# INDONESIA

## Overview

**PB Taxand, Taxand Indonesia**

PB Taxand is a tax advisory firm based in Jakarta and Surabaya, which offers a full range of tax services that focus on multinational as well as local companies.

PB Taxand's team is equipped to assist in every aspect of transfer pricing services, ranging from (1) compliance and reporting; to (2) analysis, planning and strategy; and (3) disputes and controversy:

- Under compliance and reporting, we cover the preparation of transfer pricing country-by-country reports; master file; and local file documentation.
- With analysis, planning and strategy, we cover business restructuring, the setting up Transfer Pricing strategy, and the preparation of transfer pricing policy.
- With disputes and controversy, we cover assistance in transfer pricing audits; objections; appeals; judicial reviews; Mutual Agreements Procedures; and the prevention or resolution of tax disputes, by concluding unilateral, bilateral or multilateral APAs.

## General: Transfer Pricing Framework

**The Rule of Arm's Length Principle in Indonesia**

The arm's length principle is regulated in several domestic regulations in Indonesia, as follows:

- Income Tax Law

  The rule of the arm's-length principle is stipulated under article 18 paragraph 3 and 4 of the Income Tax Law No. 36 of 2008 ("Income Tax Law"). This law has undergone multiple amendments, with the most recent changes being incorporated in Law Number 7 of 2021 regarding the Harmonization of Tax Regulations.
- Value Added Tax Law on Goods and Services

  It is also stipulated in Article 2 of Law Number 8 of 1983, which refers to Value Added Tax on Goods and Services as well as Sales Tax on Luxury Goods, which has also undergone multiple amendments, with the most recent changes being incorporated in Law Number 7 of 2021 regarding the Harmonization of Tax Regulations.
- Government Regulation

  The arm's length principle is further regulated in Articles 32, 33, 35, 36 and 37 of Government Regulation No 55 of 2022.

**The rule of Transfer Pricing Documentation in Indonesia**

Under the Law No. 28 of 2007 of The Consolidation of General Provisions and Tax Procedures in the Article 28 stipulates that Taxpayers are required to maintain bookkeeping for general documentation.

Meanwhile, the Transfer Pricing documentation is stipulated under Article 10 of Government Regulation number 74 of 2011 ("GR 74").

## Transfer Pricing Regulation and Guideline in Indonesia

Minister of Finance provides detail regulation regarding Transfer Pricing under Minister of Finance Regulation number 172 of 2023 ("MOF-172).

MOF 172 combines all regulations related to transfer pricing in Indonesia, including related party definition and classification; the arm's length principle; Transfer Pricing Documentation; Primary adjustment and Secondary adjustment on Income Tax; Value Added Tax adjustment; Corresponding adjustment for domestic dispute remedy; advance pricing agreements ("APA") and mutual agreement procedure ("MAP").

Aside from the domestic regulations stated above, the Indonesian transfer pricing rules and the arm's length principle are generally in line with the OECD Guidelines.

The OECD Guidelines are not formally incorporated in Indonesian legislation; however, the ITO practically adopts the OECD TP Guidelines in TP regulations in Indonesia. The ITO also acknowledges the OECD TP Guidelines as an internationally accepted guide in providing explanations and clarifications on the (application of the) arm's length principle.

## Accepted Transfer Pricing Methodologies

Methods of transfer pricing at the implementation stage of the arm's length principle under the MOF-172 consist of:

a) Method of price comparison between independent parties (Comparable Uncontrolled Price method ("CUP"))

b) Resale Price Method ("RPM")

c) Cost Plus Method ("CPM")

d) Other methods, including:

   1) Profit Split Method ("PSM")

   2) Transactional Net Margin Method ("TNNM")

   3) Comparable Uncontrolled Transaction ("CUT") Method

   4) Method in Tangible Asset and Intangible Asset Valuation

   5) Business Valuation

If the CUP or CUT method and other methods offer the same reliability, the CUP or CUT are preferred over the other methods. If RPM/CPM and PSM/TNMM offer the same reliability, RPM/CPM are preferred over the PSM/TNMM.

