INDONESIA'S SHIFTING COAL MONEY

How vast sums have been moved offshore and out of sight

Part 3: Taxing times for Adaro

July 2019
Coal is a controversial energy source. Worldwide, it is increasingly seen as high-cost and high-risk, as one of the biggest contributors to climate change, a source of deadly air pollution and the cause of many other types of environmental destruction.

An increasing number of governments are acting to phase-out coal. This and the reputational costs of supporting coal anywhere in the world are causing those funding the sector to flee at increasing rates. Banks, insurers or lenders are now announcing new restrictions on average every two weeks.¹

Indonesia is one of the world’s top coal producers and exporters. With global demand for coal dropping, a raft of planned new coal-fired power stations in Indonesia could help to maintain a market for its coal.

However, within Indonesia, coal is also seen as increasingly controversial. Recent corruption scandals, a swathe of improperly issued licenses, contaminated land and water, and the reliance on an increasing level of government subsidies, among other problems, are creating a growing body of opposition to the industry.

Previous findings in this multi-part investigation offered another potent reason why the Indonesian government, international banks and investors should shun Indonesia’s Big Coal: because they might lose their money as well as their reputation.

This instalment highlights how the Indonesian government might be losing out on revenue, which it could potentially be able to spend for the benefit of Indonesian citizens, from the offshore practices of one of the country’s biggest coal companies.
TAXING TIMES FOR ADARO

Adaro Energy, one of Indonesia’s largest coal companies, has recently expanded its network of offshore companies in Singapore and Mauritius which collects part of the profits from its coal trading and also holds its investment in a coal mine in Australia.

The use of tax havens to hold funds and assets raises a risk that the hundreds of millions of dollars which Adaro holds offshore may never be subject to tax in Indonesia. Tax avoidance is not usually illegal, but it is increasingly frowned upon around the world as it can significantly reduce the amount of revenue that governments collect and therefore have available to spend on their countries’ economic and social development.

At the same time as expanding its offshore network, Adaro stands to benefit from Indonesian government financial guarantees for the US$4 billion Batang coal-fired power plant, which will be the biggest in Indonesia, in which Adaro is a joint venture partner. Adaro expects the power plant to create up to US$80 million a month in revenues for the joint venture, of which Adaro itself owns 34 per cent, once it is up and running. This means that, in effect, Adaro is relying on the government (and therefore Indonesian citizens) to provide a guarantee for one of its sources of future profit while, at the same time, making use of offshore companies which may reduce its potential tax payments in Indonesia.

ADARO’S OFFSHORE NETWORK

Adaro Energy, one of Indonesia’s largest coal companies, likes to strike a patriotic note in some of its public messages. Its chief executive Garibaldi Thohir, who is also an investor in the company, remarked in a 2017 interview: “We had a conviction that Indonesians can manage their natural resource assets [as well as foreigners]. As … Indonesian businessmen, we wanted to make a bigger contribution.”

In public statements the company is keen to “emphasize” its “commitment to the nation” through its tax payments and other contributions to stress that “as a national company [it] is, committed to contributing to the development and progress of Indonesia’s economy through taxes” and that it aspires to provide “its full support for the advancement of the nation.”
Adaro pays very large sums in tax in Indonesia and its subsidiary Adaro Indonesia was recently awarded the status of “Golden Taxpayer” by the tax authority. However, Global Witness has learned that Adaro has also followed the practice of many Western multinationals by channelling some of its earnings into, and holding assets in, tax havens in ways which may help it to avoid or minimise tax it pays in Indonesia.

Tax avoidance is a public issue in Indonesia, which collects an unusually small percentage of tax by international standards. Huge sums are known to have flowed out of the country and into tax havens. Under a tax amnesty in 2016 and 2017, Indonesian corporations and wealthy individuals declared over US$350 billion in assets, approximately 25 per cent of which were held outside the country.

Like many other extractive companies in the region, Adaro has a marketing subsidiary in low-tax Singapore. This subsidiary, Coaltrade Services International, buys coal from other Adaro subsidiaries which mine it in Indonesia, as well as from third parties and sells it at a mark-up. Coaltrade also acts as a sales agent for Adaro and third parties for which it is paid commission.

Such arrangements are common, but they can become open to question if the sales and marketing arrangements have the appearance that they are being used to shift profit from a higher-tax country like Indonesia into a low-tax country like Singapore. Corporate tax avoidance is increasingly frowned upon and companies which are found to have avoided tax can in some circumstances be compelled by tax authorities to pay additional tax, sometimes with interest and penalties.

