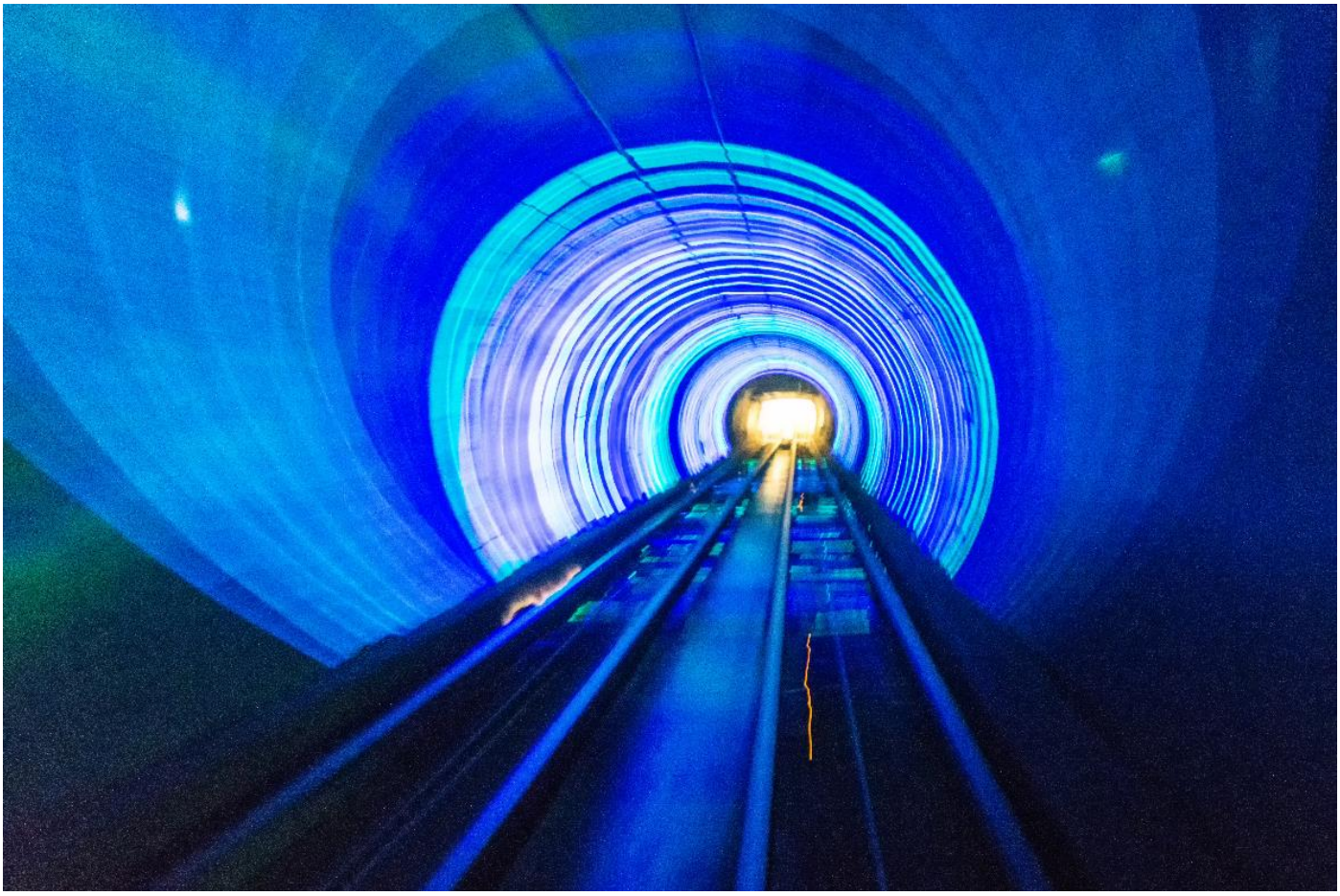

Indonesia Transfer Pricing Alert January 2024

Indonesia releases updated Transfer Pricing Guidelines

The much-anticipated updated Transfer Pricing Guidelines for Indonesia have been officially released through the issuance of Minister of Finance ("MoF") Regulation No. 172 of 2023 ("PMK-172") dated and effective as of 29 December 2023. PMK-172 consolidates various transfer pricing matters that were previously covered under separate regulations, including application of arm's length principle, transfer pricing documentation requirements, transfer pricing adjustments, Mutual Agreement Procedure ("MAP"), and Advance Pricing Agreements ("APA").

