gas from the Contractor's share; and
8. Income outside CC in form of uplift and/or transfer of Participating Interest transfer, shall be adopted in accordance to this Government Regulation within 3 (three) months.

## **CHAPTER XII CLOSING PROVISIONS**

### **Article 39**

CC in upstream oil and gas activities which was signed or extended after the enactment of this Government Regulation must be in accordance with the provisions in this Government Regulation.

### **Article 40**

This Government Regulation shall come into effect at the date of promulgation.

For public cognizance, it is instructed to promulgate this Government Regulation by publicizing it in the State Gazette of the Republic of Indonesia.

Issued in Jakarta

On 20 December 2010

PRESIDENT OF THE REPUBLIC OF INDONESIA

DR. H. SUSILO BAMBANG YUDHOYONO

Promulgated in Jakarta

On 20 December 2010

MINISTER OF JUSTICE AND HUMAN RIGHTS OF THE REPUBLIC OF INDONESIA

PATRIALIS AKBAR

GAZETTE OF THE REPUBLIC OF INDONESIA NUMBER 139 OF 2010

## **ELUCIDATION OF GOVERNMENT REGULATION OF THE REPUBLIC OF INDONESIA NO. 79 OF 2010**

### **CONCERNING COST RECOVERY AND INCOME TAX PROVISIONS IN OIL AND NATURAL GAS BUSINESS**

#### **GENERAL**

Article 33 paragraphs (2) and (3) of 1945 Constitution confirms that production sectors that are vital for the State and those that control the basic needs of the people at large shall be controlled by the state, including those on oil and natural gas that constitute non-renewable strategic natural

resources. As oil and natural gas constitute vital sources of state revenues, they need to be managed efficiently and optimally for the maximum benefits of the people's welfare and prosperity. To date oil and natural gas management has been conducted through production sharing contracts that are also applied by most oil producing countries.

This Government Regulation provides better certainty for more optimal state revenues generating from production sharing contracts or from other income, among others:

- a. costs that can be deducted from the gross income will equal costs recoverable from the Government;
- b. types, terms, and method of allocation, and total limit of the costs to be accurately regulated to secure more optimal state revenue and ensure legal certainty;
- c. indirect taxes such as VAT, import duty, land and building tax, regional tax and retribution that have been state-borne, that are amended to be jointly borne by the state and Contractors by way of recording the indirect taxes as cost components;
- d. Contractors are required to conduct self-remittance of the income tax due for the income received or obtained from other than CC scheme.

The enactment of this Government Regulation is intended to prevent any abuse in implementing the Double Taxation Avoidance Agreement.

In optimizing the state revenue from existing contracts, Law No. 41 of 2008 concerning the 2009 state budget that instructs the Government to issue regulations that govern the recovery of operating costs spent by Contractors in CC. For this purpose, provisions stipulated in this Government Regulation also apply to PSCs that had been signed prior to the enactment of this Government Regulation with considering several transitional provisions.

## **BY ARTICLES**

### **Article 1**

Sufficiently clear

### **Article 2**

Sufficiently clear

### **Article 3**

#### Paragraph (1)

For CC in respect of upstream oil and natural gas, the Government provides the natural resources whereas the Contractor is required to bring in the capital and technology. The consequence is that the Contractor is not allowed to charge interest cost or royalty cost and the like in the cost recovery.

#### Paragraph (2)

Sufficiently clear

### **Article 4**

#### Paragraph (1)

In principle, all expenditures for goods and equipment purchased by the Contractors is state-owned, thus the expenditures shall be cost recoverable by the Government to Contractors based on the purchase price.

#### Paragraph (2)

Sufficiently clear

**Article 5**

Paragraph (1)

Good business practice shall include fair and generally applied business practices that are in line with business ethics, whereas good technical includes:

- a. complying with work safety and health, as well as environmental protection and management requirements;
- b. producing oil and natural gas in accordance with good reservoir management principles;
- c. producing oil and natural gas wells in appropriate manners;
- d. using appropriate enhanced oil production technology;
- e. improving the reservoir capacity to channel fluids using the appropriate techniques; and
- f. complying with the equipment standard requirements.

Paragraph (2)

Point a

Routine expenditures include payment of salaries, maintenance costs, and post-mining operations costs.

Point b

Project expenditures include the construction of production facilities and seismic survey activity.

Paragraph (3)

Sufficiently clear.

Paragraph (4)

Sufficiently clear.

**Article 6**

Authorisation for financial expenditure is an authorisation for expenditure (AFE).

**Article 7**

Sufficiently clear.

**Article 8**

Sufficiently clear.

**Article 9**

Paragraph (1)

Sufficiently clear.

Paragraph (2)

Lifting price variance shall be the price difference occurring due to the difference between monthly Indonesian crude oil price and weighted average Indonesian crude oil price.

Paragraph (3)

Sufficiently clear.

Paragraph (4)

Sufficiently clear.

**Article 10**

Paragraph (1)

Sufficiently clear

Paragraph (2)

Development of work area in this provision includes extensification and intensification.

**Article 11**

Costs that are deductible from the income shall be equal to the costs recoverable by the Government to Contractors with regard to the CC, or the other way around. This principle is known as uniformity principle.

Operating costs as regulated in this article shall be costs that are used as basis in calculating the production sharing and taxable income.

Paragraph (1)

Sufficiently clear

Paragraph (2)

Sufficiently clear

Paragraph (3)

Point a

Sufficiently clear

Point b

Sufficiently clear

Point c

Sufficiently clear

Point d

Sufficiently clear.

Point e

The depreciation expenses include:

1. production facility;
2. office building, storage, housing;
3. machinery and equipment.

Paragraph (4)

Sufficiently clear.

Paragraph (5)

Point a

Included in the gas transportation cost from point of production to point of delivery is marketing cost.

Point b

Sufficiently clear.

**Article 12**

Paragraph (1)

Point a

Costs to obtain, collect and maintain the income referred to as daily costs that can be booked as expenses in the year of spending. To be treated as costs, they have to have direct or indirect relations to the business activities or to activities in obtaining, collecting, and maintaining income from oil operational field activities that commercially produced in the respective work area in Indonesia.

As such, costs spent to obtain, collect, and maintain non-tax object income under Income Tax provisions and/or for income that is imposed with final income tax, shall not be treated as cost recovery.

Point b

Sufficiently clear.

Point c

Sufficiently clear.

Point d.

Sufficiently clear.

Paragraph (2)

Point a

Sufficiently clear.

Point b

Head office's direct costs that are borne by the project shall be costs related directly to oil operational activities in Indonesia, on the following conditions:

1. shall not be carried out by domestic agencies/institutions;
2. shall not be carried out by Indonesian workforce; and
3. not routine.

Point c

Sufficiently clear.

Point d

Sufficiently clear.

Point e

Sufficiently clear.

Point f

Sufficiently clear.

Paragraph (3)

Minister of Finance Regulation stipulate at least the time to implement the remuneration.

### Article 13

Point a

Sufficiently clear.

Point b

Sufficiently clear.

Point c

The granted estates can not be treated as costs, as it is State-owned.

Point d

Sufficiently clear.

Point e

Sufficiently clear.

Point f

Sufficiently clear.

Point g

Sufficiently clear.

Point h

Sufficiently clear.

Point i

Sufficiently clear.

Point j

Sufficiently clear.



Point k

Sufficiently clear.

Point l

Sufficiently clear.

Point m

Sufficiently clear.

