mitigation in respect of the full effect of this particular amendment has brought into the Singapore tax concept the "tax haven" status. If the charterer is resident in tax haven countries (and they are given a list of about 17 countries) then 3% of the gross is deemed to be Singapore tax liability. It is possible that this particular approach may well be that we are on the way to the Australian approach where any transaction with a tax haven country is subject to the scrutiny of the Comptroller or the Department of Foreign Exchange. It is unlikely however we will reach that far because Singapore's foreign exchange regulations are so liberal. But nevertheless the opening up is quite clear.

I would like to end by saying that in as much as we have competition from Hong Kong and Manila the rates are marginal and if tax were the only reason, the tax havens would be the only people in the world who would be doing this kind of business. This 10% and 15% rate is not prohibitive and I do not see Singapore's position as a financial centre being seriously eroded merely by this marginal difference.

REGULATORY ASPECTS OF OFFSHORE LENDING TO INDONESIAN CORPORATE ENTITIES

by

WILLIAM HUI

Representatives of commercial banks and merchant banking houses in an international financial centre often have to concern themselves with the security instruments pertaining to loans made to borrowers in neighbouring countries. They also need to know the laws, regulations and policies pertaining to offshore loans in such countries. I will outline the regulations applicable to offshore loans made to Indonesian corporate entities by Singapore-based banking and financial institutions.

In terms of the applicable regulations two questions may be posed:

(1) Are the funds intended as part of the capitalisation of a *Perseroan Terbatas* (Indonesian limited liability company) organised under the Foreign Investment Laws of Indonesia?

(2) Is the proposed borrower a government-owned enterprise?

The regulatory strictures vary in relative strictness of procedure and enforcement depending upon the answer to each of the above questions.

1. *PRIVATE ENTERPRISES*

(A) Within the Foreign Investment Law

If the funds to be borrowed are for the purposes of direct investment under commitments made within the processes and procedures of the Foreign Investment Law, 1967, a borrower may obtain the approval of the BKPM (*Badan Koordinasi Penanaman Modal*) stating in its application the amount, the term of years, and other particulars

of the proposed borrowing. The loan funds for capitalising companies organised in Indonesia under the framework of the Foreign Investment Law cannot be obtained from local or Indonesian sources but must originate from abroad, consistently with the Indonesian Government's desire to encourage inflows of foreign capital.

Related to this rule is a grievance expressed often by the non-bank financial institutions in Jakarta: they complain that they are not allowed to lend to customers any Indonesian funds which would be used as investment capital under the Foreign Investment Law. Bank Indonesia's position is that the function of these non-bank financial institutions is to make facilities available to domestic corporations.

When seeking approval for the proposed borrowing, a loan agreement in draft form should be submitted to Bank Indonesia before the parties proceed to final execution thereof. Bank Indonesia will consider such elements of the transaction as the principal amount involved, the repayment period and the grace period, if any. As a matter of policy, Bank Indonesia will require that the term, that is, the repayment period including the grace period (if any), should not be less than three years — on the reasoning that as a central bank they would disfavour borrowed funds flowing into the country and out again within shorter periods, thus requiring various kinds of special efforts on their part to provide the necessary foreign exchange.

Regulations exist which prohibit units within the Indonesian banking system (i.e., the state-owned banks, the private Indonesian banks and the private foreign banks) from giving guarantees to foreign lenders. However, parent corporations in Indonesia are allowed to guarantee the borrowings of their subsidiaries from foreign lenders.

Bank Indonesia takes a very serious view of its responsibilities in the area of supervision and regulation of the debt:equity ratio or capital structure of companies organised under the Foreign Investment Law. In this regard, "guidance" has been provided in the form of stipulated ratios which would be permissible. Depending on the industrial sector involved, Bank Indonesia would permit a debt: equity ratio of 60:40 or 70:30.

Another Ministry is involved in the application process: it would be advisable to send a carbon copy of the application for the approval of the loan to the *Departemen Keuangan*, the Ministry of Finance.

(B) Outside the Processes of the Foreign Investment Law

If the proceeds of the proposed loan are to be used outside the processes of the Foreign Investment Law for trade or manufacturing or otherwise, the general rule is that the parties can negotiate and sign loan agreements without prior reference to the authorities. But thereafter it would be necessary to file a report to inform Bank Indonesia of the particulars of the loans, attaching therewith a copy of the loan agreement. There is no need to include mortgage documents among the documents sent to Bank Indonesia.