PMK-172 supersedes the previous regulations on transfer pricing documentation requirements, MAP, and APA, while reinforcing the provisions outlined in those prior regulations.

The enforcement of PMK-172 supersedes the previous regulations on transfer pricing documentation requirements[1], MAP[2], and APA[3] while reinforcing the provisions outlined in those prior regulations. This regulation has also been aligned with the Tax Regulations Harmonization Law (UU Harmonisasi Peraturan Perpajakan) and related implementing regulations.[4]

While PMK-172 will apply to all pending and ongoing MAP and APA applications, the transfer pricing documentation requirements will be effective from fiscal year 2024. The following sections provide an overview of the updated guidelines and highlights the key amendments introduced in PMK-172.

[1] MoF Regulation Number 213/PMK.03/2016 concerning The Type Of Documents And/Or Additional Information That Must Be Maintained By A Taxpayer Who Conducts Transactions With An Affiliated Party, As Well As The Management Procedures ("PMK-213") dated 30 December 2016.
[2] MoF Regulation Number 49/PMK.03/2019 concerning The Implementation Guidelines of Mutual Agreement Procedure ("PMK-49") dated 26 April 2019.
[3] MoF Regulation Number 22/PMK.03/2020 concerning The Implementation Guidelines of Advance Pricing Agreements ("PMK-22") dated 18 March 2020.
[4] Government Regulation Number 50 of 2022 concerning The Implementation of General Tax Provisions Law ("GR-50") dated 12 December 2022 and Government Regulation Number 55 of 2022 concerning the implementation of the Income Tax Law ("GR-55") dated 20 December 2022.

Application of arm's length principle

Expansion of scope of transactions subject to arm's length principle

PMK 172 clarifies the definition of "control" within the context of establishing a "special relationship" which includes both direct or indirect control, shared control through management or technology, the presence of common decision-makers, and commercial and/or financial affiliations.

PMK-172 mandates the application of the arm's length principle to the "transactions influenced by special relationship". The "transactions influenced by special relationship" include within their ambit not only the transactions between related parties, but also the transactions involving parties without a "special relationship" where the related party of one or both of the parties to the transactions determines the counterparty and the transaction price. The regulation does not provide examples of the latter type of related party transactions, but a typical example may include vendor contracts negotiated at the group level under which the Indonesian taxpayer also receives or provides goods/ services. While PMK-172 requires that both of these transaction categories to comply with the arm's length principle, interestingly, the regulation does not seem to require the latter to be included in the transfer pricing documentation, though the regulation allows authority in the Directorate General of Taxes ("DGT") to audit the compliance with the arm's length principle for all types of transactions influenced by special relationship.

Separately, PMK-172 also clarifies that the provisions relating to application of arm's length principle and the documentation requirement also apply to Permanent Establishments.

Reinforcement of *ex-ante* principle

"*Ex-ante*" principle was introduced in the Indonesian transfer pricing regulations in 2016 and it has sparked considerable debate regarding its implementation since then. PMK-172 reinforces the requirement to comply with the arm's length principle and states that the arm's length principle should be implemented and transfer pricing documentation must be prepared based on the data and information available "at the time the related party transactions are conducted."

With the continued focus of the DGT on the compliance with the *ex-ante* principle, it is important that taxpayers in Indonesia consider and comply with this unique requirement in their transfer pricing compliance.

PMK-172 introduces certain changes to Indonesian transfer pricing regime, including expanded definition of arm's length principle, reinforced ex-ante compliance, guidance on TP methods and comparability analysis together with substance check in testing ALP.

Additional guidance on transfer pricing methods and comparability analysis

Supplementary guidance has been included in this regulation on transfer pricing methods. Notably, methods involving the valuation of tangible and intangible assets, as well as business valuation, are acknowledged. It is however noted that the application of these methods must adhere to the relevant regulations, with the most recent being MoF Regulation No. 79 of 2023 as of the release of this alert.

PMK-172 further advocates use of traditional transaction methods (CUP/CUT[5], CPM[6], RPM[7]) over transactional profit methods (PSM[8], TNMM[9], etc.) in conducting a transfer pricing analysis. Nevertheless, the selection of the most appropriate transfer pricing method would depend on the accuracy and reliability of the method. New guidance on the application of profit split method has been incorporated while also clarifying the definition of 'unique and valuable contributions.' Under PMK-172, relevant profits to be split can be based on either gross profit or net operating profit.

