TAX INCENTIVES TO ATTRACT PRIVATE INVESTMENT IN INFRASTRUCTURE: INDONESIAN PERSPECTIVE

by

Wawan Juswanto

Ministry of Finance, Indonesia

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INTRODUCTION: the Need of Infrastructure Financing – Developing Asia

Infrastructure financing from private sectors is urgently needed.

Infrastructure is essential to support the basic needs and the economic.

- *Huge population with rapid growth, more than doubled from 1.8 bn (1966) to 4 bn (2015)*
- *Developing Asia is expected to grow by 5.5% in 2020, beyond emerging markets (4.1%) and the world average (2.5%).*

Developing Asia will need to invest USD 1.7 tn each year from 2016 to 2030 (ADB, 2017)

Insufficient infrastructure investments (ADB, 2017)

- *gap of 2.4% of GDP (2016-2020).*
- *lower-middle-income economies : 5.6% GDP*

92% of infrastructure funding in developing Asia is sourced from the public sector (ADB, 2017)

- *Limited fiscal space*

INTRODUCTION: the Need of Infrastructure Financing - Indonesia

Amid economic performance, the infrastructure quailty is still left behind and the development is still unequally distributed

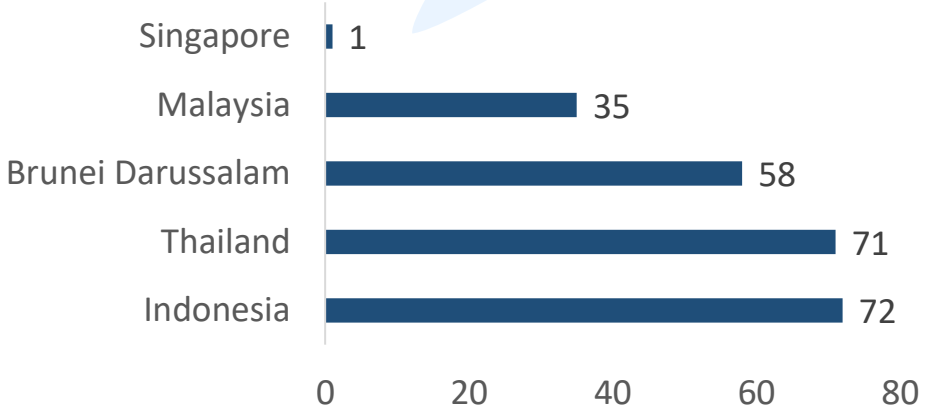
USD 1,1 trillion

Indonesia GDP in 2019

The largest in South East Asia

Projected to be one of the developed countries with a GDP of USD 7.3 trillion in 2045.

Infrastructure Quality, Overall Rank

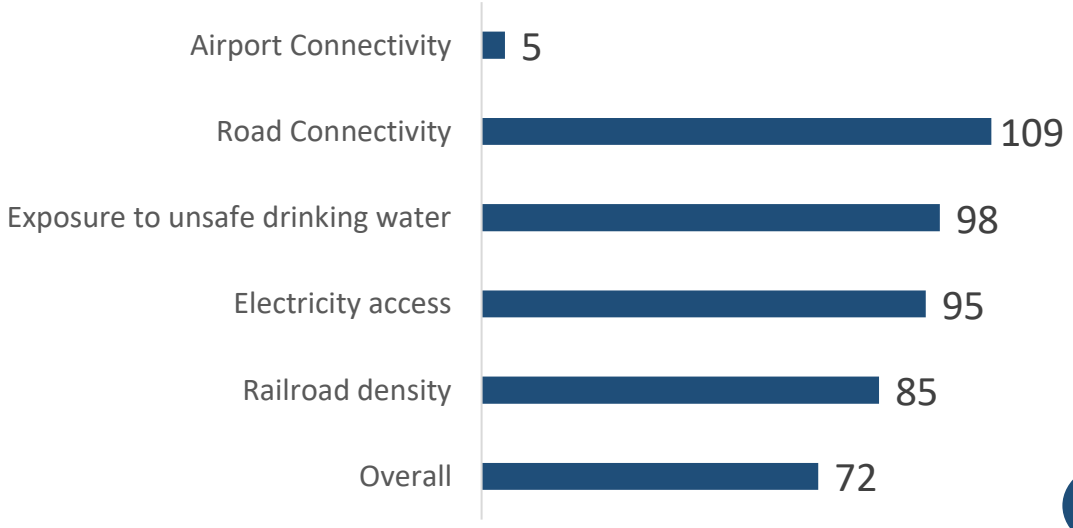


Global Competitiveness Report, 2019

Unequal economic development

- More than 55 percent of GDP is concentrated in Java (BPS, 2020).
- Inequal electricity distribution (Kemen ESDM, 2018)
  - Electricity ratio Indonesia: 98.3 percent
  - Electricity ratio Bali: 100 percent
  - Electricity ratio West Nusa Tenggara: 62.7 percent