2. *STATE ENTERPRISES*

If the proposed borrower is an Indonesian state enterprise or a state-owned corporation, special regulations govern the procedures

applicable to proposed borrowings by such enterprises which are owned or controlled by the central or the local government. These regulations cover all the government-owned enterprises classified by Act No. 9 of 1969 as follows: *Perusahaan Jawatan* (abbreviated "*Perjan*") or departmental agencies, *Perusahaan Umum* (abbreviated "*Perum*") or public corporation, *Perusahaan Perseroan* (called the "*Persero*") or state companies and joint venture state enterprises organised in *Persero* form established with foreign investors or other third parties. There are a considerable number of such state enterprises, so it is often a significant matter whether or not your borrower is likely to be one of them. The regulations apply to any of these *Badan Usaha Negara* even if only 1% of the shares therein are owned by the central or a local government. The proposed borrowing by any such state-owned enterprise must receive the approval of the Ministry of Finance, Bank Indonesia and Bappenas, the National Planning Board.

The application for such approval is submitted to the *Departemen Keuangan.* Bank Indonesia will then consider the application and make recommendations thereon to the *Menteri Keuangan* (the Minister for Finance) himself. Now, within the Ministry of Finance the *Direktorat Persero* will evaluate the application for the foreign loan. If approval is given in principle, the draft of the loan agreement has to be submitted. Bank Indonesia will then consider the terms of the loan and may make recommendations for the deletion of unacceptable provisions or suggest the inclusion of protective clauses to cover these state-owned enterprises. The *Direktorat Persero* at the Ministry of Finance will be responsible for making recommendations concerning the acceptability of the proposed debt: equity ratio of the enterprise. Bank Indonesia has a greater voice concerning the proposed interest rate.

In terms of interest rates generally, if it is a Foreign Investment Law private (P.T.) company borrowing, Bank Indonesia will have a strong voice concerning the rate of interest to be charged, and it could make its influence felt in the decision whether to approve the proposed borrowing. If the borrowing is for purposes outside the scope of the Foreign Investment Law, Bank Indonesia will still make suggestions as to acceptable interest rates. Concerning government-owned enterprises borrowing from foreign lenders, the interest rate factor is under the strict control and guidance of Bank Indonesia. Generally, in the past, interest rates that were slightly above LIBOR or SIBOR rates have been acceptable to the Indonesian regulatory authorities.

DISCUSSION

J.R. Hudspeth: *Mr. Lee, in referring to the IGAs you mentioned that the Singapore government must approve an investment for it to be eligible under these agreements. But when you say "Singapore government", does it vary from body to body as to which Singapore entity approves it depending on the industry whether it is manufacturing or finance or is this approval function done by one specific body of the government?*

Lee Bian Tian: *The approval function is done by one specific body, that is the Ministry of Finance.*

James Chia: *I would like to ask Mr. William Hui about the foreign exchange control. We seem to get in Singapore a lot of funds being brought into Singapore by individuals. I am not too sure whether these individuals are carrying money across the Straits to avoid foreign exchange controls in fact or is it permitted by the Indonesian Government?*

William Hui: *It is very interesting to note that the Indonesian foreign control regulations are extremely liberal. As long as you have the necessary funds with which to purchase foreign exchange there are no difficulties in getting foreign exchange. But if you are talking about funds that have to be loaned — hot money type funds — funds that have never been the subject of required tax payments, then I really don't know.*

James Wong: *I would like to address a question to Mr. Lee Bian Tian. I note from the paper here that the risks covered by the investment guarantee agreements include "political reasons" and "non-commercial reasons." It would appear that some of the reasons mentioned here are also covered by current commercial insurance policies like the Institute War Clauses, clauses covering damage caused by riots (e.g. Institute Strikes, Riots & Civil Commotion clauses). In Singapore, following the pattern in UK, there is currently established the Export Credit Guarantee Insurance Company which provides insurance coverage for some of the hazards and risks faced by exporters not hitherto covered by commercial insurance policies. The point of interest to me is whether or not under the investment guarantee agreements, coverage against losses are provided for risks which are not currently covered by the commercial insurance policies. If the same risks are covered by the investment guarantee agreements, which are here broadly defined in your paper to cover a broad range of assets such as movables and immovables, rights etc., then such agreements may well compete with the commercial insurance and also the facilities provided by the export credit guarantee insurance. Would you like to comment on that?*