Point n

Costs related to merger and acquisition, comprising:

- a. Personal and consultant costs related to due diligence,
- b. External costs for press release, promotion, and the chance of company's logo,
- c. Costs related to separation program or retention program, costs related to information system technology (so long as the old system has not been completely depreciated), costs related to office building movement, costs incurred due to changes in the policies concerning on-going projects.

Point o

'Interest on loan' shall be an interest on borrowings to finance the petroleum operation.

Point p

Sufficiently clear.

Point q

Sufficiently clear.

Point r

'Planning error' shall be the Contractor's error in preparing the plan that can be categorized as major negligence or willful misconduct. Major negligence or willful misconduct shall be every willful conduct or negligence committed on purpose by the management or by the senior officer of the Contractor that:

1. the consequence is known or should be known to be detrimental to others, as a result of the action or failure related to the safety or ownership of other persons or entities, or
2. in a fatal manner breaches the standards of prudence or a fatal negligence results in a harmful consequence.

Point s

The 'Contractor's negligence' shall be a major negligence or willful misconduct.

Part of the construction cost for production facilities/equipment that cannot be charged, will be non recoverable operating costs in the following cases:

1. there is no proof that the production facilities' capacity has met the agreed target, and as such the costs can only be charged proportionately against the proven capacity;
2. there is no proof that the production facilities' performance meets the established criteria, and as such the costs can only be charged proportionately against the proven performance;
3. during the construction period, there is repairment/remaking/replacement occurred of all and/or part of the production facilities that are covered in the construction all risk insurance;
4. during the guarantee period damage occurs as a result of manufacturing errors, and as such the repair or replacement cost shall be borne by the goods/service supplying contractor.

Point t

Number 1

‘Transactions that bring loss to the Government’ shall be a transaction that is not in accordance with the law provisions, thus resulted in loss to the Government such as, the procurement of goods and services, which are not in accordance with the stipulated specifications and others.

Number 2

In this provision, not through a tender process shall be the procurement of required goods and services should be through a tender process, however the procurement of goods and services for emergency purposes can be made not through a tender process.

Number 3

Sufficiently clear.

Point u

Sufficiently clear.

Point v

Sufficiently clear.

Point w

Sufficiently clear.

Point x

There is exception in this provision if there is an urgent national interest which includes production continuity, acceleration of oil and/or gas production, which provides benefit to the Government.

**Article 14**

Additional income shall be from the sale of by-products such as sales of sulfur and sales of additional electricity capacity.

**Article 15**

Sufficiently clear.

**Article 16**

Paragraph (1)

Sufficiently clear.

Paragraph (2)

‘Placed into service’ shall be the time when a tangible property starts to be used and has fulfilled all the requirements as stipulated by the Executive Board.

Paragraph (3)

Sufficiently clear.

Paragraph (4)

Sufficiently clear.

**Article 17**

Paragraph (1)

‘Fiscal year’ shall be the calendar year.

Paragraph (2)

Sufficiently clear.

Paragraph (3)  
Sufficiently clear.

Paragraph (4)  
Sufficiently clear.

#### **Article 18**

Sufficiently clear.

#### **Article 19**

Paragraph (1)  
Sufficiently clear.

Paragraph (2)  
'Policy' shall be for cost recovery purposes which is based on the economic field or several fields in a proposed single plan of development (POD basis) or economy in a field (field basis) or field development based on economy of one or several wells by not building its own production facilities (put on production).

#### **Article 20**

Paragraph (1)  
Point a  
Sufficiently clear.

Point b  
Sufficiently clear.

Point c  
'Unrecovered cost from previous year' shall be balance of operating costs that cannot be recovered at the beginning of the year, so it can be recovered in the current year in accordance with a production sharing scheme.

Paragraph (2)  
Sufficiently clear.

Paragraph (3)  
Sufficiently clear.

Paragraph (4)  
Sufficiently clear.

Paragraph (5)  
Sufficiently clear.

Paragraph (6)  
Sufficiently clear.

Paragraph (7)  
Sufficiently clear.

Paragraph (8)  
Sufficiently clear.

#### **Article 21**

'Point of delivery' shall be the point where oil and/or natural gas transfer of title takes place from the Government to a Contractor.

**Article 22**

Paragraph (1)

Sufficiently clear.

Paragraph (2)

‘Indonesian crude oil price’ shall be crude oil price set out by the Minister periodically.

Paragraph (3)

Sufficiently clear.

**Article 23**

Paragraph (1)

Sufficiently clear.

Paragraph (2)

‘Components of cost of sales’ shall be the costs associated with further gas processing activities up to the gas sales, such as financing costs of refinery construction, refinery operation expenses, transportation and marketing costs.

**Article 24**

Sufficiently clear.

**Article 25**

Paragraph (1)

Sufficiently clear.

Paragraph (2)

Sufficiently clear.

Paragraph (3)

‘Tax rate’ in accordance with the Income Tax provisions shall be tax rate elected by the Contractor, i.e. the tax rates prevailed at the time of PSC signing or prevailing tax rates from time to time.

Paragraph (4)

Sufficiently clear.

Paragraph (5)

Sufficiently clear.

Paragraph (6)

Sufficiently clear.

Paragraph (7)

‘Oil and gas income tax payment assessment letter’ shall be tax assessment letter issued by the Director General of Tax following a tax audit.

Paragraph (8)

‘Temporary oil and gas income tax payment assessment letter’ shall be tax assessment letter issued by the Director General of Tax prior to a tax audit which is used among others for Head Office’s internal management purposes.

Paragraph (9)

Sufficiently clear.

Paragraph (10)

Sufficiently clear.

Paragraph (11)

Sufficiently clear.

**Article 26**

Sufficiently clear.

**Article 27**

Paragraph (1)

Sufficiently clear.

Paragraph (2)

Sufficiently clear.

Paragraph (3)

Participating Interest is implemented based on provision in law.

Paragraph (4)

Sufficiently clear.

**Article 28**

Sufficiently clear.

**Article 29**

Sufficiently clear.

**Article 30**

Sufficiently clear.

**Article 31**

Paragraph (1)

Sufficiently clear.

Paragraph (2)

Sufficiently clear.

Paragraph (3)

In the event the interest in a Work Area is owned by Contractor A, Contractor B, and Contractor C, and Contractor A's interest is transferred to Contractor D, the tax obligations on the interest shall be borne by Contractor D as of the effective transfer of the interest.

Paragraph (4)

Sufficiently clear.

**Article 32**

Paragraph (1)

Point a

In the event Contractor A has signed a contract with the Government for oil and/or natural gas mining operation in Work Area X, Contractor A who also acts as an Operator shall register the Work Area to obtain a different tax ID number from the Contractor's tax ID number.

Point b

Sufficiently clear.

Point c

Sufficiently clear.

Paragraph (2)

In the event Contractor B acts as an Operator replacing Contractor A, the obligations shall transfer to Contractor B as of the effective transfer of the operator.

**Article 33**

Sufficiently clear.

**Article 34**

Paragraph (1)

‘Standard or norm, type, category and amount of costs’ shall be a qualitative and/or quantitative measure with range of values that represent the technical condition and the reasonableness element of cost of goods and services used as a comparison in the Work Plan and Budget approval and AFE.

Operating cost is based on the realization of the cost spent through the process of procurement of goods and services in accordance with the provisions in law. Standard or norm, type, category, and amount of costs will be evaluated as required.

Paragraph (2)

Sufficiently clear.

**Article 35**

Sufficiently clear.