Indonesia Rank, Based on Subsectors



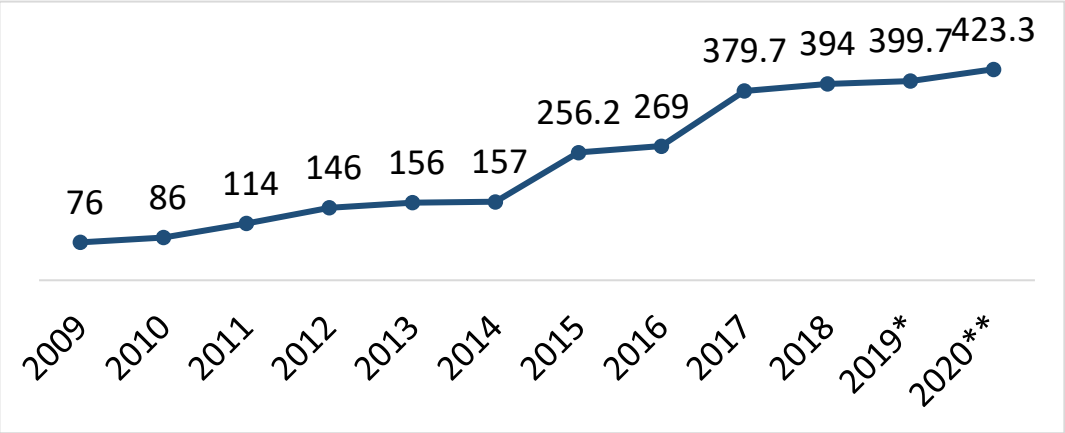
Global Competitiveness Report, 2019

Infrastructure Financing in the Budget

Despite the significant increase in infrastructure spending, the budget is not sufficient for infrastructure financing needs

- Infrastructure development as one of the general policies of national development for economic growth and equitable development (Bappenas, 2015).
- Since 2015, the government increased infrastructure spending significantly.

Infrastructure spending, IDR Tn



Source: Ministry of Finance

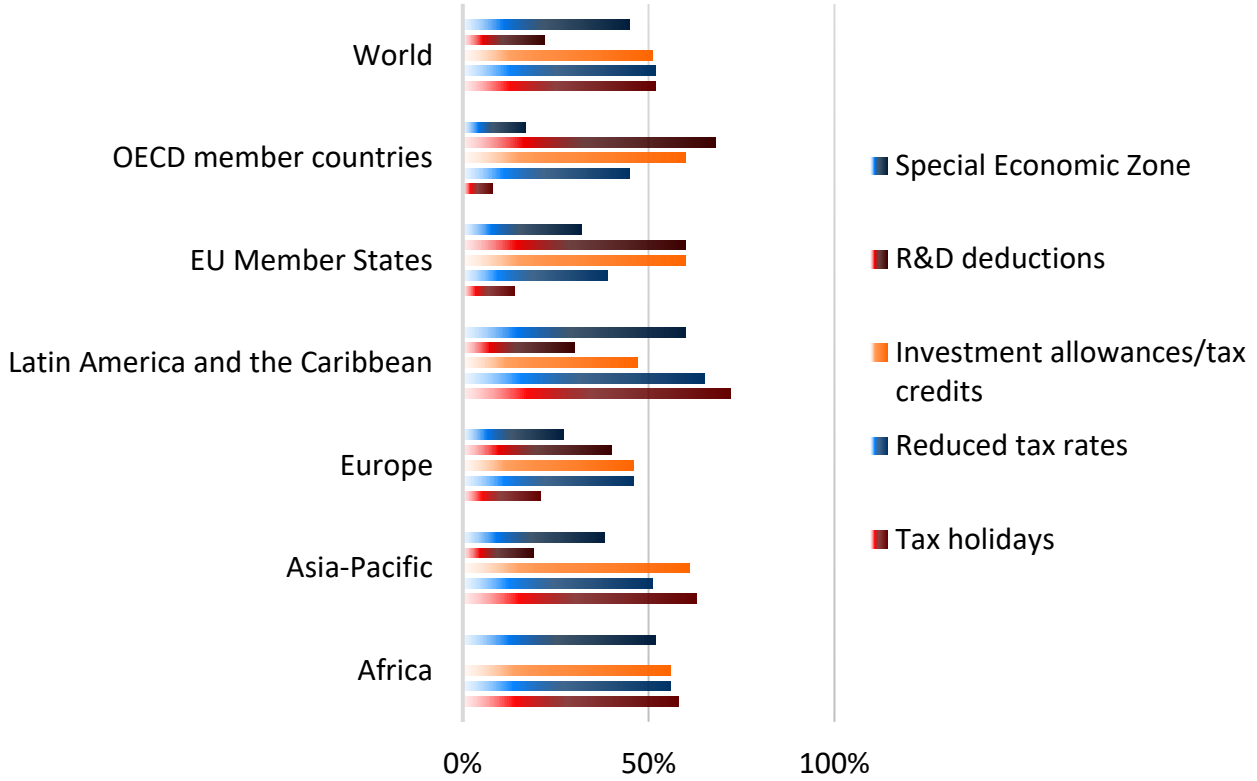
However, it's not enough...