Lee Bian Tian: *As far as I understand, the sort of risks that are guaranteed or protected against under the IGAs are normally not covered under commercial insurance. I cited the case of Canada which has legislation under which the Canadian government grants to its nationals foreign investment insurance which covers the three major risks all of which I have mentioned. One risk is that of expropriation, the other repatriation of capital and earnings, and the third one is war risks. Although it appears to me war risks is a strange bedfellow of the other two.*

John Taylor: *Mr. Lee, in relation to the question of investment guarantee agreements, some countries which are now investing more in the Asian region than hitherto (for example, Australia) have not concluded guarantee agreements with Singapore. Is there any reason for this?*

Lee Bian Tian: *I don't know of any reason. In the case of the six countries with which Singapore concluded the IGAs, I understand that the initiative was made by these countries and not by Singapore. But it does not necessarily mean that countries having no IGAs with Singapore won't invest. We have no IGA with Japan and yet Japan makes a lot of investments in Singapore.*

Chairman: *The question that follows would be, is it the practice of the Japanese government to have IGAs with other developing or developed countries and then consider what is the position with Singapore. It is obvious that the US and West Germany for instance have IGAs with a lot of governments including developing countries as well. Does the same hold for Japan and in which case are there any factors which make it unnecessary to have an IGA between Japan and Singapore?*

Lee Bian Tian: *Well I don't know. Up till now I do not think there is any initiative by the Japanese to seek an IGA with Singapore. I do not know why. But as far as Singapore is concerned an IGA means liability because under the present circumstances I do not expect very much if any Singapore investments being made in the other countries that are parties to IGAs with Singapore. It all appears to be one way. So Singapore has little or no reason to initiate an IGA with other countries.*

Chairman: *Other than to attract investment from those countries?*

Lee Bian Tian: *Yes.*

N. Kasiraja: *Mr. Lee, I note from your contribution that the enforcement machinery for the breach of the IGA seems to be inadequate. The national of the other party to the IGA has been expropriated or prejudiced. He is fated to go to the arbitration tribunal. He is in doubt because he is not a party to the agreement. I am thinking specifically about the future. Singapore would like to invest and protect its investments in the Asean countries. The question I would like to pose is, is there any possibility of the IGAs being made watertight as between the Asean countries and Singapore particularly from Singapore's point of view?*

Lee Bian Tian: *If I understand you correctly what you are saying is that if, say, a national of the US has investments with Singapore and assuming that there is a legal dispute between the Singapore government and that US investor arising from the investment in Singapore, if Singapore refuses to refer such dispute to arbitration the national has no remedy. Is that what you are saying?*

N. Kasiraja: *It is the arbitration tribunal.*

Lee Bian Tian: *On the contrary, I think that if the US national decides that the dispute should be referred to arbitration by the Centre Singapore is obligated to do so.*

N. Kasiraja: *Although the national is not a party here?*

Lee Bian Tian: *This is because Singapore has agreed with the other contracting party that if there is a legal dispute arising from the investment with a national of the other contracting party, this dispute will be referred to arbitration. But I think I must hasten to point out that this provision does not appear in all the IGAs, only in two or three as far as I remember. Of course in the absence of such provision there is nothing to prevent the parties concerned agreeing to reference to arbitration.*

N. Kasiraja: *My problem is if one party refuses to take it up before the arbitration tribunal, it is very doubtful whether the national of the other party to the agreement has a status to appear in the arbitration tribunal.*

Lee Bian Tian: *I don't think a party to the IGA where there is such a provision can refuse if the national of the other party affected chooses to go to arbitration at the Centre. The only problem is where the national himself does not wish to refer a dispute to arbitration at the Centre then Singapore cannot say he must do so because that national is not a party. It is the other way.*

Robert Beckman: *A question for Mr. Lee regarding the settlement of investment disputes in the World Bank Convention. My understanding is that Convention is mostly procedural. There is very little substantive law provision there. I have a question as to the arbitration clause in the IGAs. First, how are the arbitrators chosen? For example, if in the US/Singapore clause there were a question as to whether there were an illegal expropriation or a dispute as to whether the compensation offered by Singapore were just or were adequate, by whose law would you determine the question?*

Lee Bian Tian: *There seems to be two questions. One, in relation to a dispute between Singapore and the foreign investor. In this situation the Convention itself has a provision and I think it provides that if the parties do not agree on what law to apply then the law of the host state will apply, in other words, Singapore law will apply. But in the case where there is a dispute between the two contracting parties to the IGA, the IGA has a provision providing for the method of appointment of arbitrators. I think this is true of the US IGA. There is a procedure concerning the appointment of arbitrator and in such a dispute international law would apply.*