**Article 36**

Paragraph (1)

‘Certain circumstances’ shall be natural disaster that caused loss to the country in the form of decreasing in revenue and/or loss of state assets in the oil and/or gas exploration and/or exploitation.

Paragraph (2)

Sufficiently clear.

**Article 37**

This provision is intended to maintain the amount of Government’s share (tax and non-tax state revenue) does not change in accordance with the Government’s share stated in the CC.

**Article 38**

Point a

Sufficiently clear.

Point b

Sufficiently clear.

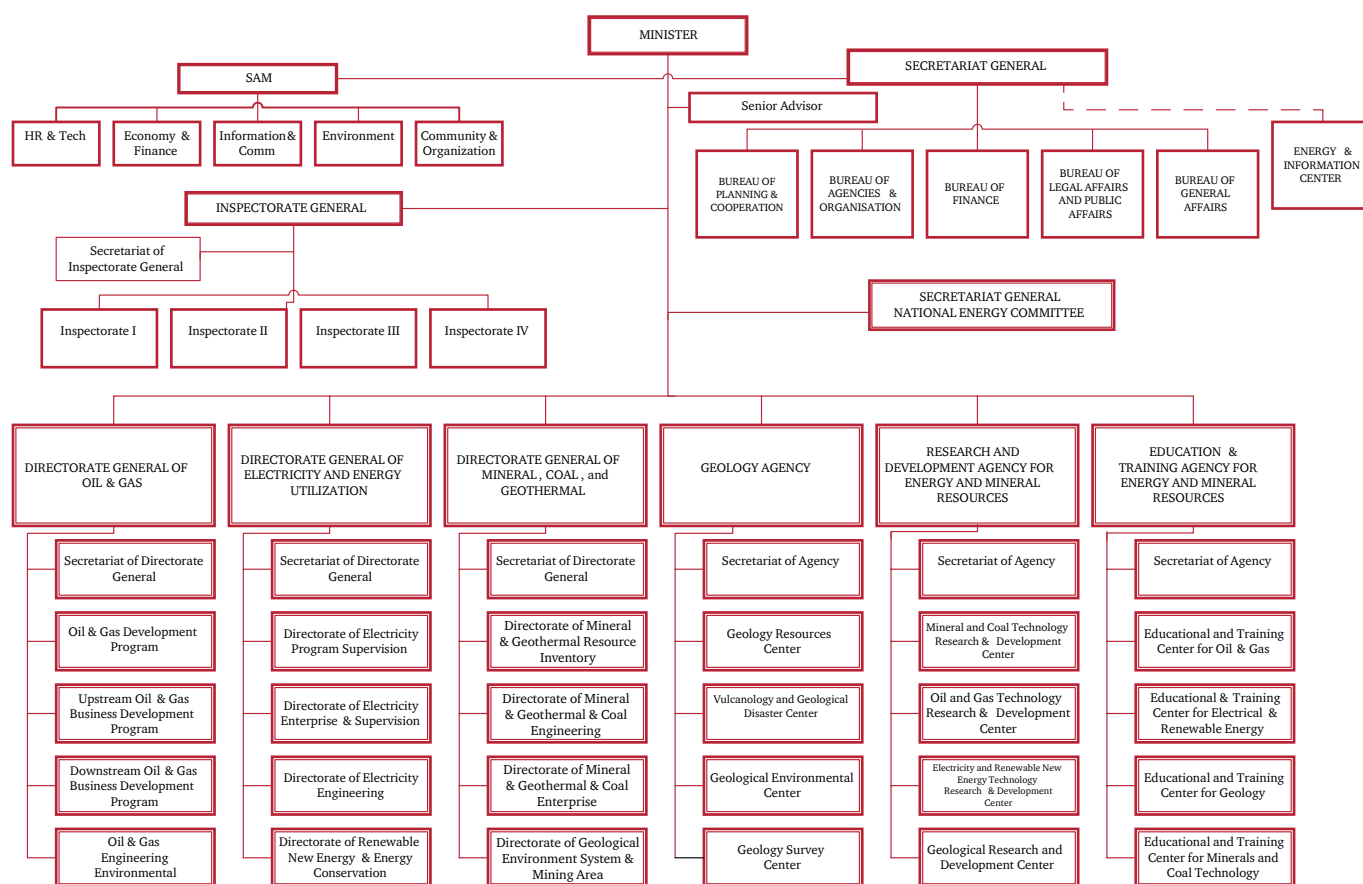
**Article 39**

Sufficiently clear.

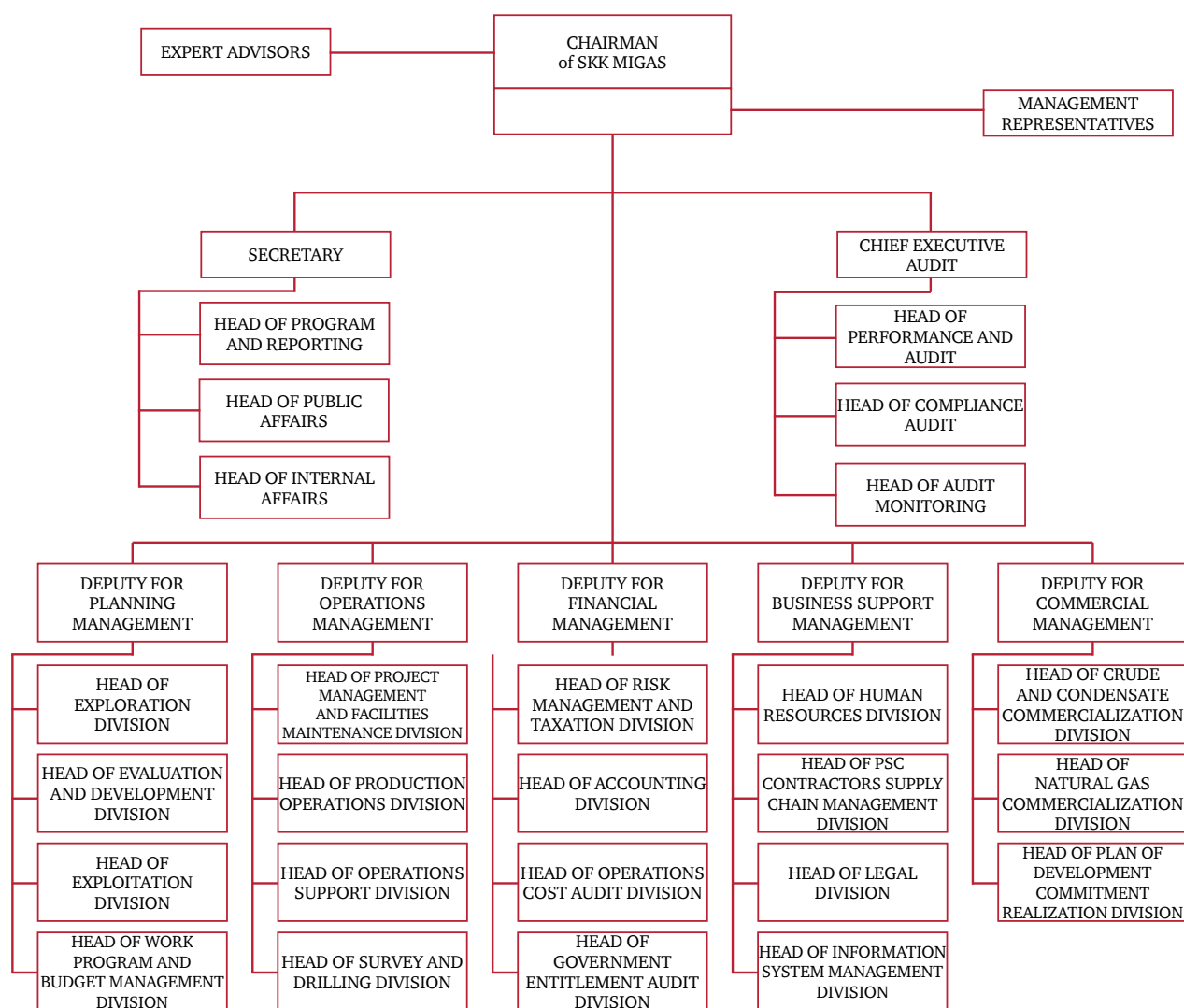
**Article 40**

Sufficiently clear.