- The government is only expected to contribute 37 percent of USD 433,6 billion to finance its infrastructure (2020-2024) (Bappenas, 2020)
- Limited fiscal space:
  - Mandatory spendings, 20% for education and 5% for health.
  - Weak tax performance. Only 11.5% in 2017, below the OECD (34.2%), Latin America and Caribbean (22,8%), and Africa (18.2%) (OECD, 2019).

Tax Incentives to Attract Direct Investment

- Direct investment can affect the availability of infrastructure in ASEAN (Wang, 2019)
- Tax incentive has a positive impact on attracting FDI in developing countries (Klemm & Parys, 2009).
- Tax incentives are needed in competing for FDI with other countries that also provide tax incentives (OECD, 2008)

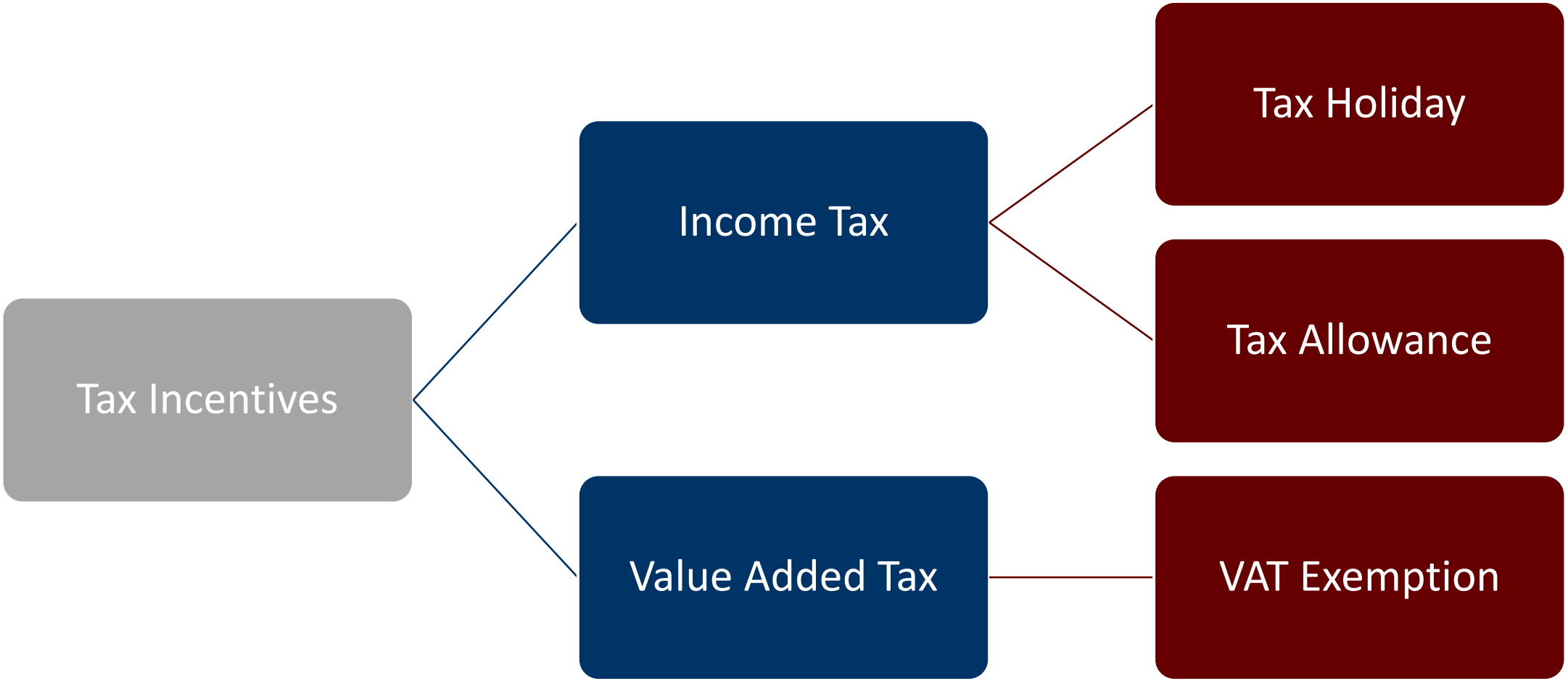
The Prevalence of Selected Tax Incentives



