1 Indonesia

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I. Introduction

Indonesia, this name means Indian Islands, invented by J. R. Logan, in Malaya in 1850. Taken from the Greek, *Indos* (India) and *nesos* (island), it has parallels in Melanesia, "black islands"; Micronesia, "small islands"; and Polynesia, "many islands." A German geographer, Adolf Bastian, used it in the title of his book, *Indonesien* , in 1884, and in 1928 Indonesian nationalists adopted it as the name of their nation.

Consisted of more than 17.000 islands, Indonesian lands spread out between two big continents Asia and Australia and lay over the Equator between the Indian Ocean and the Pacific Ocean. While the land borders withthe north to East Timor and Papua New Guinea and to the east with Malaysia , it also neighbors Australia to the south, and Philippines, Vietnam, Singapore, and Thailand to the north, also India to the northwest.

After the independence day at 17 August 1945, the national anthem titled “Indonesia Raya” have been sung by children throughout the country to begin the school day, by civil servants at flag-raising ceremonies, over the radio to begin and close broadcasting; in cinemas and on television and at national day celebrations. Radio and television, government owned and controlled for much of the second half of the twentieth century, produced nationalizing programs as diverse as Indonesian language lessons, regional and ethnic dances and songs, and plays on national themes. Officially recognized "national heroes" from diverse regions are honored in school texts, and biographies and with statues for their struggles against the Dutch; some regions monumentalize local heros of their own.

The Bhinneka Tunggal Ika ("Unity in Diversity") is Indonesia motto, the concept that this country always united even the country's citizens divide themselves along a vast slew of ethnicities, clans, tribes and even castes. The nation's official ideology, first formulated by President Sukarno in 1945, is the “Pancasila”, or Five Principles: belief in one supreme God; just and civilized humanitarianism; Indonesian unity; popular sovereignty governed by wise policies arrived at through deliberation and representation; and social justice for all Indonesian people.

I.1.History and Culture

The modern of Indonesia begins in the period from 2500BC to 1500BC with a wave of light brown-skinned Austronesian immigrants, thought to have originated in Taiwan. This Neolithic group of people, skilled in open-ocean maritime travel and agriculture are believed to have quickly supplanted the existing, less-developed population. Indonesian history has been influenced by foreign powers drawn to its natural resources. Muslim traders and Sufi scholars brought the now-dominant Islam,while European powers brought Christianity and fought one another to monopolise trade in the Spice Islands of Malukuduring the Age of Discovery.

There is no one unified Indonesian culture as such, but the Hindu culture of the former Majapahit empire does provide a framework for many of the cultural traditions found across the central islands of Sumatra, Java, Bali and Lombok. Perhaps the most distinctively "Indonesian" arts are wayang kulit shadow puppetry, where intricately detailed cutouts act out scenes from the Mahabharata and Ramayana and other popular folk stories, and its accompaniment the gamelan orchestra, whose incredibly complex metallic rhythms are the obligatory backdrop to both religious ceremonies and traditional entertainment.Modern-day Indonesian popular culture is largely dominated by the largest ethnic group, the Javanese.

I.2. Geography and Climate

The nation of Indonesia is almost unimaginably vast, more than 17,000 islands providing 108,000 kilometers of beaches. The distance between Aceh in the West and Papua in the East is more than 4,000km (2500 miles).The Ring of Fire Indonesia has more than 400 volcanoes, of which 130 are considered active, as well as many undersea volcanoes. The island of New Guinea (on which the Indonesian province of Papua is located) is the second largest island in the world. Here are some main islands in Indonesia:

- Sumatra (incl. the Riau Islands and Bangka-Belitung), wild and rugged, the 6th largest island in the world has a great natural and cultural wealth with more than 40 million inhabitants. Habitat to many endangered species.
- Kalimantan (Borneo), the vast majority of this, the world's third largest island, is covered by the Indonesian province. Uncharted jungles, mighty rivers, home of the orangutan, a paradise for the adventurer.
- Java (and Madura), the country's heartland, big cities including the capital Jakarta, and a lot of people packed on this island. Also features the cultural treasures of Yogyakarta, Borobudur and Prambanan.
- Bali, by far the most popular visitor destination in Indonesia, Bali's blend of unique culture, legendary beaches, spectacular highland regions and unique underwater life make it a perennial favourite amongst global travellers.
- Sulawesi (Celebes), strangely shaped, this island houses a diversity of societies and some spectacular scenery, Toraja culture, rich flora and fauna, world class diving sites.
- Nusa Tenggara, also known as the Lesser Sunda Islands, the "Southeast Islands", contain scores of ethnic groups, languages and religions, as well as Komodo lizards and more spectacular diving.
- Maluku (Moluccas), the historic Spice Islands, fought over to this day, largely unexplored and almost unknown to the outside world.
- Papua (Irian Jaya), the western half of the island of New Guinea, with mountains, forests, swamps, an almost impenetrable wilderness in one of the most remote places on earth.

Indonesia is a warm place. It has no spring, summer, autumn, or winter, just two seasons: rainy and dry, both of which are relative (it still rains during the dry season, it just rains less). While there is significant regional variation, in *most* of the country (including Java and Bali) the dry season is April to October, while the wet season is November to March. In the highlands temperatures will naturally be cooler, and there are even snow-covered peaks in Papua, whose mountains can soar above 5000m.

Since the country is very large, Indonesia is divided into three time zones:

GMT +7: Western Indonesian Time (WIB, *Waktu Indonesia Barat*) Sumatra, Java, west/central Kalimantan.
GMT +8: Central Indonesian Time (WITA, *Waktu Indonesia Tengah*) Bali, south/east Kalimantan, Sulawesi, Nusa Tenggara.
GMT +9: Eastern Indonesian Time (WIT, *Waktu Indonesia Timur*) Maluku, Papua.

I.3.Demography

The Indonesian archipelago has been an important region for trade since at least the 7th century, when Srivijaya and then later Majapahit traded with China and India. Local rulers gradually absorbed foreign cultural, religious and political models from the early centuries CE, and Hindu and Buddhist kingdoms flourished. From this point onward, dozens of kingdoms and civilizations flourished and faded in different parts of the archipelago. Some notable kingdoms include Sriwijaya (7th-14th century) on Sumatra and Majapahit (1293-c.1500), based in eastern Java but the first to unite the main islands of Sumatra, Java, Bali and Kalimantan as well as parts of Peninsular Malaysia. Indonesia also consists of hundreds of distinct native ethnic and linguistic groups, with the largest and politically dominant ethnic group being the Javanese. In a numerical scale, the largest ethnic groups are the Javanese (45%) from central and eastern Java, the Sundanese (14%) from western Java, the Maduranese (7.5%) from the island of Madura, and Coastal Malays (7.5%), mostly from Sumatra. This leaves 26% for the Acehnese and Minangkabau of Sumatra, the Balinese, the Iban and Dayaks of Kalimantan, and a bewildering patchwork of groups in Nusa Tenggara and Papua.

The population is unevenly spread throughout the islands within a variety of habitats and levels of development, ranging from the megalopolis of Jakarta to uncontacted tribes in PapuaProvinces are usually grouped around larger islands and include smaller surrounding islands. Indonesia also has the world's largest Muslim population. Ethnically it is highly diverse, with more than 300 local languages. The people range from rural hunter-gatherers to a modern urban elite.

Religion,does play a very important role in Indonesian society. Indonesian nationals are obliged to adhere to one of the religions that have been selected by the government (Islam, Christianity, Catholicism, Hinduism, Buddhism and Confucianism).Indonesia contains a Muslim-majority. Indonesia also has the world's largest Muslim population. Approximately 87.2 percent of the total Indonesian population or 207.2 million individuals in absolute numbers - is Muslim. However, Indonesia is not an Islamic nation (only in the special region of Aceh on the northern tip of Sumatra Islamic Sharia law is being applied). But despite being a secular democracy, principles based on Islamic doctrine do play a large role in the politics, the economy and society of Indonesia. There are also some 16.5 million Protestants (6.9 percent of the total population), 6.9 million Catholics (2.9 percent of the population), and 4 million Hindus (1.7 percent) living in Indonesia. Lastly, there exist small minorities of Buddhists as well as those who practice Confucianism, mostly members of the ethnic Chinese community.

I.4 Government and Political Situation

The Indonesian governmental system consists of three branches, executive branch, legislative branch, and judicial branch. The executive branch consists of the president, the vice president and the cabinet. Both the president and vice president are chosen by the Indonesian electorate through presidential elections. They serve for a term of five years that can be extended once by another term of five years when re-elected by the people. During these elections the president and vice president run as a fixed, inseparable pair, which implies that the composition of this pair is of great political strategic importance. Important matters that are of influence include ethnic (and religious) background and (previous) social position in Indonesian society. Indonesia’s legislative branch is the People’s Consultative Assembly (*Majelis Permusyawaratan Rakyat*, abbreviated MPR). It has the power to set or change the Constitution and appoints (or impeaches) the president. The MPR is a bicameral parliament that consists of the People’s Representative Council (*Dewan Perwakilan Rakyat*, abbreviated DPR) and the Regional Representative Council (*Dewan Perwakilan Daerah*, abbreviated DPD).

The DPR, consisting of 560 members, draws up and passes laws, produces the annual budget in cooperation with the president and oversees the general performance of political affairs. It is elected for a five-year term through proportional representation based on general elections. The DPD deals with bills, laws and matters that are related to the regions, thus increasing regional representation at the national level. Every Indonesian province elects four members to the DPD (who serve for a five-year term) on non-partisan basis. As Indonesia contains 33 provinces, the DPD consists of a total of 132 members.

The highest court in Indonesia's judiciary system is the independent Supreme Court. It is the final court of appeal and also deals with disputes between lower courts. A relatively new court, established in 2003, is the Constitutional Court, which monitors whether decisions made by the cabinet and parliament (MPR) are in line with the Indonesian Constitution. However, most of the legal cases in Indonesia are handled by the public courts, administrative courts, religious courts and military courts. A Judicial Commission oversees the maintenance of honour, dignity and behaviour of Indonesian judges.

II. Overview of Macroeconomy Activity and Fiscal Position

II.1. Macroeconomic Activity

The Macroeconomic policy in 2016 was directed at mitigating economic risks triggered by unfavorable global conditions. The response involved four areas of policy focus. First, to mitigate the risk of slowing economic growth by strengthening the role of domestic demand as a source of economic growth. Second, to maintain the economic stability and financial system stability that has been maintained and has become a foothold for economic growth. Third, to reinforce the economic structure through improvements in efficiency and productivity in order to continue to improve the competitiveness of the economy in the medium and long term. Fourth, to manage various policies pursued to remain within the corridor of sound macroeconomic policy to support the sustainability of economic growth. The macroeconomic policy direction was pursued through policy synergy between the Government, Bank Indonesia, and the Financial Services Authority.

This synergy was implemented in a policy mix bringing together fiscal, monetary, macro prudential, micro prudential, payment system, and structural policies. The policy mix was not only directed to mitigate short-term cyclical risks, but also to strengthen the economic structure in the medium and long term. Consistent efforts to strengthen the economic structure were pursued in line with the commitment to build a more competitive and resilient national economy in the medium and long term. In line with the macroeconomic policy direction, Bank Indonesia also employed a policy mix by combining monetary, macroeconomic, and the payment system and rupiah currency management policies.

II.1.1 Policy Response in 2016

In general, the macroeconomic policy adopted in 2016 sought to mitigate risks that could impair the sustainability of economic growth, macroeconomic stability, and financial system stability. The responses set in motion encompassed four main policy directions. First, to mitigate the risk of slowing economic growth by strengthening the role of domestic demand as a source of growth. This policy response was crucial, because a flagging economy may set off various interrelated risks that if allowed to persist would derail the recovery of the economy as a whole. Second, to maintain the prudently managed economic stability and financial system stability that has become the cornerstone for economic recovery. Third, to pursue structural reinforcement of the economy through efficiency and productivity gains aimed at achieving sustained improvement in competitiveness over the medium and long term. Fourth, to ensure that the various policies in operation kept within the corridor of sound macroeconomic policy in support of sustainable economic growth.

The macroeconomic policy direction is taken by policy synergy among Government, Bank Indonesia, and the Financial Services Authority (OJK). Policy synergy was implemented in a policy mix of fiscal, monetary, macro prudential, micro prudential, and structural policies, including policy for the payment system and currency management. The policy mix not only sought to mitigate short-term cyclical risks, but also to reinforce the structure of the economy in the medium and long term. Bank Indonesia also pursued a policy mix by combining monetary and macro prudential policies as well as policy for the payment system and currency management. Consistent with the macroeconomic policy stance, the Government strengthened the fiscal stimulus by increasing expenditure for productive sectors while consistently safeguarding the outlook for fiscal sustainability. This policy direction was incorporated into the 2016 State Budget. The budget targeted a 17% increase in government spending to be funded by a substantial 21.6% increase in domestic revenues. Under this budget plan, the 2016 state budget deficit was targeted at 2.15% of GDP. As events unfolded, the fiscal policy strategy for 2016 encountered challenges. During the first half of the year, domestic tax revenues underperformed as a result of protracted low commodity prices and only modest improvement in the domestic economy.

Meanwhile, actual government spending by the end of the first half of 2016 was quite high at 44.3% of target. This in turn produced a budget deficit for the first half of 2016 at 1.9% of GDP.

The government responded to this challenge by taking steps for fiscal consolidation in the second half of 2016 in order to maintain the credibility of fiscal sustainability. On the revenues side, the government lowered the tax revenue target to a more realistic level while pressing forward with the optimization of existing potential, including the tax amnesty program. By the end of 2016, the tax amnesty program had raised a total of Rp 107 trillion in tax redemptions. The success of the tax amnesty not only covered the short term need for state revenues, but also represented a step forward for strengthening the future tax base. By the end of the year, the various fiscal consolidation measures pursued by the government contained the deficit under the Revised 2016 State Budget to 2.5% of GDP, below the 2.6% level of the previous year.

This achievement thus maintained a low, prudent, and sustainable government debt position at 27.8% of GDP. Bank Indonesia responded to the macroeconomic policy stance by strengthening the policy mix of monetary, macroprudential, payment system and currency management policies. In line with the Government, Bank Indonesia policy mix sought not only to provide a response to short-term cyclical issues, but also to strengthen economic resilience in the medium and long term. In the short-term cyclical response, the policy sought to mitigate the risk of contraction in economic growth that if allowed to persist would lead to renewed susceptibility weighing down on macroeconomic and financial system stability. The medium-term structural policy response was implemented in various measures to strengthen the effectiveness of monetary policy transmission in managing the stability of the economy. The measures pursued by Bank Indonesia in 2016 were part of the Bank Indonesia transformation launched in 2014.

Monetary policy focused on creating space for strengthening the momentum of economic recovery and bolstering financial system stability while consistently safeguarding the macroeconomic stability that is already in place. The monetary policy stance was adopted in view of steady improvement in macroeconomic stability, reflected in low inflation in line with the target, a sound and declining level of current account deficit, and stable rupiah exchange rate. In turn, these conditions provided space for monetary policy easing. In line with the policy stance, the Bank Indonesia policy rate was lowered 150 bps in 2016, bringing the new policy rate, the BI 7-Day (Reverse) Repo Rate (BI7DRR), to 4.75% in December 2016. In addition, the statutory reserve requirement (RR) was reduced to 6.50%.

Exchange rate policy sought not only to keep exchange rate movement aligned to fundamentals, but also to improve effectiveness in maintaining economic stability. Bank Indonesia pursued stabilization of the rupiah in order to prevent excessive volatility, as this would carry the risk of renewed pressure on the exchange rate and inflation. The exchange rate policy was also reinforced by measures to improve the management of foreign exchange demand and supply, including the implementation of prudential principles in managing external debt of the non-bank corporation and implementation of regulations on mandatory use of the rupiah currency in the territory of the Republic of Indonesia. Furthermore, the strategy was continued for improve external sector resilience in support of the rupiah exchange rate policy by maintaining adequate international reserves in terms of both first line of defense and second line of defense. Monetary policy was also strengthened by reformulation of the monetary policy operation framework, representing one part of the transformation undertaken by Bank Indonesia. The principal objectives of this reformulation were three-fold: to strengthen the signaling of monetary policy, to improve the effectiveness of monetary policy transmission, and to promote financial market deepening.

This reformulation was carried out in a changeover of the policy rate from the BI Rate to the BI7DRR, effective from 19 August 2016. This reformulation was also accompanied by measures to accelerate financial market deepening on both the rupiah and foreign exchange money markets. Bank Indonesia policy mix was also supported by macro prudential policy aimed at strengthening bank intermediation while consistently maintaining financial system stability. In 2016, Bank Indonesia updated the regulations for the loan/financing-to-value ratio in a further increase in loan-to-value (LTV) or financing-to-value (FTV) ratio for property loan. Bank Indonesia also made changes to the regulation on the loan-to-funding ratio (LFR) related to RR by raising the lower limit of the target ratio from 78% to 80% in order to stimulate the bank intermediation function.

Following this, Bank Indonesia reset the Countercyclical Capital Buffer (CCB) to 0% after careful consideration of the most recent conditions in the economy and the systemic risk of credit growth. The OJK also introduced various micro prudential policies in support of policy synergy for safeguarding financial system stability. In 2016, OJK policy was aimed at ensuring that activities in financial services operate in a regulated, fair, transparent, and accountable manner that in turn can strengthen financial system resilience and consumers protection. The main function of the OJK is to regulate and supervise financial services activities in the banking industry, capital market, insurance, pension funds, multifinance companies, and other institutions operating in financial services.

Bank Indonesia also pursued policies in the payment system to strengthen the payment system infrastructure in keeping with international standards. These policies are among the measures taken in support of structural reinforcement of the economy through the creation of an efficient payment system. Following the smooth launching of the second generation of Bank Indonesia Real Time Gross Settlement (BI-RTGS) and the second generation of Bank Indonesia National Clearing System (SKNBI), Bank Indonesia updated and made changes to service features in the payment system with a bulk payments service implemented on 2 May 2016. Bank Indonesia also introduced the concept of the National Payment Gateway (NPG) to serve as infrastructure for integration of various payment channels in order to facilitate electronic payment transactions. In this area of the payment system, Bank Indonesia also established closer policy synergy with the Ministry of Social Affairs when integrating the non-cash payment system with disbursement of social assistance under the Family Hope Program (PKH). In the cash payment system, policy sought to meet the need for cash in society in regard to adequate cash volume, appropriate denominations, timeliness of supply, and fit for circulation.

The Bank Indonesia policy mix was implemented by forging closer policy coordination with the Government and other stakeholders. Policy coordination involved actions for inflation control both at the central government and regional levels. Bank Indonesia also coordinated with other authorities to promote financial market deepening and financial inclusion, as well as with the Financial System Stability Committee (KSSK) concerning measures for ensuring financial system stability. Coordination in financial system stability was strengthened with the adoption of the Act concerning Prevention and Resolution of the Financial System Crisis (PPKSK). In addition, policy coordination focused on acceleration of structural reforms in support of sustainable economic growth. The policy mix and policy coordination was also bolstered by an effective strategy for policy communication to the public.

The various policy initiatives were supported by structural policies to improve efficiency and productivity in the economy. In this regard, the Government has moved forward with multifaceted development of infrastructure, including energy infrastructure with construction of power plants and infrastructure for connectivity, such as toll roads, airports, light rapid transit (LRT), and so on. In 2016, the Government also focused on policies such as harmonization of regulations, ease of licensing procedures, and fiscal incentives. The Government set out the policy focus in the Economic Policy Packages IX-XIV, which carried forward from the policy packages launched in 2015. Prominent key points that stand out in the 2016 Economic Policy Packages include Government actions to improve ease of doing business in Indonesia as an initiative to encourage investment. In addition, the Government also pursued efforts to strengthen export-oriented economic activities by providing financing facilities to micro, small, and medium enterprises (MSMEs) under the Export-Oriented People’s Business Credit (KURBE) scheme.

Performance of the Indonesian Economy in 2016 The policy synergy undertaken by the Government, Bank Indonesia, and the OJK, with support from the predominant role of domestic demand, successfully charted the course for ensuring the continued resilience of the Indonesian economy in 2016. The combination of the two factors proved adequate to mitigate risk from adverse global conditions. The structure of the economy, which is still approximately 60% driven by private consumption, helped to minimize the impact of limited performance in the external sector. The sizeable role of private consumption was also closely linked to the effect of stimuli from fiscal, monetary, and macro prudential policies, and the positive impact of well managed economic and financial system stability. In turn, these conditions enabled the economy to resume an upward growth trend with continued support from macroeconomic and financial system stability. Indonesia's economic growth improved from 4.9% in 2015 into 5.0% in 2016, buoyed by domestic demand despite slack performance in real exports.

