BUDIARTO
— LAW PARTNERSHIP —
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Are Equity Profits Distributable As Dividends?

This question was posed in the Asia Business Law Review No. 5 ("ABLR") in July 1994. In that edition, ABLR presented two different views to address this question. One of them is the joint opinion of two accountants (Leong Kwong Sin and Pang Yang Hoong, the "Accountants") and the other one is from a lawyer (George Shenoy, the "Lawyer").

What is Equity Profit?

The definition of equity profit was restated in the ABLR as profit which a subsidiary / associate has made and has not distributed as dividends but which under the equity method of accounting is recognized in the parent's financial statements.

The Views of the Accountants

In general, the view of the Accountants was that profits of subsidiary / associate shall remain the legal profit of the company that earned it, until they are properly distributed by the company to the parent.

However, the Accountants said that in certain exceptional cases, such as where the subsidiary / associate is wholly owned by the parent, the corporate veil of the subsidiary / associate can be lifted and the group can be viewed as essentially one single entity. As such, the equity profits of the subsidiary / associate are effectively the profits of the parent (and hence, are distributable as dividends by the parent).

The Views of the Lawyer

The Lawyer presented a more straightforward view. He shared the first view of the Accountants but did not agree that corporate veil can be lifted for the purpose of allowing the parent to pay dividends out of the profits of the subsidiary / associate which are yet to be distributed to the parent. The reason for his disagreement is that until the law is changed to allow the lifting of corporate veil for the present purpose, each company shall remain as a separate legal entity in accordance with the common law landmark case of Salomon v Salomon & Co.

Our Views as Indonesian Lawyers

After almost 20 years, the view of the Lawyer is still relevant in Indonesia as before. Limited company (perseroan terbatas) is a distinct legal person under Indonesian company law. Corporate veil can be lifted only in certain exceptional cases and there is no legal basis for lifting the corporate veil to allow the parent to pay dividends out of the undistributed profits of its subsidiary / associate. This principle is also adopted by the

Indonesian tax law and is evident from the fact that each company is taxed independently from its parent, subsidiary or associate.

Further, we are of the opinion that the same principle also applies in relation to the consolidated profits of controlled subsidiaries.

The Practice in Indonesia

We have performed an empirical research on 17 randomly selected companies. All the companies are listed on the Indonesia Stock Exchange and have declared dividend payments during their respective Annual General Meeting of Shareholders in 2013.

Our finding is that all dividend payment decisions and declarations were made based on their respective consolidated financial statements and hence, from the consolidated retained profits. This practice may pose the risk of the company paying dividends out of profits which (1) were still belonged to the subsidiaries; and (2) should remain with the subsidiaries but for the accounting consolidation.

The Legal Consequences

The legal consequences of a company paying dividends out of profits which are yet to be received from its subsidiaries are (amongst others):

1. the payment may cause the company (on a "standalone basis") to have a negative net profit and hence, the directors will be personally liable to the stakeholders;
2. the shareholder holding 25% shareholding percentage or more may not be entitled to a tax free treatment on (all or part of) the dividend payment if the payment or part of the payment is not from the retained profits of the company.

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What Do New Investment Rules Mean For Companies In Indonesia?

Indonesia's Capital Investment Coordinating Board ("BKPM") has recently published Head of BKPM Regulation No. 5 of 2013 concerning Direct Investment License and Non-License Guidelines and Procedures ("Regulation No. 5/2013") and BKPM Regulation No. 12 of 2013 on amendment to Regulation No. 5/2013 ("Regulation No. 12/2013") (New Investment Rules).

The New Investment Rules present new procedural rules on investment licensing, approval processes and other procedural matters relating to foreign investment in Indonesia. In general the New Investment Rules may potentially impact new investment for establishing a foreign investment company ("PMA Companies"), existing PMA Companies and domestic investment companies ("PMDN Companies").

There are several key changes introduced by the New Investment Rules:

1. License and Non-License

   In the framework of Regulation No. 5/2013, the requirement to obtain Registration License (Pendaftaran Penanaman Modal) for the establishment of PMA companies, has been removed from BKPM's licensing authority. Instead, a Principle License (Izin Prinsip) will need to be obtain for the establishment of a new business, the commencement of a new business in the event of change of status from PMDN to PMA, and vice versa, or a new project location. A Business License (Izin Usaha) is needed once the PMA companies is ready to commercially operate. If a company has obtained a Registration License under the previous regulation, it may proceed directly to obtain a Business License, however if a company requires a fiscal or non fiscal facility it will have to apply for a Principle License.

