Mergers & Acquisitions

New Regulation on Investment: Improved Clarity in Some Areas, but Questions Remain

BKPM recently updated its regulations to streamline procedural and licensing requirements for investment companies. The new guidelines are relevant to all current foreign and domestic investors and investment companies, as well as prospective investors interested in pursuing Indonesian interests. The regulation is effective from 2 January 2018 for BKPM and 2 July 2018 for regional investment coordinating bodies.

Introduction

As part of the Indonesian government's continuous effort to improve ease of doing business in Indonesia, the Head of the Indonesia Investment Coordinating Board (*Badan Koordinasi Penanaman Modal* or "**BKPM**") issued Regulation No. 13 of 2017 on Guidelines and Procedures for Investment Facilities and Licensing ("**Regulation 13**") on 4 December 2017.

Prior to Regulation 13, the regulatory framework governing direct investment (which includes the regulations listed below) was generally perceived to be rather cumbersome and disorganized. Regulation 13 aims to streamline the framework as far as possible. It repeals and replaces the following regulations:

1. Head of BKPM Regulation No. 8 of 2015 on Procedures for Applications for Income Tax Facilities in Certain Business Sectors and/or Regions, as amended by Head of BKPM Regulation No. 18 of 2015;
2. Head of BKPM Regulation No. 13 of 2015 on Guidelines on Applications for Corporate Income Tax Reduction Facilities, as amended by Head of BKPM Regulation No. 19 of 2015;
3. Head of BKPM Regulation No. 14 of 2015 on Guidelines and Procedures for Investment In-Principle License as amended lastly by Head of BKPM Regulation No. 8 of 2016;
4. Head of BKPM Regulation No. 15 of 2015 on Guidelines and Procedures for Licensing and Non-Licensing of Investment; and
5. Head of BKPM Regulation No. 16 of 2015 on Guidelines and Procedures for Investment Facilities.

While Regulation 13 reiterates the rules as set out in the regulations it replaces, it also introduces a number of new provisions that clarify existing uncertainty in the market. This alert provides a snapshot of this new important regulation in the Indonesian direct investment realm.

Simplified Licensing Requirements for Non-Industrial/Construction Businesses

Previously, all companies intending to invest in Indonesia were required to follow a two-stage process in applying for the BKPM's approval. This involved, first, applying for the so-called in-principle license (*izin prinsip*) and subsequently, once the investment company (either a foreign direct investment (PMA) company or domestic direct investment (PMDN) company) has commenced operation or production, the business license (*izin usaha*).

Mergers & Acquisitions

Under Regulation 13, not all companies must go through this two-step process. Companies engaging in certain types of business can immediately apply for a business license and commence operations no later than 1 year after the business license is granted.

Companies that qualify for the above rule are those that:

1. do not engage in construction activities, and/or do not need time to start construction activities;
2. do not require any customs-duty facilities, such as import duty facilities for machinery or other capital goods;
3. are an officially established Indonesian legal entity (e.g. limited liability companies or cooperatives) with the permitted shareholding composition that is relevant to their line of business;
4. have obtained a Tax Identification Number (*Nomor Pokok Wajib Pajak*); and
5. occupy an office or business premise.

Based on these qualifications, it appears that non-industrial/construction companies will be the main benefactors of this newly-introduced rule. These companies may include trading and service-based providers.

Note, given point No. 3 above, and if investors wishes to apply for the business license immediately, they will need to set up the company prior to applying for the business license from BKPM. The downside to this new rule is that if BKPM decides to decline the application for whatever reason, investors will be left with a company that they now cannot use to run their planned business operations. In such cases, the investor would either need to liquidate the company, sell it to another party or look for another line of business.

Similarly, point No. 3 will be problematic if we look at it from an M&A perspective. As an illustration, consider an acquisition by foreign parties of a non-PMA target company, operating in a non-industrial/construction business. Under the legal framework preceding Regulation 13, that target company would have needed to secure the following documents:

1. BKPM approval (in the form of an in-principle license). The outcome of this process would result in the target company becoming a PMA company. Given the difficulty in obtaining this approval, it is usually required as a condition precedent – a document that must be obtained *prior to* closing of the acquisition (i.e., the point in time in which payment of the consideration should be made); and
2. Acknowledgement letter/approval from the Minister of Law and Human Rights (MOLHR). In an acquisition transaction, this acknowledgement letter and/or approval from MOLHR is delivered *at closing* – typically simultaneous to payment of the consideration.