The predominant role of domestic demand was driven by the fiscal stimulus channeled through a range of infrastructure projects, particularly in the first half of 2016, in addition to the positive impact of monetary and macro prudential policies relaxation. The infrastructure spending in the first six months of 2016 provided a boost to construction investment that went on to strengthen economic growth until the third quarter of 2016 (Table 2). The policy response also maintained the level of consumer confidence and helped to sustain buoyant growth in household consumption at 5% in 2016.

However, the role of private sector was limited due to internal consolidation strategies pursued in the private sector in response to sluggish conditions in the global economy. Under these strategies,corporates held back from expansion, and as a result non-construction investment remained weak until the third quarter of 2016. Based on quarterly dynamics, the contribution of real exports and private corporations to economic growth began to improve in the fourth quarter of 2016. In that quarter, growth in real exports reached 4.2% (yoy), the first such positive growth recorded since the third quarter of 2014. Performance improved for private sector corporations as reflected growth in non-building gross fixed capital formation in the fourth quarter of 2016 that strengthened to 7.1% (yoy), the highest level since 2013. The positive developments in real exports and non-building investment acted to curb the risk of slowdown in economic growth from cutbacks in the fiscal stimulus during the fourth quarter of 2016.

In spatial analysis, improved economic growth during 2016 was recorded primarily in the regions of Sumatra, Java, and Kalimantan. Economic growth in the most provinces in Sumatra and Java mounted higher than the preceding year. Similar progress was visible in Kalimantan, with increased economic growth in nearly all provinces. Economic growth in these different regions was driven mainly by buoyant household consumption and renewed growth in exports in the fourth quarter of 2016 in line with commodity price increases in the global markets. Alongside this, economic growth remained strong in various regions of Eastern Indonesia in 2016 despite slowing a little compared to 2015 due to the depressed mining sector. Unemployment and poverty levels eased in line with the improvement in economic growth.

During 2016, open unemployment dropped from 6.2% recorded in 2015 to 5.6%. The numbers of people living in poverty also fell from 11.2% of the total population in 2015 to 10.7%. The positive impact of various improvements result led to reduction in income disparities reflected in decline in the Gini ratio from 0.402 in 2015 to 0.397 in 2016.Improvement achieved in the Indonesia balance of payments helped to bolster external sector resilience. In 2016, the balance of payments recorded a USD12.1 billion surplus with contribution from a reduced deficit in the current account (CA) and a heftier surplus in the capital and financial account (CFA). The drop in the CA deficit from 2.0% of GDP in 2015 to 1.8% of GDP in 2016 was a heartening development amid slack performance in exports due to unfavorable global economic conditions. The lower CA deficit is explained in part by the subdued level of imports that represented a positive contribution from adjustments by domestic business agents to cope with falling external demand and the impact of rupiah exchange rate movement in line with fundamentals. Meanwhile, the increase in the CFA surplus came in response to high capital inflows spurred by positive perceptions among foreign investors of the outlook for the Indonesian economy, including the effect of the successful outcome of the tax amnesty program. The positive outcome in the balance of payments produced an increase in Indonesia's international reserves from USD105.9 billion in 2015 to USD116.4 billion in 2016. Total external debt also remained at a prudent level of 34% of GDP, down from 36% of GDP in 2015 in line with the consolidation process of the corporate sector.

The balance of payments surplus recorded in 2016 had a positive impact on the rupiah exchange rate, which remained stable during the year. Unlike other regional currencies that suffered depreciation, the average value of the rupiah in 2016 appreciated by 0.7% over 2015. Point-to-point, the rupiah in 2016 closed at Rp13,473 per USD, up 2.3% over the level at the end of 2015. The rupiah gains were mostly evident in the first three quarters of 2016, in line with the rise in foreign capital inflows to Indonesia and improvement in the structure of foreign exchange demand. Steady improvement was visible in foreign exchange demand, representing a positive outcome of the implementation of prudential principles (KPPK) in managing external debt of the non-bank and mandatory use of the rupiah within Indonesian territory.

Foreign capital inflows, much of which were placed in Indonesian financial market instruments, also strengthened the performance of Indonesian stock market and bond market. Following gains in 2016, the IDX Composite Index closed the year at 5,296, up from 4,593 in 2015. Yield on 10-year government bonds also declined 77 bps to 7.97%, among others from the effect of reductions in interest rates and lower inflation. In 2016, improving economic conditions in Indonesia were also bolstered by subdued inflation. Inflation in 2016 was recorded low at the level of 3.02%, representing a continuation of level reached in 2015 within the 4±1% targeting range. Contributing to this achievement were persistently low commodity prices, more stable rupiah exchange rate, prudently managed aggregate demand, and diminished inflation expectations. These factors contributed to low core inflation at 3.07%. The low inflation was also attributed by inflation in administered prices due to falling prices, mainly in the first six months of 2016, for such strategic energy commodities as petroleum-based fuels, electricity billing rates for customers in the 1,300 VA brackets and above, and 12 kg LPG cylinder. Alongside this, volatile foods inflation remained well under control despite a modest increase over 2015 due to disruptions in supply from the La Nina effect.

Financial system stability also remained firm, despite concerns over increased credit risk. Various banking resilience indicators remained strong, including the liquidity and capital adequacy indicators. Improvement in bank liquidity indicators in 2016 was reflected in the ratio of liquid assets to deposits, which climbed to 20.9%. The increase in liquidity resulted in part from the expansionary fiscal operations by the government and the effect of Bank Indonesia's relaxation of the statutory reserve requirement (RR). Capital adequacy ratio strengthened from 21.2% in 2015 to 22.8% in 2016. However, credit risk mounted higher, as reflected in the rise in non-performing loans (NPLs) from 2.5% to 2.9% in 2016 even though still within safe level at less than 5%. Increased credit risk prompted banks to carry out internal consolidation, which affected monetary policy transmission through both the interest rate and the credit channel.

In the interest rate channel, indications suggest that higher credit risk put a brake on decline in loan interest rates. Loan interest rates eased by just 80 bps in significant difference to the policy rate and deposit rates that had previously reduced by 150 bps and 123 bps. In the credit channel, mounting credit risk deterred banks from lending. During the times of weak corporate demand for credit and less than optimum decline in loan interest rates, banks also undertook internal consolidation that in turn resulted in lacklustre credit growth at 7.95% in 2016. This represented a downturn compared to the 2015 growth of 10.4%. The financial system stability that was prudently maintained and the low systemic risk were closely linked to the healthy condition of the national payment system.

Various payment system indicators showed an upward trend and operation of the payment system by Bank Indonesia and the industry proceeded well without any significant disruption. The payment system operated by Bank Indonesia and the payments industry achieved growth in transaction value. For non-cash retail transactions in particular, transaction value climbed 15.5% in 2016. In the cash payment system, currency management exerted a positive influence reflected in the timely provision of cash currency in adequate volume, appropriate denominations, and in fit condition for circulation. Outlook for the Economy in 2017 and the Medium TermThe Indonesian economy is predicted to achieve further gains in 2017, bolstered by improvement in the global and domestic economic outlook. At the global side, economic growth is projected to improve in comparison to 2016, which may keep energy and non-energy commodity prices at high levels.

On the domestic side, the economic outlook is also predicted to improve as consolidation process of corporations and banks begins to ease. Corporations, buoyed by renewed business optimism, partly driven by increases in global commodity prices, are expected to move forward with business expansion as already evident in the fourth quarter of 2016. In tandem with corporate optimism, banks are also predicted to begin increasing lending, spurred by forecasts that credit risk will begin to ease. The outlook for improvement in the economy is also bolstered by the fiscal policy stance for a continued stimulus for the economy in 2017, targeting sectors with higher multiplier effects. In 2017, the Government budget target for infrastructure spending is Rp387 trillion, up significantly from the Rp267 trillion in 2016.

II.1.2 International Environment

In 2016, the global economy again faced multiple risks that previously emerged in 2015. Three main risks were manifest in 2016: decline in economic growth, prolonged low commodity prices, and high uncertainty on financial markets. These issues took on added complexity as a result of geopolitical uncertainties in some countries. Various developments subsequently impacted the process of global economic recovery, which moved forward at a sluggish pace in departure from earlier forecasts. In 2016, global economic growth again lacked momentum and was unevenly distributed. Global economic growth was recorded at 3.1% in 2016, down slightly from 3.2% in 2015 and below the 3.4% forecast at the beginning of the year. In analysis by category of countries, the lethargic global economic growth was mainly attributable to the protracted weakness in advanced economies, where growth slipped to 1.6% from the 2015 level of 2.1%.

The economic downturn in advanced countries was contributed by decelerating economic growth in the US, Europe, and Japan. In contrast, economic growth in emerging market economies mounted slightly from 4.0% in 2015 to 4.1%. The positive development in emerging market economies was bolstered by performance in Asian countries such as India and Indonesia, which recorded increased economic growth, while economic growth in China eased from 6.9% to 6.7%. The sluggish global growth were influenced by a number of factors. In the US, economic growth decelerated in response to the lingering weakness in residential and non-residential investment caused by the ongoing decline in the oil and mining sectors. In Europe, investment also slowed, primarily in the aftermath of the Brexit referendum at the end of June 2016 that sparked uncertainty and dampened investor appetite for investment. In Japan, the stagnating economy resulted from decline in nearly all components of GDP, namely consumption, investment, and exports.

At the same time, the economic slowdown in China was largely influenced by the economic rebalancing strategy of the Government in response to lack of momentum in the global economy. The impact of the fragile global growth was widespread, as many countries responded to decline in the world economy by resorting to a domestic-oriented growth strategy. This strategy also brought about a weakening in the relationship between global economic growth and world trade volume. The relationship between the two indicators even more deteriorated because of indications of concurrent decline in the global value chain. As a result, the elasticity of global economic growth with respect to world trade volume fell from 0.6 in 2015 to only 0.3 in 2016. These developments in turn weighed down on the exports and economic growth of numerous countries. The feeble growth in the world economy affected global commodity prices, which remained low until the third quarter of 2016. However, world inflation began climbing in the fourth quarter of 2016 due to rising commodity prices and an upturn in world aggregate demand.

In 2016, the Indonesian economy held its ground amid sluggish global economic conditions replete with uncertainty. Key to this achievement was the structural predominance of domestic demand and support from adequate policy responses. In turn, the combination of these two factors mitigated the risk of fallout from weak global economic growth, protracted low global commodity prices, and the heightened uncertainty hanging over global financial markets. In 2016, Indonesia’s economic growth climbed from 4.9% in 2015 to 5.0%. Higher growth was also supported by a sound level of economic stability marked by low inflation, decline in the current account deficit, stable exchange rate, and well maintained financial system stability with low systemic risks.

Overall, the economic dynamics of 2016 indicated positive improvements in the Indonesian economy. The economic stability maintained through consistency in policies previously set in motion provided a robust foundation for domestic economic adjustment and enabled the Indonesian economy to resume an upward growth trend. The economic growth achieved by Indonesia in 2016 studs in contrast with the stagnated growth in many leading economies. In addition, Indonesia has forged more robust policy synergy both in the cyclical policies responding to short-term conditions and in structural policies. In turn, this synergy will support the economic recovery process and strengthen economic resilience in the medium and long term.The Global Economy in 2016 The global economy continued to struggle with three main issues as it had in 2015. These three issues posed renewed challenges to Indonesia's economy in 2016. The three issues weighing down on the world economy are interrelated and have kept global economic recovery moving at a slow pace . Adding to the complexity of problems facing the global economy were geopolitical uncertainties, including outcomes in the Brexit referendum and US election that are radically different from market expectations.

These conditions then contributed to the already high uncertainties and in the final outcome disrupted the process of global economic recovery. The first issue was related to the depressed and unevenly distributed global economic growth. Due to the ongoing consolidation in the global economy, including in China, global growth remained weak at 3.1% in 2016, below the 3.2% level recorded in 2015 . In the quarterly dynamics, global economic growth actually picked up in the fourth quarter of 2016, but this was insufficient to raise growth for the overall 2016 beyond the level achieved in 2015.

The absence of improvement in the global economy brought with it challenges for the Indonesian economy. Unfavorable global conditions carried the risk of impairing Indonesia's economic recovery in 2016. If allowed to persist, this risk would not only hamper improvement in economic growth, but also weigh down on economic and financial system stability.

The correlation between the two was mutually reinforcing, as feeble economic growth poses a risk of upsetting economic and financial system stability that will then bear down on economic growth itself. The challenges for the Indonesian economy began with the risk of a renewed slump in economic growth, triggered by the slack outlook for exports. This risk had considerable relevance given the sluggish pace of global economic growth that could weaken demand for products exported by Indonesia, particularly non-commodity. Exports were increasingly susceptible to decline because low commodity prices could put pressure on Indonesia's terms of trade. With a considerable portion of primary commodities in the Indonesian exports, deterioration in Indonesia's terms of trade could then lead to even further loss of export performance. The risks from the sluggish export outlook assumed greater urgency due to the possible impact on corporate and banking performance. Falling export revenues could result in greater corporate susceptibility to difficulties.

Corporate vulnerability could then worsen if domestic demand remained slack, including weakness resulting from the second-round effect of corporate responses opting more for internal consolidation rather than business expansion. Corporate performance facing risk of decline could ultimately impact performance in the financial sector, including the banking industry. Banking performance would be faced with downside risk from escalation in credit risk caused by sluggish corporate performance.

The risk of deteriorating performance in the banking industry could in turn impair the effectiveness of monetary policy transmission through the interest rate and credit channels. Escalating credit risk could then influence bank behaviour in setting interest rates, particularly lending rates. Loan interest rates would then be less elastic to changes in the central bank policy rate if, at the same time, credit risk was on the rise. In addition, mounting credit risk could deter banks from extending credit. Taken together, problems in the interest rate and credit channels would then carry the risk of diminishing the banking role in promoting economic growth.

The fiscal space for stimulating the economy was also at risk of contraction due to reduction in potential tax revenues. The risk of decline in taxes was not only due to direct impact from contraction in non-tax revenues due to falling commodity prices, but also the effect of indirect impacts leading to shrinking income tax and value added tax revenues. Overall, the risk of reduced tax revenues could in turn restrict capacity for government expenditures in supporting economic recovery, given the necessity on the other hand for continued efforts to safeguard the prospects of fiscal sustainability.

The challenges facing the economy involved even greater complexity as they could spread on a wider scale and possibly derail macroeconomic and financial system stability. The risk of a deteriorating domestic economic prospect could adversely impact the outlook for investment in Indonesia, including inflows of portfolio investment. Portfolio investment would face an escalating risk of contraction accompanied by heightened volatility if uncertainty broke out on global financial markets, including uncertainty over increases in the FFR and geopolitical risks. If this persisted, it could put pressure on the rupiah exchange rate and domestic financial system stability. The weakening in the rupiah would in turn stoke inflationary pressure, affecting not only core inflation but also inflation in volatile foods and administered prices. Overall, these multifaceted challenges to the domestic economy demanded prompt action. Had issues been allowed to fester, they could have become mutually reinforcing with disruption to the process of economic recovery. Feeble economic growth could increase corporate risk and bank credit risk while impairing monetary policy transmission and diminishing fiscal space to deliver a stimulus. These risks to the economy could also have exacerbated the risks to macroeconomic and financial system stability that in turn could again derail the process of economic recovery. Aside from cyclical response, structural responses also had to be bolstered further to strengthen matters of geographical relevance, such as interregional connectivity and cost efficiency of logistics.

II.1.3 Trade Balance

Indonesia’s trade balance recorded a surplus in August 2017. The trade surplus stood at USD 1.72 billion in August 2017, reversing the USD 0,27 billion deficit registered in July (Graph 2.20). The trade surplus originated from a larger increase in the non oil and gas trade surplus than in the oil and gas trade deficit. Cumulatively, from January - Agustus 2017, the trade surplus stands at USD 9.11 billion, nearly doubling the USD 5.13 billion posted in the same period one year ago. The non-oil and gas trade was recorded surplus at USD 2.41 billion in August 2017, increasing from USD 0.34 billion the month earlier. The non oil and gas trade surplus stemmed from a USD 1.49 billion (mtm) increase in non oil and gas exports, while non oil and gas imports fell USD 0.58 billion (mtm). Non oil and gas exports were driven by shipments of animal and vegetable fats and oils, mineral fuels, electrical machinery and appliances, jewellery/gems and knitted articles of apparel. In contrast, imports of motor vehicles and component parts, optical devices, cotton , fertiliser and jewellery/gems contributed to the non oil and gas import decline. Consequently, the non oil and gas trade surplus for the period from January - August 2017 stands at USD 11.44 million (ytd).

The oil and gas trade balance recorded USD 0.68 billion deficit in August 2017, up slightly on the USD 0.61 billion posted the month earlier.The increase was prompted by a USD 0.18 billion (mtm) surge of oil and gas imports, in particular crude oil, which outpaced the corresponding USD 0.11 billion growth of oil and gas exports. Cumulatively, the oil and gas trade deficit for January - August 2017 at USD 5.33 billion (ytd).

II.1.4 Indonesia Balance Payment

Indonesia’s balance of payments (BOP) recorded a significant surplus in 2016, despite unfavorable global economic condition. The BOP surplus was supported by a narrow current account deficit and large capital and financial account surplus. Furthermore, the solid BOP position was indicative of a smooth domestic economic adjustment in response to global dynamics and the favorable domestic economic outlook perceived by international investors. Robust BOP performance in 2016 also strengthened external sector resilience, as reflected by an increase in the position of reserve assets to USD116.4 billion.

The balance of payments (BOP) improved significantly in 2016, despite unfavorable global economy due to global economic moderation and prolonged low international commodity prices through to the third quarter of 2016. After 2015, when a USD1.1 billion deficits was recorded, the BOP position reversed to record a USD12.1 billion surplus in 2016 (Chart 4.1) on the back of a narrower current account deficit and larger capital and financial account surplus. The current account deficit was maintained at the healthy level of 1.8% of GDP, down from 2.0% of GDP in the year earlier. Meanwhile, the capital and financial account surplus increased significantly from USD16.9 billion to USD29.2 billion in 2016.

The positive BOP performance in 2016 was indicative of the domestic economic resilience. On one hand, the narrower current account deficit evinced that the domestic economy performed well despite undesirable global economic dynamics. The domestic private sector lowered demand for imports in response to weak domestic demand and export performance through to the third quarter of 2016. In addition, the private sector remained sufficiently flexible in terms of exploiting the momentum of rising international commodity prices in the fourth quarter, which prompt an increase in export performance. On the other hand, the significant capital and financial account surplus also evinced the favorable domestic outlook perceived by global investors despite ongoing high global economic uncertainty. Well maintained economic stability, supported by solid policy coordination among authorities, affected the positive perception of foreign investors. Such development, in turn, triggered foreign capital inflows to Indonesia, thus supporting the significant capital and financial account surplus in 2016.

In general, solid BOP performance in 2016 strengthened external sector resilience. The BOP surplus contributed to an increase in the position of reserve assets from USD105.9 billion in 2015 to USD116.4 billion, equivalent to 8.4 months of imports and servicing government external debt.

II.1.5 Current Account

In 2016, the current account deficit narrowed to a solid level. The current account deficit was observed to narrow to USD16.3 billion (1.8% of GDP), from USD17.5 billion (2.0% of GDP) in 2015 in 2016. On a quarterly basis, the current account deficit primarily narrowed in the fourth quarter of 2016, as non-oil and gas exports soared to USD 36.3 billion on rising international commodity prices. The positive contribution of non-oil and gas exports subsequently fed through to a sharp decline in the current account deficit, namely 0.8% of GDP in the fourth quarter, the lowest level since 2012.

The decreasing current account deficit in 2016 was also supported by a larger non-oil and gas trade surplus, coupled with a narrower oil and gas trade deficit and services account deficit. The non-oil and gas trade surplus was boosted by non-oil and gas exports, which rebounded significantly in the fourth quarter as international commodity prices began to rise. Well controlled non-oil and gas imports growth also further supported the larger non-oil and gas trade surplus. Meanwhile, the narrower oil and gas trade deficit was attributable to a decline of oil and gas imports due to the low global oil price and positive impact of the Government’s energy reform policy. A decrease of freight payments due to less import activity contributed to the improvement in the services account, along with an increase in the number of international travelers visiting the Indonesian archipelago.