   Regulation No. 5/2013 upholds the applicability of any previously issued license or non-license until such license or non-license expires. The applications for licenses or non licenses that were submitted and deemed complete and correct prior to the effectiveness of Regulation No. 5/2013, but for which the licenses or non-licenses have yet to be issued, will be processed under the provisions contained in the New Investment Rules.

   Under Regulation No. 5/2013, BKPM is authorized to issue Business License on behalf of government ministries in accordance with applicable laws and regulation of the related ministries.

2. Minimum Capital Investment

   Prior to Regulation No. 5/2013, investment thresholds required of a PMA Company were set by BKPM on a case by case basis. The introduction of Regulation No. 5/2013 had remedied uncertainty by introducing investment thresholds:

   (a) the minimum total investment for a PMA Company (excluding investments in land and buildings) is IDR10,000,000,000 (ten billion Rupiah) or the equivalent in USD Dollars;

   (b) the minimum issued and paid up share capital of a PMA Company is IDR2,500,000,000 (two billion and five hundred million Rupiah) or the equivalent in USD Dollar;

   (c) the minimum equity of a shareholders is IDR10,000,000 (ten million Rupiah) or its equivalent in US Dollars.

3. Process Issues

   (a) Presentation at BKPM.

   Regulation No. 12/2013 requires a presentation at BKPM on applying application for a Principle License. If this presentation requirement is imposed, it will cause the process of license application much more longer.

   (b) Application and required documents.

   i) Signatories.Application submitted by an incorporated company shall be signed by a member of the board of directors who is authorized under the company's articles of association. For the company that is not yet incorporated, then the application shall be signed by all shareholders of the to-be-established company.

   For an attorney in fact, there are strict requirements on who can be an attorney in fact.

   ii) Original Documents. All original documents has to be shown at the time of submission of an application to BKPM. However, this requirement does not apply to foreign companies.

   iii) Power of attorney. Power of attorney to sign a BKPM application and/or to process the application to BKPM shall be granted without the right of substitution.

4. Modification of Investment Plans

   Investor must obtain a Principle License for amendment if it changes its initial capital investment plans. The changes which require this Principle License is the changes on the company name, address, project site or busines sector, production capacity, marketing and estimated annual value of export, investment plans , the company's capital and financing sources, and participation in the company's capital as set forth in its initial Principle License or Principle License for expansion.

5. Mergers

   Prior to Regulation No. 5/2013, the surviving company from a merger could directly apply for a Business License for Company Merger (Izin Usaha Penggabungan Perusahaan). However, Regulation No. 5/2013 requires the surviving company to first obtain a new Principle License for Company Merger (Izin Prinsip Penggabungan Perusahaan).

   The New Investment Rules intend to achieve harmonisation of investment applications, excellent investment service and improvement of investment performance in Indonesia. It will be interesting to see how the changes are implemented in practice, as BKPM also determines matters based on policy.

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No Deadline To Claim Your Severance Pay

According to Article 96 of the Indonesian Manpower Law No. 13 Year 2003 ("Manpower Law"), any claim/demand for the payment of the worker/ laborer's wages and all other claims/demands for payments that arise from an employment relation shall expire after the passage of a period of 2 (two) years since such claims first come into existence. However, on September 19, 2013 the Constitutional Court (Mahkamah Konstitusi) declared that the Article 96 of Manpower Law is inconsistent with the 1945 Constitution (Undang-Undang Dasar Tahun 1945) and therefore has no binding effect[1].

This decision was made after Marten Boiliu, a former security guard of PT Sandy Putra Makmur, filed a judicial review on September 2012 , over the Article 96 after failing to receive his severance pay (pesangon), rewards (uang penghargaan), and compensation (uang penggantian hak) after being fired in 2009. Later he claimed for his payments to PT Sandy Putra Makmur on June 2012. According to Article 156 paragraph 1 of the Manpower Law, employer is obliged to pay the dismissed worker severance pay and or a sum of money as a reward for service rendered during his/her term of employment and compensation pay for rights or entitlements that the dismissed worker has not utilized.

Contrary to the regulation, Marten did not receive his severance pay, rewards and compensation from PT Sandy Putra Makmur. However, his attempt hit stumbling block as the regulation only allows employees to claim payments within the period of 2 years. Nevertheless, Marten filed for an appeal to the Constitutional Court and won his appeal.

The Constitutional Court decides through decree no. 100/PUU-X/2012 that the Article 96 of Manpower Law is contradictory to Article 28D paragraph (1) and (2) of 1945 Constitution which declared that every person shall have the right of recognition, guarantees, protection and certainty before the law and of equal treatment before the law and that every person shall have the right to work and to receive fair and proper remuneration and treatment in employment.