The scenario above is risk-minimum because the buyer will pay consideration of the acquisition only after the critical requirement of the deal (i.e. obtaining BKPM approval) has been completed.

Regulation 13 now reverses this process, in that the requirement to obtain MOLHR documentation (be it an acknowledgement letter and/or approval from MOLHR) *is a prerequisite* to applying for the BKPM approval (now, in the form of a business license). In this respect, parties to the transaction (especially on the buyers' side) are now exposed to risk due to the potential likelihood that after obtaining the MOLHR acknowledgement letter and/or approval (and after payment of the consideration has been made), the business license from BKPM is not issued for whatsoever reasons. In light of this new rule, we understand that it may be difficult to implement it into the M&A common practice in Indonesia, considering this may likely pose a risk to any of the parties involved in the transaction.

Lenience for Property Development Businesses

Regulation 13 introduces greater leniency to foreign investors planning to invest in the property development sector. Under the previous regulation, PMA companies (including those engaged in property development business) were required to have a minimum investment value of at least IDR 10bn (excluding land and buildings). This significant minimum requirement is problematic, primarily for property PMA companies. With Regulation 13, BKPM allows such companies to *include* land and buildings when calculating their investment value, easing the difficulty for these companies to meet the minimum IDR 10bn threshold. This exemption will only apply to property PMA companies that own the following types of properties: (i) an entire building; or (ii) an integrated residential complex.

Reinforcing the Nominee Restriction Rule

As is widely understood amongst market participants, Indonesia's investment law prohibits nominee arrangements between foreign investors and domestic nominee shareholders (Article 33 of Law No. 25 of 2007 on Investment, "**Investment Law**"). Recognizing that such illegal practice remains popular and continues to exist in the country, Regulation 13 empowers BKPM in certain situations to request investors to provide a signed and notarized (*waarmerking*) statement confirming that they will not act as a nominee of a foreign party.

Venture Capital Investment Term Extended

The previous regulations permitted Indonesian venture capital companies to hold shares in an investment company (be it a PMA or PMDN company), but only for a limited period – being a maximum of 10 years, extendable for another 5 years. Regulation 13 expands this rule, allowing the 5-year extension period to be renewed up to twice. In practice, this is likely to be very beneficial for companies (particularly start-ups) in need of help from venture capitalists, as it will provide more time for such companies to work with and obtain (financial and non-financial) assistance from venture capital companies.

Regulation 13 restates the preceding rule on the status of venture capital companies' investments in portfolio companies (i.e., the investees) in that the investments will be regarded as domestic investments, even though there are foreign shareholdings in the venture capital companies.

Greater Clarity on the Divestment Rules

Previous regulations (particularly Head of BKPM Regulation No. 14 of 2015) provided guidance with respect to the divestment requirement attached to PMA companies (companies with 100% or partial foreign shareholding). Typically, these divestment requirements that apply to PMA companies are those that were set up prior to the enactment of the Investment Law.

Several issues dealt with under the regulatory framework preceding Regulation 13 (including Head of BKPM Regulation No. 14 of 2015) are as follows:

1. Divested shares
   There are instances where the divestment clause in a PMA company's investment license is silent or cryptic on how many shares that company should divest. Head of BKPM Regulation No. 14 of 2015 clarified that the

shares divested by the PMA company in question can be in whatsoever number insofar as they are worth at least IDR 10mio. Regulation 13 reiterates this rule.

2. Sell back to foreign parties
   The divestment rule requires the purchaser to be an Indonesian individual (or Indonesian entity whose shares are 100% held by Indonesian parties). It was initially unclear as to whether those shares could then be sold back to the original foreign shareholder or any other foreign parties. The framework preceding Regulation 13 (i.e., Head of BKPM Regulation No. 14 of 2015) clarified this issue, with Regulation 13 reiterating, that such transaction is permissible provided the share divestment process is complete (i.e., parties have obtained approval from the MOLHR).