Table 1. Balance of Payment

List		2013	2014	2015	2016
I. Current Account		-29.115	-26.233	-17.519	-16.347
	A. Goods (Net)	5.833	6.902	14.049	15.390
	-Exports	182.089	175.290	149.124	144.441
	- Imports	-176.256	-168.387	-135.076	-129.051
	1. General	4.069	5.393	13.319	14.803
	-Exports	180.294	173.757	147.725	143.061
	- Imports	-176.225	-168.363	-134.406	-128.258
	a. Non Oil and Gas	13.777	17.233	19.023	19.625
	-Exports	146.706	145.005	130.541	130.173
	- Imports	-132.928	-127.771	-111.518	-110.548
	b. Oil and Gas	-22.483	-23.914	-13.106	-9.702
	-Exports	17.889	13.806	7.833	6.267
	- Imports	-40.372	-37.719	-20.938	-15.969
	c. Gas	12.775	12.074	7.402	4.880
	-Exports	15.700	14.946	9.351	6.620
	- Imports	-2.925	-2.873	-1.949	-1.741
	d. Other goods	1.765	1.509	730	587
	-Exports	1,795	1.533	1.400	1.380
	- Imports	-31	-24	-670	-793
	B. Services (Net)	-12.072	-10.532	-8.697	-6.486
	C. Primary Income (Net)	-27.055	-27.822	-28.379	-29.681
	D.Secondary Income (Net)	4.178	5.22	5.508	4.430
II.	Capital & Financial	22.010	43.586	16.860	29.198
	A. Capital Account	45	27	17	9
	B. Financial Account	21.964	43.559	16.843	29.188
	-Assets	15.467	-12.039	-21.489	19.178
	-Liabilities	37.431	55.598	38.332	10.01
	1. Direct Investment	12.295	15.266	10.704	15.121
	-Assets	-11.112	-10.421	-9.705	11.359
	-Liabilities	23.407	25.686	19.779	3.762
	2. Portofolio Investment	10.875	25.802	16.183	18.872
	-Assets	-1.273	2.409	-1.268	2.186
	-Liabilities	12.148	23.393	17.451	16.686
	3. Financial Derivatives	-334	-213	20	-9
	-Assets	345	159	667	609
	-Liabilities	-679	-372	-647	-618
	4. Other Investment	-871	2.705	-10.064	-4.796
	-Assets	-3.427	-4.186	-11.812	5.024
	-Liabilities	2.556	6.891	1.748	-9.820
III.	Total (I+II)	-7.105	17.353	-659	12.851
IV.	Net Error and Omissions	-220	-2.105	-439	-762
V.	Overal Balance (III + IV)	-7.325	15.249	-1.098	12.089
VI.	Reserves & Related Items	7.325	-15.249	1.098	-12.089
	Memorandum				
	-Reserves Assets Position	99.387	111.862	105.931	116.362
	-In Month of Imports and Official Debt Repayment	5.5	6.4	7.4	8.4
	- Current Account / GDP (%)	-3.2	-3.0	-2.0	-1.8

II.1.6 Service Account, Primary Income Account and Secondary Income Account.

The services account improved on the back of a narrower transportation services trade deficit and an increase of travel services receipts. The services trade deficit reduced by 25.4% compared to the previous year due to a narrower transportation services trade deficit, specifically freight, in line with the decline of imports of goods. The services account was also buoyed in the reporting period by an increase of travel services receipts as the number of international travelers visiting Indonesia increased.

Despite recorded a narrower deficit, the transportation services balance still demands attention. This is primarily attributable to the freight services which continuously posted a trade deficit. Such condition is increasingly important due to the freight services trade deficit constitutes the largest share of the total services account deficit, namely 67.7% in 2016. The large and persistent freight deficit is indicative of constraints in the domestic transportation industry in terms of supporting international trade.

Furthermore, the value of freight services payments to international carriers is larger compared to the value of imports. The transportation services account deficit is reflected in the comparatively large percentage of freight costs paid to foreign companies to convey imported goods (freight import to import ratio) by sea, at around 5%. Meanwhile, the corresponding percentage of freight receipts from non-residents to convey exported goods (freight export to export ratio) was recorded at only around 1%.

Such conditions demonstrate the need to strengthen domestic freight services and, therefore, support a resilient services account.

II.1.7 Capital and Financial Account

The capital and financial account balance recorded a surplus in 2016 totaling USD29.2 billion, increasing significantly from USD16.9 billion in 2015. Direct investment and portfolio investment surpluses were the main contributors to the increase, while the other investment deficit narrowed. In general, the promising domestic economic outlook perceived by global investors drove the larger capital and financial account surplus, despite widespread global uncertainty. The positive perception held by global investors was supported by the promising economic outlook, maintained economic stability and attractive yields. Furthermore, the Tax Amnesty policy strengthened expectations of rupiah appreciation and future economic resilience, including fiscal sustainability. The positive sentiment, in turn, dampened global risks linked to uncertainty surrounding the proposed FFR hikes, as well as geopolitical risks in Europe and the US in the latter half.

II.1.8 Investment

Investment is expected to continue expanding, mainly supported by building investment. Building investment poated solid gains on the back of the government inclination to spend, especially capital spending, which increased as of August 2017 on the same period last year. Private investment also increased in the form of electricity and road infrastructure projects by state owned enterprises as well as the development of affordable housing. Moreover, cement sales accelerated at the beginning of the third quarter of 2017, indicating stronger building investment in the reporting period. Investment was also buoyed by non building investment.

II.1.9 Direct Investment

Net direct investment stood at USD15.1 billion in 2016, increasing by 41.3% compared to that in 2015 in line with optimism regarding domestic economic outlook, including the impact of an increase in the ease of doing business index. The Indonesia’s ranking on the ease of doing business index (EODB) jumped from 106 to 91. Based on country of origin, Singapore and Japan continued to dominate foreign direct investment (FDI). The combined value of FDI from both countries totaled USD12.9 billion. Furthermore, other Asian countries also remained major investors in Indonesia. Direct investment from China was recorded at USD163 million in 2016, half of the USD324 million invested in 2015. Meanwhile, direct investment from the United States recorded a net outflow totaling USD0.9 billion, contrasting the trend in 2015.

In terms of economic sector, FDI realization in 2016 concentrated in the manufacturing industry and trade sector. The value of investment in the manufacturing industry reached USD7.5 billion, with Singapore and Japan as the major investors. Meanwhile, recently increasing investment in the trade sector overtook investment in the agricultural, fisheries and forestry sector. Accordingly, investment in the trade sector totaled USD2.0 billion in 2016, primarily originating from Singapore as the major investor.

The increase of direct investment was also reflected in the positive realization of foreign direct investment (FDI) recorded by the Indonesia Investment Coordinating Board (BKPM). FDI realization data published by BKPM showed an 8.4% increase in 2016, rising from USD365.9 trillion to USD396.6 trillion, equivalent to USD29.0 billion.

II.1.10 Portfolio Investment

Portfolio investment also recorded a large surplus in 2016 due to the promising domestic economic outlook and attractive yields. Despite a highly uncertainty in global financial markets, portfolio investment recorded a net surplus of USD18.9 billion in 2016, even exceeding the USD16.2 billion registered in 2015. The influx of portfolio investment primarily occurred during the first three quarters of 2016, which recorded a net inflow totaling USD19.3 billion, surpassing that recorded in the same period one year earlier. The public sector was the main driver of portfolio investment inflows, as reflected by the large number of non-resident holdings of public sector securities, through issuances of global bonds and global sukuk. During the same period, the private sector also recorded a net inflow, but not as significant as that posted by the public sector.

II.1.11 Other Investment

The other investment deficit significantly narrowed in 2016 due to the Tax Amnesty policy, particularly due to the repatriated funds. The net inflow of funds was primarily recorded in the second half of the year, with other investments therefore recording a surplus for the year on the asset side. Meanwhile, non-resident other investments on the liability side experienced a deficit caused by a net payment of foreign loans by the public and private sectors. Other investments on the liability side experienced a deficit as the private sector exercised prudent management of international sources of financing. This is reflected by a net payment on the liability side, which stemmed from significantly smaller withdrawals of loans than the scheduled repayments. Such developments are in line with ongoing consolidation in the corporate sector, hence corporations have been more inclined to improve internal financial conditions rather than expand.

II.1.12 Export

Export commodity prices remained comparatively high. The prices of mining commodities, particularly coal, continued to climb in July and August 2017 due to strong global demand. Meanwhile, the export prices of manufacturing products remained relatively stable in the third quarter of 2017. In contrast the prices of agricultural produce increased more slowly after vegetable oil experienced a price correction due to abundant supply.

The government has been more inclined to consume in the third quarter of 2017. Greater government consumption stemmed from a change in spending composition, with increasing procurement and social assistance. As of August 2017, central government spending grew 7,9% (yoy), compared to 3,8% (yoy) one year ago, primarily in the form of social assistance. On the other hand, spending on the procurement of goods remained limited in line with government efforts to more effectively absorb budget. Export based industries maintained robust building investment in line with persistently high international commodity prices. In addition, stronger non building investment was also evidenced by increasing imports of raw materials and capital goods from January - August 2017 compared to conditions in the same period one year earlier. Furthermore, heavy equipment sales increased in all economic sectors in July 2017. In term of transportation, import of spare parts and equipment continue to rise. The realisation of real non-oil and gas exports grew 8.04% (yoy) in August 2017, which was down slightly on the previous period due to seasonal factors and the base effect of Eid-ul-Fitr . By commodity group, agricultural exports expanded by 32.8% (yoy), supported by high demand for vegetable oil as prices moderated. Meanwhile, real coal exports experienced a contraction despite positive growth in nominal terms due to elevated prices. On the other hand, real manufacturing exports achieved positive but limited growth on the back of base metals, calculated rubber, footwear as well as motor vehicles and component part.

II.1.13 External Debt

Improved external resilience was also evidenced by the performance and profile of external debt in Indonesia. External debt grew slower in 2016, accompanied by a lower ratio of external debt to GDP. The position of external debt at the end of 2016 stood at USD317.0 billion, with growth rate decelerating from 5.9% in 2015 to 2.0% in 2016. Consistent with slower external debt growth, the ratio of external debt to GDP in 2015 also decreased from 36.0% to 34.0%. Furthermore, such ratio is also considered safe and is within the range of peer countries. The position of private external debt declined in 2016, contracting by 5.6% and reducing the share of private external debt from 54.1% to 50.1% of total external debt in Indonesia. Long-term external debt, accounting for 74.0% of total private external debt, contributed to the lower position of private external debt, while trade credit edged up short-term external debt. Consequently, the position of private external debt at the end of 2016 reached USD158.7 billion, down from the USD168.2 billion posted in 2015. The decline of private external debt stemmed primarily from loan agreements and debt securities. Such developments are in line with a more prudent behaviour of corporate sector in terms of managing sources of financing, including foreign loans, due to ongoing internal consolidation. The position of public external debt increased as the government issued more global bonds and global sukuk.

The largest position of public external debt, in the form of tradable government bond (SBN), increased by 21.1% compared to the position in 2015 to fund the state budget deficit. Meanwhile, government policy to reduce foreign loans continued in 2016. Consequently, the position of government external debt in the form of loan agreements has fallen gradually from USD68.1 billion in 2010 to USD54.2 billion in 2016.Based on remaining maturity, the structure of external debt in Indonesia was categorized as sound, reflecting the dominant long-term external debt at USD262.3 billion or 86.7% of the total. The dominance of long-term external debt was also prevalent in the private sector.

II.1.14 Exchange Rate

The Rupiah was stable, with the value trending upwards. In August 2017, the Rupiah appreciated by an average of 0.02% to Rp. 13.343 per USD after USD slumped and an influx of foreign capital flowed onto the domestic FX market, leading to a net supply. USD depreciation stemmed from the dovish statements relayed by the Federal Reserve and European Central Bank, along with concerns over US growth. Meanwhile foreign capital flows were drawn to positive yields in Indonesia. Furthermore, rupiah exchange rate volatility was mitigated and, therefore, lower than reported in peer countries. Notwithstanding Bank Indonesia will continue to stabilise the rupiah in line with the currency's fundamental value, while maintaining market mechanisms.

II.1.15 Inflation

Inflation was controlled at a rate lower than previously expected. CPI inflation in August 2017 stood at 2.53% (ytd) or 3.82% (yoy) after supply improved as demand returned to normal in the wake of Eid-ul-Fitr and the school holidays, combined with government policy and close coordination with Bank Indonesia. Furthermore, core inflation was recorded as its lowest rate for the past three years. Moving forward, low inflation is expected to persist within the target range, supported by anchored expectations, relatively stable exchange rates and the downward global inflation trend. Nevertheless, Bank Indonesia will continue to strengthen policy coordination with the central government and regional administrations to control inflation, to support achievements of the inflation targets at 4.0±1% in 2017 and at 3.5±1% in 2018 and 2019.

II.1.16 Financial System

Financial system stability maintained, albeit slow banking intermediary functions. Stability is reflected in a highg Capital Adequacy Ratio (CAR) of 23.0% and liquidity ratio of 23.3% in July 2017, while non performing loans (NPL) stood at 3.0% (gross) or 1.4% (net). However, banking intermediation has not shown signs of improvement. July's credit growth, while improving from 7.8% (yoy) in the previous month, remained low at 8.2% (yoy). High credit growth occurred only on building , electricity, services and agriculture sectors, while other sectors' growth remained low. Deposit growth decelerated from 10.3% (yoy) to 9.7% (yoy), decreasing especially in the forex deposit. Moving Forward, bank intermediation is expected to improve in line with Bank Indonesia decision to perform rate cut and macro prudential policy easing, as well as progress in banking and corporation consolidation. In addition, economic financing through capital markets is also expected to improve, in line with financial markets deepening efforts.

II.2 Domestic Environment

II.2.1 Economic Overview Per September 2017

Indonesia's national economy is expected to improve in the third quarter of 2017. Domestic demand was indicated to increase, particularly in term of household consumption, trough increasing retail sales and sales of durable goods. Building investment is expected to maintain positive growth in line with increased government spending, while robust non-building investment in export base industries is due to persistently high international commodity prices. Furthermore, the government is more inclined to expand spending, which, coupled with the impact of monetary policy easing, is helping to drive domestic economic momentum.

Household consumption is expected to improve. Stronger retail and automotive sales, supported by low inflation, government spending and monetary policy easing that maintained public purchasing power, were indicative of improving household consumption. Retail sales in August 2017 grew 5.8% (yoy) after contracting 3.3% (yoy) the month earlier (graph 2.13). Entering the third quarter of 2017, automotive sales improved on the back of positive motorcycle and car sales data in August 2017. In term of incomes, the real wages of farm labourers and term of trade (ToT) posted positive growth. Furthermore, consumers remained optimistic in the third quarter of 2017, albeit slightly less upbeat in August 2017. Bank Indonesia's Consumer Confidence Index (CCI) stood at 121.9 in August 2017, down slightly from 123.4 in July 2017.

II.2.2 Economic Growth

Indonesia economic growth rebounded in 2016. Smooth domestic economic adjustment combined with a solid macroeconomic policy response successfully mitigated external risks and nurtured national economic growth, which accelerated to 5.0%. In the fourth quarter of 2016, several developments have indicated a surge of nonbuilding investment activity and exports, thus supporting economic expansion, which are expected to persist into 2017. Stronger economic growth in Indonesia lowered unemployment, reduced poverty and narrowed income inequality in 2016.

Weaker-than-expected global economic growth posted a number of challenges in terms of stimulating domestic economic growth in 2016. The challenges were triggered by the flagging global economy, prolonged low global commodity prices and highly uncertain global financial markets. The various external risks became a concern in terms of efforts to spur domestic economic growth in Indonesia because global economic growth remained sluggish and Indonesia's terms of trade (ToT) was weak due to low global commodity prices, which threatened to undermine export performance. Furthermore, investment in Indonesia was also at risk of decline if global financial market uncertainty remained high. The various risks demanded vigilance and an appropriate policy response because of the potential to unwind existing efforts to foster domestic economic growth.

Smooth domestic economic adjustment coupled with a solid macroeconomic policy response succesfully mitigated external risk and nurtured positive domestic economic growth. Economic growth in Indonesia was recorded at 5.0% in 2016, up from 4.9% in the year earlier, due to the dominant role of domestic demand, particularly through solid household consumption. Large fiscal stimuli during the first half of the year, underpinned by monetary and macroprudential policy easing by Bank Indonesia, also supported strong domestic demand in 2016. Meanwhile, the role of private investment, especially nonbuilding investment, increased significantly through to the third quarter of 2016 on the back of internal corporate consolidation in the private sector. Real exports of goods and services remained weak until the third quarter of 2016 due to weak global demand and low commodity prices. The role of private nonbuilding investment and exports began to pick up in the fourth quarter of 2016 on rising global commodity prices, which offset the risk of economic moderation due to fading fiscal stimuli.

Stronger economic growth in 2016 was also accompanied by better quality growth in terms of employment, poverty and income inequality. The level of open unemployment fell from 6.2% in 2015 to 5.6% in 2016, supported by an increase in GDP absorption to employment. Poverty was also reduced, falling from 11.2% in 2015 to 10.7% in 2016 of the total population, with the gains particularly evident in urban areas in line with stronger manufacturing industry performance along with wholesale and retail as well as services. In addition, the income gap narrowed, reflected by a lower Gini ratio, improving from 0.402 in 2015 to 0.397 in 2016.

II.2.3 GDP – By Expenditure

Indonesian economic growth in Indonesia rebounded in 2016 after two years of decline. Economic growth was observed to accelerate from 4.9% in 2015 to 5.0% in 2016 In general, domestic economic growth accelerated despite inauspicious conditions reported in various other countries, which strived to stimulate growth during a period of sluggish global economic expansion. Stronger domestic economic growth in 2016, against a backdrop of global economic moderation, was inextricably linked to smooth domestic economic adjustment and a solid macroeconomic policy response. An economic structure dominated by household consumption successfully dampened the risk of an economic downturn due to weaker external sector performance. Resilient household consumption was supported by low inflation and improving consumer confidence. Simultaneously, an expansive fiscal policy response during the first half of the year, together with monetary policy easing, also supported stronger economic growth in 2016. In general, revamping domestic economy has boosted economic resilience in 2016, stronger than the previous year.

Table 2. GDP Growth by Expenditure

GDP Components	2013	2014	2015	2016
Household Consumption	5.43	5.15	4.96	5.01
Non-Profit Institution Serving Household (NPISH) Consumption	8.18	12.19	-0.62	6.62
Government Expenditure	6.75	1.16	5.32	-0.15
Gross Fixed Capital Formation	5.01	4.45	5.01	4.48
Building	6.74	5.52	6.11	5.18
Non Building	0.63	1.58	1.95	2.45
Export	4.17	1.07	-2.12	-1.74
Import	1.86	2.12	-6.41	-2.27
Gross Domestic Product	5.56	5.01	4.88	5.02

source : BPS - Statistic Indonesia

II.2.4 GDP – By Industrial Origin

GDP by industrial origin corroborated the dominant role of domestic demand, including fiscal policy, in terms of supporting economic growth in 2016. Several sectors linked to domestic demand, in particular the electricity sector, trade, transportation and accommodation sectors posted gains in 2016, while the construction and real estate improved in the first half of the year. In contrast, the agricultural sector continued to decline due to persistently low global commodity prices up to the third quarter. The mining sector rebounded in 2016, but underperformed on low mining commodity prices up to the third quarter. The wholesale and retail sector recorded 3.9% growth in 2016, up considerably on the 2.9% posted in the year earlier. The gains stemmed from domestic demand specifically household consumption, which boosted economic growth in 2016. In the first half of the year, wholesale and retail sector growth accelerated, amongst others, due to an adjustment to the Eid-ul-Fitr cycle and the earlier disbursement of 13th and 14th-month salaries. In addition, maintained consumer purchasing power in line with low inflation also supported growth in the wholesale and retail sector.

Mirroring the trade sector, growth of the accommodation, foods and beverages sector also accelerated, climbing from 4.3% in 2015 to 4.9% as international travelers visiting Indonesia soared 15.0% on the previous year to 12 million, the highest level in the past six years. Tourism has been boosted by investment to increase the number of hotel rooms available as well as the development of new tourist destinations, including 10 strategic national tourist regions. The impact of fiscal stimuli on domestic demand translated into solid growth in several economic sectors. The electricity sector recorded 5.4% growth in 2016, up from 0.9% in the year earlier. Furthermore, growth in the construction sector was also strong during the first half of the year, driven by large-scale government-led infrastructure projects. Nonetheless, construction sector performance tailed off sharply in the latter half of the year in line with fiscal consolidation in the government sector. Indicatively, cement sales contracted during that period. Such developments, in turn, slowed construction sector growth for the year to 5.2% from 6.3% in 2015.