Michael Hwang: *I just like to touch on a point which relates to the choice of Singapore as a financial centre and as an investment centre. One of the factors is the efficiency and reliability of the legal system and the legal service in that country. As far as Singapore is concerned I think there are no serious doubts as to the integrity of our legal system. I am thinking in particular of one aspect of the system which is, the time it takes for any case to come to trial. Now the bottom line of any legal agreement or any legal right or remedy is, "how long does it take before you get your money or before you get your remedy?" In this respect the situation was rather poor in Singapore until about 2 or 3 years ago. Formerly it took about 3 years for a case to come to trial in the High Court from the time of its inception to the time of the hearing. With the revision in the jurisdiction of the various courts the situation has much improved. Much of the backlog has been cleared. We are now on to something like 1 to 1½ years for an ordinary case. If the case doesn't take more than a day it will probably be heard within about 6 to 9 months. This is a relevant factor when you compare a similar time lag situation in the other competing countries in the region for financial centres and investment centres. I think in terms of time lag for court hearings we are ahead of Malaysia; we are certainly ahead of the Indian sub-continent; we are certainly ahead of Indonesia; I think probably of the Philippines. But I think we are behind Hong Kong. I believe*

Hong Kong cases come faster to trial and this is relevant because so often a factor militating against investments or loans is this — you can draw up the most beautiful agreement in the world but at the end of the day what is the worth of that agreement unless there is a reliable and speedy means of enforcing your security or of protecting your investment.

J.R. Hudspeth: *I first came to Singapore in 1969, when the exchange rates were set by the Bankers' Association and I heard some similar arguments about the clients not being able to tell a good exchange rate from a bad one. So there were similar arguments but it is now possible for every bank to set its own exchange rate and apparently not too many people are getting hurt. The other point is to Mr. Khattar. I think he made a statement which I found interesting being a regional office. There was a conclusion that I think many people automatically assume and this is that a regional office is a business development or a marketing office and therefore does, in some way, produce revenue. But I think a point to consider is that some regional offices serve as supervising centres and administration centres and in this role do not derive or produce any profit but supervise several profit making centres and if one of the centres was to be. for example, a Singapore branch if that branch was supervised more closely and therefore ran more efficiently and made more money it would pay more taxes in Singapore. If the regional office supervised offices outside of Singapore and they also were more efficient and paid taxes it would be income derived outside of Singapore. But I agree that it is something that the Inland Revenue is considering.*

James Chia: *I would like to add to what Mr. Michael Hwang has said about the position of the legal system. From my observation there is another feature which is also fairly important. I believe two years ago there was an article in the Far East Economic Review comparing the two cities Hong Kong and Singapore and it has attracted a lot of attention and they labelled Singapore as a city with too much legislation so that the foreign investors investing in Singapore has to go through several authorities before he gets a clear picture. Foreign embassies are assisting their nationals as to the obstacles they have to overcome but there are limitations. But lately I observed from certain government promotional agencies that they are appreciating the foreign investors' point of view. One specific example is the Economic Expansion Incentives (Relief from Income Tax) Act. There are rules and regulations governing such pioneer enterprises and one particular question relates to "losses carried forward after the post final period." Now through no fault of the corporation which has run into periods of recession and have incurred losses, if the authorities continue to abide by the rule that there is no loss carried forward after the pioneer period, then all these companies would have to bear the losses themselves I believe consideration is being given by the relevant authorities at this time. In time to come Singapore may not be the most attractive place to set up an industry and it is urged that the authorities ought to make rules less cumbersome for the foreign investors.*

Brij Soin: *I would like to make a few comments on what Sat-Pal said earlier. One is on this question of arriving at the expenses that are to be deducted from the offshore income in the case of the*