3. Time extension for divestment process
   The timeframe in which PMA companies must divest shares should adhere to the requirements stated in the divestment clause of the relevant PMA company's investment license. Head of BKPM Regulation No. 14 of 2015 allowed PMA companies to apply for an extension with which to meet that legal obligation in circumstances where they cannot locate a purchaser.

Now, Regulation 13 provides greater clarity with respect to the divestment issue, and addresses the right of the PMA company to waive the divestment obligation. It appears that BKPM realises that the divestment rule, which is a legacy from the pre-Investment Law regime, is burdensome for investment companies. To ease these problems, Regulation 13 sets out the criteria for several waivers that may be available to PMA companies, as follows:

1. For PMA companies with partial foreign shareholding, the waiver is available *only* if the existing Indonesian shareholder(s) is reluctant for a change to be made to the current shareholding set up; or
2. For PMA companies with 100% foreign shareholding, the waiver is available if the shareholders have no intention to sell their shares to any Indonesian party.

In order to exercise the waiver, the shareholders of the PMA company must document the above in a resolution of the General Meeting of Shareholders, and submit this resolution to BKPM. However, it remains to be seen how BKPM will handle this process, and what the likelihood will be that BKPM rejects the waiver request.

Conversion Requirement for PMA Company Subsidiaries

Under the preceding regulatory framework (i.e., Head of BKPM Regulation No. 14 of 2015), subsidiaries of a company that had just converted to a PMA company were required to follow suit within 1 year of the parent-company PMA's in-principle license being issued. Regulation 13 regulates these rules verbatim but with a small caveat that the timeframe for carrying out the conversion is when the subsidiaries in question undergo a 'corporate action.' The regulation is unclear on what a corporate action refers to. Until the date of publication of this alert, no clarification from BKPM has been obtained. Pending such clarification, the term corporate action may be defined as strict (e.g. only any action of the subsidiary that requires BKPM approval) or loose (e.g. any action of the subsidiary that requires or that does not require BKPM approval) as possible.

Negative Investment List and Portfolio Investments – Clarity at last?

Article 21 of Regulation 13 sets out a few provisions in respect of how the Negative Investment List (*Daftar Negatif Investasi*) – which determines the business sectors in Indonesia that are either completely closed,

completely open or conditionally open to foreign investment – applies to listed companies. Article 21 specifically provides as follows:

1. A PMA company taking out a listing on the Indonesian Stock Exchange will be exempt from the foreign investment restrictions set out in the Negative Investment List. Thus, for example, a non-listed PMA company that operates in the distribution sector may have a maximum foreign ownership of 67% under the Negative Investment List. However, upon becoming a listed company, that company's percentage of foreign ownership may exceed 67%; and
2. Where a PMDN company lists its shares on the Indonesian Stock Exchange, and a foreign investor subsequently purchases the offered shares (with that foreign purchaser's name and shareholding stated in the articles of association) then that PMDN company must change its status to a PMA company. However, unlike the PMA company situation illustrated above at point 1, the language of Article 21 is unclear and does not explain whether the Negative Investment List will apply to such a PMDN company upon converting into a PMA company.

Note, these provisions were initially introduced under existing regulations, namely Head of BKPM Regulation No. 6 of 2016 (this regulation amends (but not repealed) Head of Regulation No. 14 of 2015). Although these regulations and Regulation 13 have clarified a few uncertainties, there are still unresolved longstanding issues pertaining to listed companies and the Negative Investment List. See our review on Head of BKPM Regulation No. 6 of 2016 in the previous edition of our client alert.

Representative Offices

BKPM authorized to issue representative office permits for foreign construction and oil and gas companies

In addition to issuing permits for foreign company representative offices (*Kantor Perwakilan Perusahaan Asing* or "**KPPA**") and foreign trading company representative offices (*Kantor Perwakilan Perusahaan Perdagangan Asing*), Regulation 13 now empowers BKPM to issue permits to foreign construction service provider representative office (*Kantor Perwakilan Badan Usaha Jasa Konstruksi Asing*) and foreign oil and gas company representative office (*Kantor Perwakilan Perusahaan Asing Minyak dan Gas*). Hence, investors in the construction and oil and gas sector planning to set up representative offices in Indonesia should now interact with BKPM for applying the required permits.