Mining sector performance rebounded in 2016. Mining industry growth was recorded at 1.1% in 2016, reversing the previous 3.4% contraction reported in 2015. Mining sector performance has been strongly influenced by government policy through enactment of the Mineral and Coal Mining Act in 2015, which restricted exports. The policy compelled a number of firms to build metal ore smelters, some of which began operating in 2016. Mining industry performance was also boosted by rising prices of natural resources, particularly coal, starting in the fourth quarter of 2016. Elevated global commodity prices were a boon for the mining sector, where persistently low prices had squeezed performance through to the fourth quarter.

Table 3. GDP by Industrial Origin

Industrial Origin	2013	2014	2015	2016
Agriculture, Forestry, and Fishing	4.20	4.24	3.77	3.25
Mining and Quarrying	2.53	0.43	-3.42	1.06
Manufacturing	4.37	3.64	4.33	4.29
Electricity	5.23	5.9	0.9	5.39
Water Supply, Garbage, Waste Management and Remediation Activi	3.32	5.24	7.07	3.6
Construction	6.11	6.97	6.36	5.22
Wholesale and Retail Trade, Repair of car and Motorcycle	4.81	5.18	2.59	3.93
Transportation and Storage	6.97	7.36	6.68	7.74
Accomodation, Food , and Water Supply	6.8	5.77	4.31	4.94
Information and Communication	10.39	10.12	9.69	8.87
Financial Services	8.76	4.68	8.59	8.9
Real Estate Activities	6.54	5.00	4.11	4.3
Business Activities	7.91	9.81	7.69	7.36
Government Administration	2.56	2.38	4.63	3.19
Education Services	7.44	5.47	7.33	3.84
Health Services	7.96	7.96	6.68	5.00
Other Services	6.4	8.93	8.08	7.8
Taxes Less Subsidies on Product	21.80	5.08	32.24	19.31
Gross Domestic Product	5.56	5.01	4.88	5.02

II.2.5 Domestic Demand

Domestic demand was also an important pillar of domestic economic growth in 2016. Domestic demand was primarily supported by solid household consumption, growing at around 5% each quarter, which contributed around 55% of GDP. In addition, government consumption also bolstered economic growth, particularly during the first semester. Nonetheless, the role of government consumption faded in the second half of the year in line with fiscal consolidation. The role of investment, specifically nonbuilding investment, was solid through to the third quarter on large-scale government infrastructure spending. Meanwhile, listless exports and nonbuilding investment were relatively weak through to the third quarter, before gaining momentum towards yearend.

Several factors supported solid household consumption growth at 5.0% in 2016. Consumers were upbeat as reflected by a Consumer Confidence Index (CCI) that returned to optimistic territory at the beginning of 2016, which helped maintain solid consumption. More confident consumers stemmed from macroeconomic stability in the form of low inflation and relatively stable exchange rates. Furthermore, low inflation, and maintained consumer purchasing power supported household consumption. The government’s fiscal stimuli, coupled with monetary and macroprudential policy easing by Bank Indonesia, also helped to maintain consumer purchasing power. In addition, consumption by non-profit institutions serving households (NPISH) increased due to the various preparations undertaken for the local elections to be held in 2017.Fiscal stimuli also played an important role in terms of supporting domestic demand and economic growth in 2016, especially during the first half of the year.

II.2.6 Growth of Household Consumption

Household consumption gains primarily manifested in the consumption of non-foods & beverages, while consumption of foods & beverages declined. Consumption of non-foods & beverages recorded 4.9% growth in 2016, up from 4.7% in the year earlier, affecting secondary goods and tertiary goods. In terms of secondary goods, spending on transportation and communication accelerated from 4.6% in 2015 to 5.7%. Concerning tertiary goods, spending on restaurant and hotel services showed an increase. In general, non-food consumption gains were not only indicative of improvements in the structure of household consumption but were also early indications of future economic growth momentum.

II.2.7 Government Consumption

Positive government consumption growth was recorded in the first two quarters of 2016, even soaring to 6.2% (yoy) in the second quarter due to increased government spending on goods and services. Personnel expenditure also increased significantly due to isbursements of 14th-month salary for civil servants in June 2016. In addition to central government spending, stronger government consumption was also supported locally by regional administrations, which drove government consumption in the first semester.

The role of government consumption in terms of boosting domestic demand dwindled in the second half of the year in line with fiscal consolidation. In the third and fourth quarters of 2016, government consumption experienced respective contractions of nearly 3.0% (yoy) and 4.1% (yoy). Such developments were explained by the government's response to adjust spending by around 12.5% compared to the state budget allocation in 2016. The spending cuts affected ministries/agencies and, more significantly, non-ministries/agencies, reaching 12.6% due to non-energy subsidies. Congruent with lower government spending in the second half of the year, government consumption was also observed to contract in 2016 by 0.2%, reversing conditions in 2015 when positive growth of 5.3% was recorded.Investment, particularly building investment, also showed a similar trend to government consumption. Building investment recorded robust growth during the first semester in line with government's avowed commitment to expand infrastructure spending and, therefore, strengthen the structure of the economy moving forward. Infrastructure spending by the Government in 2016 accounted for 15.2% of the total budget, up slightly from 14.2% in 2015. The strong support from government infrastructure spending, in turn, edged up building investment growth in the first and second quarters to 6.8% (yoy) and 5.1% (yoy) respectively.

II.2.8 Employment and Welfare

The uptick of economic growth in 2016 improved employment conditions. Open unemployment fell from 6.2% in 2015 to 5.6% in 2016, as full-time employment increased from 65.8% to 68.7% over the same period. Furthermore, the Labor Participation Rate also increased, rising from 65.8% in August 2015 to 66.3% in August 2016 Contrasting conditions in the mining industry and economic sectors reliant on domestic demand, the agricultural, forestry and fisheries sector has experienced a slow. In 2016, growth decelerated from 3.8% to just 3.3%. Such developments were explained by prolonged low global commodity prices in 2016, especially crude palm oil (CPO). In general, the positive correlation between economic growth and labor absorption could be observed in job vacancies online data, which has tracked an upward trend since the beginning of 2016 in line with stronger economic growth One factor that has boosted labor absorption in the transportation sector as well as the wholesale and retail sector is the rapid proliferation of online businesses engaged in e-commerce or application-based transportation services. In addition, unemployment has also fallen in terms of nearly all education levels, especially for secondary and tertiary education.

Stronger economic growth also helped to reduce poverty. Around 780 thousand people were lifted out of poverty in 2016, lowering the total to 27.8 million. This also helped to reduce the percentage of the poor to the total population from 11.2% in 2015 to 10.7%. Less poverty was primarily found in urban areas, while rural gains were more limited. The share of the poor in urban areas accounted for 7.7% of the total, down from 8.2% in 2015. Income inequality was also shown to narrow in 2016 as the economy gained momentum, while unemployment and poverty level also fell.

II.3. Fiscal Situation

The direction of 2016 fiscal policy was aimed at strengthening the stimulus for the domestic economy, while still maintaining the credibility of the prospect of fiscal sustainability. Policies were also aimed at responding to prevailing risks in the global economy, which included limited growth and lower commodity prices. These policies were outlined in the 2016 State Budget, optimizing the strategy of tax collection as well as improving the quality of spending into productive sectors and priorities, including by increasing infrastructure spending. The strategy was sustained by efforts to maintain sustainability of fiscal financing needs so as to manage any fiscal risks in the medium and long term. The first semester of 2016, however, had already posed serious challenges to the fiscal policies. The domestic tax revenue up to the first semester of 2016 had not been as expected due to low commodity prices and moderate domestic economy growth. Meanwhile, state expenditure had already reached 44.3% of the target, in turn pushing the budget deficit to 1.9% of GDP in the first semester of 2016.

In the second semester of 2016, the Government took consolidation measures, both from revenue and expenditure side, in order to maintain credibility of fiscal sustainability. From the revenue side, tax revenue was revised downwards to a more realistic target, while still optimizing any potential revenue sources from taxation.

This included revenue from the tax amnesty program, which by the end of the 2016 had already collected Rp107 trillion in clearance levy. In terms of expenditure, allocations were scrutinized for spending into priority and more productive sectors, such as infrastructure, food security, education and health.All these efforts had in the end helped secure credibility of fiscal sustainability, with the 2016 Revised State Budget's deficit ending at 2.5% of GDP, lower than the previous year of 2.6% of GDP. This achievement helped keep Indonesia's total public debts by the end of 2016 at a healthy level of 27.8% of GDP.

Policies were aimed at anticipating cycles of high uncertainties in the global economy, while strengthening the domestic economy's structure to improve its capacity and competitiveness. In its implementation, the fiscal stimulus was not only in the form of an increased amount of spending, but also the quality of spending by allocating more state spending to productive sectors and priorities, such as infrastructure spending.

In the initial stage, fiscal policies were outlined in the assumptions and targets of the 2016 State Budget, which was approved in November 2015. Among the budget's assumptions was global oil prices standing at USD50 per barrel, an economic growth at 5.3% and inflation at 4.7%. State revenue was then estimated to reach Rp1,820.5 trillion, an increase of 21.8% compared to 2015 realization. State expenditure, meanwhile, were allocated at Rp2,095.7 trillion, an increase of 16% compared to the realization of 2015. Overall, these estimates make the 2016 APBN deficit estimated at 2.15% of GDP. In its development, global and domestic conditions were not in line with expectations, thus posing challenges to 2016's fiscal management. The global economic growth remained limited and weighed down on commodity prices, including that of crude oil. This in turn affected the prospects for domestic economy, putting the expectations for both economic growth and inflation off their marks.

Revenue targets were also at risk of not being reached so that it could interfere with fiscal resilience. The Government promptly responded to those challenges by revising some of the assumptions and targets of the 2016 APBN to be more realistic. In the Revised State Budget (APBN-P) 2016 set in mid-2016, the assumption of 2016 oil prices was reduced to USD40 per barrel in line with the limited global economic growth. As a result, the assumption of economic growth and inflation fell to 5.2% and 4.0% respectively. The budget's posture was revised as well, with state revenue down to Rp1,784.2 trillion, largely due to non-tax state revenue expected to be only Rp245.1 trillion, from previously Rp273.8 trillion. State expenditure was consequently revised as well, cut to Rp2,082.9 trillion. This balanced out to the budget's deficit being revised slightly up at 2.37% of the GDP.

Despite the budget revision, 2016 fiscal management challenges remained apparent. The limited global economic growth and lower commodity prices, including oil price, had already affected state revenue from meeting its target for the first semester. In the meantime, the realization of government spending has been recorded quite large, particularly infrastructure spending. Realized state expenditure grew 15% in the first half of 2016 compared to the achievement in the same period of the previous year, and had already reached 44.3% of its target for 2016. These conditions were in turn to cause deficit APBN-P 2016 in thefirst half of 2016 has reached 1.9% of GDP.

The government responded to these challenges by taking fiscal consolidation measures, both in terms of revenue and expenditure side. The consolidation measures were contained in Presidential Instruction No. 8 Year 2016 dated August 26, 2016 which comprises preparation of Ministry/Institution's austerity for the Implementation of APBN-P Year 2016. Spending were reallocated to priorities and more productive sectors, including for infrastructure, food security, education, and health. On the revenue side, the tax revenue target was revised downwards to a more realistic amount, while optimizing other potential sources for tax revenue, including through the tax amnesty program, which by the end of 2016 had already collected Rp107 trillion in clearance levy.

II.3.1 State Revenue

Efforts to increase state revenue as a basis to sustain fiscal stimuli still faced some challenges in 2016. Limited growth still plagued the global economy, affecting Indonesia's domestic economy as well, and in turn affecting tax revenue. Meanwhile, low commodity prices, including that of crude oil, affected non-tax state revenue. Overall, less favorable global conditions had impact on the state revenue, both tax revenue and Non-Tax State Revenue (PNBP). State revenue by the end of 2016 amounted to Rp1,546.9 trillion, or only 86.7% of its target in the 2016 Revised State Budget. This was due to tax revenue being short by Rp254 trillion, thus only reaching 83.1% of its target. The shortfall in tax revenue in 2016 was even higher than the Rp249 trillion shortfall the previous year. Non-Tax State Revenue, however, increased in 2016, amounting to Rp261.9 trillion, or up 3.2% from the previous year. This was due to improving performance and efficiency within the state ministries and other governmental agencies.

Tax revenue only grew by 3.6% in 2016, lower than 8.2% in the previous year. Revenue from oil-and-gas income taxes, value-added taxes, and property taxes had even decreased (Chart 7.1). Revenue from non-oil-and-gas income taxes continued to increase, although this was slower than the previous year. Tax revenue in 2016 were particularly affected by the Government's policy to again increase the amount of Non-Taxable Income (PTKP). Tax revenue managed to increase, partly due to the tax amnesty program, which by the end of 2016 had contributed Rp107 trillion in clearance levy. The program had particularly contributed to the increase in revenue from non-oil-and-gas income taxes, which by the end of 2016 reached Rp630.1 trillion.

Revenue from tobacco excise were down to Rp143.5 trillion in 2016, from Rp144.6 trillion the previous year. This was due to the latest changes to the Government's incentive of postponing the excise payments for cigarette manufacturers and cigarette importers. The incentive had previously increased tobacco excise revenue from Rp116 trillion in 2014. Tax shortfall in 2016 has placed the importance of continuing tax reforms to improve tax revenue ahead. Tax revenue has yet strengthened its position as the economy's source of financing, with Indonesia's tax ratio in 2016 at only 10.3% of GDP, down from the previous year's 10.7% of GDP (Chart 7.2). Improving the tax ratio has become even more important lately, as lower global commodity prices have also pulled down the ratio of oil-and-gas revenue in 2016 to only 0.29% of GDP, from the previous year's 0.43% of GDP.

II.3.2 State Expenditure

The overall state expenditure in 2016 increased from 2015, but the share of central government spending was lower than the target. Total state expenditure for 2016 amounted to Rp1,860.3 trillion, an increase of 3.5% compared to 2015 realization. The increased spending largely went into regional transfer funds and village funds, both of which in 2016 were up 14% from the previous year. Actual central government spending for 2016, meanwhile, only amounted to 88% of the Rp1,306.7 trillion allocated in the 2016 Revised State Budget, or only totaling Rp1,150.1 trillion, down from Rp1,183.3 trillion in the previous year.

The decreasing spending of central government was influenced by fiscal consolidation process. In the process of consolidation, austerity is more directed to the components of routine operational expenditure, while cuts on capital expenditure components are minimized. In this strategy, the Government instructs budget savings to be made on unranked events, events not held until the end of year, as well as for events that were not urgent and could be carried over to the next fiscal year.

Despite the spending cuts, fiscal stimulus through infrastructure spending was maintained. The ratio of infrastructure spending to the total state expenditure was up to 14.4% for 2016, compared to 14.2% in the previous year. The infrastructure spending included government financing through the public-private partnership (PPP) financing schemes and State Equity Participation (PMN) to SOEs. A total of 12 PPP projects worth Rp93.8 trillion were realized in 2016, with other major projects, such as the Batang power plant, the Palapa Ring telecommunications project, and the Umbulan tap-water plant, finally entered their financial closing after having been delayed. The granting of PMN to PT Sarana Multi Infrastruktur (PT SMI) and PT Penjaminan Infrastruktur, and other SOEs were also implemented. A positive change in the central government spending was the reallocation of energy subsidies to non-energy subsidies. Subsidies for diesel fuel were cut from Rp1,000 per liter to Rp500 per liter on July 1, 2016, leading to a lower amount of energy subsidies for the fiscal year. The energy subsidy was then allocated to some non-energy subsidies include subsidized interest of People’s Business Credit (KUR), subsidized mortgage interest, down payment home assistance that are realized using budget for program’s credit subsidy. In overall, subsidies totaled Rp174.2 trillion in 2016, lower than the 2015’s achievement Rp186.0 trillion.

In contrast to central government spending, transfers to the regions and village funds increased in the 2016 fiscal year, despite their allocations in the revised budget not being fully spent. The transfers increased, mainly due to an increase in the Special Allocation Funds to the regions, and the central government’s latest policy of converting any unspent transfer funds into government bonds. The banking industry had indeed reported lower savings and deposit funds from regional governments, indicating thatthe policy had encouraged regional governments to actually spend their transfer funds.

II.3.3 Budget Financing

The overall state revenue and state expenditure standings throughout 2016 resulted in a deficit of Rp305.2 trillion, or 2.5% of GDP. This was higher than a deficit of 2.37% of GDP expected in the 2016 Revised State Budget, but remained at a safe and healthy level in maintaining fiscal sustainability, swaps, and back-to-back loans. Long-term investment instruments are also available, such as infrastructure bonds. In order to facilitate the hedging of repatriation funds in the domestic banks, Bank Indonesia has provided additional facilities in plain-vanilla transactions such as forward through a net settlement system for unwinding purpose, early termination and roll-over options, as well as of structured products through call spread options.

Going forward, further tax reforms must be carried out to increase the tax base that the tax amnesty program had added to, and unlock the potential of more tax revenue. The clearance levy and declared assets during the tax amnesty program had shown the fiscal potential of untapped tax revenue from both existing and unregistered taxpayers.

These tax revenue, however, would be more sustainable for Indonesia’s fiscal capacity if the tax base can be continuously increased. For that matter, such efforts as thetax amnesty program must be continued through other tax reforms, which include improving the tax regulation and tax administration, widening the tax base through the effective use of information technology, and capacity building for tax compliance officers.

III. Tax Structure: Institution and Reality

III.1 Historical Background

III.1.1 Pre Independence Day

Indonesia has a long history of colonization by the European. It was during the era of Dutch and Britain Colonials rules that land tax and income tax were introduced. Since 1600s, the Dutch Government through the VOC (*Vereenigde Oost-Indische Compagnie*), its delegating authority, issued policies to increase the colony revenue through some taxes such as agricultural products tax. During the period of 1811-1816, British rule with Thomas Stamford Raffles as a governor was changing the patterns of land tax applied by the Dutch into a new *landrent* (land tax). In 1836 when the Dutch ruled again, Governor Van Den Bosch started enforcing the *cultuurstelsel* (forced cultivation system), which aimed to produce various commodities that had strong demand in world markets. Under the *cultuurstelsel*, villagers should sell those commodities to the Dutch Government in fixed price and then the earnings from those sales can be used to pay the land tax and farms tax. When the exports fell during the worldwide economic depression in the 1930s, the Dutch revenues depend largely from taxes upon income and expenditure.

III.1.2 After Independence Day

During the occupation of the Netherlands, the tax system emphasizes its function for the sake of development in the Netherlands. The amount of tax payable is entirely determined by the tax authorities. After Indonesia's independence, the changes were not so fundamentally and tax laws application were still in the hands of the tax administration authority. In 1967, a new system of tax collection called MPS (Menghitung Pajak Sendiri) or calculating your own taxes was introduced in 1967. Under this system taxpayer can calculate their own tax liabilities and at the end of the year the amount of tax payable reassessed by the tax authorities. This system is the pioneer of self assessment system in Indonesia.

III.1.3 Tax Reform

Fundamental and comprehensive changes in Indonesia tax administration took place in 1984 with the first tax reform. Since then, gradually the laws routinely amended to accommodate the country's rapidly changing business environment, as well as to support the government's objectives of improving the investment climate while increasing tax revenues.

The first tax reform came into force on January 1, 1984 with the implementation of three primary laws: General Tax Provisions and Procedures (*Ketentuan Umum dan Tata Cara Perpajakan, KUP*) Law, the Income Tax Law, and the Value-Added Tax (VAT) and Luxury Sales Tax (LST) Law. The principle amendment under these laws was the change of official assessment into self assessment system. The reform continued in 1985 with the enactment of land and Building Tax Law and The Stamp Duty Law. This era was the beginning of voluntary compliance of taxpayer.

The year 1994 was the commencement of the second tax reform. Some regulations were amended, they are: General Tax Provisions and Procedures Law, VAT and LST Law, Income Tax Law and Land and Building tax law. The second reform came into effect on January 1, 1995, with changes, additions and deletions of several articles from previous legislation.

Under the third tax reform, three new tax laws were introduced in 1997. The first one is Tax Dispute Settlement Agency Law. This Law became a basis to the birth of the new agency and at the same time replaced the legacy from Dutch Law. The provisions concerning appeal in Indonesia law were previously set in *Regeling van het Beroep in Belastingzaken* which last amended in 1959. The two other tax laws that enacted in the third tax reform were Tax Collection through Distress Warrants Law and The Law of Acquisition Duty of Right on Land and Buildings.