On the comparability side, the regulation also clarifies that if there are more than one external comparables with similar comparability and reliability levels, the external comparables originating from the same country or jurisdiction as the tested party shall be selected and used as the comparables. It further requires the use of single-year comparable data for the analysis

[5] Comparable Uncontrolled Price / Comparable Uncontrolled Transaction
[6] Cost Plus Method
[7] Resale Price Method
[8] Profit Split Method
[9] Transactional Net Margin Method

on the arm's length basis, while also allowing use of a multiple year comparable data, provided that it is proven to enhance comparability.

Finally, PMK-172 expands the arm's length range definition to encompass full range, in addition to interquartile range. The full range is applicable when only two selected comparables are available, whereas the interquartile range can be utilized when there are at least three selected comparables.

Preliminary stage on the substance-check in the application of arm's length principle

PMK-172 provides guidance on the preliminary stage in the application of the arm's length principle which, in essence, seeks to evaluate the substance of the transaction/arrangement, including substantiation of their existence and benefits. The regulation provides guidance on the preliminary steps for service transactions, transactions related to the use or right to use intangible assets, financial transactions involving loan, other financial transactions, transfer of assets, business restructuring, and cost contribution arrangement.

In elucidating the substantiation of benefits, PMK-172 clarifies that such substantiation may be reflected in increased sales, cost reduction, safeguarding commercial positions, or fulfillment of other commercial activity needs, including efforts to generate, collect, and sustain revenue. In the context of service transactions, PMK-172 also clarifies the type of costs that are deemed as "shareholder activities".

If the taxpayer is unable to substantiate these conditions in the preliminary stage, the regulation states that the transaction/arrangement shall be deemed to be non-compliant with the arm's length principle and accordingly allows the DGT to re-determine the amount of income and/or deduction without further assessing its overall compliance with the arm's length principle.

The guidance on the preliminary stage reinforces the "substance over form" principle which should be the core of any transfer pricing analysis. It is imperative for the taxpayers to assess their transactions influenced by special relationship in light of the guiding principles provided in this regulation.

Transfer pricing documentation requirements

PMK-172 introduces additional mandatory information to be included in the Local File, such as factors to be considered in performing industry analysis, analysis on transaction conditions, and more detailed explanations on comparability analysis.

The regulation also introduces a strict timeline of one month for submission of the transfer pricing documentation (master file and local file) upon request from the DGT. Failure to comply may result in the transfer pricing documentation not being taken into consideration.

The regulation also introduces certain changes in the context of Country-by-Country Reports ("CbCR"). The criteria for CbCR filing by domestic taxpayers serving as the parent entity of a Business Group is changed to a consolidated gross turnover of no less than IDR 11 trillion in the tax year preceding the reported tax year, departing from the previous rule tied to the tax year in question.

Furthermore, PMK-172 has revised the gross turnover calculation method for CbCR purposes, specifying that it should include income derived from both business and non-business activities after deducted by sales returns, deductions, and cash discounts. In contrast, PMK-213 previously considered gross sales before factoring in discounts, rebates, or other deductions. In addition, the definition of the parent entity has shifted from being control-based to ownership-based.

Lastly, the foreign exchange reference date for determining the equivalent value in Euro of the parent entity's consolidated gross circulation shall be the currency rate as of 1 January 2023.

Secondary adjustment of deemed dividend and the Value Added Taxes (VAT)

In case there is a difference between the taxpayer's reported price/margin vis-à-vis the arm's length price, the said difference shall be treated as dividends and accordingly will be subject to secondary adjustments. These deemed dividends may arise either from the DGT's re-determination of income and/or deductions for the calculation of the taxpayer's taxable income or from the voluntary revision of Corporate Income Tax Return ("CITR") by the taxpayer. PMK-172 clarifies that the deemed dividend is subject to the withholding tax, whereby the taxpayer can still avail themselves of benefits under tax treaties to determine the rate.

PMK-172 emphasizes that both domestic and cross-border transactions subject to primary adjustment will undergo secondary adjustments, regardless the nature of special relationship between the transacting parties. Nevertheless, an exemption clause is provided, stipulating that secondary adjustment will not be applicable if:

a. there is an addition and/or repatriation of cash or its equivalent in the specified amount before the issuance of the tax assessment letter; and/or
b. the taxpayer agrees to the Transfer Pricing re-determination by the DGT.