(Juárez & Manrique, 2018)

- The costs of tax incentives will occur only when the investment generates profit (Easson, 2001).
- While developed countries tend to offer financial incentives such as grants, subsidized loans or loan guarantees, developing countries usually do not have the same possibilities to provide capital upfront (Muyaa, 2018).
- Tax holiday, reduced tax rates, and tax alowances, are widely used in the world, especially in LAC, APAC, and Africa.

Tax Incentives Related to Infrastructure in Indonesia



Tax Holiday: Overview

exemption of corporate income tax for "pioneer industries"

1967 First introduced to attract FDI.

1983 Abolished by the implementation of Income Tax Law

2007 Re-introduced in Investment Law

2011 Implemented

Criteria of Pioneer industries

- Have broad connection and linkage
- Generate added value and high externalities,
- Introduces new technology,
- Provide strategic value for the national economy.

Tax Holiday : Scope of Pioneer Industries

MoF Regulation 130/2011	MoF Regulation 159/2015	MoF Regulation 35/2018	MoF Regulation 150/2018
1. Basic metals 2. Oil refinery or basic organic chemicals derived from oil and gas 3. Machinery 4. Renewable energy 5. Telecommunications equipment.	1. Upstream metal (previously basic metals) 2. Oil refinery 3. Basic organic chemicals derived from oil and gas 4. Machinery 5. Telecommunications and information 6. Sea transportation - added 7. Processing industries for agriculture, forestry, and fishery products - added 8. processing industries which represent a primary industry in an SEZ - added; **9. economic infrastructure other than those under a PPP - added**	1. Integrated upstream basic metal; 2. Integrated oil and gas refinery; 3. Integrated petrochemicals from oil, gas, or coal; 4. Integrated inorganic basic chemicals; 5. Integrated organic basic chemicals from agriculture, plantation, or forestry products; 6. Integrated pharmaceutical raw materials; 7. Semi-conductor and other main components of computers (such as semiconductor wafer, backlight for liquid crystal display, electrical driver, or liquid crystal display) which are integrated with computers manufacturing; 8. Main components of communication equipment (such as semiconductor wafer, backlight for liquid crystal display, electrical driver, or liquid crystal display) which are integrated with smartphones manufacturing 9. Main components of health equipment which are integrated with irradiation, electromedical or electrotherapy manufacturing 10. Main components of industrial machinery which are integrated with machinery manufacturing 11. Main components of machinery (such as piston, cylinder head, or cylinder block) which are integrated with motor vehicles manufacturing 12. Robotics components which are integrated with the manufacturing industry 13. Main components of vessels which are integrated with vessel manufacturing 14. Main components of aircraft (such as the engine, propeller, rotor, or structure components) which are integrated with aircraft manufacturing 15. Main components of trains (such as engine or transmission) which are integrated with train manufacturing 16. Power plant machinery **17. Economic infrastructure.**	1. Integrated upstream basic metal; 2. Integrated oil and gas refinery; 3. Integrated petrochemicals from oil, gas, or coal; 4. Integrated inorganic basic chemicals; 5. Integrated organic basic chemicals from agriculture, plantation, or forestry products; 6. Integrated pharmaceutical raw materials; 7. Irradiation, electromedical, or electrotherapy equipment - change 8. Main components of electronics or telematics equipment (such as semiconductor wafer, backlight for liquid crystal display, electrical driver, or liquid crystal display) - change 9. Machinery and main components of machinery - change 10. Robotics components that support the creation of manufacturing machinery - change 11. Main components of power plant machinery - change 12. Motor vehicles and main components of motor vehicles - change 13. Main components of vessels - change 14. Main components of trains - change 15. Main components of aircraft and activities supporting the aerospace industry; change 16. Agricultural, plantation, or forestry-based processing that produce pulp; added **17. Economic infrastructure;** 18. The digital economy, which includes data processing, hosting, and related activities – added