Almost all the tax laws were amended in the fourth tax reform which came into effect in 2001. Beside the second amendment of Indonesia primary tax laws (General Tax Provisions and Procedures Law, VAT and LST Law, and Income Tax Law), the new Tax Court Law was also enacted to replace The Tax Dispute Settlement Agency Law. Based on Tax Court Law, the administrative appeal body (that accepts taxpayer's request to review tax assessment made by the tax authority) is not a part of the tax authority institution. Tax Court is under The Tax Court Secretary, Ministry of Finance. The Trial is conducted in Jakarta, and currently there are two courts placed outside Jakarta, they are in the city of Yogyakarta and Surabaya.

III.2 Tax Structure

III.2.1 Tax Administration

Tax is a compulsory contribution to the country that has to be paid by an individual or a cooperation based on the Act. It is without direct rewards and used for the purposes of the state for the greatest welfare of the people. Tax payments constitute the realization of the citizen obligation and the role of the Taxpayer to directly and collectively implement the tax obligations for state financing and national development. From the philosopher point of view, paying taxes is not only an obligation, but it is the right of every citizen to participate in the form of contribution to the state financing and national development.

The obligation on taxation has become the entire society responsibility. This is in accordance with the *self-assessment* system adopted in the Indonesian Tax System. The Government, in this case the Directorate General of Taxes, in accordance with its function is obliged to conduct counseling/guiding, service, and supervision. In carrying out its functions, the Directorate General of Taxation strives to provide the best service to the public according to the vision and mission of the Directorate General of Taxation

Tax classification based on the collection authority in Indonesia can be divided into 2 (two) namely the Central Tax and Local Tax. **Central Tax** is the taxes administered by the Central Government which in this case is mostly managed by the Directorate General of Taxes **-** Ministry of Finance, while **Local Taxes** are taxes that are managed by the Regional Government at both the Provincial and District / City levels.

The taxes levied by the Provincial Government as well as the District / City are as follows:

1. Provincial Taxes, including:
    a. Vehicle tax;
    b. Transfer of Motor Vehicle Title;
    c. Motor Vehicle Fuel Tax;
    d. Surface Water Tax;
    e. Cigarette Tax.
2. District / City tax, including:
    a. Hotel Tax;

b. Restaurant tax;
c. Entertainment Tax;
d. Advertisement tax;
e. Street lighting tax;
f. Non-metallic and rock mineral taxes;
g. Parking Tax;
h. Groundwater Tax;
i. Swallow's nest tax;
j. Land Tax and Rural and Urban Buildings;
k. Acquisition of Land and / or Building Rights.

The central taxes administered by the Directorate General of Taxes include:

1. Income Tax (Income Tax)
   Income Tax is a tax imposed on an individual or an entity on income received or accrued within a tax year. Referred to as income is any additional economic capability received or obtained by a Taxpayer originating either from Indonesia or from outside Indonesia which may be used for consumption or to increase the taxpayer's wealth in question by name and in any form whatsoever. Thus, the income can be in the form of business profits, salary, honorarium, gift, and so forth.

2. Value Added Tax (VAT)
   VAT is a tax imposed on the consumption of Taxable Goods or Taxable Services within the Customs Area (within the territory of Indonesia). Persons, corporations, or governments that consume Taxable Goods or Taxable Services are subject to VAT. Basically, any goods and services are Taxable Goods or Taxable Services, unless otherwise provided by the VAT Act.

3. Sales Tax on Luxury Goods (PPnBM)
   In addition to VAT, the consumption of certain Taxable Goods classified luxury, also subject to PPnBM. The meaning of Taxable Goods classified as luxury are:

   a. It is not a basic necessity; or
   b. The goods are consumed by certain communities; or
   c. In general, the goods are consumed by high-income people; or
   d. It is consumed to show status; or
   e. If consumed can damage the health and morale of society, and disturb the public order.

4. Stamp Duties
   Stamp duties shall be imposed on the use of documents, such as letters of agreement, notarial deeds, and receipts of payments, securities and securities, containing the amount of money or nominal amount above a certain amount in accordance with the provisions.

5. Land and Building Tax (Property Tax)
   Property tax is a tax imposed on the ownership or use of land and / or buildings. This is a central tax but almost all realization of property tax revenue will be submitted to the Provincial Government either District or City.

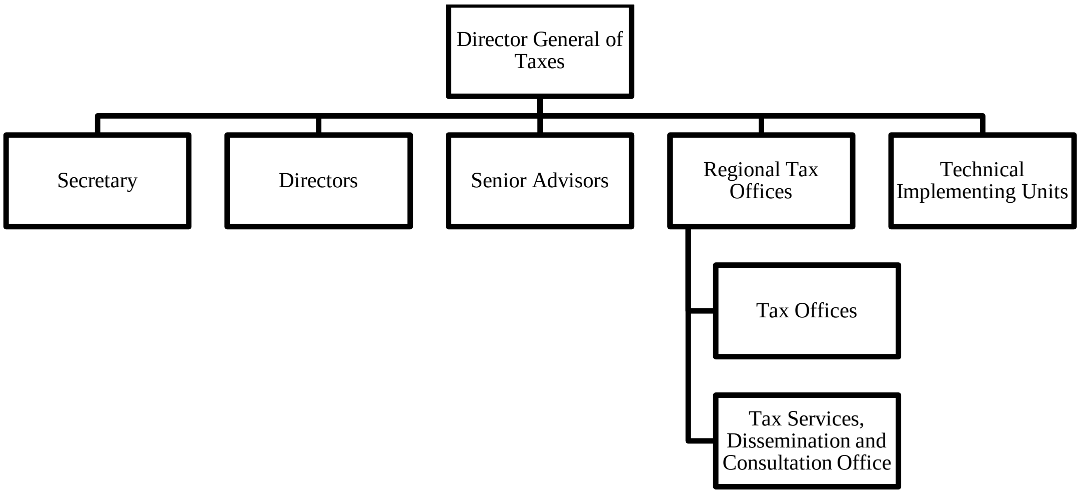
   Starting January 1, 2010, the UN Rural and urban areas become Local Taxes as long as the Regional Regulations on the United Nations relating to Rural and Urban Affairs have been issued. In the period from January 1, 2010 to December 31, 2013, the Regional Regulation has not been issued yet, the Rural and Urban Rural is still being collected by the Central Government.

   Beginning January 1, 2014, rural and urban UN is a local tax. For UN Plantations, Forestry, Mining is still a Central Tax.

III.2.2 Profile of Directorate General of Taxes

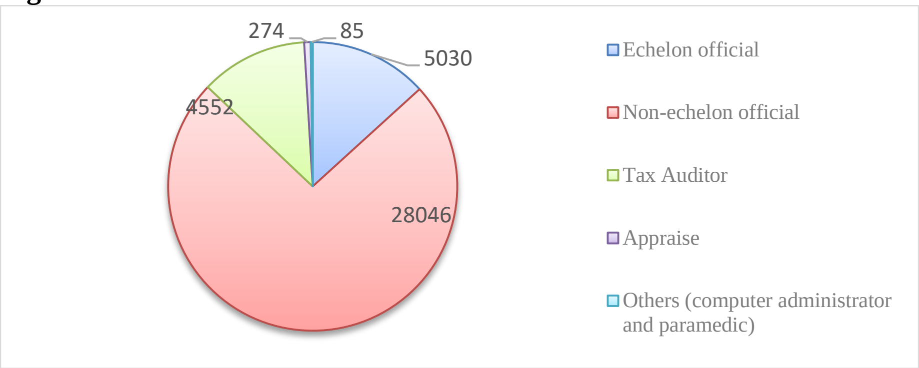
Directorate General of Taxes (DGT) is Indonesia's tax collection agency that responsible to formulate and implement policies in terms of taxes based on legislation. The Agency was organized as an Echelon I-unit under the Ministry of Finance. The DGT consists of the head office and operational offices. It supervises 33 Regional Taxation Offices, 1 Data Processing Center, 335 Tax offices throughout Indonesia, and 207 Tax Service, Dissemination, and Consultation Offices.

Figure 1. DGT Organization Chart



The number of personnel at DGT in 2015 is 37.987, increased by more than 3.000 persons from previous year. The distribution based on gender is 70.54% male and 29.46% female. Female number increased by 3% compared to the year 2014. According to job position, the number of personnel can be describe in the following chart 2.

Figure 2. Number of DGT Personnel



Source: Directorate General of Tax, annual report 2015

III.2.3 Tax Revenue

Realized net tax revenues in 2015 amounted to Rp 1.060.860.570.511.080,00 or 81.97 percent ofthe target, grew by 7.69 percent from previous year.Tax revenue growth in more details is described as follow:

Table 4. Net Tax Revenue

Year	Non-Oil & Gas Income Tax	VAT & Sales Tax on Luxury Goods	Land & Building Tax	Other Taxes	Oil & Gas Income Taxes	Total	
						Excluding Oil & Gas Income Tax	Including Oil & Gas Income Tax
2011	358.01	277.8	29.89	3.93	73.1	669.63	742.72
2012	381.60	337.58	28.97	4.21	83.46	752.37	835.83
2013	417.69	384.72	25.3	4.94	88.75	832.65	921.4
2014	459.08	408.83	23.48	6.29	87.44	897.68	985.13
2015	552.22	423.71	29.25	5.57	50.11	1,010.75	1,060.86

Source: Directorate General of Tax, annual report 2015

III.2.4 Taxpayers' Compliance

Taxes are the backbone of state revenue. More Than 75 Percent of National revenue derived from taxes. DGT continues to provide insight to the public awareness of paying and reporting taxes in continuing the sustainable development. To Improve Taxpayer compliance, DGT perform a variety efforts of creating simpler tax return submission. Besides by coming directly to the Tax Office (KPP) nearby, taxpayers may enter their tax return through the tax return drop box placed in various offices and shopping centers. With the growing use of the Internet in Indonesia, DGT also facilitate the delivery of tax return through the application of e-SPT which was developed since 2004.

Table 5. Compliance Ratio of Annual Income Tax Return Filling, 2012-2015

Taxpayers Category	2015	2014	2013	2012
Corporate	58.00%	47.40 %	47.85%	48.43%
Individual	60.63%	59.91 %	56.78%	52.55%
Overall Compliance Ratio	60.42%	59.12 %	56.21%	52.31%

Source: Directorate General of Tax, annual report 2015

To be a registered taxpayer, the registration can be done via e-registration or through the service counter in every district tax office. E-registration is one of the facility provided by DGT to increase the number of registered taxpayer. DGT also performs other efforts to arouse the awareness of the unregistered taxpayer through intensive socialization conducted in each level of institution, by tax district units at the local level, by the Counseling, Service and Public Relation field at Regional Office level, and by the Directorate of Counseling, Service and Public Relation at the head quarter level.

Table 6. Registered Taxpayer

Type of Taxpayers	2015	2014	2013	2012	2011
Individual	30,199,395	27,687,515	25,109,959	22,131,323	19,881,684
Treasurer	453,946	412,827	563,737	545,232	507,882
Corporate	2,682,781	2,474,086	2,328,509	2,136,014	1,929,507
Total	33,336,122	30,574,428	28,002,205	24,812,569	22,319,073

Source: Directorate General of Tax, annual report 2015

The socialization programs range from face to face through various workshops, seminars, sports events, car free day and other outdoor activities or indirect contact through www.pajak.go.id sites, television and radio electronic, print media newspapers, school text books and booklets, and by using online and social media.Socialization are intensively conducted by the unit of KPP, and units of Field Services, Education and Public Relations (P2Humas) Regional Office (Regional Office-Regional Office), as well as by the Directorate P2Humas Office DJP either through socializing face to face through various workshops, seminars, sports together, Car Free Day and many other outdoor activities, or socializing without face to face through www.pajak.go.id sites, television and radio electronic media, print media newspapers, school text books and booklets, and through online media and social media, are expected to raise awareness of the tens of millions of taxpayer.

III.3 Current Tax Regulation

III.3.1 Corporate Income Tax

III.3.1.1 Overview

A company will be considered taxable in Indonesia if it has a presence and conducts business in the country. This definition includes a place of management, branch, representative office, office building, agent, factory or workshop, construction or mining site. A firm required to register at the relevant DGT's office for their location/status on or shortly after establishment. Tax return should be filed annually by corporations to compute the income tax payable. The reported income includes all overseas income as the Indonesian tax law adopts the worldwide income basis. Tax paid offshore in relation to foreign source income can be credited in the same tax year subject to certain limitations.

III.3.1.2 Tax Rates

A single flat rate of 25 percent applies since 2010. Public company that satisfy a minimum listing requirement of 40 percent and other conditions are entitled to a tax discount of 5 percent off the standard rate, giving an effective tax rate of 20 percent. To be eligible, a public company must have at least 40 percent of the outstanding shares owned by at least 300 persons, each holding less than 5 percent of the paid-in shares, and this condition must be maintained for at least 183 days in a tax year. Small enterprises, i.e. corporate taxpayers with an annual turnover of not more than IDR 50 billion, are entitled to a tax discount of 50 percent of the standard rate for taxable income of up to IDR 4.8 billion.

III.3.1.3 Tax Residence

A company is treated as a resident of Indonesia for tax purposes by virtue of having its establishment or its place of management in Indonesia. A foreign company carrying out business activities through a permanent establishment (PE) in Indonesia will generally have to assume the same tax obligations as a resident taxpayer.

III.3.1.4 Taxable Income

The object of tax is income, which is defined as any economic benefit received or accrued by a taxpayer, whether originating from within or outside of Indonesia, which is used for consumption, or which increases the wealth of the taxpayer, in whatever name or form. For a company, income can be defined as follows:

1. Gross profits from business;
2. Gains upon the sale or transfer of property (realized capital gains);
3. Interest, dividends, and royalties (subject to certain exceptions);
4. Rents;
5. Income from debt forgiveness and;
6. Surplus on revaluation of assets (favorable tax rate may apply).

Exchange gains or losses resulting from normal movements in currency exchange rates are, in most cases, included in taxable income in the current fiscal year irrespective of whether they are realized or unrealized. Gains or losses arising from a change in currency rates resulting from a government regulation or decree (revaluation or devaluation) may be subject to special concessions.

III.3.1.5 Exempt Income

Excluded from the definition of taxable income are, among others:

1. Gifts or donations that are not related to the business or profession of the parties involved;
2. Dividends received by a resident company from another resident company, provided:
   The dividend is sourced from retained earnings, the recipient owns at least 25 percent of paid up capital.
   The holding companies no longer need to undertake any other business activities due to removal of the ”active business” criteria for holding companies. Therefore any interest expense incurred in relation to the holding company’s investment will not be deductible since the dividends received are not taxable.
3. Income received by venture capital companies in the form of profits or dividends, as long as the investee companies meet certain requirements and the companies are not listed on the stock exchange and.
4. Income From The capital invested by the Pension Fund, in the fields of certain specified by regulation of the Minister of Finance

III.3.1.6 Capital Gains Tax

Capital gains or losses may come from sales of a company’s assets. It is calculated as the difference between the sales proceeds and the tax written down value of the assets concerned. Capital gains are assessable while a capital loss is tax-deductible only if the asset concerned is used in the running of the business, i.e. for obtaining, collecting, and securing assessable income. The exemptions are for transactions in stock on the Indonesian stock market and on private property. The gain or loss is ignored and tax is instead charged on the transaction value. The tax rate is 0.1% of transaction value of stock, except for founder shares sold by founder 0.5% of transaction value. For Land and building, tax rate is 5 % of transfer value – final tax for individuals, foundations and for corporations.

III.3.1.7 Dividend

Tax is withheld from dividends as follows:

1. Resident recipients. Dividends received from an Indonesian company by a limited liability company incorporated in Indonesia (*Perseroan Terbatas*/PT), a cooperative, or a state-owned

company (BUMN/BUMD), are exempt from income tax if the following conditions are met: the dividends are paid out of retained earnings; and the company earning the dividends holds at least 25 percent of the paid-in capital in the company distributing the dividends;

If these conditions are not met, the dividends are assessable to the company earning the dividends at the ordinary tax rates alongside the company's other income. Upon declaration, dividends are subject to Article 23 income tax at 15 percent, which constitutes a prepayment of the corporate tax liability for the company earning the dividends. Dividends received by firma, commanditaires, foundations and similar organizations are always subject to 15 percent withholding tax. Dividends received by resident individual taxpayers are subject to final income tax at a maximum rate of 10 percent.

2. Non-resident recipients: 20 percent (lower for treaty countries) final withholding tax is due on dividends paid to a non-resident recipient.

III.3.1.8 Deductions

The taxable income is determined after deducting allowable deduction cost from gross income. The lists of allowable deduction cost are as follows:

1. The costs of deriving, recovering and conserving such income including, the costs of materials, wages, salaries of employees, employee bonuses, honoraria, cash allowances, interest, rent, royalties, travel expenses, waste treatment costs, insurance premiums, administrative costs, and taxes other than income tax;
2. Promotional and sales costs;
3. Bad debts, provided strict conditions are fulfilled;
4. Depreciation of the acquisition cost of property and amortization of costs incurred in obtaining rights and other costs that have a useful life of more than one year;
5. "Zakat" donations if paid to an approved body by a Moslem individual or Moslem-owned business;
6. Losses from the sale or transfer of assets;
7. Foreign exchange losses;
8. Costs of research and development performed in Indonesia;
9. Scholarships, apprenticeships and training costs;
10. Donations (as regulated by Government Decree) in relation to: National disasters, Research and development in Indonesia, The provision of educational facilities, and Development of sports;
11. The provisioning of reserves for re-forestation and closure/maintenance of industrial waste storage locations are deductible for these business sectors (as further regulated by Minister of Finance Decree);
12. Goodwill can be capitalized and amortized;
13. Office refreshments;
14. Prior year losses;
15. Contributions to a pension fund approved by the MOF.

Additionally, entertainment costs are an allowable deduction where they relate to securing, acquiring and collecting income, but substantiation requirements exist. Full details of each expense are required to be lodged with the annual tax return.

Moreover there are also some non-allowable deductions cost from gross income, the list as follows:

1. Benefits-in-kind (BIKs) (e.g., free housing, 50 percent of the acquisition and maintenance costs of certain company provided cars), except food and drink provided to employees in the workplace, employee benefits required for job performance, such as protective clothing and uniforms, transportation costs to and from the place of work, accommodation for ship crews

and the likes, the cost of providing BIKs in remote areas, and 50 percent of the acquisition and maintenance costs of cellular phones;

2. Private expenses;
3. Non-business gifts and aid, except Islamic alms ("Zakat");
4. Provisions: However, certain types of provision d. are claimable as deductible expenses: provision for doubtful accounts for banking and financing companies, insurance claims provision for insurance companies, deposit security provision for the Deposit Security Blanket Institution (LPS), reclamation provision for mining companies, forestation provision for forestry companies, and area closure and maintenance provision for industrial waste processing businesses;
5. Income tax payments;
6. Tax penalties;
7. Profit distributions;
8. Employer contributions for life, health and accident insurance and contributions to unapproved pension funds, unless the contributions are treated as part of the taxable income of employees;
9. Expenses relating to income which is taxed at a final rate, e.g., interest on loans relating to time deposits;
10. Expenses relating to income which is exempt from tax, e.g., interest on loans used to buy shares where dividends to be received are not subject to income tax;
11. Salaries or compensation received by partnership or firm as members where their participation is not divided into shares.

III.3.1.9 Losses

Losses may be carried forward for a maximum of five years. However, for a limited category of businesses in certain regions or businesses subject to certain concessions, the period can be extended for up to ten years. The carrying-back of losses is not allowed. Tax consolidation is not available.

III.3.1.10 Capital Allowances

Expenditure incurred in relation to assets with a beneficial life of more than one year are categorized and depreciated from the month of acquisition by the consistent use of either the straight-line or the declining-balance method, as follows:

1. Category 1 – 50 percent (declining-balance) or 25 percent (straight-line) on assets with a beneficial life of four years. Examples of assets in this category are computers, printers, scanners, furniture and equipment constructed of wood/rattan, office equipment, motorcycles, special tools for specific industries/services, kitchen equipment, manual equipment for agriculture, farming, forestry and fishery industries, light machinery for the food and drink industries, motor vehicles for public transportation, and equipment for the semi-conductor industry.
2. Category 2 – 25 percent (declining-balance) or 12.5 percent (straight-line) on assets with a beneficial life of eight years. Examples of assets in this category are furniture and equipment constructed of metal, air conditioners, cars, buses, trucks, speed-boats, containers and the like. The category also covers machinery for agriculture, plantations, forestry activity, fisheries, and for food and drink, and light machinery, logging equipment, equipment for construction, heavy vehicles for transportation, warehousing, and communication, telecommunications equipment, and equipment for the semi-conductor industry.
3. Category 3 – 12.5 percent (declining-balance) or 6.25 percent (straight-line) on assets with a beneficial life of 16 years. Examples of assets in this category are machines for general mining other than in the oil and gas sector, machines for the textile, timber, chemical, and machinery

industries, heavy equipment, docks and vessels for transportation and communication, and other assets not included in the other categories.