## Appendix B - Ministry of Energy and Mineral Resources Organization Chart



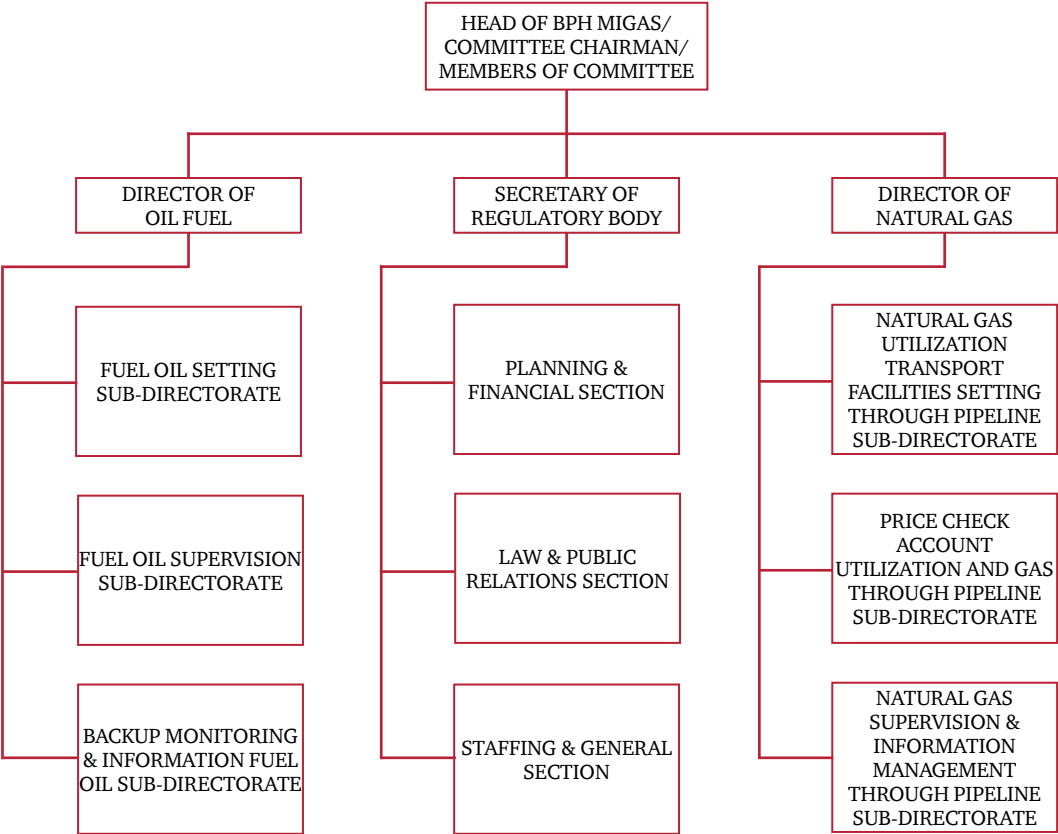
Source: Official website of Ministry of Energy and Mineral Resources



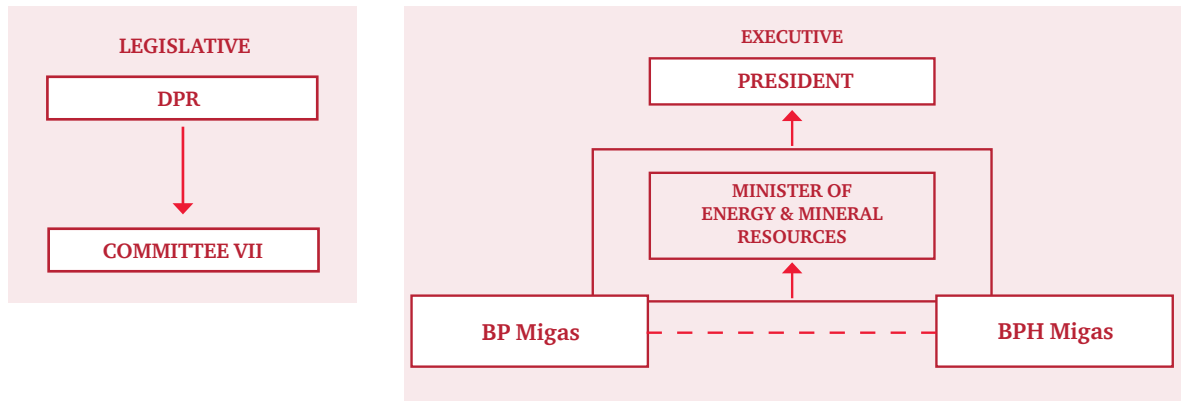
Source: SKK Migas



Appendix D - BPH Migas Organisation Chart



Source: BPH Migas



**Function:**

1. Committee VII of the House of Representatives has oversight function for all oil and gas activities undertaken by the Government. Committee VII has the right to perform fit and proper tests in relation to the election of the chairman of BP Migas;
2. The Minister for State-owned Enterprises is the Government's representative for shareholders at PT Pertamina meetings;
3. Oil and gas upstream regulatory body BP Migas has oversight function for all contractors including PT Pertamina; and
4. BPH Migas reports to the President, and the Head of BPH will also periodically report to the President through the Minister (on a semi-annual basis).

**Source:** Official website of People's Representatives Council

## 1. IPA (Indonesia Petroleum Association)

### History and Function of the IPA

The IPA was founded in 1971 by representatives from seven organizations - Pertamina, Lemigas, BP, Caltex, Jenny Joint Venture, Shell and Union Oil.

The IPA brings together the key players in the upstream oil and industries to assist members realize their company goals, advance individual members' professional interests, and act as a successful bridge between industry and Government. The IPA is the chosen vehicle to promote partnership in the Indonesian petroleum industry. It represents around 90% of oil and gas exploration and production in Indonesia.

IPA consists of 13 Committees which report to the IPA Board of Directors. Details of each of these Committees and their purpose is provided in the table below:

No.	Committee title	Purpose
1	Associate Members	To provide a forum to identify, analyse and discuss multi-disciplinary issues affecting Associate Members, as well as to communicate and exchange relevant information for its members.
2	Communications	To help build public awareness of the IPA as a reliable partner of the Government and the general public in the oil and gas industry, and increase the understanding of the important role that the oil and gas business plays in Indonesia, particularly in relation to: <ul style="list-style-type: none"><li>• Project's benefit</li><li>• Environmental commitment</li><li>• Good corporate governance</li><li>• State of art of technologies implementation / transfer of technologies</li></ul>
3	Convention	To coordinate, plan and conduct the annual IPA Convention and Exhibition.
4	Data Management	To provide a forum in which industry and government organizations can work on: the development of technical data standards; the formulation of regulatory requirements; the design and implementation of government-sponsored, technical data management initiatives; and the operation of technical data management systems.
5	Environment & Safety	To help the Government and its agencies pursue ongoing environmental activities, and to promote a consistently high standard of environmental management. To acts as an independent liaison between the PSCs and Government bodies associated with environmental matters, and provides a forum in which to interpret, clarify and communicate environmental requirements and concerns for IPA Company Members.
6	Exploration	To focus on enhancing the exploration climate in Indonesia, including formulating specific recommendations to the Government to encourage and accelerate exploration activities, as well as exchanging information and creating synergy among the PSCs.