Tax Holiday : Key Development

Since 2018 the government implemented "trust and verify" regime: ***simple and certain***

MoF Regulation	130/2011	159/2015	35/2018	150/2018
Effective date	15 August 2011	16 August 2015	4 April 2018	27 November 2018.
Eligible Sectors	5	9	17	18
Economic Infrastructure	No	Yes (excl. PPP scheme)	Yes	Yes
Income Tax Reduction	100%	**10% to 100%**	100%	50% and 100%
Concession Period	5-10 fiscal years	5-15 fiscal years	5-20 fiscal years	5-20 fiscal years
Investment Threshold	IDR 1 tn (USD 67,9 mn)	IDR 500 bn (USD 33,95 mn)	IDR 500 bn to IDR 30 tn (USD 33,95 mn to USD 2,03 bn)	IDR 100 bn to IDR 30 tn (USD 6,79 min to USD 2,03 bn)
Determinant	Analysis by authorities	Analysis by authorities	**Based on Investment value**	**Based on Investment value**
Time limit	Not Specified	Not Specified	**5 working days**	**5 working days**
Submission method	Offline	Offline	Offline	**Online (OSS System)**
Administrative requirement	Deposit 10% of investment valuae	Debt-to-Equity ratio Tax Clearance Commitment letter of bank deposit	Debt-to-Equity ratio Tax Clearance	Debt-to-Equity ratio Tax Clearance

Concession Period	Investment Threshold
5 years, 50% exemption	IDR 100 bn
5 years, 100% exemption	IDR 500 bn (USD 33,95 million)
7 years, 100% exemption	IDR 1 tn (USD 67,9 million)
10 years, 100% exemption	IDR 5 tn (USD 339,5 million)
15 years, 100% exemption	IDR 15tn (USD 1,02 billion)
Up to 20 years, 100% exemption	IDR 30 tn (USD 2,03 billion)

Other relaxations in 2018:

- Taxpayer outside the list of pioneer industries can still apply if fulfills the other requirements (subject to inter-ministries meeting).
- The taxpayer in national strategic project can apply (based on a ministerial level decree) ...

  generally covers large-scale infrastructure programs, including toll road projects, national roadway projects, railway projects, airport projects, ports, housing, water treatment, air transportation, and other sectors.

Tax Holiday: Results

Different regimes yield different results

	2011	2015	2018 As of February 2020
Companies	5	▼ 0	▲ 67
Investment	IDR 39.4 tn (USD2.8 bn)	▼ 0	▲ IDR 1,102 tn (USD 78 bn)
Workforces	4,855	▼ 0	▲ 54,086

Source: Ministry of Finance

23 of 67 investors are from economic infrastructure sector

No	Province	Number of Taxpayer	Investment Amount (IDR Tn)	Workforce
1	Aceh	2	9,6	965
2	Banten	2	57,2	376
3	Bengkulu	2	6,0	87
4	Central Java	1	55,7	30
5	Central Sulawesi	1	9,8	2250
6	East Kalimantan	1	5,4	200
7	East Nusa Tenggara	2	2,1	70
8	Jambi	1	12,5	500
9	North Sumatera	3	33,1	981
10	Papua	1	0,1	98
11	South Sulawesi	2	7,2	250
12	South Sumatera	3	41,3	505
13	West Java	1	2,0	19
14	West Kalimantan	1	4,5	310
	Total Economic Infrastructure	**23**	**246,6**	**6,641**

Source: Ministry of Finance

Tax Holiday: Evaluation

Simplicity and certainty are the key

- Limited sectors (5)
- Complicated requirements, e.g. deposit 10% investment

- Five days processing time
- Concession period based on the investment amount.
- Verify when the investment is realized.

Online Single Submission

2011 — 2015 — April 2018 — Nov 2018 - …

Uncertain

Ranged tax reduction (10%-100%) rather than a single rate (100%)

Tax Allowance: Overview

Income tax incentive for investment in certain sectors and certain locations

Benefit

(Regulated in Article 31A of Income Tax Law, cannot be changed by Government Regulation)

Reduction of taxable income

by 30 percent of the total investment (tangible fixed assets, including land).