4. Category 4 – 10 percent (declining-balance) or 5 percent (straight-line) on assets with a beneficial life of twenty years. Examples of assets in this category are heavy construction machinery, locomotives, railway coaches, heavy vessels, and docks.
5. Building category – 5 percent (straight-line) on assets in the permanent building category with a useful life of 20 years; or 10 percent (straight-line) on assets in the non-permanent building category with a useful life of ten years. Included in the cost of the buildings is the land and building transfer duty (DAL&BR) on building rights.

Intangible property or costs, including the cost of extending building use rights, rights for business use, rights for use and DAL&BR on land rights with a useful life of more than one year, should be amortized on the following bases, as appropriate:

1. By using the straight-line or the declining-balance method at the rates specified in categories 1, 2, 3, and 4 under Depreciation, based on the useful life of the property:
   Category 1 - 4 years;
   Category 2 - 8 years;
   Category 3 - 16 years;
   Category 4 - 20 years.
   Membership of the category is determined on the basis of the nearest useful life (e.g., an intangible asset with a useful life of six years may fall under Category 1 or Category 2, while an intangible asset with a useful life of five years is under Category 1).
2. The costs of incorporation and expansion of the capital of an enterprise are claimed in full in the year in which the expenditure is incurred or are amortized using either the declining-balance or straight-line method at the following rates:
   Category 1 – 50 percent declining-balance; 25 percent straight-line
   Category 2 – 25percent declining-balance; 12.5percent straight-line
   Category 3 - 12.5 percent declining-balance; 6.25 percent straight-line
   Category 4 – 10 percent declining-balance; 5 percent straight-line

3. Costs incurred for acquiring the right to oil and natural gas concessions with a beneficial life of longer than one year are amortized using the production-unit method.
4. Costs incurred in the acquisition of mining rights, forest concessions, and other rights to exploit natural resources and natural products with a beneficial life of longer than one year are amortized using the production-unit method but not may not exceed 20 percent per annum.
5. Costs incurred before the commencement of commercial operations with a useful life of longer than one year are capitalized and amortized according to the rates set out.

   Subject to DGT approval, corporate taxpayers and PEs who maintain rupiah accounting may undertake a revaluation of their non-current tangible assets for tax purposes. This may be carried out once every five years. Each revaluation must include all business-related assets which are owned by the company and located in Indonesia, except for land and buildings (these may be omitted). Before requesting the DGT's approval, the company concerned must determine that it has settled all of its outstanding tax liabilities

   The revaluation must be conducted on a market or fair value basis. The market values must be determined by a government-approved appraiser. These are subject to DGT adjustments if the values, in DGT's view, do not represent the fair or market values of the assets. Once approved, the depreciation applied to depreciable assets must be based on the new tax book values (approved values) on the basis of a full useful life (in other words, as if the assets were new). The excess of the fair market value over the old tax book value of the revalued assets is subject to final income tax at a rate of 10 percent. Subject to DGT approval, taxpayers facing financial difficulties may pay this tax in installments over 12 months.

   Fixed assets falling under categories 1 and 2 must be retained at least to the end of their useful life. Land, buildings, and assets falling under categories 3 and 4 must be retained for at least 10 years of the revaluation date. Additional final income tax at a rate of 10 percent is imposed on the original revaluation gains if the revalued assets are sold or transferred before the end of this minimum retention period (this does not apply to assets transferred because of force *majeur*, assets transferred based on government decision/policy/court decision or assets transferred in the course of a tax-neutral business merger, a consolidation, or a business split and fixed asset withdrawal because of irreparable damage).

III.3.1.11 Tax Payments

Resident taxpayers and Indonesian PEs of foreign companies have to settle their tax liabilities either by direct payments, third party withholdings, or a combination of both. Foreign companies without a PE in Indonesia have to settle their tax liabilities for their Indonesian-sourced income through withholding of the tax by the Indonesian party paying the income.

1. Monthly tax installments (Article 25 income tax) constitute the first part of tax payments to be made by resident taxpayers and Indonesian PEs. As a prepayment of their current year corporate income tax liability, a monthly tax installment is generally calculated using the most recent corporate tax return. Special installment calculations apply for new taxpayers, finance lease companies, banks and state-owned companies, listed companies and other taxpayers with periodical reporting requirements.
2. The tax withheld by third parties on certain income (Article 23 income tax) or tax to be paid in advance on certain transactions (e.g., Article 22 income tax on imports) constitute other prepayments for the current year corporate tax liability of the income recipient or the party conducting the import.
3. If the total amounts of tax paid in advance through the year (Articles 22, 23, and 25 income taxes) and the tax paid abroad (Article 24 income tax) are less than the total corporate tax due, the company concerned has to settle the shortfall before filing its corporate income tax return. Such a payment is referred to as Article 29 income tax.
4. Certain types of income earned by resident taxpayers or Indonesian PEs are subject to final income tax. In this respect, the tax withheld by third parties (referred to as Article 4.2 income tax) constitutes the final settlement of the income tax for that particular income.
5. For foreign companies without a PE in Indonesia, the tax withheld from their Indonesia-sourced income by the Indonesian party paying the income (Article 26 income tax) constitutes a final settlement of their income tax due.

III.3.2 Individual Income Tax

III.3.2.1 Overview

The extent of the Indonesian income tax liability depends upon the individual's residence status in Indonesia. Resident individuals are taxed on their worldwide income, regardless of where such income arises or for whom work or services are performed. For Indonesian-source income, there is an extensive framework of withholding taxes so that income tax is often collected by deduction at source, for example in relation to employment income, interest, dividends, royalties, rent and income from sales of property, and listed shares.

Non-resident individuals are exempted from the worldwide income reporting obligation and tax is imposed only on income derived in Indonesia. Deductions are limited to individual personal allowances. Resident individual taxpayer who receive or earn annual income exceeding the income threshold must register with the tax office and file annual income tax returns. The tax return should state the individual's income, including compensation from employment, investment income, capital gains, overseas income, and other income. Tax return also provides a summary of the individual's assets and liabilities.

A family is generally regarded as a single tax reporting unit with only a single Tax Identification Number in the name of the head of the family (typically the husband). His wife and his dependent children's income must be reported on the same tax return in his name. A married woman has two options. She can choose to have her own tax identification number and report her own income tax return separately from her husband. Otherwise, she can merge her income to her husband's tax return.

III.3.2.2 Tax Rates

Most income earned by individual tax residents is subject to income tax at the normal tax rates:

Table 7. Individual Income Tax Rate

Taxable Income	Rate
Up to IDR 50,000,000	5%
Above IDR 50,000,000 up to IDR 250,000,000	15%
Above IDR 250,000,000 up to IDR 500,000,000	25%
Above Rp 500,000,000	30%

Source: Directorate General of Taxes.

III.3.2.3 Main Personal Relief

A new Annual non-taxable income (PTKP) for resident individuals started to implement on June 27 2016 are as follows:

Table 8. Individual Main Personal Relief

	Amount
Taxpayer	54,000,000
Spouse	4,500,000
Each dependent (max of 3)	4,500,000
Occupational expenses (5% of gross income, max Rp.500,000/month)	6,000,000
Employee contribution to Jamsostek for pension fund (2% of gross income)	Full amount
Pension maintenance expenses (5% of gross income, max Rp.200,000/month)	2,400,000

Source : Directorate General Of Taxes.

III.3.2.4 Tax Residence

Indonesian tax law distinguishes between resident and nonresident taxpayers. Residents are defined as individual if he/she fulfills any of the following conditions:

1. resides in Indonesia;
2. present in Indonesia for 183 days or more in any continuous 12-month period;
3. present and reside in Indonesia during the fiscal years and intend to remain there.

Nonresident taxpayers are individuals present in Indonesia for fewer than 183 days with no intention to reside. Nonresidents need not register for tax purposes. Resident individual taxpayers are taxed on their worldwide gross income less allowable deductions and nontaxable income. Nonresident employees in the oil and gas sectors are taxed on deemed salaries based on job titles. The provisions of tax treaties may override these rules.

III.3.2.5 Taxable Income

Income is defined as any economic benefit received or accrued by a taxpayer that is used for consumption or that increases the wealth of the taxpayer, in whatever name or form. The following types of income are subject to tax:

1. Compensation or payments received or earned in connection with work or services.
2. Lottery, prizes, and awards.
3. Gross profits from individual business activities.
4. Gains from the sale or transfer of assets.
5. Refunds of tax payments already deducted as expenses.
6. Interest.
7. Dividends, in whatever name or form, paid by a corporation, payments of dividends by an insurance company to policy holders.

III.3.2.6 Benefits-in-kind

Benefits in kind received by employees, including discounted or free housing, are not taxable to the employee nor deductible to the provider/employer. However, company cars and cellular phones provided to the employee are deductible at 50% of the acquisition cost by way of depreciating those assets over their useful lives (8 years and 4 years), while cellular phone refill vouchers and repair expenses can be claimed as deduction at 50%. A full deduction however applies to food and drinks provided to employees in the workplace and employee benefits required for job performance such as protective clothing and uniforms, transportation costs to and from the place of work, accommodation for ship crews and the like, and also for housing provided in remote areas approved by the Minister of Finance.

III.3.2.7 Tax Payments

A substantial part of individual income is collected through withholding by third parties. Employers are required to Withhold Article 21/26 income tax on a monthly basis from the salaries and other compensation payable to their employees. If an employee is a resident taxpayer, the amount of tax withheld should be based on the normal tax rates (as set out above). If he/she is a non-resident taxpayer, the withholding tax is 20 percent of the gross amount (and may be set at a lower rate under a tax treaty). Various other payments to individuals also call for withholding tax obligations from the payers. These include, among others: pension payments made by government-approved pension funds; severance payments; old-age security saving payments from Jamsostek; scholarships; fees for services; prizes/awards.

Typically the amount of tax withheld from this income is based on normal tax rates. Fees for certain professionals, such as lawyers, notaries, accountants, architects, doctors, actuaries and appraisers, are required to be calculated based on 50% of the gross income.

III.3.3 Tax rate for Small and Medium Enterprises and Individual Business

On 12 June 2013, Government Regulation No. 46 Year 2013 (GR-46) has been issued and effected from 1 July 2013. The regulation stipulates that individual and corporate taxpayers, except permanent establishments, with annual income up to IDR 4.8 billion are subject to final tax at 1%. It is intended for small and medium enterprises (SMEs), including individual businesses with small to medium range trading and services activities (other than professional services, such as: lawyers, accountants, translators, insurance agents, etc.). GR-46 is not applicable to construction services which the income is subject to final tax under the Government Regulation No. 51 Year 2008 as latest amended by the Government Regulation No. 40 Year 2009. Some categories of income also excluded from this rule such as employment income, capital income (interest, dividends, royalties), non-business – related capital gains, and other income such as: debt forgiveness and/or gifts. However, they are subject to normal income tax rates.

III.3.4 Withholding Tax

Indonesian income tax is collected mainly through a system of withholding taxes. Where a particular income item is subject to withholding tax, the payer is generally held responsible for withholding or collecting the tax.

III.3.4.1 Article 21 – Salaries and Other Payments to Individuals

Employers are required to withhold Article 21 income tax from the salaries payable to their employees and pay the tax to the State Treasury on their behalf. The same withholding tax is applicable to other payments to non-employee individuals (e.g., fees payable to individual consultants or service providers). Resident individual taxpayers without Taxpayer Identification Number (TIN / NPWP) are subject to a surcharge of 20 percent in addition to the standard withholding tax.

III.3.4.2 Article 22 - Imports

Article 22 income tax is typically applicable in the following events:

1. Import of goods;
2. Sale of goods to the government calling for payments from the State Treasury, the State Budget General Directorate, or certain state-owned companies;
3. Sale/purchase transactions of steel, automotive, cigarettes, cement, and paper products.
4. The sale/purchasing of very luxurious goods.

III.3.4.3 Article 4 (2) – Final Income Tax

Resident companies, PEs, representatives of foreign companies, organizations, and appointed individuals are required to withhold final tax from the following gross payments to resident taxpayers and PEs:

Table 9. Final Income Tax Rate

Description	Tax Rate
Rental of land and/or buildings	10%
Proceeds from transfer of land and building right	5%
Fees for constructions work performance	2/3/4%
Fees for constructions work planning	4/6%
Fees for constructions work supervision	4/6%
Interest on time or saving deposits and on Bank Indonesia Certificates (SBIs) other than that payable to bank operating in Indonesia and to government-approved pension funds	20%
Interest on bonds other than that payable to banks operating in Indonesia and government- approved pension funds	15%
Proceeds from sale of shares on Indonesian stock exchanges. Founder shareholders may opt to pay tax at 0.5% of the market price of their shares upon listing, otherwise, gains on subsequent sales are taxed under normal rules	0.1%
Income from lottery prizes	25%
Certain income received by individuals and corporate (except PEs) with gross turnover of not more than IDR 4.8 billion in one fiscal year.	1%

III.3.4.4 Article 23 – Residents

Certain types of income paid or payable to resident taxpayers are subject to Article 23 income tax at a rate of either 15 percent or 2 percent of the gross amounts. Income Tax Article 23 set at 15 percent rate of the gross amounts on dividends, interest (including premiums, discounts and loan guarantees fees), royalties, prizes and awards.

III.3.4.5 Article 26 – Non-Residents

Resident taxpayers, organizations, and representatives of foreign companies are required to withhold 20 percent tax from the following payments to non-residents:

1. On Estimated Net Income (ENI), being a specified percentage of the gross amount:

Table 10. Non Resident Estimated Net Income

Description	ENI	Effective Tax Rate
Insurance premiums paid to non-resident insurance companies:		
By the insured	50%	20%
By Indonesian insurance companies	10%	2%
By Indonesian reinsurance companies	5%	1%
Sale of non-listed shares by non-residents	25%	5%
Sale for by the non-residents holding of Indonesian of a conduit company companys hares/where PE serves as an intermediary	25%	5%

Where the recipient is resident in a country which has a tax treaty with Indonesia, the withholding tax rates may be reduced or exempted. Refer to withholding tax rates under treaties.

2. On gross amount, the object of tax would be: Dividends; Interest, including premiums, discounts (interest), swap premiums, and guarantee fees; Royalties, rents and payments for the use of assets; Fees for services, work, and activities; Prizes and awards; and Pensions and any other periodic payments. The notional annual is distributions of after-tax profits of a branch or PE. After-tax profits of a PE are exempt from withholding tax if they are reinvested in Indonesia in the form of

equity participation in a company established and domiciled in Indonesia for which the PE acts as the founder or one of the founders.

III.3.5 Value Added Tax and Sales Tax on Luxury Goods

Both Entity and individual, in whatever form, which in the course of its operations, produces, imports or exports taxable goods, conducts trading activities or renders taxable services, is required to register as a Taxable Entrepreneur with the DGT. However, only a resident or a PE can obtain a VAT registration. Registration by non-residents is not allowed.

III.3.5.1 Taxable Goods and Services

Value Added Tax (VAT) is typically due on events involving transfers of taxable goods or provisions of taxable services in the Indonesian Customs Area. The taxable events include:

1. Deliveries of taxable goods in the Customs Area by an enterprise;
2. Importation of taxable goods;
3. Deliveries of taxable services in the Customs Area;
4. Use or consumption of taxable intangible goods originating from outside the Customs Area in the Customs Area;
5. Use or consumption of taxable services originating from outside the Customs Area in the Customs Area;
6. Export of taxable goods (tangible and intangible) by an enterprise;
7. Export of taxable services by an enterprise.

Deliveries of taxable goods are defined very broadly and include the following:

1. Deliveries of a title to taxable goods according to an agreement;
2. Transfers of taxable goods according to a leasing-with-option or finance-lease agreement;
3. Deliveries of taxable goods to an intermediary trader or an auction official;
4. Own-use and/or free gift of taxable goods;
5. Remaining taxable goods and certain assets originally not for sale at a company's dissolution;
6. Deliveries of taxable goods within a company (e.g., between branches, or between the head office and its branches) unless the company, at the DGT's approval, centralizes its VAT reporting;
7. Deliveries of taxable goods on consignment;
8. Deliveries of taxable goods by a taxable entrepreneur in the framework of *syariah-based* financing, whereby the deliveries are deemed to take place directly from the taxable entrepreneur to the party in need of the taxable goods.

Indonesia have exemption on goods for basic necessities, mining taken from natural resources, food served in hotels and restaurants, including food and drinks provided by catering services, money, gold and securities. Some broad area of service fields also exempted under VAT law, they are medical, social and religious services, postal and account transfer services, banking, insurance and non-banking financial leasing, educational services, finance leasing, art and entertainment services, radio and television broadcasting services, other than advertisements, public transportation services, i.e. land, sea and domestic air transportation, manpower and recruitment services, hotel and boarding house services, services provided by the government relating to public administration and formality requirements, parking services, public telephone (by coin) services, food and catering services.

III.3.5.2 Tax Rates and Tax Base

VAT at the general rate of 10% is imposed on importers, manufacturers, wholesalers and retailersand on the provision of most services. While the VAT laws permit amendments of the rates for individual items, currently the products with a rate other than 10% are cigarettes and used cars. Services such as package deliveries and travel agents are taxed at 1%, while factoring is imposed at 5% on the fees received. Exports of taxable goods are effectively excluded from VAT by being subject to the tax at a nil rate.

By law all goods and services, unless stated differently, constitute taxable goods or taxable services. VAT for a particular taxable event is calculated by applying the VAT rate to the relevant tax base. In most cases, the tax base is the transaction value agreed between the parties concerned. For certain events or situations, other parameters must be used as the tax base, including:

1. Market value for transactions between related parties, remaining inventories of taxable goods at a company's dissolution, and sales of (non-inventorial) assets originally not for sale;
2. Cost of sales for own-use or free gifts and internal deliveries of taxable goods (e.g., between branches, from the head office to branches);
3. Auction price for deliveries of taxable goods to an intermediary trader of an auction officer;
4. Agreed price for deliveries of taxable goods through an intermediary trader
5. Average result per film for movies
6. IDR 12 million per copy of imported movies
7. 20% of total costs incurred or paid, exclusive of the acquisition price of land, for the self-construction of a building
8. Retail selling prices for deliveries or imports of tobacco products
9. 10% of the actual billing for package shipment services
10. 10% of the actual billing for tour and tourism agency services whose deliveries are not based on commissions
11. 20% of selling price on the deliveries of gold jewelry, including services carried out by the factory in relation to gold jewelry
12. 10% of actual billing on the deliveries of freight forwarding services in which billing includes freight charges.

III.3.5.3 Relief for Export Manufacturers

There are a number of relief schemes to allow exporter manufacturers to operate on a virtually VAT and duty-free basis. Such schemes include bonded zones, economic development zones (KAPET) and free trade areas. The Government has approved a number of Bonded Areas located throughout Indonesia. Free trade areas and free ports are located in Indonesia but are considered outside the customs area and, therefore, goods brought into these areas are exempt from import duties, VAT and STLG. Business activities that can be carried out in a free trade area include, among others, trade, services, mining, transportation, banking and manufacturing. Sabang, Batam, Bintan and Karimun are currently the free trade areas in operation.

III.3.5.4 VAT Reporting

Companies and individuals designated as taxable enterprises are bound to report their business activities and settle VAT liabilities thereon on a monthly basis. Typically VAT is to be accounted for on a decentralization basis. Hence, a company carrying out business activities through a number of business units (branches) in the working areas of different tax offices (KPP) must register each with the relevant KPP. It is in this context that internal deliveries of taxable goods within a company are subject to VAT.

Based on specific DGT approval, a company may centralize its VAT reporting and thereby may exclude internal deliveries of taxable goods from the VAT scope. To obtain DGT approval, a company must satisfy a number of conditions, including sales administration centralization and the restriction of the business units to be centralized from any deliveries of taxable goods. However, companies who file e-tax returns may choose to centralize their VAT reporting without regard to the fulfillment of the other conditions, merely by submitting a written notification to the DGT.

Despite this default VAT reporting basis, companies registered with certain tax service offices (Special Tax Office, Large Tax Office, and Medium Tax Office) are required to centralize their VAT reporting. VAT liabilities are typically to be settled by an input-output mechanism. A vendor of taxable goods or a taxable service is typically to charge VAT to the buyer. From the vendor's perspective, it is an output tax. The buyer has to pay the VAT to the vendor which, from its perspective, is an input tax. To the extent that the goods are relevant for running the buyer's business, the input tax can be credited against its own output tax. Similarly, the vendor will also offset the output tax against its own input tax on the acquisition of taxable goods or taxable services. If the accumulated output tax for a particular month exceeds the accumulated input tax for the same period, the taxpayer concerned has to settle the difference by the following month. On the contrary, if the accumulated input tax for a particular month exceeds the accumulated output VAT, the taxpayer may ask for a refund on the end of tax year or carry over the overpaid VAT to the following months.