Validity period of KPPA permit extended…indefinitely

Generally, BKPM considers a KPPA to be a temporary office entity that a foreign company will establish prior to or in preparation for setting up a permanent office. As such, the KPPA system is designed to be a short-term solution, and previous BKPM regulations (Head of BKPM Regulation No. 15 of 2015) restricted the time for which a KPPA permit could remain valid to a total of 5 years (3 years for the initial validity period, extendable for one year up to twice). Regulation 13 amends this restriction by providing that a KPPA permit will be valid for 3 years, and extendable for as long as the parent office (i.e., the foreign company) intends. The parent office will set out its terms with respect to this period through an appointment letter granted by the parent office to the KPPA. Given this, though subject to BKPM's confirmation, a KPPA's permit may be extended for as long as its parent office wishes.

'Amnesty' Period

On 30 September 2016, BKPM issued a public announcement reminding investment companies which had been granted an in-principle license (or any other license equivalent to an in-principle license) that those companies yet to apply for a business license must do so by no later than 8 October 2016, or their in-principle license would be invalidated. Under this rule, should an investment company's in-principle license be invalidated, the company would need to reapply for this license in order to legally continue its operations in Indonesia. Regulation 13 appears to provide a form of 'amnesty' for those companies, in that they are now allowed to immediately apply for a business license (that is, without going through the process of re-applying for the in-principle license).

This 'amnesty' period is only valid for 6 months from the date Regulation 13 came into effect – 2 January 2018 for BKPM and 2 July 2018 for regional investment coordinating bodies.

Contacts

Ahmad Fikri Assegaf
Partner
Banking and Finance

D +62 21 2555 7880
F +62 21 2555 7899
ahmad.assegaf@ahp.id

Bono Daru Adji
Partner
Managing Partner

D +62 21 2555 7878
F +62 21 2555 7899
bono.adji@ahp.id

Eko Ahmad Ismail Basyuni
Partner
Mergers & Acquisitions

D +62 21 2555 7802
F +62 21 2555 7899
eko.basyuni@ahp.id

Eri Raffaera Budiarti
Partner
Mergers & Acquisitions

D +62 21 2555 7811
F +62 21 2555 7899
eri.budiarti@ahp.id

Tunggul P. Utomo
Partner
Mergers & Acquisitions

D +62 21 2555 7822
F +62 21 2555 7899
tunggul.utomo@ahp.id

Our Regional Contacts

RAJAH & TANN | *Singapore*

Rajah & Tann Singapore LLP
T +65 6535 3600
F +65 6225 9630
sg.rajahtannasia.com

R&T SOK & HENG | *Cambodia*

R&T Sok & Heng Law Office
T +855 23 963 112 / 113
F +855 23 963 116
kh.rajahtannasia.com

RAJAH & TANN 立杰上海
SHANGHAI REPRESENTATIVE OFFICE | *China*

Rajah & Tann Singapore LLP
Shanghai Representative Office
T +86 21 6120 8818
F +86 21 6120 8820
cn.rajahtannasia.com

ASSEGAF HAMZAH & PARTNERS | *Indonesia*

Assegaf Hamzah & Partners

Jakarta Office
T +62 21 2555 7800
F +62 21 2555 7899

Surabaya Office
T +62 31 5116 4550
F +62 31 5116 4560
www.ahp.co.id

RAJAH & TANN | *Lao PDR*

Rajah & Tann (Laos) Sole Co., Ltd.
T +856 21 454 239
F +856 21 285 261
la.rajahtannasia.com

CHRISTOPHER & LEE ONG | *Malaysia*

Christopher & Lee Ong
T +60 3 2273 1919
F +60 3 2273 8310
www.christopherleeong.com

RAJAH & TANN NK LEGAL | *Myanmar*

Rajah & Tann NK Legal Myanmar Company Limited
T +95 9 7304 0763 / +95 1 9345 343 / +95 1 9345 346
F +95 1 9345 348
mm.rajahtannasia.com

GATMAYTAN YAP PATACSIL
GUTIERREZ & PROTACIO (C&G LAW) | *Philippines*

Gatmaytan Yap Patacsil Gutierrez & Protacio (C&G Law)
T +632 894 0377 to 79 / +632 894 4931 to 32 / +632 552 1977
F +632 552 1978
www.cagatlaw.com