Accelerated depreciation/ amortization

A reduced WHT rate of 10%

for dividend payment to non-residents or tax treaty rate, if its lower

(normal rate: 20%)

An extended period of loss carry forward up to 10 years.

(normal period: 5 years)

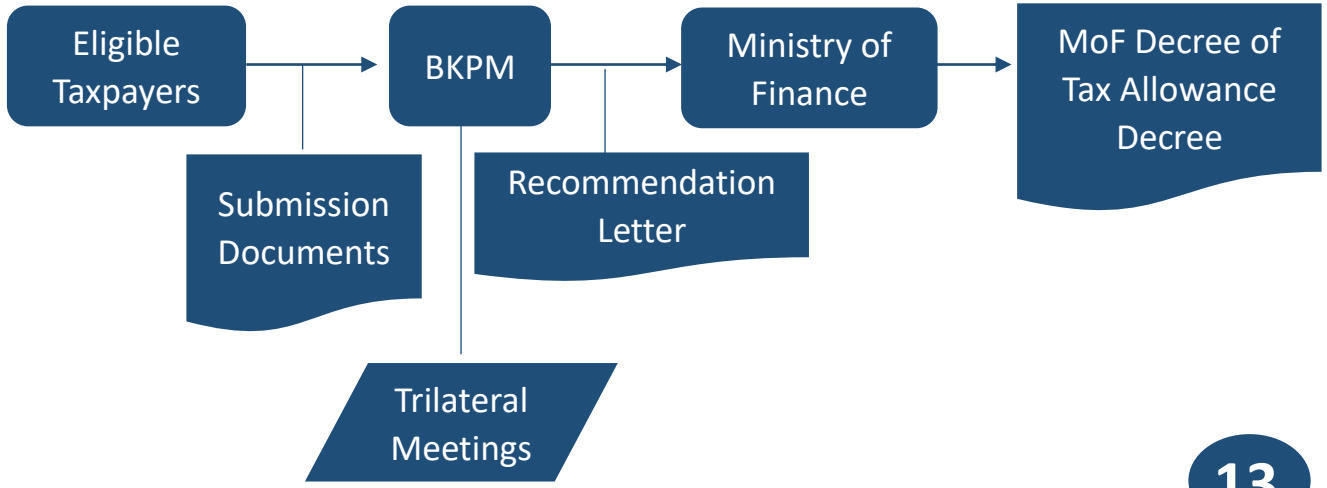
Tax Allowance: Development

	2011	2015	2016	2019
Certain sectors	52	66	71	166
Certain sectors and locations	77	77	74	17
Starting point	**Realized 80% of investment**	Started commercial Production		
Application	Offline			**Online**
Application period	**Not Specified**	25 days		**5 days**

The eligible sectors significantly increased, especially in 2019.

Prior to 2019, the application is done through long and bureaucratic process. Before 2015, the period is not specified. It even take up to 2 years (Gumelar, 2015)

Tax Allowance Application Process (before 2019)



Tax Allowance: Infrastructure Sectors

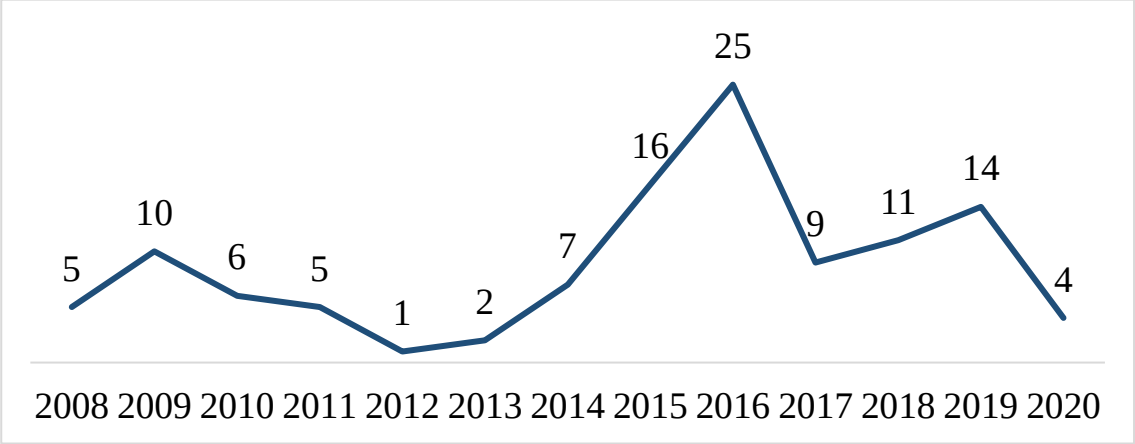
Business Sectors	Scope of Products	Regulation
Geothermal Powerplant	Exploration, drilling, and processing of geothermal energy into electricity	GR 62 of 2008
Power Plant	Conversion of new energy and renewable energy into electricity	GR 52 of 2011 GR 18 of 2015 GR 9 of 2016
	Micro and mini-power plant	GR 78 of 2019
Collection, purification, and distribution of freshwater	Taking drinking water directly from springs and groundwater, purifying surface water from water sources, and channeling water directly through piping networks and from water terminals, tank trucks for sale to consumers.	GR 52 of 2011 GR 18 of 2015 GR 9 of 2016 GR 78 of 2019
Management and Disposal of Hazardous Wastewater	All related products	GR 78 of 2019
Building construction of processing, distribution, and collection of drinking water, wastewater, and drainage	Construction, maintenance, and repair of sewerage structures in municipalities and wastewater treatment buildings, residential drainage networks, retention basins, pumping buildings, and construction of similar buildings	GR 52 of 2011
Highway Construction	Construction, enhancement, maintenance, and improvement of toll road outside Java Island	GR 52 of 2011
Tourism Area	Excluding those in Special Economic Zone	GR 52 of 2011 GR 18 of 2015 GR 9 of 2016 GR 78 of 2019