A Threat to Legal Certainty?

Hamdan Zoelva is the only Constitutional Judge who has a dissenting opinion against the said court decision. According to Hamdan Zoelva, a prescriptive period is common to be found both in Indonesian Civil Law and Indonesian Criminal Law as it is necessary to guarantee the legal certainty.

Still according to Hamdan Zoelva, this will affect the growth of business community in Indonesia, and thus may be affect the condition of labors in the companies. Manpower Regulation should not protect the labors, but also entrepreneurs and the business community. Zoelva also stated that the Article 96 should only be applicable for employers exhibiting unfair employment practices to their workers by not fulfilling employees legal obligations based on the prevailing laws.

By declaring the Article 96 as unconstitutional and has no binding effect, the employers should worry about continuous claims/demands made by former workers which may worsen the investment climate in Indonesia. With the increase of the minimum wage by the average of 40% this year, the constitutional court decision will only worsen the investment climate and add burden among potential investors who already faced by numerous challenges such as unfriendly government policies, red tape and poor infrastructure.

[1]Indonesia's Constitutional Court Decision No. 100/PUU-X/2012 dated March 26, 2013.

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Potential New Rulings On RDPT

Indonesia Financial Services Authority (Otoritas Jasa Keuangan or "**OJK**") plans to issue a new regulation regarding Limited Collective Investment Contract Mutual Fund (Reksa Dana Berbentuk Kontrak Investasi Kolektif Penyertaan Terbatas or "**RDPT**"). On October 22, 2013, OJK has released on its website, www.ojk.go.id, a draft of new regulation ("**Draft RDPT Regulation**") regarding RDPT. RDPT is a mutual fund that is not allowed to be offered in public offering and where the holders of unit are limited to only for 49 (forty nine) holders (including the investment manager which by law shall own 1 unit of its RDPT). Currently, RDPT is regulated by Capital Market Supervisory Board and Financial Institution (Badan Pengawas Pasar Modal dan Lembaga Keuangan or "**Bapepam-LK**", whose function, duty and authority were assigned to OJK on December 2012 pursuant to Law No. 21 Year 2011 regarding OJK) Regulation No. IV.C.5 and attachment to the Head of Bapepam-LK Decree No. Kep-43/BL/2008 regarding RDPT ("**Regulation No. IV.C.5**").

The followings are several major changes that have been proposed in this Draft RDPT Regulation.

Portfolio of Mutual Fund

In the Draft RDPT Regulation, OJK will allow RDPT to have investments in several securities and to use its fund to fund multiple projects with the limitation that all projects are disclosed from the beginning when the mutual fund is issued. This provision is not retroactive as the Draft RDPT Regulation states that Collective Investment Contract of RDPT which has been registered with the OJK and became effective before the Draft RDPT Regulation comes into force cannot invest in project other than the one that has already been defined in such RDPT.

Ownership of RDPT Unit

In Regulation No. IV.C.5, if the Investment Manager intends to issue an RDPT, then the Investment Manager has to fulfill some requirements i.e. the paid up capital of the Investment Manager shall be at least Rp 25.000.000.000,- (twenty five billion Rupiah) and the Investment Manager shall own minimum 1 (one) unit of its RDPT. However, OJK intends to amend these provisions. In the Draft RDPT Regulation, the requirement regarding minimum paid up capital of the Investment Manager is no longer applicable, but the Investment Manager is required to own at least 1 (one) unit of its RDPT if the assets under management of the Investment Manager were less than or equal to Rp200.000.000.000,- (two hundred billion Rupiah). However, if the assets under management is more than Rp200.000.000.000,- (two hundred billion Rupiah), then the Investment Manager shall own at least 2 (two) unit of its RDPT.

Furthermore, Regulation No. IV.C.5 states that the RDPT units shall not be owned by more than 50 (fifty) holders including the unit that is held by the Investment Manager (it can only be owned with total of 49 (forty nine) holders). But in the Draft RDPT Regulation, the RDPT units are prohibited to be owned more than 50 (fifty) holders. So, if the Draft RDPT Regulation were issued, the total unit holders can be allowed are 50 (fifty) holders.