The scope, procedure, and required evidence of cash repatriation is expected to be further regulated under a circular letter.

Repatriation as one of the mechanism to get relief from secondary adjustments.

In addition, the DGT is authorized to adjust the undervalued selling price or replacement value (with reference to reasonable market price) to compute the VAT payable for transactions influenced by special relationship. This adjustment can also ensue as a consequence of transfer pricing re-determination by the DGT. Importantly, this adjustment should not impact the VAT input of the counterparty buyer/service recipient, who would remain eligible for the input VAT as stated in the tax invoice.

Understandably, the secondary adjustment of deemed dividend and the VAT would be significant additional tax costs in situations where the DGT imposes transfer pricing corrections. While an exemption from secondary adjustment of deemed dividend on repatriation of funds relating to primary adjustment is a welcome move, the pre-condition of agreement with the DGT's transfer pricing corrections and the short timeline to bring in the funds (before the issuance of assessment letter) could potentially constrain the extent to which taxpayers can be benefitted from this new provision. In any case, it is imperative for taxpayers to meticulously plan and support their transfer pricing arrangements to avoid any transfer pricing corrections.

Domestic corresponding adjustment

In Indonesia, domestic transactions between two Indonesian related parties are also covered under the purview of transfer pricing. Any transfer pricing correction made by the DGT in the context of domestic transactions would typically result in double taxation hitherto in the absence of a mechanism for corresponding adjustment as generally seen under MAP in cross-border situations. In situations which involve double taxation arising from the DGT's re-determination of transfer prices through a tax audit on a resident taxpayer, the resident counterparty now has the option to avail domestic corresponding adjustment.

Domestic corresponding adjustment can be availed if the resident taxpayer, whose transfer prices has been re-determined by the DGT:

a. concurs with the DGT's adjustment; and
b. refrains from pursuing legal action against the tax assessment letter related to the adjustment.

PMK-172 introduces a notable change by allowing domestic corresponding adjustment.

PMK-172 further details the steps to be taken by the resident taxpayer and its resident counterparty to apply for the domestic corresponding adjustment. This adjustment will be executed through revision of CITR or the issuance/revision of tax assessment letters of the resident counterparty, depending on specific conditions outlined in the regulation.

While corresponding adjustment is an option made available under this regulation, it is vital to remember that taxpayers must agree with the DGT's adjustment to access this facility. In such case, the taxpayers should weigh their options and positions having regard to a thoughtful evaluation of the strength of their case considering legal and technical basis, supporting documents, legal avenue to be pursued and other factors depending on the circumstances.

Mutual Agreement Procedure (MAP)

PMK-172 reaffirms that in instances where the MAP process is concurrently pursued with domestic legal remedies, and if the MAP process fails to result in a mutual agreement by the time of the pronouncement of the appeal decision or Judicial Review, the DGT has the authority to:

- Continue negotiations if the disputed issue concluded in the appeal decision or Judicial Review decision does not pertain to the issue for which the MAP is pursued; or
- Refer to the appeal decision (if Judicial Review is not pursued) or Judicial Review Decision as the position in the negotiation or to terminate the negotiation if the case is related to the issue for which the MAP is pursued.

PMK-172 re-affirms that MAP should not postpone tax payment and collections, as well as refund for overpayment.

PMK-172 also reiterates the interaction between the MAP decision letter and domestic disputes decision letter(s) on the same disputed items. Furthermore, if a MAP Decision Letter is issued to the taxpayer after tax objection, appeal, and/or judicial review, the basis for imposing administrative sanction in the tax collection letter should consider the tax amount specified in the MAP Decision Letter.

While the previous regulation included a provision that the MAP does not postpone tax payments and collection, PMK-172 now clarifies that the MAP similarly should not postpone the refunds for tax overpayments.

Advanced Pricing Agreement (APA)

PMK-172 introduces the multilateral APA process in Indonesia's APA regime. As the name suggests, a multilateral APA typically involves multiple jurisdictions as part of the APA negotiation, and it is expected to require additional time in the negotiation process. The introduction of Multilateral APA provides a strategic option for taxpayer to preemptively address complex transactions as well as transfer pricing challenges across multiple jurisdictions, bolstering overall compliance and risk management.