Adaro disclosed in 2008 that the Indonesian tax authority had concluded that its coal sales to Coaltrade in 2004 and 2005 were under-priced. Adaro was selling coal to Coaltrade at a low price, and Coaltrade then sold the coal to third parties at the higher market price and booked the resulting profit

Indonesian Finance Minister, Sri Mulyani Indrawati, presents Adaro CEO Garibaldi Thohir with the ‘Golden Taxpayer’ award. Screenshot from Adaro’s 2017 annual report.
in low-tax Singapore, rather than in Indonesia where it pays a higher rate of tax. The Indonesian tax authority made a “transfer pricing adjustment” – that is, it required Adaro to recalculate the price of the coal sold to Coaltrade and pay more tax in Indonesia on the resulting increased profit in Indonesia. Adaro reported that as result it had paid an additional US$33.2 million in tax in 2008 to settle the matter.\textsuperscript{9} Coaltrade’s accounts, analysed by Global Witness, show that the mark-up which it made on buying and selling coal dropped from about 15 per cent on average, before the tax authority’s intervention, to about 4 per cent since then.\textsuperscript{10} In other words, less profit from coal sales was being booked in Singapore, rather than in Indonesia. However, Coaltrade started to earn significantly more money than before from another source: commissions earned from selling coal mined in Indonesia for other Adaro subsidiaries, based in Indonesia, as well from third parties.

Coaltrade’s accounts show that in the three years before 2009 it earned about US$4 million a year in commissions, on average. Between 2009 and 2017, however, it earned nearly US$55 million a year from commissions, on average, or US$490.5 million in total. These commissions fed into a total profit before tax, after other income and expenses had been accounted for, of US$416.8 million for the years from 2009 to 2017.\textsuperscript{12} Global Witness asked Adaro detailed questions as to how it calculated the value of these commissions, but the company declined to answer them.\textsuperscript{12}

Coaltrade’s profit was taxed in Singapore at an average annual rate of 10.7 per cent during this period, according to its accounts. This is much lower than the average annual

**ADARO’S OFFSHORE NETWORK:**

Moving vast amount of profit out of Indonesia (2009–2017)

- **1.** Coal is mined in Indonesia
- **2.** Some coal is sold and marketed in Singapore
- **3.** 90\% of profits (US$338 million) go to Mauritius
- **4.** Some of the profits are sent to a company based in Labuan (a Malaysian tax haven)
- **5.** The Labuan company invests in a mine in Australia

*Could this offshore network have helped Adaro pay up to US$125 million less tax in Indonesia?*
rate of 50.8 per cent that Adaro paid on its profits in Indonesia. Over 70 per cent of the coal sold by Coaltrade between 2009-17 came from Adaro’s coal mining subsidiaries in Indonesia. If the commissions for selling Adaro’s Indonesian coal had been taxed in Indonesia at the higher annual average rate, rather than being taxed in Singapore, then Indonesia might have collected up to US$125 million more in corporate income tax between 2009 and 2017, or nearly US$14 million a year. Global Witness asked Adaro to comment on this point but received no reply.

There are non-tax reasons for a coal marketing operation to be based in Singapore, which is an established trading hub for commodities. However, the very wide gap between Adaro’s tax rate in Indonesia and Coaltrade’s tax rate in Singapore makes it reasonable to believe that the payment of these commissions from Indonesian-mined coal also served to ensure a greater amount of Adaro’s profits were booked in Singapore, rather than in Indonesia, where more tax would likely have been payable on them. Given that, it is likely this will have had the effect of reducing the amount of Indonesian tax that Adaro might otherwise have paid.

Global Witness asked Adaro to comment on the point that had it not structured its business in this way Indonesia might have levied significantly more tax on it, and also whether it had a tax ruling or other official endorsement from the Indonesian tax authority which showed that the latter had approved the level and scope of these commissions paid to Coaltrade. Adaro did not provide an answer to either of these points.

A tax authority in another country has taken issue with how Singapore has been used as a sales and marketing hub. Two giant Australian extractive companies, BHP Billiton and Rio Tinto, have been challenged by the Australian tax authority in respect of their profits in Singapore.

BHP said in November 2018 that it had paid an extra 529 million Australian dollars (approximately US$374 million) in tax in Australia to settle the dispute, without making an admission of tax avoidance. Rio Tinto has set aside US$380 million in provisions – money that might have to be paid out at a later date – and some or all of this money is related to the ongoing Australian tax dispute.