Due Diligence of the Project

Although it is not stated in the Regulation No. IV.C.5 that the funded project of RDPT must be examined, but in practice, if an Investment Manager intends to issue a new RDPT, then OJK always requires a full due diligence report on the funded project of RDPT. In the Draft RDPT Regulation, it is clearly stated that the Investment Manager shall do a due diligence investigation on the proposed Security and do the monitoring of the progress of the project constantly. Furthermore, if the investment of RDPT is in debt security, then the parties involved in the process must be Capital Market Supporting Agencies and Professionals.

Monitoring Agent

In the Draft RDPT Regulation, OJK requires a Monitoring Agent be appointed in debt security investment to act as the representing party of the RDPT. The role of the Monitoring Agent is to monitor the utilization and receipt of the fund of RDPT. This Monitoring Agent is a new profession created under this Draft RDPT Regulation.

It is noteworthy that in 2011, OJK had issued a draft of new regulation on RDPT, but for some reasons that draft was not passed into regulation.

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The New Regulation Regarding Guidance For Plantation Business Licences Is Finally Issued

After having been postponed for several times and long deep intense discussion with the major players in plantation business, the Ministry of Agriculture has finally released the new Regulation No. 98/PERMENTAN/OT.140/9/2013 of 2013 (the "**New MOA Reg**") regarding Guidance for Plantation Business Licences. This New MOA Reg replaces the previous Ministry of Agriculture Regulation No. 26 of 2007 (the "**MOA Reg 26/2007**"). Set out below are several changes that have been made in the New MOA Reg.

Maximum Land Ownership for One Company or Group Companies

The main point to note is the maximum area of land which may be owned by a plantation company under the New MOA Reg. Although there are some objections from most of major players in plantation business and associations, the New MOA Reg provides the maximum area of land is now apply to an entire group of companies rather than only to an individual company. The group companies is defined as group of people or companies which are related to each other in the sense of ownership, management and/or financial. Previously under the MOA Reg 26/2007, the maximum limit of land ownership was applied for an individual company (not as a group). Although, the maximum of land ownership restriction is changed, this restriction is not entirely new in the sense that there is already a separate Minister of Agrarian Regulation No. 2 of 1999 regarding Location Permit (Izin Lokasi) which sets limit hectares of land per group companies.

Before the New MOA Reg was enacted, there are several drafts have been made public. Unlike the previous drafts, the New MOA Reg does not contain restriction applicable to the total area of land which may be held by a group within a single province.

The total hectare of land ownership varies depending on the types of plant. For example, the maximum hectare of land ownership for an oil palm plantation is 100,000 hectares whereas for tea and sugarcane plantations are 20,000 hectares and 150,000 hectares, respectively. The above limitation is not applicable to state owned companies, cooperatives and plantation companies which have most of their shares owned by public.

Integrated Between Cultivation Plantation and Processing Industry

The New MOA Reg requires cultivation activities of a coconut palm plantation (having more than 1,000 hectares of land), tea (having more than 240 hectares of land) and sugarcane plantation (having more than 2,000 hectares of land) to be integrated with a processing industry activity. Previously under the MOA Reg 26/2007 this kind of requirement is only applicable for oil palm company.

The industry processing company must cover at least 20% of its supply for its own plantation and the remaining supply can be from adjacent society plantation through partnership. Such partnership must be written for the minimum period of 10 years based on the format provided in the New MOA Reg.

Requirement to Divest for Processing Industry Company

Another important issue relates to plantation business licence for processing industry (IUP-P). There is a new requirement on palm oil processing industry companies holding IUP-P to divest some of their shares to farmers' cooperative. The divestment requirement begins in the 5th year after the commencement of commercial operations. The share divestment requirement will gradually increase from 5% in the 5th year and up to 30% in the 15th year. Failing to fulfill such divestment requirement, the company will be given three written warnings within 4 months and ultimately the company's IUP-P and land title will be revoked. The New MOA Reg does not give clear mechanism on how the divestment will be implemented in practice.

Report on Changes of Shareholder and Management Composition

Changes on shareholder composition or management of a plantation company must be reported to the issuer authority within 2 months since the completion of such change of shareholders or management. Failing to notify the changes of shareholders or management to the authority, the plantation company will be given three written warnings and ultimately revocation of IUP-P or IUP-B or IUP and land title of such company.

Does this Regulation is Retroactive?

It is not entirely clear whether the draft Regulation will apply retroactively especially on whether or not group companies which have land banks more than the maximum land ownership threshold is required to divest their lands to meet the requirement under the New MOA Reg. The New MOA Reg however does define that the existing IUP/IUP-P/IUP-B that has been granted before the issue of the New MOA Reg will still be honoured. The plantation companies which already have land banks more than the maximum hectares of land ownership may not increase their land banks.

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