RAJAH & TANN | *Thailand*

R&T Asia (Thailand) Limited
T +66 2 656 1991
F +66 2 656 0833
th.rajahtannasia.com

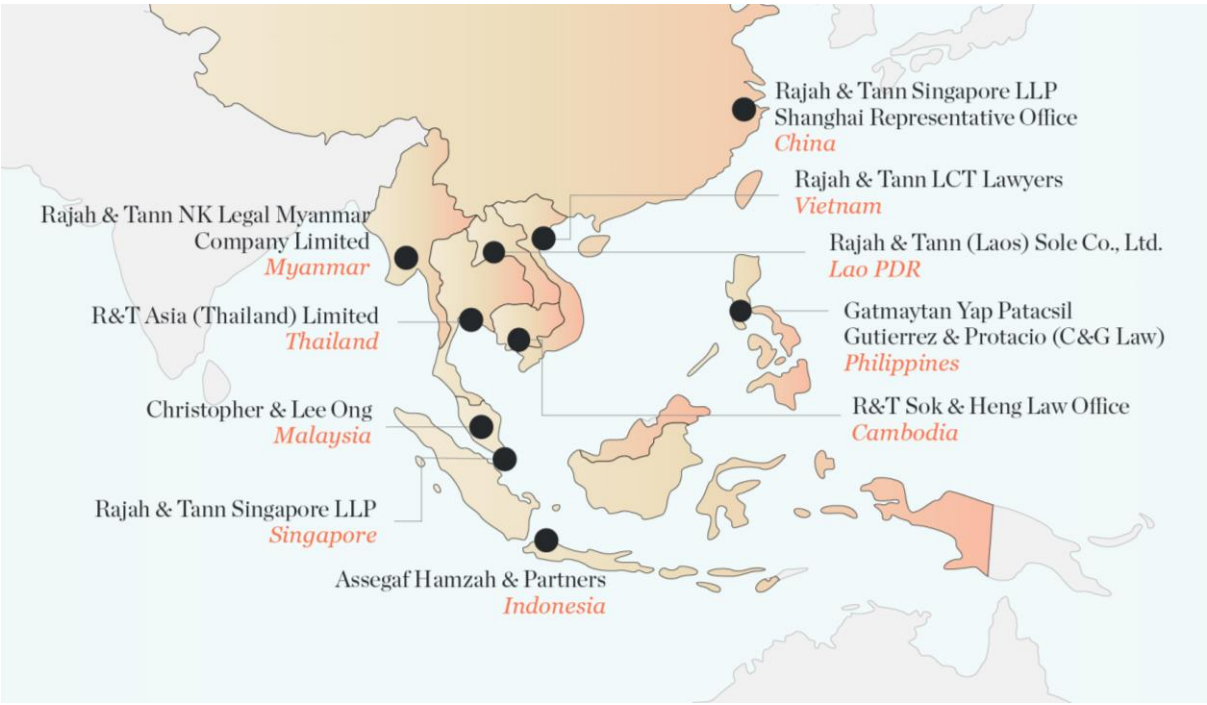
RAJAH & TANN LCT LAWYERS | *Vietnam*

Rajah & Tann LCT Lawyers

Ho Chi Minh City Office
T +84 28 3821 2382 / +84 28 3821 2673
F +84 28 3520 8206

Hanoi Office
T +84 24 3267 6127
F +84 24 3267 6128
www.rajahtannlct.com

Our Regional Presence



Based in Indonesia, and consistently gaining recognition from independent observers, Assegaf Hamzah & Partners has established itself as a major force locally and regionally, and is ranked as a top-tier firm in many practice areas. Founded in 2001, it has a reputation for providing advice of the highest quality to a wide variety of blue-chip corporate clients, high net worth individuals, and government institutions.

Assegaf Hamzah & Partners is part of Rajah & Tann Asia, a network of local law firms in Singapore, Cambodia, China, Indonesia, Lao PDR, Malaysia, Myanmar, Philippines, Thailand and Vietnam. Our Asian network also includes regional desks focused on Japan and South Asia.