No.	Committee title	Purpose
7	Finance & Tax	To provide a forum to interpret, clarify and communicate important financial issues to the IPA membership. They include tax, regulations, procedures and other activities important to the petroleum industry in Indonesia. The committee stays abreast of all laws, decrees and regulations that affect the IPA Member Companies, sharing relevant information concerning laws, decrees and regulations, and addressing matters of mutual interest.
8	Human Resources	To provide a forum to discuss, interpret, clarify and communicate all matters concerning human resources and industrial relations-related laws and regulations for IPA company members. The committee represents the oil and gas sector in working with the government in the creation or modification of these regulations, and acts as liaison between the PSCs and the government, Pertamina, BP MIGAS offices associated with human resources and industrial relations.
9	LNG and Gas	To analyse regulations being developed by SKK Migas with regard to the export of natural gas, and determines their impact on the IPA members. To develop recommendations to the IPA Board on actions which would maintain the existing level of Indonesian LNG and Pipeline natural gas exports and increase the level of such exports, and reviews, clarifies and communicates issues covering natural gas exports to the IPA Membership.
10	Professional Division	To promote the transfer of technical information, advance new technologies for companies working in the industry, and facilitate the professional development of IPA members through an active program of luncheon talks, short course workshops and technical symposia, technical publications, quarterly newsletter and an interactive website.
11	Regulatory Affairs	To educate stakeholders about the IPA's key regulatory-related issues such as contract sanctity, improved corporate governance, and fair and consistent application of the rule of law. It also supports the IPA Board and other IPA committees in drafting and commenting on new laws and regulations, such as proposed amendments to the existing laws and regulations pertaining to the oil and gas industry, and on other current oil and gas legal issues.
12	Supply Chain Management	To propose improvements in Supply Chain Management that will increase efficiency and reduce costs.
13	Unconventional Gas	To focus on issues, studies and regulations being developed regarding CBM, shale gas and other unconventional gas resources.

### Eligibility

There are three categories of membership:

1. Corporate Member (an active PSC contractor).
2. Associate member (Organizations that are associated in other ways with petroleum and/or geothermal industries in Indonesia, including but not limited to petroleum service companies and similar organizations, educational institutes, and non-profit organizations). Almost 100 organizations are associate members of the IPA.
3. Individual Member (a person active in the PSC environment).

### **Contact Details**

#### **INDONESIAN PETROLEUM ASSOCIATION**

Indonesia Stock Exchange Building  
Tower II, 20th Floor (Suite 2001)  
Jln. Jendral Sudirman Kav. 52-53  
Jakarta 12190, Indonesia  
Phones: +62 (021) 515-5959  
Fax.: +62 (021) 5140-2545 / 6  
E-mail address: ipa@cbn.net.id  
Website: www.ipa.or.id

## **2. Indonesia Gas Association (IGA)**

### **History and Function of the IGA**

The IGA was founded in 1980, primarily to serve as a forum for its members to discuss matters of mutual interest related to natural gas ranging from exploration to end-user, including marketing, development, production, transportation, distribution and processing. The initial focus was on LNG, and the IGA has played, and continues to play, a strong role in the International Gas Union (IGU) through active participation in World Gas Conferences and international events dealing with LNG.

The IGA's purpose and objectives are:

1. To provide a forum in which the members of the Association can discuss matters relating to the exploration for and the development, production, gathering, manufacturing, processing, transmission, distribution, storage, utilization and marketing of natural hydrocarbon gas or manufactured gas;
2. To develop knowledge, learning and research and development in the areas of gas technology and environmental protection related to gas industries;
3. To cooperate with other organizations in programs of mutual benefit and to generate interest in and serve as a forum for communication and dialogue with and among both the public and private sectors impacted by the gas industry in Indonesia;
4. To promote the economic development, increase safety awareness and environment aspects of the natural gas industry in Indonesia, including information exchange with the Government of Indonesia;
5. To promote the development of infra-structure necessary to support the gas industry in Indonesia;
6. To promote cooperation among producer, transporter, consumer and regulatory/ policy maker in gas industry;
7. To disseminate and exchange information and analyses concerning such aspect of the gas industry; and
8. To establish contacts and cooperation with similar associations and professional organizations outside Indonesia.

**Contact Details**

Indonesian Gas Association (IGA)  
c/o: PT. Perusahaan Gas Negara (Persero), Tbk  
Tower A, 1st Floor  
Jl. KH. Zainul Arifin No. 20  
Jakarta 11140, Indonesia  
Email: [secretariat@iga.or.id](mailto:secretariat@iga.or.id)  
Website: [www.iga.or.id](http://www.iga.or.id)

**3. Indonesian Association of Geophysicists (HAGI)**

HAGI is a professional organization for geophysicists in Indonesia. It was established in 1975. HAGI offers training courses, conventions and luncheon talks.

**Contact Details**

Gedung Patra Office Tower  
Lt. 20 Suite 2045  
Jl. Jend. Gatot Subroto Kav 32-34  
Jakarta 12950  
Phone/Fax: +62 21 525 0040  
Email: [secretariat@hagi.or.id](mailto:secretariat@hagi.or.id)  
Website: [www.hub.hagi.or.id](http://www.hub.hagi.or.id)

**4. Indonesian Association of Geologists (IAGI)**

IAGI is a professional organization for geologists in Indonesia. IAGI was established on 13 April, 1960 as a not-for-profit organization. The organisation organises regular annual meetings, luncheon talks and field trips.

**Contact Details**

Gedung Mineral dan Batubara Lt.6  
Jl. Prof. Dr. Soepomo, SH No.10  
Jakarta 12870  
Telephone: +6221 837 02848  
Fax: +6221 837 02577  
Email: [secretariat@iagi.or.id](mailto:secretariat@iagi.or.id)  
Website: [www.iagi.or.id](http://www.iagi.or.id)

## Licences

Sector	Presence/Field of Activity	Approvals and Licences
Upstream	1. Presence is by way of a Co-operation Contract with SKK Migas. This can be a PSC or a Service Contract. Foreign companies will create a PE for tax purposes and a branch in Indonesia through their interest in the Co-operation Contract.	1. A prospective upstream investor must bid for exploration acreage as described in Section III of this publication.
	2. A MIGAS Representative Office can be set up by foreign oil and gas companies to have a presence in Indonesia while they search for suitable acreage.	2. A MIGAS Representative Office licence is issued by the Director of Oil and Gas Business Development.
	3. Development of a commercial discovery	3. Initial PoD requires approval of the MoEMR; subsequent PoDs together with work plans and budgets require approval of BP Migas.
	4. Field processing, transportation, storage and sale of own production by a contractor under a Co-operation contract do not require a business licence provided those activities are not intended to make a profit. In cases where a profit is to be earned, for example where excess capacity is rented out for fees, the contractor is required to establish a separate business entity and obtain a downstream business licence.	4. Business licence will be obtained from BPH Migas, if profit oriented.
	5. Importing.	5. An Importer Identification Number ( <i>Angka Pengenal Impor/ API</i> ) and Customs Identity Number ( <i>Nomor Identitas Kepabeanan/ NIK</i> ) is required.