ACUs. From the purely practical side there are 3 formulae which have been adopted by the Revenue Department and these evolved in a room the size of this. Have about 10 officers sit and do the assessment work. Unfortunately, the files don't go to one officer only. If they did we'd have only one formula. The irony of it is that thousands of dollars have already been paid and are lying there, non-refundable until the Revenue Department makes a decision as to which formula is the correct one. This has been going on since 1974. Now Sat-Pal said, "Well the code of law will decide." But I am afraid that we don't have very many cases which are taken to the Board of Review. I think probably one in two years. So it is not something that we can suddenly jump up and say, could you please take this case to the court of law. This is a real problem and fortunately I believe the MAS is now coming into the arena and is hammering out a formula or a series of formulae which have been put before the banking community so that an agreement can be reached with foreign banks and local banks, who are running ACUs and who have a variety of expenses. But the problem is and very much the practitioner's problem, why does it take four years for a simple problem like this to be resolved. The second comment I have to make is why have a law which is not to be enforced? I mean it is pointless. You are creating problems for everybody. Now Sat-Pal can give a warranty by referring to the Tax department who will obviously, for various reasons, confirm that it is right. But there are many taxpayers who do not have that facility. The next point I want to make is about these regional offices. I think this is a point which is very important in that from experience we have established that a regional office which is a pure expense office or a pure purchasing office which provides facilities for big corporations which are operating in Indonesia does not carry on the business here and that the Comptroller has no right to arbitrarily impose a 5% profit element to it. All they do is that they spend millions of dollars out of Singapore, buying here, keeping very high flown geologists etc. in Singapore who travel up and down Indonesia and at the end of the day if they have spent S$5 million they get a remittance from the States of S$5 million. They do nothing here which is tantamount to carrying on a business and I think that is the important factor. Are they carrying on a trade or business here? I think the Revenue Department should be resisted if they are arbitrarily imposing this 5% tax. And the last point I want to make is about insurance companies. In the last speech of the Minister he said that businesses or companies carrying on reinsurance business will be taxed at the rate of 10% and not 40%.

Chairman: *I wonder if I should spare James the agony of repeating what he has said before because I can sympathise with him in so far as the Tax Department obviously wants some flexibility in the way it can handle and is unable always to give clear-cut rulings which accountants and lawyers would want. James, do you have any response?*

James Chia: *I think Mr. Soin has been pinpointing very extreme examples. I am certain that this particular example that he has brought out has been over exaggerated. Rules and regulations legislated by Parliament result in certain interpretation. Complicated problems always arise in society. Rules and regulations do not encompass these complicated circumstances. Thus the Revenue authorities*

meet relevant representative groups to iron out difficulties in the treatment of certain expenses or profits. If the suggestion is to legislate for it or to empower the Minister then we might just have to go to Parliament too frequently, and that is something which we do not want. So this informal approach and agreement among the representative groups in Singapore is for the present moment I believe working very well.

J.L. Taylor: *One aspect of transnational investment in Singapore which was not considered is investment by multilateral inter-governmental organizations like the Asian Development Bank. The ADB has made several loans to Singapore to finance the foreign exchange requirements of specific development projects. All loans made by the Bank to date have either been made to, or guaranteed by, the Republic of Singapore.*

In the past, Bank involvement in project financing has resulted in the Bank being the sole foreign lender for the particular project or one of a number of governmental or other multilateral lenders for that project. Recently, however, our Bank has embarked on the co-financing of projects with commercial banks: in the case of ADB this new practice began in early 1976, in respect of a project in Singapore which was co-financed with the Bank of America. In view of the provision in our Charter which requires the Bank to cooperate with entities concerned with the investment of development funds in the Asian and Pacific region, our Bank looks favourably upon such co-financing in appropriate projects; and commercial banking institutions may find our Bank's involvement as a co-lender useful because of the supervisory role which we play in project implementation.

Another principal aspect of ADB's operations relates to the funding of the Bank, which depends partly on public and private borrowings in member countries. To date no borrowings have taken place in the Asian Currency Market (either in Hong Kong or Singapore) although Singapore recently passed legislation which removed certain restrictions on the Bank's borrowing activities in Singapore.

Concerning the role of lawyers in transnational transactions, significant discussion occurred yesterday on the question of the extent to which lawyers should be involved in such transactions. Workshop participants may therefore be interested to learn that, to assist the Bank in both its project lending and its borrowings, the Bank has a staff of 19 lawyers of 10 different nationalities from within and outside the Asian and Pacific region. From a very early stage in the Bank's existence, lawyers have been actively involved in almost all aspects of the Bank's operations. For example, except in the case of minor projects, lawyers travel with and provide direct assistance to the Bank team which appraises the suitability of a project for Bank financing. It has been felt that this increases the perspective and depth of the lawyers' knowledge both of the project and of the local conditions under which it is to be implemented. It is believed that this has substantially improved lawyers' abilities to contribute to the Bank's operations.

(Concluded)