For transfer pricing examinations, in line with the OECD TP Guidelines, ITO must begin by analyzing the approach of the Taxpayers, including the methodology selection. The taxpayer, however, must be able to substantiate the reason for the selected method, which is deemed appropriate in view of the relevant facts and circumstances.

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## Transfer Pricing Documentation Requirements

Article 28 of the Consolidation of General Provisions and Tax Procedures Law and Article 10 of Government Regulation 74 (GR 74) requires taxpayers to document all intercompany transactions to support its arm's length nature. The provision requires Indonesian taxpayers to document the transactions conducted with related parties, which includes both cross-border and domestic transactions.

With regards to the obligation to prepare Transfer Pricing Documentation, under MOF 172, MNEs and Domestic companies are obligated to prepare Master files and Local files and Country-by-country reports,  if certain threshold criteria are met.

However, the threshold criteria does not prevent the Tax office to examine the related parties transactions and issue assessment accordingly if found during examination that the transaction conducted are not according to the arm's length principle.

## Local Jurisdiction Benchmarks

Comparable selection depends on the applied TP method. For benchmarking purposes, the Taxpayers may use local and overseas comparables as long as they fulfill a sufficient level of comparability.

As there are limited number of local comparables published in the commercial database, ITO would accept an overseas comparable when applying the arm's length principle in Indonesia.

## Advance Pricing Agreement ("APA") Overview

Under MOF 172, the Taxpayer may submit a Unilateral APA, Bilateral APA or Multilateral APA application to the ITO for its related party transactions. APA may also be applied to domestic related party transactions in Indonesia. An APA can cover up to five years forward and Taxpayers may also apply for a rollback. The roll-back period is subject to approval from ITO and certain criteria such as: the requested roll back period is still within the statute of limitation; it has not been audited or if it is ongoing a tax audit process, then the audit has not been concluded; or such year is not subject to the criminal investigation.

Below are the requirements to apply for an APA.
A taxpayer must:

a) have fulfilled the obligation to submit its Annual CITR for three fiscal years prior to the fiscal year for which the APA is being applied;

b) have met and fulfilled the obligation to prepare and maintain Transfer Pricing Documentation in the form of master file and local file for three fiscal years prior to the fiscal year for which the APA is being applied;

c) not be subject to a criminal investigation or taxation criminal proceedings;

c) only include related party transactions that have already been reported by the Taxpayer in the Corporate Income Tax Return; and

e) apply the Arm's Length Principle to the related party transactions AND the application of the arm's length principle would not result in a situation where the operating profit of Taxpayer is lower than operating profit already reported in the Corporate Income Tax Return.

The implementation of the APA must be documented in the taxpayer's transfer pricing documentation on an annual basis

## Transfer Pricing Audits

TP audits are usually a part of a general tax audit or a specific audit for Income Tax or Value Added Tax. However, the ITO is currently very aggressive in analyzing intercompany transactions, especially with overseas related party transactions.

In practice, the ITO often focuses on the following conditions and specific transactions:

- Company that incurs a loss for several years or earns substantially low profit
- Special related party transactions, such as use of intangible assets, intragroup services, and intercompany loans

## Secondary Adjustment

Under the elucidation of article 18 paragraph 3 of Income Tax Law, the ITO will apply a secondary adjustment after the Primary tax adjustment during the tax audit. There is only a single treatment on the secondary adjustment, which is to treat as a deemed dividend, regardless whether the transaction is conducted with shareholder or other affiliated party as the counterparty.

## Corresponding Adjustment

MOF 172 introduces and also regulates the corresponding adjustment as domestic resolution remedy for Transfer Pricing adjustment. This serves as a prevention of double taxation domestically.

The corresponding adjustment may be applied for the Counter related party as long as the Audited taxpayer accept the Transfer Pricing Assessment conducted by the ITO, and surrender its rights to bring the disputed items to higher level (Objection).