Sector	Presence/Field of Activity	Approvals and Licences
Downstream	1. Corporate bodies involved in processing to produce refined product including fuel oil, gas fuel, LPG and LNG. This does not include field processing.	1. Business licence from the MoEMR. (The MoEMR may assign this authority to other parties).
	2. Corporate bodies involved in transportation of crude oil, gas and refined products for commercial purposes.	2. As 1. above.
	3. Corporate bodies involved in the storage of crude oil, gas and refined products for commercial purposes.	3. As 1. above.
	4. Corporate bodies involved in purchasing, selling, exporting and importing crude oil, gas and refined products including gas through pipelines.	4. As 1. above but consisting of a Wholesale Trading Business Licence and a Trading Business Licence.
	5. Processing Activities.	5. Where processing is the primary business and transportation, storage and trading are secondary a processing business licence only is required except where the corporate body intends to operate a wholesale trading business when it must obtain a wholesale trading business licence first.
	6. Transportation of Gas.	6. Transportation of gas through the national pipeline system requires approval from BPH Migas.
	7. Transportation to support storage	7. Where a transportation business is operated purely to support a storage business the corporate body will only require a storage business licence.



Sector	Presence/Field of Activity	Approvals and Licences
	8. Transportation and storage supporting a trading business.	8. Where transportation and storage businesses are operated purely to support a trading business the corporate body will only require a trading business licence.
	9. LNG	9. A separate licence to store LNG is required.
	10. Product registration.	10. Oil and gas products sold in the domestic market are required to be registered with the DGOG.
	11. Importing	11. Transportation of gas through the national pipeline system requires approval from BPH Migas.
Service Providers	1. PMA licence.	12. The licensing of certain oil and gas support activities is assigned to BKPM. BKPM will apply the negative list in determining the percentage equity that a foreign investor may hold. Please see our regulatory update in chapter 2 of Oil and Gas in Indonesia Investment and Taxation Guide 2014.
	2. Additional Licences	13. In some cases additional licences may be required e.g. in the case of underwater testing an Underwater Work Licence from the Ministry of Transportation and a Special Transportation Licence for FPSO/FSO also from the Ministry of Transportation.

Sector	Presence/Field of Activity	Approvals and Licences
	3. Registration Certificate.	14. Oil and gas service companies intending to bid on work for co-operation contracts must apply for Registration Certificate from the DGOG.
	4. Company Certification (SP).	15. Oil and gas service companies intending to bid on work for co-operation contracts should have the relevant SPs for the work being bid. The SPs should be applied for through the relevant business association.
	5. Importing.	16. An Importer Identification Number ( <i>Angka Pengenal Impor/ API</i> ) and Customs Identity Number ( <i>Nomor Identitas Kepabeanan/ NIK</i> ) is required.

### Summary of PSC Generations - Prior to 2008\*

Elements	1 <sup>st</sup> Generation PSC (1965 – 1975)	2nd Generation PSC (1976-1988)	3rd Generation PSC (1988 - recent)	4 <sup>th</sup> Generation – 1995 East Indonesia*	5th Generation Post Law no 22/2001
FTP	None	None	15 – 20%	15%	10% to BP MIGAS and not to be shared with Contractor
Cost recovery limit	40%	100%	80 – 85%	85%	90%
Income tax					
● Effective on net income		● 45% to 35%	● 35% to 30%	● 30%	30%
● On distributable income after tax (withholding)		● 20% or 11% to 13%	● 20% or 13% to 14%	● 14%	14%
● Total		56%, 48% (Depend on the tax regime)	48%, 44% (Depend on the tax regime)	44%	44%
Equity split Government/ Contractor	Determined on after tax basis:	Determined on after tax basis:	Determined on after tax basis:	Determined on after tax basis:	Determined on after tax basis (based on negotiation), example:
● oil	● 65/35%	● 85/15% split	● 85/15% split	● 85/15% split	● 75/25% split
● gas	● n/a	● 70/30% or 65/35% split	● 70/30% split	● 60/40% split	● 60/40% split
● oil		Before tax at 56%:	Before tax at 48%:	Before tax at 44%:	Before tax at 44%:
● gas		● 65.909/34.091%	● 71.154/28.846%	● 73.215/26.785%	● 55.357/44.643%
		● 31.818/68.182% (for 70/30% split)	● 42.308/57.592%	● 28.571/71.429%	● 28.571/71.429%
		● 20.455/79.545% (for 65/35% split)			
● oil		Before tax at 48%:	Before tax at 44%:		
● gas		● 71.154/28.846%	● 73.215/26.785%		
		● 42.308/57.592% (for 70/30% split)	● 46.429/53.571%		
		● 32.693/67.307% (for 65/35% split)			
Investment credit	0%	20%	17% to 20%	0%	17% (oil), 55% (gas)
DMO - oil	DMO was defined as 25% of Contractor share of total oil production at .20 cents/bbl.	25% of Contractor share of total oil production, full price for first years and .20 cents/bbl thereafter.	25% of Contractor share of total oil production, full price for first five years and 10% of export price thereafter.	25% of Contractor share of total oil production, full price for first five years and 25% of export price thereafter.	A floor percentage of Contractor share of total oil production, full price for first five years and 25% of export price thereafter.
DMO - gas	N/A	N/A	N/A	N/A	A floor percentage of Contractor share of total gas production, weighted average contract price.

Elements	1 <sup>st</sup> Generation PSC (1965 – 1975)	2 <sup>nd</sup> Generation PSC (1976-1988)	3 <sup>rd</sup> Generation PSC (1988 - recent)	4 <sup>th</sup> Generation – 1995 East Indonesia*	5 <sup>th</sup> Generation Post Law no 22/2001
Depreciation					
● Oil	No distinction between oil and gas. DDB or SLD as follows: <ul style="list-style-type: none"> <li>● 14 Years for production facilities</li> <li>● 3-18 years for moveable equipment</li> <li>● 14-20 years for others</li> </ul>	● Seven years for capital costs (DDB) and 10 year amortization of non-capital costs (switching to SLD). Post 1985 7 Year DB (Balance of unrecovered capital costs is eligible for full depreciation at the end of the individual assets' useful life)	● Seven years DB (Balance of unrecovered capital costs is eligible for full depreciation at the end of the individual assets' useful life)	● Seven years DB (Balance of unrecovered capital costs is eligible for full depreciation at the end of the individual assets' useful life)	● Seven years DB (Balance of unrecovered capital costs is eligible for full depreciation at the end of the individual assets' useful life).
● Gas		● Fourteen years (switching to SLD Post 1985 7 Year DB (Balance of unrecovered capital costs is eligible for full depreciation at the end of the individual assets' useful life), except for certain contract still use 14 year.	● Fourteen years (switching to SLD). Post 1985 7 Year DB (Balance of unrecovered capital costs is eligible for full depreciation at the end of the individual assets' useful life), except for certain contract still use 14 year.	● Seven years DB (Balance of unrecovered capital costs is eligible for full depreciation at the end of the individual assets' useful life)	● Seven years DB (Balance of unrecovered capital costs is eligible for full depreciation at the end of the individual assets' useful life)
Interest recovery	None	Available	Available	Available	Available
Abandonment liability to PSC contractor	None	None	None. Post 1995 PSCs require the Contractor to provide for abandonment.	None. Post 1995 PSCs require the Contractor to provide for abandonment.	PSCs require the Contractor to provide for abandonment.