In relation to the APA application submission timeline, in addition to the requirement of lodging the same 12 to 6 months before the fiscal year of the APA period begins, PMK-172 further clarifies the condition if the APA process is triggered by the counterparty's submission. In the latter case, the steps involving counterparty's APA application submission, treaty partner's Competent Authority's notification to the DGT, and the local taxpayer's APA submission must be submitted before the fiscal year of the APA period begins.

Additionally, for roll-back periods, PMK-172 makes the conditions more stringent. While the previous regulations debarred inclusion of fiscal years under investigation for tax crime or on which tax crime punishment is being served, the new regulation also debars those fiscal years which are under the stage of initial evidence examination, tax crime prosecution, or proceedings.

PMK-172 introduces Multilateral APA.

During APA materiality testing, under PMK-172, the DGT is authorized to request exchange of information from the counterparty, seek evidence/information from financial institutions or other entities, and request appraisals.

Furthermore, PMK-172 eliminates the administrative sanctions arising from the implementation of APA resulting from the revision of CITR and the issuance/revision of the tax assessment letter for the covered or rollback period(s). Whilst providing an elimination of the administrative sanction, PMK-172 highlights that the amendment to the CITR will be subject to a secondary adjustment, unless a cash addition/repatriation is carried out referring to the exemption clause of the secondary adjustment.

Key takeaways

Indonesia's updated transfer pricing guidelines present a comprehensive approach by consolidating various aspects of transfer pricing principles in a single regulation.

DGT's continued focus on the compliance with ex-ante principle, expanded scope of transactions subject to arm's length principle and the reinforcement of substance check as part of the preliminary stage, indicates DGT's expectation of a meticulous and well-supported transfer pricing analysis to be conducted by the taxpayers.

The secondary adjustments of deemed dividend and VAT are likely to add some burdens and tax costs for taxpayers facing disputes. In such case, the newly introduced avenues of corresponding adjustment and exemption from secondary adjustment of deemed dividend (subject to repatriation of funds relating to primary adjustment) are welcome moves and should be part of the considerations for taxpayers while assessing their options and dispute resolution strategies.

In conclusion, PMK-172 reflects the Indonesian government's effort and commitment to address some of the most controversial issues thus far and promote clarity and certainty. This brings in some new opportunities and few other challenges. Taxpayers are strongly advised to evaluate the implications of these new guidelines on their businesses in Indonesia to navigate this transformative regulatory landscape successfully.

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Contact Persons

Questions concerning any of the subjects or issues contained in this newsletter should be directed to your usual contact in our firm, or any of the following individuals:

Transfer Pricing
Roy David Kiantiong
National Transfer Pricing Leader
rkiantiong@deloitte.com

Transfer Pricing
Balim
Partner
bbalim@deloitte.com

Transfer Pricing
Shivaji Das
Senior Technical Advisor
shivdas@deloitte.com

Transfer Pricing
Sandra Suhenda
Partner
ssuhenda@deloitte.com

You may also get in touch with your usual contact in our firm, or any of the following Tax Partners:

Business Tax
Melisa Himawan
Tax Managing Partner
mehimawan@deloitte.com

Business Tax and M&A
John Lauwrenz
jlauwrenz@deloitte.com

Business Tax
Budi Prasongko
bprasongko@deloitte.com

Business Tax and International Tax
Cindy Sukiman
csukiman@deloitte.com

Business Tax and Business Process Solutions
Ratna Lie
ratnalie@deloitte.com

Business Tax
Hermanto Suparman
hsuparman@deloitte.com

Business Tax
Dionisius Damijanto
ddamijanto@deloitte.com

Business Tax
Roy Sidharta Tedja
roytedja@deloitte.com

Business Tax
Wisesasari
wisesasari@deloitte.com

Business Tax
Heru Supriyanto
hsupriyanto@deloitte.com

Business Tax
Reggy Widodo
rwidodo@deloitte.com

Global Employer Services and Business Process Solutions
Irene Atmawijaya
iatmawijaya@deloitte.com

Business Tax
Muslimin Damanhuri
mdamanhuri@deloitte.com

Business Tax, Indirect Tax and Global Trade Advisory (Customs)
Turmanto
tturmanto@deloitte.com

Global Employer Services
Sri Juliarti Hariani
shariani@deloitte.com

Deloitte Touche Solutions
The Plaza Office Tower, 32nd Floor
Jl. M.H. Thamrin Kav 28-30
Jakarta 10350, Indonesia
Tel: +62 21 5081 8000
Fax: +62 21 2992 8303
Email: iddttl@deloitte.com
www.deloitte.com/id