**ADARO GOES FURTHER OFFSHORE**

Some of Coaltrade’s profits in Singapore have flowed even further offshore, to the Indian Ocean tax haven of Mauritius.

Adaro now controls a group of offshore companies with nearly a billion US dollars’ worth of assets. This group consists of Arindo Holdings in Mauritius, which owns Vindoor Investments, also in Mauritius, which owns Coaltrade in Singapore. The group had only 22 employees as of mid-2017, most of whom worked for Coaltrade, which suggests that its other companies exist primarily to hold assets and funds, rather than to carry out any service or function that requires staff.

Between 2009 and 2017 more than 90 per cent of Coaltrade’s net profits, totalling US$338.5 million, were paid in dividends to Vindoor. It is not clear where these profits ultimately ended up after being paid on to Vindoor, as Vindoor does not publish its
Mauritius, the Indian Ocean island where Adaro Energy has two subsidiaries in its offshore network © Getty Images/DeAgostini

accounts and not all of Arindo Holdings’ accounts are available online (companies are not required to publish any or all of their accounts in Mauritius). Neither company appears to have paid tax in Mauritius until at least September 2017, after which Arindo changed the status it held under local corporate law, in order to raise capital and become listed on the stock exchange of Mauritius, and it appears will now be subject to a maximum tax rate of 3 per cent.22

Arindo Holdings does not appear to have paid any dividends to Adaro since at least 2015, which implies that these profits from Coaltrade may have stayed offshore rather than flowed back to Indonesia and been taxed there.23 When Global Witness asked if that was the case, Adaro did not confirm or deny it.

In 2017 a new company was added to this offshore group: Adaro Capital in the Malaysian tax haven of Labuan. Coaltrade has reported paying US$31 million in cash to acquire Adaro Capital but not who it was acquired from.24 Adaro Capital will “mainly conduct treasury activities for investment in financial instruments,” according to Arindo Holdings, and is intended to “make a significant contribution to the Adaro Group’s earnings.”25 In other words, this company will be making investments for Adaro, which has chosen to conduct this further activity from a tax haven rather than Indonesia. Global Witness asked Adaro if one of the main purposes of setting up the company in Labuan was to avoid tax that might otherwise have been paid in Indonesia, but they did not respond.

Adaro’s Labuan subsidiary Adaro Capital now owns part of the Kestrel coal mine in Australia. In March 2017, it jointly acquired Rio Tinto’s 80 per cent stake in this mine with an investment partner for US$2.25 billion.26

The holding of this asset and potential future assets offshore could be cause for concern in Indonesia. It is common for mining assets to be owned by holding companies in tax havens and this can often ensure their ultimate owners pay less tax at home on the profits earned by an asset or on the capital gains which can be made if that asset is sold. Global Witness asked Adaro whether it expected to pay Indonesian tax on any profits or capital gains from Kestrel. Adaro did not respond.

In summary, Adaro has earned significant profit from trading coal mined in Indonesia in the low-tax jurisdiction of Singapore, rather than in its home country of Indonesia, and moved some of this profit to related companies in Mauritius where it appears not to have been subject to tax until 2017/18. If these activities had been carried out from Indonesia and taxed there at the same average rate as its parent company, Indonesia might have collected up to another US$125 million in corporate income tax between 2009 and 2017. Adaro’s network of offshore companies has also grown in size. It has established and maintained subsidiaries in other low tax jurisdictions, with the recent addition of a company based...
in the low tax jurisdiction of Labuan, through which it now holds a major investment in Australia.

This raises serious questions about whether one of the main purposes of both its activities in Singapore and its establishment and maintaining of subsidiaries in Labuan and Mauritius was to avoid tax which might otherwise have been payable in Indonesia. Global Witness put this to Adaro, however, it chose not to confirm or deny this.

**RECOMMENDATIONS**

The problems of climate change and air pollution from coal has led to governments around the world rejecting coal, with an increasing number announcing plans to scale it down or phase it out completely. This government action combined with other reputational risks associated with coal has led to an accelerating withdrawal from funding the coal industry by banks and other financial institutions.

In February 2019, the Institute for Energy Economics and Financial Analysis published research showing that global capital is “fleeing the coal sector at an alarming rate,” with over one hundred global financial institutions exiting coal, and banks, insurers or lenders announcing new restrictions on average every two weeks.