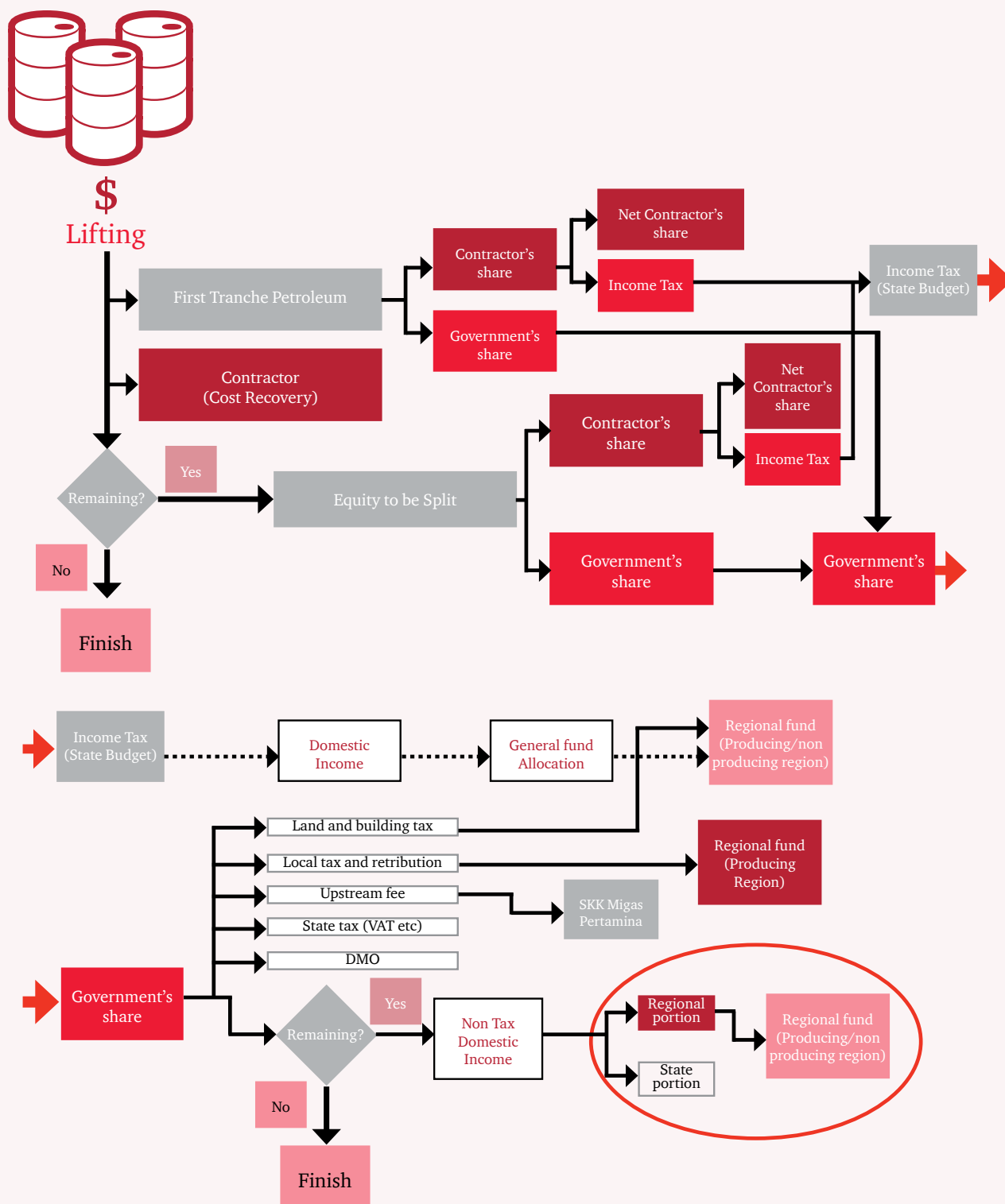
\* For PSCs post 2007 please see chapter 3 of Oil and Gas in Indonesia - Investment and Taxation Guide 2014

## Appendix H - Summary of PSC Generations

Elements	Incentive Packages		Post Law No. 22
	1988, 1989, 1992	1995 Eastern Frontier*	
Oil – after tax equipment split Government/Contractor	Frontier production: <ul style="list-style-type: none"> <li>• &lt; 50 MBOD = 80%:20%</li> <li>• 50 – 150 MBOD = 80%:15%</li> <li>• &gt; 150 MBOD = 90%:10%</li> </ul>	65/35% without investment credit	
	Conventional area = 85%:15%		
	Marginal fields and EOR in Tertiary reservoir: <ul style="list-style-type: none"> <li>• Conventional area = 80%:20%</li> <li>• Frontier = 75%:25% Pre-Tertiary and deep sea (over 600 ft) production:</li> <li>• Incremental split as for frontier production.</li> </ul> Field development in frontier areas = 80%:20% Field development in areas with water depth >1500m = 75%:25%		
Gas – after tax equity split Government/Contractor	Frontier production = 70%:30% Conventional area = 70%:30% Field development in conventional areas = 60%:35% Field development in frontier areas = 60%:40% Field development in areas with water depth >1500m = 55%:45%.	60/40% without investment credit	
DMO oil fee	10% to 15% of export price (after first five years)	25% of export price (after first five years)	
Investment	For deep sea areas: 110% (oil) over (600 ft):55% (gas) Development areas: <ul style="list-style-type: none"> <li>• Pre-Tertiary reservoir rocks = 110% for oil and gas</li> <li>• Water depth 200 – 1500m = 110% for oil and gas</li> <li>• Water depth below 1500 m = 125% for oil and gas</li> </ul>		Brown field and marginal field incentives provided
Additional cost recovery for marginal fields			20%.

- Eastern Frontier and part of Western Frontier Having Similar Geological and Geophysical Conditions.
- All Eastern Frontier excluding Bintuni, Salawati and Seram Basins.

## Government Oil & Gas Fund Flow



## Sample AFE

AFE Part 3- Summary					
<b>1. Project Title/ Location</b>	<b>2. Organization</b>	<b>3. Date</b>	<b>4. AR Number</b>		
Papua Geophysical Survey	OIL COMPANY LTD.	May 02, 2014	2010-00001		
<b>Need GOI Approval</b>	Yes	<b>Partnership</b>	Yes	<b>Budget Type</b>	CAPITAL
<b>5. AR Type</b>	Entering Ph 2	AR Link	<b>6. Investment Type</b>	Acquisition	
<b>7. Investment Description and Present Situation: Describe the scope of the proposed investment and the present situation. Justification for the AR is in Part 2.</b>					
Example:					
The Papula oil field is located in [enter description of the location]. Company seeks to acquire high-resolution geophysical and limited geotechnical survey data suitable to support the planning, engineering design, construction and installation of the flowlines, umbilicals and associated subsea infrastructure for the Papua Development [etc.].					
<b>8. Summary Economics :</b>			<b>9. Investment Magnitude :</b>		USD
a. NPV @ 10% EV	Point Forward	N/A	a. Appropriation Amount (Part 3 1a/b)	800,000	
	Full Cycle	N/A			
b. DPI @ 10% EV	Point Forward	N/A	b. Total Commitment (Part 3 - 9)	800,000	
	Full Cycle	N/A			
c. ROR %	Point Forward	N/A	c. Total Commitment Estimate for all Phases	N/A	
	Full Cycle	N/A			
d. Test Case (Low Trend Price)	NPV	N/A	d. Appropriation Amount (100% basis)	950,000	
	ROR %	N/A			
<b>10. Execution Schedule: Time in months from the start of detailed engineering to mechanical completion</b>					12 months
<b>11. Endorsements:</b>			Names:		