Import VAT on goods and self-assessed VAT on the consumption or use of foreign taxable services or intangible goods may be understood in the context of the standard input-output mechanism. Because the non-resident vendor or service provider cannot charge VAT (issue tax invoices) to the Indonesian buyer/importer, the Indonesian buyer/importer has to pay the VAT for and on behalf of the non-resident vendor or service provider. To the extent that goods/services imported or procured are relevant for running the importer/service recipient's business, the input VAT (import VAT and self-assessed VAT) should be claimable as a tax credit. A deviation from the standard mechanism, however, prevails for deliveries of taxable goods and services to VAT collectors. Presently, a VAT Collector can be either the State Treasury or a Production Sharing Contract (PSC) company including Pertamina.

III.3.5.5 Input-Output Mechanism

As the name implies, a VAT Collector is required to collect the VAT due through a taxable enterprise (vendor) on the delivery of taxable goods or services to it and to pass the VAT payment directly to the government rather than to the vendor or the service provider. A company engaged in deliveries of taxable goods or services to a VAT Collector tends accordingly to be in an overpaid VAT position.

VAT must be accounted for to the DGT on a monthly basis. Input tax for a particular tax period (month) in principle must be claimed as a tax credit against the output VAT of the same tax period. However, the claim can still be made within three months after the end of that particular tax period to the extent that the input tax has not yet been expensed or a tax audit has not yet commenced.

Since July 1, 2016, DGT implementing the use of electronic VAT invoices (e-VAT invoice) for all VAT registered taxpayers. Similar to hard-copy VAT invoices, the VAT payer should also obtain the VAT serial numbers by requesting through the tax office where the VAT payer us registered and/or website provided by the DGT. The e-VAT invoice shall use IDR currency and apply electronic signature.

III.3.5.6 VAT Refunds

Refund application can be made at the end of a book year. The DGT has to decide on a VAT refund application within 12 months after receipt of the complete set of the application on the basis of a VAT audit. If no decision is made within 12 months, the application is considered to have been approved. Monthly refunds are possible for certain taxpayers such as exporters of goods or services, suppliers to the VAT collectors in the pre-production stage and suppliers of goods and services for which VAT is not collected.

Relevant supporting documents for a VAT refund must be delivered to the DGT within a month of the application date. Any documents delivered beyond a month may be ignored by the DGT in the calculation of the VAT refund.

A taxpayer designated as an obedient taxpayer is entitled to obtain early (pre-audit) VAT refunds. Such a refund is to be based only on a verification of the VAT returns and must be granted within a month after a completed VAT refund application is received. The DGT may conduct a tax audit after the early VAT refund is granted. If it proves, based on the tax audit, that the taxpayer has received a higher VAT refund than it should, the excess amount is subject to an administrative penalty at 100 percent. The obedient taxpayer designation is a status granted by the DGT to taxpayers who fulfill certain criteria, such as filing of tax returns on time within a certain period, no tax in arrears, no criminal involvement, etc. With reference to these criteria, the DGT every year designates certain taxpayers as obedient taxpayers. Once a taxpayer is granted this status, the company is eligible to apply for early VAT refunds. It has to notify the DGT in writing if it does not want to use the privilege.

III.3.5.7 Sales Tax on Luxury Goods (STLG)

The VAT law also imposes a STLG on deliveries of luxury goods by manufacturers in Indonesia and on the importation of luxury goods. The rates vary depending on the category of the goods. According to the VAT and LST Law, the LST rate may be increased up to 200%, however currently the LST rates are between 10 percent to 125 percent. Conceptually, this tax is charged only once. Like VAT, no STLG is charged on the export of luxury goods. STLG is calculated by multiplying the applicable rate against the sales price or import price, excluding VAT. The STLG payable on the purchase of luxury goods cannot be credited against the VAT collectable when the goods are subsequently sold.

In broad terms, some of the main types of goods subject to STLG include:

1. passenger vehicles;
2. alcoholic beverages;
3. certain food and non-alcoholic beverage products;
4. household appliances and electronic goods;
5. cosmetics;
6. luxury homes and apartments.
7. It is necessary to determine the applicability of the STGL on a case by case basis as the rules are complex and subject to change. There is an exemption from STGL on certain items for public use.

III.3.6 Treaties

Indonesia’s tax treaties provide for tax benefits in the form of withholding tax exemptions for service fees and for reduced withholding tax rates on dividends, interest, royalties, and branch profits received by residents of a country with which Indonesia has signed a tax treaty. Tax exemption on the service fees is typically granted only if the foreign party earning the income does not have a PE in Indonesia.

To claim the reduced rates, the foreign party must, at a minimum, present its certificate of residence (CoR) to the DGT through the Indonesian party paying the income. Without this document, the party isnot entitled to the tax benefit and tax is withheld at a rate of 20%. For interest, dividends, and royalties, only the beneficial owner is acknowledged as the party entitled to the tax treaty benefits.

III.3.6.1 Beneficial Owner

To be the beneficial owner, the following criteria should be satisfied:

1. For individuals, that they are not receiving income as an agent or nominee
2. An institution that is explicitly named in the tax treaty or one that has been agreed to by the Competent Authority in Indonesia and its treaty country partner
3. An offshore company which earns income through a custodian from share or bond transactions made on the Indonesian Stock Exchange (except interest and dividends), that is not an agent or nominee.
4. A company whose shares are listed on the stock exchange and traded regularly.
5. A bank, or
6. Any other company which meets specific requirements:
   a. establishment of the company in the tax treaty partner country and the way he transaction is structured or undertaken are not merely done to enjoy tax treaty benefits, the business activities are managed by the company's own management which has sufficient authority to carry out transactions;
   b. The company has employee(s);
   c. The company has activities or an active business;
   d. Income derived from Indonesia is taxable in the recipient's country.
   e. The company does not use more than 50% of its total income to fulfill its obligations to other parties, such as interest, royalty, or other payments.

III.3.6.2 Thin Capitalization

Indonesia started to implement new rule on thin capitalization in the beginning of fiscal year 2016. Based on Minister of Finance Regulation number 169/PMK.010/2015, the ratio of debt to equity has set as 4 to 1. The ratio used to limit the amount of deductible interest expense related to income tax calculation. Any borrowing cost on debt which exceeds this ratio will not be tax deductible for corporate income tax purpose. The rule applies to both related- and third-party debt, whether foreign or domestically availed. Some sectors are exempted from this regulation, such as banks, financial institutions, insurance and re-insurance companies, mining, oil and gas enterprises that are bound by production sharing contract, Contract of Work or Coal Contract ofWork which itself governs the DER. If the contract does not include a provision for the Debt to Equity Ratio or the contract has expired, PMK-169 will prevail. The exempted companies subject to final income tax and infrastructure companies.

III.3.6.3 Controlled Foreign Companies

The Ministry of Finance is authorized to determine when a dividend is deemed to be derived from a foreign company established in certain countries where an Indonesian resident taxpayer holds at least 50 percent of the paid-up capital of the foreign company or together with other resident taxpayers, holds at least 50 percent of the paid-up capital. This measure is established in order to curb tax evasion by resident taxpayers through offshore investments. This applies only if the foreign company does not trade its share on the stock exchange.

If no dividends are derived from offshore company, the resident taxpayers must calculate and report the deemed dividend in its tax return; otherwise, the Ministry of Finance will do so. The dividend is deemed to be derived either in the fourth month following the deadline for filling the tax return in the offshore country, or seven months after the offshore company's tax year ends if the country does not have specific tax filing deadline requirement.

The withholding tax rates applicable under tax treaties are summarized below:

Table 11. Indonesia Tax Treaties

Country	Dividends		Interest	Royalties	Branch Profit Tax
	Portfolio	Substantial Holdings			
Algeria	15%	15%	15% / 0%	15%	10%
Australia	15%	15%	10% / 0%	15% / 10%	15%
Austria	15%	10%	10% / 0%	10%	12%
Belgium	15%	10%	10% / 0%	10%	10%
Brunei	15%	15%	15% / 0%	15%	10%
Bulgaria	15%	15%	10% / 0%	10%	15%
Canada	15%	10%	10% / 0%	10%	15%
China	10%	10%	10% / 0%	10%	10%
Czech Republic	15%	10%	12.5% / 0%	12.5%	12.5%
Denmark	20%	10%	10% / 0%	15%	15%
Egypt	15%	15%	15% / 0%	15%	15%
Finland	15%	10%	10% / 0%	15% / 10%	15%
France	15%	10%	15%/10%/ 0%	10%	10%
Germany [1]	15%	10%	10% / 0%	15% / 10%	10%
Hungary [3 4]	15%	15%	15% / 0%	15%	20%
India	15%	10%	10% / 0%	15%	10%
Iran [7]	7%	7%	10% / 0%	12%	7%
Italy	15%	10%	10% / 0%	15% / 10%	12%
Japan	15%	10%	10% / 0%	10%	10%
Jordan [3]	10%	10%	10% / 0%	10%	20%
North Korea	10%	10%	10% / 0%	10%	10%
South Korea [2]	15%	10%	10% / 0%	15%	10%
Kuwait [4]	10%	10%	5% / 0%	20%	10% / 0%
Luxembourg [1]	15%	10%	10% / 0%	12.50%	10%
Malaysia [5]	15%	15%	15% / 0%	15%	12.50%
Mexico	10%	10%	10% / 0%	10%	10%
Mongolia	10%	10%	10% / 0%	10%	10%
Netherlands	10%	10%	10% / 0%	10%	10%
New Zealand [3]	15%	15%	10% / 0%	15%	20%
Norway	15%	15%	10% / 0%	15% / 10%	15%
Pakistan [1]	15%	10%	15% / 0%	15%	10%
Papua New Guinea [7]	20%	15%	15%/10%/ 0%	15%	20%
Philippines	20%	15%	15%/10%/ 0%	15%	20%
Poland	15%	10%	10% / 0%	15%	10%
Portuguese	10%	10%	10% / 0%	15%	10%
Qatar	10%	10%	10%	5%	10%
Romania	15%	12.50%	12.5% / 0%	12.5% / 15%	12.50%
Russia	15%	15%	15%	15%	12.50%
Seychelles	10%	10%	10% / 0%	10%	20%
Singapore	15%	10%	10% / 0%	15%	15%
Slovakia	10%	10%	10% / 0%	15% / 10%	10%
South Africa [4]	15%	10%	10% / 0%	10%	20%
Spain	15%	10%	10% / 0%	10%	10%
Sri Lanka [3]	15%	15%	15% / 0%	15%	20%
Sudan	10%	10%	15% / 0%	10%	10%
Sweden	15%	10%	10% / 0%	15% / 10%	15%
Switzerland [1 6]	15%	10%	10% / 0%	12.50%	10%
Syria	10%	10%	10%	20 % / 15%	10%
Taiwan	10%	10%	10% / 0%	10%	5%
Thailand	20%	15%	15%	15%	20%
Tunisia	12%	12%	12% / 0%	15%	12%
Turkey	15%	10%	10% / 0%	10%	10%
Ukraine	15%	10%	10% / 0%	10%	10%
United Arab Emirates	10%	10%	5% / 0%	5%	5%
United Kingdom	15%	10%	10% / 0%	15% / 10%	10%
United States	15%	10%	10% / 0%	10% / 0%	10%
Uzbekistan	10%	10%	10% / 0%	10% / 0%	10%
Venezuela	15%	10%	10% / 0%	20% / 10%	10%
Vietnam	15%	15%	15% / 0%	15%	10%

III.3.7 Stamp Duty

Stamp duty is nominal and payable as a fixed amount of either Rp 6,000 or Rp 3,000 on certain documents. Examples of documents subject to stamp duty are as follows:

1. Letters of agreement and other letters (such as authorization letters, letters bestowing gifts, or declarations) which are prepared for the purpose of being used as evidence of act, fact, or condition of a civil nature.
2. Notary's deeds and their copies.
3. Deeds prepared by a designated land notary ("Pejabat Pembuat Akta Tanah").
4. All documents bearing a sum of money which:
   a. State the receipt of money;
   b. State the recording or deposit of money in a bank;
   c. Contain notification of a bank balance;
   d. Contain the acknowledgement of debt wholly or partly paid or compensated;
   e. Are in the form of valuable documents such as drafts, promissory notes, or acceptances;
   f. Are in the form of securities, in whatever name or form;
   g. Are in the form of cheque.
5. Documents to be used as instruments of evidence before a court:
   a. Ordinary letters or internal papers
   b. Paper originally exempt from stamp duty on the basis of their purpose of use, if they serve other aims or are used by other parties, and deviate from their original purpose.

The Rp 6,000 rate is applicable to (a), (b), (c), and (e). For (d), the rate is Rp 6,000 when the money value stated in the document is more than Rp 1 million, and Rp 3,000 when the value is between Rp 250,000 and Rp1 million. Values below Rp 250,000 are not subject to stamp duty. For cheque, the rate is Rp 3,000 regardless of the monetary value stated.

III.3.8 Tax Incentives

III.3.8.1 Taxation on Merger and Acquisition

Gains resulting from restructuring which involves transfer of assets are assessable and based on market value. It includes business mergers, consolidations, or business splits. On the other hand, losses are generally claimable as a deduction from income. However, a tax-neutral merger or consolidation, under which assets are transferred at book value, can be conducted but subject to the approval of Director General of Taxes. The merger or consolidation plan in question must pass a business-purpose test in order to get this approval. Furthermore, the approval is also available for business splits which constitute part of an Initial Public Offering (IPO) plan.

III.3.8.2 Investment in Certain Business Fields and or Certain Regions

Special treatments are granted to taxpayers who invest capital in certain sectors and or in certain regions, regardless they are domestic corporation (domestic capital or foreign capital) or foreign corporations. Generally, a taxpayer will qualify for the Incentives below if they can fulfill the requirements that investment in certain business anywhere in Indonesia or investment in the certain business in certain area in Indonesia. Within 6 years after the receiving the approval on such incentives, the Company is not allowed to use the Approved Assets for other purposes or transfer all or part of the Approved Assets unless they are replaced with other new assets.

Companies investing in certain business sectors and/or in certain less developed regions having high priority on a national scale can be granted tax facilities in the form of:

1. Additional deductible expense in the form of Investment Allowance in the amount of 5 percent of Investment per year up to maximum of 6 years. The Investment shall be the cost of acquisition of fixed assets including land for main business activities (Approved Assets).
2. Accelerated depreciation or amortization of assets.
3. Withholding tax on dividend paid or payable to offshore at 10 percent or at the rate of prevailing tax treaty, whichever is lower.
4. Maximum 10 years of loss carry forward.

Based on Government Rule number 9 Year 2016, there are 145 business fields which can get tax allowance. Some of those fields are food industries, garment and textile, pulp and paper, industrial chemical materials; pharmaceutical industries; rubber and products made from rubber; iron and steel, machines and equipment; electronics; land transportation vehicles; ship building and reparation; cement (in papua, sulawesi, and nusa tenggara); products and packaging made from plastic (outside java); geothermal exploitation; oil refining; and mini natural gas refining.

III.3.8.3 Bonded Zones

The industrial companies which are located in the bonded areas are provided with many tax incentives as follows;

1. Postponement of import duty;
2. Non-collection of VAT, LST and article 22 Income Tax;
3. Exemption of excise.

Exemption of Value Added Tax and Sales Tax on Luxury Goods on the delivery of products for further processing from bonded zones to their subcontractors outside the bonded zones or the other way around as well as among companies in these areas.

III.3.8.4 Foreign-Grant or Foreign-Loan-Funded Governmental Projects

Goods, materials and construction equipment imported by a main contractor in connection with an approved government project funded by foreign loans or grants are entitled to the following relief:

1. Exemption from import duty;
2. Non-collection of VAT and LST and
3. Non-collection of import income tax (article 22)

If a qualifying project is only partially funded by a foreign loan or a foreign grant, the tax facilities are determined proportionate to the amount of loan or grant.

III.3.9 Tax Assessments and Tax Audits

III.3.9.1 Tax Assessments

Indonesian taxation relies on a self-assessment system under which taxpayers are trusted to calculate, pay, and report their own taxes by themselves in accordance with prevailing tax laws and regulations. However, the DGT may issue tax assessment letters to a particular taxpayer if it finds that, based on a tax audit or other information the taxpayer has not fully paid its tax liabilities. A tax assessment letter may also be issued by the DGT to a taxpayer who ignores a warning letter to file a tax return in a specified period. Failure to maintain books in accordance with the prescribed standards is another condition that may lead the DGT to issue an official tax assessment.

One tax assessment letter pertains only to one specific tax for one particular tax period or year and typically takes into account the following factors such as the tax due, the applicable tax credits, the resulting balance between the tax due and the tax credits (overpaid, nil, or underpaid) and the administrative penalty (interest or a surcharge).

III.3.9.2 Types of Tax Assessment Letter

The name of a tax assessment letter refers to the resulting balance between the tax due and the tax credits and accordingly there are three types of tax assessment letters:

1. Overpaid Tax Assessment Letter (OTAL) if the tax due is less than the tax credit amount;
2. Underpaid Tax Assessment Letter (UTAL) if the tax due exceeds the tax credit amount;
3. Nil Tax Assessment Letter (NTAL) if the tax due amount is equal to the tax credit amount.

III.3.9.3 Tax Audits

According to Article 29 of Law concerning the General Provisions and Tax Procedures, the Directorate General of Taxes is authorized to perform audit to assess tax compliance (consist of risk based audit and routine audit) and for other purposes in respect of the implementation of the tax laws and regulations. Tax compliance audit is generated by 2 cases. The first case is mandatory by tax law in respect to the taxpayer's rights and obligations, and the second case is audit which performed when DGT detect the risks or tax gap from the business sector or specific tax payer which proposed by bottom-up risk analysis and top-down risk analysis.

III.3.9.4 Objectives of Tax Audit

In the framework of exercising administrative supervision, the Directorate General of Taxes shall undertake audit for the purpose of assessing tax compliance and for other purposes in respect of the implementation of the tax laws and regulations.

1. Audit for the Purpose of Assessing Taxpayer's Compliance
   Audit to assess taxpayers compliance is conducted to certain categories :
   a. overpayments tax return including those that have been granted preliminary tax returns;
   b. loss reported tax return;
   c. overdue or not-submitted tax return (beyond the time period specified in the Letter of Reprimand) delivered;
   d. Doing a merger, consolidation, division, liquidation, dissolution, or intend to leave Indonesia permanently;
   e. Tax return that meet the selection criteria based on the results of the analysis (risk based selection) indicating of non compliance to the tax regulation.
2. Audit for Other Purposes
   The audit for other purposes shall be conducted with regard to implementing of tax laws or tax

regulations regarding the following criteria:

a. Issuing taxpayer identification number ex-officio;
b. Terminating taxpayer identification number;
c. Confirming or revoking taxable person for Value Added Tax (VAT) purposes;
d. Taxpayer lodges objection;
e. Collecting material for determination of net deemed profit;
f. Verifying data and or information;
g. Determining whether taxpayer is located at remote area;
h. Designating one or more places where VAT is payable;
i. Audit in the framework of tax collection;
j. Determining the commencement of production or extending the time period of loss compensation relating to granting tax incentives; and or
k. Fulfilling information request from treaty partner country with respect to the implementation of exchange of information of the tax treaty.

The scope of audit for other purposes in respect of the implementation of the tax laws and regulations may cover determination, verification, or collection data and information in accordance to the purpose of audit.

III.3.9.5 Closing Conference

At the end of a tax audit, the tax auditors will provide the taxpayer being audited with a written notification of the tax audit findings containing their proposed tax audit corrections. The taxpayer will typically have to respond to the notification in writing within 7 days. In certain cases, at the tax auditors' discretion, the time limit can be extended up to 21 days. By the end of the third week of the notification, a final discussion about the tax audit findings (closing conference) will be held between the tax auditors and the taxpayer.

A closing conference will serve as the last opportunity for the taxpayer to reassert its position with regard to the tax audit corrections and to present the relevant supporting documents. The tax auditors may change some of the suggested corrections in light of the taxpayer's response to the tax audit findings notification and the closing conference discussion. The results of the final discussion are then summarized in a closing conference document. The taxpayer will have to state agree or disagree with each of the proposed corrections therein. The document should also set out which part of the taxpayer's arguments are accepted by the tax auditors and accordingly lead to the cancellation or reduction of some particular suggested corrections. By the end of the closing conference, the tax auditors and the taxpayer have to sign the closing conference document. The correction agreed to in the closing conference document will constitute a basis for the minimum amount the taxpayer must pay of the tax assessment issued based on document.