Tax Allowance: Results

The utilization has been increased over the time

- During 2007 to February 2020, 167 taxpayers with IDR 957 trillion and USD 112 billion of direct investment.
- Prior to 2015 regime : average 5 taxpayer per year.
- Between 2015-2019: average 15 taxpayer per year.

Tax Allowance utilization



Source: Ministry of Finance

Taxpayers from infrastructure sectors utilizing tax allowance

	Year	Sector	Location	Investment (IDR Bn)
1	2016	Power Plant	North Sumatera	497
2	2016	Power Plant	South Sumatera	2.469
3	2016	Power Plant	West Java	150
4	2017	Power Plant	Bengkulu	200
5	2017	Power Plant	West Java	302
6	2018	Power Plant	West Sumatera	141
7	2019	Power Plant	West Sumatera	258
8	2019	Power Plant	North Sumatera	452
9	2020	Power Plant	Gorontalo	225
10	2020	Power Plant	West Nusa Tenggara	142
11	2019	Collection, purification and distribution of freshwater	West Nusa Tenggara	330
			TOTAL	5,167

Source: Ministry of Finance

Tax Allowance: Evaluation

2011 Tax Allowance:

- Bureaucratic
- No standardized length of time for processing the application (could take up to two years)
- Investment allowance utilization starts when the taxpayer realized 80% of their investment commitment –might trigger dispute.

2015 Tax Allowance:

- Bureaucratic
- Standardized length of time for processing the application (25 working days)
- Investment allowance utilization starts at the time of commercial production – more certain.

2018 Tax Allowance:

- “Trust and verify”
- Short processing time (5 working days)
- Ease of administration: online system

VAT Exemption for Residential Buildings: Overview

Simple house

a. The building area is not exceeding 36 square meters.
b. Land area is not exceeding 60 square meters.
c. Selling price is not exceeding the following threshold (IDR 140-219 mn)
d. For the owner, the unit the first-owned residence
e. The owner is categorized as low-income
f. The unit is used as a place of residence
g. The unit is not transferrable in four years.

Student dormitories

a. Simple buildings specifically designated for student accommodation,
b. Built and funded by universities or schools, individuals or local governments,
c. Vot transferable within four years.

Residential buildings

a. Built and financed by individuals or labour cooperatives or employee cooperatives,
b. Built for permanent workers or low-income informal sector workers with agreed rental fees.
c. The unit is not transferable within four years since it was obtained.

Simple apartment

a. high rise buildings that equipped with a bathroom and kitchen
b. The sale price is not exceeding IDR 250 million.
c. The unit area is more than 21 square meters but not exceeding 36 square meters.
d. Individual bought the apartment has a monthly income of maximum IDR7 million.
e. The unit is first owned residence.
f. The unit is used as a place of residence (the unit cannot be rented).
g. The unit is not transferrable.