To address Transfer Pricing dispute resolution for international transaction, the MAP may be utilized for corresponding adjustment.

## Hot Local Topics and recent Updates

Indonesia is a capital import country; therefore, there are many special transactions conducted by overseas head offices and/or regional hubs to their Indonesian subsidiaries.

Therefore, the use of intangible transactions, intercompany service transactions and intercompany loan transactions are often scrutinized by ITO.

### The Burden of Proof in Transfer Pricing: Theory versus Practice

The burden of proof in Indonesia is on the Taxpayer, due to the implementation of the self-assessment system.

However, during tax audits for Transfer Pricing, the Tax Office has the authority to implement Transfer Pricing adjustments through using either the Taxpayer's data that may be modified or the Tax Office's own comparable data. Therefore, in practice, the Tax Office has to prove that the arm's length principle assessment aligns with OECD guidelines and local regulations.

During the tax dispute resolution, both side will have to prove their argumentation and their belief on the implementation of arm's length principle from the Taxpayer's related party transactions.

## Documentation threshold

| Master File and Local File | Criteria to Prepare Master File and Local File |
|---|---|
| The Taxpayer has related party transactions with: | The Taxpayer has related party transactions with:<br>a. a gross revenue in the previous fiscal year of more than IDR 50 billion, or<br>b. a related party transaction amount in the previous fiscal year of:<br>- more than IDR 20 billion for tangible goods transactions; or<br>- more than IDR 5 billion for each provision of service, payment of interest, use of intangible goods, or other related party transactions, or<br>c. The related party is domiciled in a country or jurisdiction with a tax rate lower than the prevailing tax rate in Indonesia (the current tax rate in Indonesia is 22%). |
| CbCR | Criteria to Prepare Country-by-Country Reports<br>a. Consolidated group turnover on of at least IDR 11 trillion in prior year, or<br>b. A Taxpayer who is a member of a Business Group, with a parent entity that is a Foreign Taxpayer, is required to file a Country-by-Country Report if the country or jurisdiction where the parent entity is domiciled:<br>- does not require the filing of Country-by-Country Report, or<br>- does not have any exchange of tax information agreement with Indonesia, or<br>- has an exchange of tax information agreement, but the Indonesian Government does not receive the Country-by-Country Report from the related country/jurisdiction. |

## Submission deadline

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| Master file | It should be available within four months following the end of the fiscal year and submitted only if requested by ITO. |
| Local file | It should be available within four months following the end of the fiscal year and submitted only if requested by ITO. |
| CbCR report | Submission is within 12 months after the end of the fiscal year. |
| CBCR notification | Submission is within 12 months after the end of the fiscal year. |

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## Penalty Provisions

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| Documentation – late filing provision | The transfer pricing documentation must be submitted to ITO one month after the request for TP documentation is issued by ITO for Tax Audit process.<br><br>If the Taxpayer submits the transfer pricing documentation after the required timeframe, ITO may reject submission of the transfer pricing documentation and consider the Taxpayer does not comply with the regulation. The ITO will treat the late filing TP Documentation as other documents. |
| Tax return disclosure – late/ incomplete/no filing | The administrative sanction for late filing of annual corporate tax return is IDR1million.<br><br>If tax returns are deemed to be incomplete, ITO will request for the Taxpayers to amend the returns.<br><br>If Taxpayers fail to file a tax return, there will be a potential tax audit by ITO.<br><br>For tax assessment letter that resulted in tax underpayment, the underpaid amount is subject to a tax surcharge of Reference Interest Rate Issued Monthly by the Minister of Finance (MoF) plus uplift of 5% or 10% divided by 12 months for a maximum of 24 months, or a surcharge of 75%, depending on the case. |
| CbCR – late/ incomplete/no filing | Not filing CbcR will be subject to sanctions in accordance with applicable tax regulations. The penalty will follow the tax returns disclosure rule above. |


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