III.3.10 Tax Dispute and Resolution

A tax dispute between a taxpayer and the DGT will typically arise following the issuing of a Tax Collection Letter (TCL) by the DGT which the taxpayer does not agree with. A UTAL, an AUTAL, and a TCL constitute legal tax collection instruments based on which the DGT may issue a Distress Warrant if the taxpayer fails to settle the underpaid tax on time. The way the DGT executes the Distress Warrant may still give rise to another tax dispute between the parties. Apart from this, a tax dispute may also arise between 2 taxpayers because one taxpayer has withheld too much tax from the income payable to the other taxpayer. What follows is a discussion on the ways available to resolve such tax disputes.

III.3.10.1 Objections and appeals

A taxpayer who does not agree with a tax assessment letter can file an objection to the DGT office within three months of the issue date. The Objection must state the tax due in accordance with the taxpayer's calculation and set out the reasons for his/her disagreement with the DGT tax assessment. A taxpayer that is going to file a tax objection with the DGT over an assessment letter must pay at least amount payable that has been agreed by the taxpayer in the closing conference during tax audit or verification process, before submitting the objection letter. With respect the unpaid portion of the assessment penalties will subsequently be applied if the taxpayer's objection is rejected or a subsequent tax appeal to the Tax Court is unsuccessful. The DGT has to issue a decision on the tax Objection within 12 months of the filing date of the Objection. If no decision is issued by the DGT within 12 months, the objection is automatically deemed approved by the DGT. If the objection is rejected by the DGT, any underpayment is subject to a surcharged of 50 percent. However, the underpaid tax and the surcharge are not payable if the taxpayer files an appeal with the tax court in respect of the objection decision.

An Objection may also be filed by a taxpayer with the DGT office with respect to tax withheld by a third party. The same time limits to file the Objection and for the DGT to decide upon it apply to this type of Objection. A taxpayer who does not (fully) accept the DGT Objection decision can file an Appeal with the Tax Court within three months of the receipt of the DGT Objection. To the extent the DGT Objection Decision calls for a payment of tax due, according to the tax court law, at least 50 percent of the tax due must be settled before filing the Appeal. According to the 2007 tax administration law, this requirement is no longer applicable. The Tax Court will typically have to decide on an Appeal within 12 months. Any underpaid tax amounts resulting from the tax court decision are subject to a surcharge of 100 percent.

III.3.10.2 Another avenue for tax dispute resolution

The DGT, following a taxpayer request or by virtue of its official position, may correct or cancel a TCL, or their derivatives issued based on those letters. The derivatives include, among others:

1. Objection Decision Letters;
2. Decision Letters on the Reduction or Cancellation of Administrative Sanctions;
3. Decision Letters on the Reduction or Cancellation of a Tax Assessment;
4. Decision Letters on an Early Refund of Overpaid Tax.

A Correction Request is an alternative for a taxpayer to the Objection by which to solve a dispute with the DGT in respect of a particular tax assessment letter. This avenue is also applicable for other tax disputes arising from virtually any other DGT decision. However, lodging an objection is generally regarded as a more robust approach. The DGT has to issue a decision on an Amendment Request within 6 months of the filing date. If no decision is issued by the DGT within 6 months, the Correction Request is automatically deemed to be approved by the DGT.

Taxpayers who do not (fully) accept the DGT Decision on an Correction Request can file a lawsuit with the Tax Court within 30 days of the receipt of the DGT decision. A lawsuit against the DGT can also be filed with the Tax Court with respect to the execution of Distress Warrant. In this respect, the lawsuit must be filed no later than 14 days of the execution date. The Tax Court will typically have to decide on an appeal within 6 months.

III.3.10.3 Judicial Review Request to the Supreme Court

A Tax Court Decision is considered to be a final decision bearing full legal force. However, the parties involved in a tax dispute may file a Judicial Review Request related to a Tax Court Decision. This can be done only if any of the following conditions prevail:

1. Tax Court Decisions based on falsehood or trickery;
2. There is written evidence of new important and decisive;
3. Granted something that is not accused or more than accused;
4. There is a part of the claim has not been concluded without considering its causes;
5. Decision on manifestly incompatible with the provisions of applicable law.

III.3.11 Tax Investigation

Tax (crime) investigation is the ultimate tax enforcement conducted when other approaches e.g. reminder, counseling, and audit are considered to be ineffective. This principle is known as “ultimum remedium” in *Law No. 28/2007 on General Tax Provisions and Procedures*. In details, the criminalization is stated on article no. 38, 39, and 39A of the Law.

In general tax crime can be divided into 2 categories:

1. Pure tax crime case, mostly related to invoice with fictitious transaction and other fictitious tax documents, is where a clear proof of crime usually detected within tax administration. For such cases, tax investigation takes the first place to conduct with covered preliminary-investigation since generally also involving fake identity of the doer.
2. Escalated tax fraud case, is the other kind of fraud by illegally evading from paying the correct amount of tax or other tax obligation. At first most of the cases can be treated with other kind of enforcement(s) such as counseling and audit, but at some extents investigation is required. This criminalization requires tax investigation to be preceded by the other enforcement(s), and even in a preliminary-investigation, tax payer can avoid investigation door by self-declaring a correction or an adjustment related to emerged data or information in accordance with tax regulations.

Among what stated in the law, there are four major modus operandi of tax crime, as follows:

1. Issuing and/or using tax invoice which is not based on real transactions
2. Withholding but do not pay the withheld tax
3. Submitting Tax Return by filing incorrect or incomplete information
4. Not submitting the Tax Return

Tax Investigation can only be conducted by Certified Tax Officers within DGT with technical support from the Police. And it is possible that tax investigator finds money laundry indication and extend the investigation based on money laundry law. Though it will burden more proofs and works, it is preferable since giving heavier charges for a stronger deterrent effect. Deterrent effect or preventive effect is the main purpose of tax investigation. The tax criminalization should be a warning to all the tax payers, so that they will do tax obligation responsibly.

III.3.12 Taxpayer rights

In order to provide more justice in the field of taxation between the balance of state rights and the rights of taxpayers, the Law on Taxation, namely the Law on General Provisions and Tax Procedures accommodate the various rights of the Taxpayers. Based on the law, the taxpayer rights can be compiling as follows:

1. To obtain TIN and or taxable person for VAT purpose Identification number after registering and reporting his business.
2. On a request, to extend the period to file annual tax return.
3. To receive a proof of receipt for a tax return filed directly to the DGT.
4. To amend the tax return.
5. On a request, the right to install or postpone the tax payment.
6. To request for correction of a notice of tax assessment.
7. The right for a refund of a tax overpayment within a maximum period of one month since the request is received due to the issuance of a notice of tax overpayment assessment.
8. To appoint a proxy by a power of attorney to exercise rights and fulfill tax obligations.
9. To obtain secrecy guarantee through official secrecy provisions.
10. To file a request for deduction or annulment of administrative penalties in the form of interest, fine and surcharge due to taxpayer's disregard or other than his intentional faults.
11. To file a request for deduction or cancellation of incorrect tax assessment.
12. To refuse a tax auditor who doesn't possess an auditor identity card, is not provided with an audit order or doesn't show them to the audited taxpayer.
13. To file a request for appeals to the tax court against decision on objection which is still considered in appropriated.
14. To file additional reasons or written explanations before a decision on objection is issued.
15. The right to file an objection on a notice of tax assessment.
16. The right to extend the period to file an objection due to circumstances beyond his control.
17. The right to obtain written information on matters which constitute the basis for imposition of tax in order to file a objection.
18. The right to obtain a decision on objection no latter 12 months since the date the objection is received by DGT. If after the time limit has elapsed, there is no decision issued, the objection shall be considered to be granted.
19. The right for a statue of limitation in a law suit of tax crime , that is a period of 10 years after the date a tax is payable or after the end of a taxable period, a fraction of a taxable period or a taxable year.
20. The right for termination of tax crime investigation when the taxpayer has paid in full the unpaid or underpaid tax or the tax which should have not been refunded, added with administrative penalty in the form of fine of 4 times of the amount of the unpaid or underpaid tax or the tax which should have not been refunded.

III.3.13 Taxpayer obligations

On the other hand, taxpayer must fulfill the obligations as follows:

1. To register and/or report his business.
2. To obtain and fill out his annual tax return correctly, completely and clearly and sign and file it to the DGT before the due date.
3. To submit a statement estimating the amount of a tax payable for a taxable year and proof of settlement of the tax payable in the case that the taxpayer files a request to extend the period to file annual tax return.
4. In case a taxpayer is an entity, the tax return must be signed by any member of the management or board of directors.
5. In case a tax return is completed and signed by other than the taxpayer, a power attorney must be attached.
6. For a taxpayer who maintains bookkeeping, his annual tax return must be accompanied with financial statement in the form of balance sheet and income statement and other information.
7. To pay an administrative penalty of 2% interest per month o the amount of tax under paid if the taxpayer voluntary amends his tax return resulting an increase in the amount of tax payable.
8. To pay or remit tax payable at state treasury or any other place of payment stipulated by Minister of Finance.

9. To pay any underpaid tax as stated in annual tax return at the latest of the 25th of the third month after the end of a taxable year.
10. Taxpayer conducting business activities or independent personal services in Indonesia is obliged to keep book and record pursuant to the provisions of the tax laws.
11. Individual taxpayer who according to the provisions of the tax laws is permitted to calculate net income by using the calculation norm is obliged to maintain records.
12. To store books, records and documents used as a basis of bookkeeping or recording for 10 years in Indonesia.
13. Keep book and record or recording in good faith, which reflects the facts or the real business activity.
14. Secure approval from DGT on changing in the method of bookkeeping and or accounting year.

IV. Country Specific Fiscal Issues

IV.1 Tax Amnesty (Update)

Tax Amnesty Program that started on July 1, 2016 has already closed by the end of March 2017. While Tax Amnesty Program is intended to reach main objectives, as follows:

1. To accelerate economic growth through asset repatriation. Economic growth expected to achieve are in terms of increase in domestic liquidity, strengthen the exchange rates and increase in investment.
2. To strengthen the tax reform towards fairer justice system. The law will contribute to more valid, comprehensive, integrated data and reliable calculation of tax potential.
3. To increase the tax revenue both short and long term. Short term revenue through inflow of redemption money and long term acceptance by more accurate tax base

that are still being evaluated, there have been some consequence updates of the program.

IV.1 .1 Tax Amnesty Revenue

Tax Amnesty Program is targeted to collect IDR 165 trillion (US $12.68 billion) for nine months. More than 350,000 taxpayers declared their assets in the first phase of the amnesty, which covered the period of July to September 2016. Based on Asset Declaration Letter for Tax Amnesty, the amount of redemption fund collected in the first phase was IDR 89.1 trillion but the actual revenue collected through redemption fund inflow (based on tax payment slip data) was IDR 97.2 trillion (US $7.49 billion) or more than 50% of the targeted amount. Asset declared through the same phase was IDR 3,621 trillion (US$ 279 billion).

The final result of tax amnesty revenue are described in the following table:

Table 12. Redemption Money Revenue

Type of Declaration	Total Revenue (IDR Trillion)
Declaration of domestic asset	4.881
Declaration of offshore assets without repatriation	1.036,37
Declaration of offshore assets with repatriation	146,69

Source: https://www.pajak.go.id

with the total participants and declaration letter as follows:

Table13. Declaration Letter

Tax Payer Type	Number of Tax Payer	Number of Declaration Letter
Individual	413.631	447.435
Company	125.784	130.500
Small and Medium Individual	321.895	338.517
Small and Medium Company	111.238	112.738
Total	972.548	1.029.190

Source: https://www.pajak.go.id

Taxpayer type grouped based on different tariff applied, and the different between number of taxpayer and number of declaration letter is because of revision made by taxpayer. As the program officially closed, the tax amnesty statistics has already been concluded, the physical documents are stored in a secure place, and digital data has already been integrated into database system.

IV.1 .2 Consequent Regulation

After the tax amnesty, Finance Minister Sri Mulyani issued Minister of Finance Regulation (PMK) Number 165 / PMK.03 / 2017 concerning Voluntary Asset Disclosure procedure with Final Rate (PAS-Final). Previously from some existing data mentioned that the potential money of Indonesian people circulating abroad so big, more than Rp11.000 trillion. Allegedly there are still treasures that have not been revealed or have not been repatriated. Meanwhile, the tax amnesty period has expired or in other words, "No more Amnesty Taxes".

In the Post Amnesty Tax period we are facing today, there are consequences that must be faced for Amnesty Tax participants who have not reported the property properly, or do not repatriate within 3 years, transfer the treasures out of Indonesia within 3 years, or for non-participants of Amnesty Tax as provided for in Article 18 of the Tax Amnesty Law. Under these provisions, the taxpayer may be subject to sanctions of up to 200% of unspecified or under-expressed property.

Therefore, PAS-Final is intended to provide opportunity to as many taxpayers who still have not reported the property properly in the Statement of Assets (SPH) for Amnesty Tax participant or in SPT for non-Tax Amnesty participants. PAS-Final provides facilities to taxpayers so as not to be subject to sanctions Article 18 of the Tax Forgiveness Law on the terms of the taxpayer has not been examined. In this case the PAS-Final endeavors to provide justice, service, convenience, and of course encourage taxpayer compliance.

Considering the Directorate General of Tax (DGT) continues to process data-matching with third parties including 67 government and private agencies, the gap for taxpayers to hide the assets is definitely small. Moreover, DGT has now been authorized in accordance with Law No. 9 of 2017 to access financial data owned by financial institutions, including in 2018 DGT has the authority to exchange financial data with 100 other countries. Therefore, tax inspectors will surely find the potential of property hidden by the taxpayer with armed with hundreds of data that has been obtained by the DGT.

The current tax law has stated obligation to declare assets owned by tax payers in their tax filing return. And by the end of tax amnesty program, undeclared assets will be assumed as new income and taxed accordingly.

Undeclared assets will be taxed with final tariffs as follows: 25 % for corporate, 30 % for personal, and 12,5% for specific (small and medium) individuals. Penalty of 200% in addition to the final tax will be imposed on undeclared assets that belong to tax amnesty participants, while for nontax-amnesty participants only 2% monthly interest will be imposed. However by the newly issued regulation, there is still room to avoid the penalty. Tax payers are allowed to self-declared (again) their assets with only final tariff imposed as long as they are not being audited. This regulation is currently being disseminated.

Tax amnesty participants have got benefits offered by the program as follows:

1. Tax clearance, there is no tax obligation in the past will be accounted,
2. Administration sanction is abolished on outstanding assessment letter,
3. Current Tax Audit, Preliminary Investigation, and Investigation is stopped,
4. The omission of tax on property transfer.

However, in the second “invitation” to declare assets, tax payer will not enjoy such facilities other than the penalty omission.

IV.2 E-Commerce Taxation

E-commerce grows from time to time, including in Indonesia. Though the number of e-commerce user and revenue are relatively low compared to other major countries, the growing is considered significant. The trend can be described from the following table:

Table 14. E-commerce Revenue Trend

($ million)

Nation	2013	2014	2015	2016
China	181,62	274,57	358,59	439,72
Japan	118,59	127,06	135,54	143,13
Korea	18,52	20,24	21,92	23,71
India	16,32	20,74	25,65	30,31
Indonesia	1,79	2,60	3,56	4,89

Source: http://www.jraba.org,Jurnal Riset Akuntansi dan Bisnis Airlangga,

There is no different treatment between e-commerce and conventional businesses in the current tax law. Through self-assessment system, there should be no serious obstacle for taxpayer to fulfill their tax obligation. In 2013, DGT has release a circular letter to explain how e-commerce is implemented in tax perspective. Included in the explanation are:

1. Classified ads,
2. Market Places,
3. Retail Online,
4. Daily Deals,

that actually can be interpreted into conventional transaction models, and then tax can be imposed accordingly.

Since it is hard to monitor and to control e-commerce, the corresponding tax compliance seems relatively low. On the other hand, e-commerce grows fast with increased complexities. Some issues such as cross border transaction (territorial matter), new model transaction, new models of payment, digital transaction record, and the other digital innovation has become government attention, especially tax authority. There is an expectation to impose tax on e-commerce transaction with specific regulation, even though using current regulation, DGT has succeeded collecting tax from Google, one of the biggest e-commerce entity, for their corresponding transaction in accordance with Indonesian tax rules.

While discussion on e-commerce taxation continues, the government has intention to boost the economy from E-commerce by issuing The President Regulation on Road Map E-Commerce, dated on July 21, 2017. Government look forward the potential economy from this segment. This road map also provides platform for potential e-commerce tax regulation.

V. Conclusion: Where We Stand and Where We Go?

V.1 Global Environment

In 2016, the Indonesian economy remained resilient. The major role played by domestic demand and policy responses set in motion proved adequate to mitigate multifaceted risks from the global economy that could have weighed down on the performance of the economy. Indonesia’s economic growth returned to an upward trend in 2016, buoyed by sustained macroeconomic stability. The gains in the economy were also accompanied by more robust synergy in both cyclical and structural policy. Looking forward, the outlook for economic recovery will continue despite various global and domestic risks that call for vigilance. Therefore, policy synergy will be strengthened further to forge greater economic resilience that will serve as a vital pillar in accelerating sustainable economic recovery.

Government responses this situation with doing policy mix responses, maintain macroeconomic stability and financial system stability (FSS) and also capitalizing momentum of recovering economy.

V.2 Fiscal Policy

As part of the implementation of the National Development Planning System, in 2015 the DirectorGeneral of Taxes set DGT Strategic Plan Year 2015—2019 through the Director General of Taxes DecreeNo. KEP-95/PJ/2015 which was the medium-term strategic planning document for a period of five years.The strategic planning document included the establishment and elaboration of the vision and mission,policy objective, destination statement, strategic objectives and key performance indicators, as well asDGT strategic initiatives and programs.

The Policy Objective from 2015-2019 has been set as follows:

1. Year 2015, Guidance year of taxpayer’s compliance,
2. Year 2016, Law Enforcement
3. Year 2017, Reconciliation
4. Year 2018, Sinergy of Government Agencies, Institution, Association, and other parties,
5. Year 2019, State Budget Self-Reliance.

Even though the time arrangement may be changed, the policy objectives are still remain the same.

In addition, targets for taxation revenue will be achieved under an extra efforts policy with the following actions: optimizing audits with focus on individual high-performing sectors, transfer pricing and fraud; broadening of the tax base and intensification of tax receipts through measures to optimize use of IT, e-tax invoices and improvements to regulations; and campaigning the year of law enforcement.

V.3 Challenge on Tax Administration

Indonesia signed a multilateral competent authority agreement on automatic exchange of financial account information on 4 June 2015 and committed to apply the common reporting standard (CRS) issued by OECD. The implementation of exchange of information that will come into effect on September 2018. With the upcoming implementation of the global automatic exchange of information (AEOI) between tax authorities, Indonesia government will have more access to increase tax compliance and reduce tax evasion. Before the implementation of AEOI, Indonesia will begin a gradual exchange of information with the US government in September 2016 under the FATCA scheme.

FATCA requires the FFI should report to the US government for information related to the financial accounts owned by US residents or other entity in which the US citizen holds a substantial ownership interest. The exchange of information could strengthen the position of the government in preventing tax base erosion cause by the transfer of funds to the low tax jurisdiction. Indonesia's participation in international cooperation is one of the efforts to overcome the world financial crisis.

On the other side, Tax Amnesty Program has already been closed, but the homework related to the objectives are still become tax administration challenges highlighted as follows:

1. To monitor repatriation in order to accelerate economic growth through asset repatriation.
2. To strengthen law enforcement towards fairer justice system. The law will contribute to more valid, comprehensive, integrated data and reliable calculation of tax potential.
3. To manage the tax amnesty data, reconcile and use them effectively to increase the tax revenue,

Related program described above namely PAS-Final is another persuading approach to the taxpayer. Besides providing benefit to them, it is expected to reduce the work load of Directorate General of Taxes in performing tax enforcement.

Another big challenge is to strengthen the tax authority by structural reformation. In the OECD comparison study, Indonesian Tax Authority, The Directorate General of Taxes, has only 2 of 8 commonly delegated taxation authorities, thus improving thecondition may also involves structural reformation. Many ideas about the reformation have already been discussed during the recent years, but the choice has not been decided yet.The next reformation of Indonesian taxation still continue to be discussed in the parliament.

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