## Sample AFE

AFE Part 3 - Cost & Schedule and Safety Target							
<b>1. Project Title/ Location</b>	<b>2. Organization</b>	<b>XYZ Share</b>	<b>3. Date</b>	<b>4. AR Number</b>			
Papua Geophysical Survey	OIL COMPANY LTD.		May 02, 2014	2010-00001			
<b>Need GOI Approval</b>	Yes	<b>Partnership</b>	Yes	<b>Budget Type</b>	CAPITAL		
<b>Appropriation Amount:</b>		<b>EV Cost (100%)</b>	<b>Cost Target (P40 or 90% Ind Avg.)</b>	<b>Benchmarked Amount</b>			
<b>1. Capital/Expense Amount Requested</b>	a. 950,000	b. 0	c. 0				
<b>Associated Amounts:</b>							
2. Expense Amount Requested			0				
3. Working Capital Requested			0				
4. Contractual Commitments			0				
5. Previous Amount Appropriated for Project			0				
6. Value of Existing Assets Incorporated into Project			0				
7. Related Projects/Commitments Caused by this Appropriation			0				
8. Sub Total Associated Amounts (2+3+4+5+6+7)			0				
<b>Total Commitment:</b>							
9. Total Expected Commitment (1a/b + 8) use 1b if cost target set (Policy 190 Total Commitment Threshold)			950,000				
<b>10. Financed Amount:</b>	<b>11. Leased Amount:</b>	<b>12. Underlying Currency (%):</b>	<b>13. Exchange Rate to USD:</b>				
0	0	0	0				
<b>14. Requested Capital and Expenditure:</b>							
	<b>Year 1</b>	<b>Year 2</b>	<b>Year 3</b>	<b>Year 4</b>	<b>Year 5</b>	<b>Total Beyond YR 5</b>	<b>Total</b>
Year	2010	0	0	0	0	0	
Capital	950,000	0	0	0	0	0	950,000
Expense	0	0	0	0	0	0	0
Contingency & Allowances	0	0	0	0	0	0	0
Total	950,000	0	0	0	0	0	950,000
<b>15. Reviews:</b>							
<b>Phases</b>	<b>Review Type</b>		<b>Date</b>		<b>Name &amp; BU's</b>		
<b>16. Project Lead</b>							



Sample WP&B

OPERATOR :  
CONTRACTOR :  
BUDGET YEAR :

SKK MIGAS  
PRODUCTION SHARING CONTRACT  
BUDGETED FINANCIAL STATUS  
OIL & GAS

Budget  
Schedule  
No. 1

LINE	DESCRIPTION	1st QUARTER		2nd QUARTER		3rd QUARTER		4th QUARTER		TOTAL		
		1) \$M \$ Amount	2) Per BBL	3) \$M \$ Amount	4) Per BBL	5) \$M \$ Amount	6) Per BBL	7) \$M \$ Amount	8) Per BBL	9) \$M \$ Amount	10) Per BBL	
1	LIFTINGS											
2	Oil/Condensate (MBBLS)											
3	Gas (MMCF)											
4	GROSS REVENUE											
5	First Tranche Petroleum											
6	GROSS REVENUE AFTER FTP											
7	Investment Credit											
8	COST RECOVERY											
9	Unrecovered Other Cost											
10	Current Year Operating Cost											
11	Depreciation-Prior Year Assets											
12	Depreciation-Current Year Assets											
13	TOTAL COST RECOVERY											
14	TOTAL RECOVERABLES											
15	EQUITY TO BE SPLIT											
16	Indonesia Share :											
17	Government FTP Share											
18	Government Equity Share											
19	Domestic Requirement											
20	Government Tax Entitlement											
21	TOTAL INDONESIA SHARE											
22	Contractor Share :											
23	Contractor FTP Share											
24	Contractor Equity Share											
25	Less : Gross Domestic Requirement											
26	Add : Domestic Requirement Adjustment											
27	Taxable Share											
28	Government Tax Entitlement											
29	Net Contractor Share											
30	TOTAL RECOVERABLES											
31	TOTAL CONTRACTOR SHARE											
	UNRECOVERED OTHER COSTS	11) 1st QTR	12) 2nd QTR	13) 3rd QTR	14) 4th QTR	TAX COMPUTATION		15) 1st QTR	16) 2nd QTR	17) 3rd QTR	18) 4th QTR	19) TOTAL
32	Balance Beginning					Taxable Share						
33	Additions					Add: Investment Credit						
34	Recovered					Less: Bonus Payment						
35	Balance End of Quarter					Taxable Income						
						Government Tax Entitlement						

## Sample FQR

OPERATOR :  
 CONTRACT AREA :  
 QUARTER ENDED :  
 Expressed in Thousands of Dollars

SKK MIGAS  
 PRODUCTION SHARING CONTRACTS  
 FINANCIAL STATUS REPORT OIL / GAS  
 (SUMMARY)

Line	LAST QUARTER		THIS QUARTER					DESCRIPTIONS	YEAR TO DATE				
	1) ACTUAL \$ Amount	2) ACTUAL Per BBL	3) ACTUAL \$ Amount	4) ACTUAL Per BBL	5) BUDGET \$ Amount	6) BGT Per BBL	7) OVER (UNDER) BUDGET		8) ACTUAL \$ Amount	9) ACTUAL Per BBL	10) BUDGET \$ Amount	11) BGT Per BBL	12) OVER (UNDER) BUDGET
1								LIFTINGS					
2								Oil/Condensate MBBLS					
3								Gas MMCF					
4								GROSS REVENUE					
5								FIRST TRANCHE PETROLEUM					
6								GROSS REVENUE After FTP					
7								INVESTMENT CREDIT					
8								COST RECOVERY :					
9								Unrecovered Other Costs					
10								Current Year Operating Costs					
11								Depreciation - Prior Year Assets					
12								Depreciation - Current Year Assets					
13								TOTAL COST RECOVERY					
14								TOTAL RECOVERABLES					
15								EQUITY TO BE SPLIT					
16								Indonesia Share					
17								SKK MIGAS FTP Share					
18								SKK MIGAS Equity Share					
19								Lifting Price Variance					
20								Domestic Requirement					
21								Government Tax Entitlement					
22								TOTAL INDONESIA SHARE					
23								Contractor Share					
24								Contractor FTP Share					
25								Contractor Equity Share					
26								Lifting Price Variance					
27								Less: Gross Domestic Requirement					
28								Add : Domestic Requirement Adjustment					
29								Taxable Share					
30								Government Tax Entitlement					
31								Net Contractor Share					
32								Total Recoverables					
33								TOTAL CONTRACTOR SHARE					

Line	THIS QUARTER	TAX COMPUTATION	YEAR TO DATE
34		Taxable Share	
35		Add: Investment Credit	
36		(Over)/Under Lifting	
37		Government Tax Entitlement	
38		Taxable Income	
39		Government Tax Entitlement	

Line	UNRECOVERED OTHER COSTS	YEAR TO DATE
40	Balance Beginning	
41	Additions	
42	Recovered	
43	Balance End of Quarter	



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