The findings in this briefing offer yet another reason why the Indonesian government and its citizens should be concerned with the plans to expand the industry by building substantial numbers of new coal-fired power stations. At the same time as one of Indonesia’s biggest coal companies stands to benefit from government guarantees to build what will be the biggest coal power station in the country, the same company is also using an expanding offshore structure which is likely to reduce the amount of profits which might be subject to Indonesian tax and contribute to the country.

In particular, Global Witness recommends

**THE INDONESIAN GOVERNMENT SHOULD:**

1. Refer all matters raised in this briefing to the Indonesia tax authority to review.
2. Drastically reduce the number of coal-fired power stations planned in the rolling ten-year electricity generation plan (RUPTL). This should be reviewed and announced as soon as possible and implemented in the 2020 update to the rolling ten-year plan.
3. Create a comprehensive plan for an energy transition away from coal in Indonesia, towards renewable energy, in line with the Paris Agreement goals that the world’s nations have agreed to.

**PRIVATE AND PUBLICLY-OWNED BANKS AROUND THE WORLD SHOULD ADOPT COAL POLICIES THAT:**

1. Exclude project finance for new coal mines and coal-fired power plants in Indonesia.
2. Exclude general corporate financing and advisory services to Indonesian companies that are highly dependent on coal power.27
3. End all their exposure to Indonesian companies involved in coal, creating a time bound plan to achieve this.

www.globalwitness.org
4 Press release “Appreciation and Award 2019 Taxpayer (March 2019)”, www.adaro.com
6 To qualify to become a “golden taxpayer” a company must:
   i) submit tax returns in a timely manner;
   ii) have no tax arrears for all types of taxes, except when they have a permit to pay tax in instalments or for taxes that have been postponed;
   iii) have financial statements audited with an unqualified opinion for three consecutive years; and
   iv) not have been convicted of a tax crime in the last five years.
7 World Bank. Country Partnership Framework for the Republic of Indonesia, For the period FY16-FY20. 3rd November 2015, P. 38. The tax to Gross Domestic Product ratio at that time was 10.9 per cent.
8 The Economist, “Indonesia’s tax amnesty passes its deadline” 30th March 2017. Indonesia-Investments.com, “Tax Amnesty Program Indonesia Ended, What Are the Results?”
10 Global Witness analysis of Coaltrade’s financial statements from 2007 to 2017. The latter is the most recent year for which financial statements were available, as of 22 May 2019. Although Adaro Energy had published its 2018 financial statement then, Coaltrade had not.
11 Ibid.
14 Between 2009 and 2017 the percentage of coal sold by Coaltrade was 72.8 per cent from fellow Adaro subsidiaries and 27.2 per cent from third parties. Between 2006 to 2008 it was 74.5 per cent from Adaro subsidiaries and 25.5 per cent from third parties. Adaro’s financial statements 2009 to 2017.
15 Coaltrade’s financial statements show that it paid a total of US$42.2 million in tax in Singapore between 2009 and 2017 (inclusive) on pre-tax profits of US$416.8 million. Global Witness has calculated how much tax might have been paid in Indonesia on the same profit, at the average rate of tax paid by Adaro on profits in Indonesia over the same period which was 50.8 per cent.
16 Ibid. 12.
18 Rio Tinto, Annual report for 2017, Note 9b.
19 Arindo Holdings (Mauritius) Limited, abridged unaudited financial statements for the quarter ended 30th September 2018.
22 Ibid. 20, Notes to the financial statements, Note 17. Arindo changed its status in Mauritius in September 2017 from a Global Business Category 2 company, which did not have to pay tax, to a Global Business Category 1 company which is subject to a maximum of 3 per cent tax on dividends and capital gains, Arindo Holdings, “Abridged Financial Statements 2017” P. 2, Background. The reason it gives for changing its status is to raise capital and list in Mauritius, P. 7.
26 Arindo Holdings. Notification for binding agreement in relation to acquisition of Rio Tinto’s 80 per cent interest in Kestrel coking coal mine. 29th March 2018. 27 Highly coal-dependent companies are defined as those where over 30 per cent of their revenues or energy mix comes from coal; and/or annual production, trading, or consumption of coal exceeds 20 million tonnes annually; and/or installed power capacity is greater than 10,000 MW; and/or the company is planning investments in new coal-related infrastructure. Such criteria are designed to ensure that highly diversified companies, who may fall below the 30 per cent threshold but who have large absolute exposures to coal, are still accounted for.