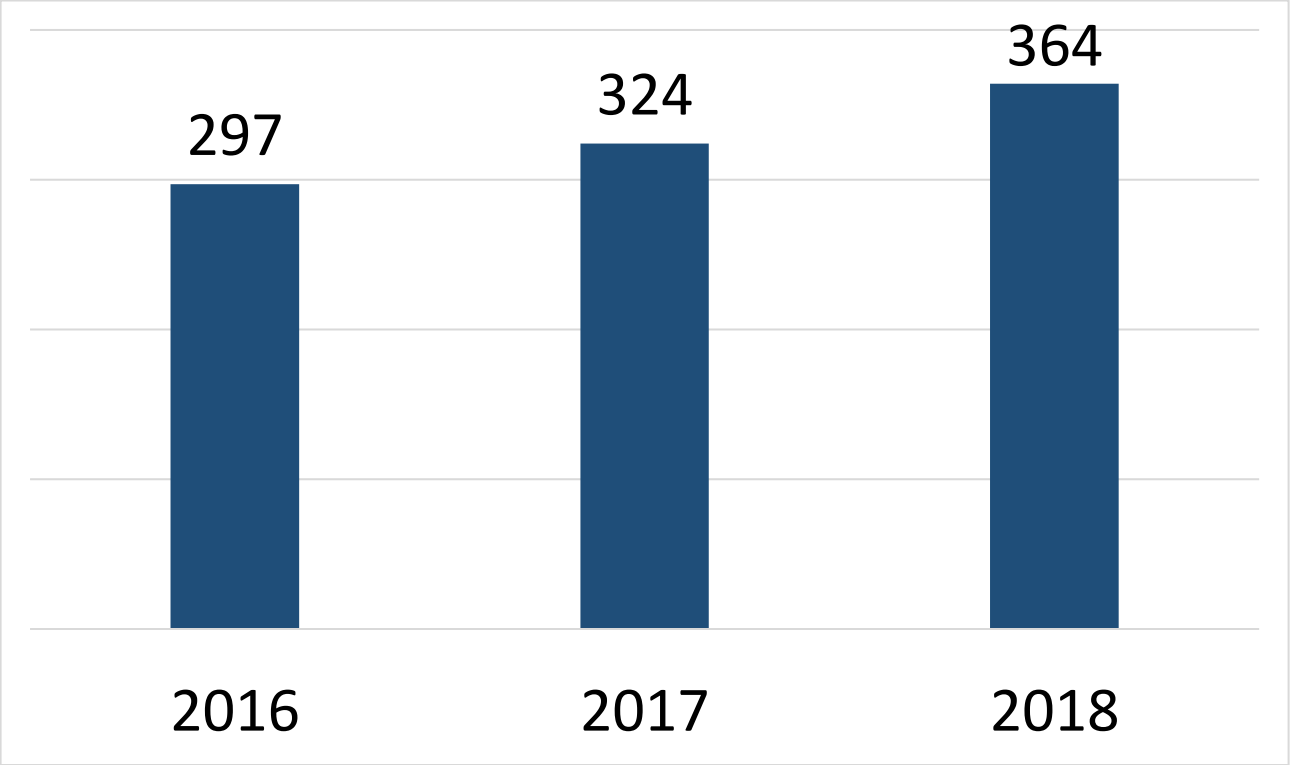
Other residential houses

a. Building for employees, built and funded by a company (not for commercial use)
b. Building for victims of natural disasters
c. The building is not transferable within four years.

VAT Exemption for Residential Buildings: Results

During 2016 to 2018, VAT-exemption for housing has resulted in IDR 9,85 trillion in turnover.

Revenue Foregone from VAT Exemption of Housing (IDR tn)



Source: BKF (2019)

Conclusions and Policy Recommendations

- Indonesia implemented tax holiday and tax allowance to attract direct investment, and VAT exemption to ensure the availability of decent housing for low-income households.
- The utilization of tax holiday and tax allowance was limited in the initial periods: simplicity of procedures and certainty play an essential role in attracting investment. The implementation of OSS system should be optimized.
- Add more infrastructure sectors in the list of tax holiday as well as tax allowance
  - Indonesia mid-term development plan 2020-2024: **Basic service infrastructure** (including water supply and sanitation, electricity access, telecommunications and internet services, safety systems transportation, pioneer transportation services, multi-purpose and irrigation reservoirs), **Economic infrastructure** (transportation infrastructure, electricity, and energy), and **Urban infrastructure** (construction of mass public transportation, construction of city gas pipelines, drinking water, sanitation pipes, and waste management).
  - Put more infrastructure sectors in the list of tax allowance although already listed in as tax holiday recipients, to accommodate taxpayers with smaller-scale investment.

THANK YOU!