

Deloitte Indonesia  
Business and Industry  
Updates

Transfer pricing and the COVID-19 phenomenon:  
An Indonesian perspective



This article has been adapted from the original version which was published in the International Tax Review's World TP publication on 30 September 2020. It has been revised to take into consideration some recent developments, including the OECD Guidance on the Transfer Pricing Implications of the COVID-19 Pandemic and other relevant regulatory developments in Indonesia. To view the original article, please click **here**.

# A practical guide to navigating COVID-19 transfer pricing considerations in Indonesia

In the wake of the unprecedented disruption caused by COVID-19, this article offers a practical look at the impact of the pandemic on several transfer pricing aspects that Indonesian taxpayers should consider, as well as some practical steps that they can take to navigate these challenges.

COVID-19 has caused an unprecedented level of disruption to businesses across all sectors. Even amidst Indonesia's economic slowdown – its Gross Domestic Product (GDP) contracted by about 2.1% in 2020 – the government has needed to expend a significant sum totalling about IDR 215 trillion<sup>1</sup> to protect its people and business through improvements to the health care system and social safety nets, tax cuts and incentives, vaccination roll-outs, capital injections, and financing subsidies.

While these government assistance packages are much needed, they are likely to result in the inevitable ballooning of Indonesia's budget deficit. From a fiscal perspective, the government will therefore need to find ways to increase its sources of revenue, and tax enforcement is likely to become an important tool – particularly those relating to cross-border transfer pricing arrangements.

## A challenging transfer pricing landscape

Amongst the top concerns for many multinational enterprises (MNEs) are the implications of COVID-19 and its accompanying economic turbulence – including but not limited to funding or liquidity issues, supply chain disruptions, reduced demand, idle capacity, lockdown costs, and excess inventory – on the profit-and-loss (P&L) outcomes of their subsidiaries. From a transfer pricing perspective, this raises two important questions for MNEs with operations in Indonesia:

- How will the Directorate General of Taxes (DGT) assess the transfer pricing implications of losses incurred by subsidiaries?
- What steps can MNEs take to navigate any potential challenges arising from these transfer pricing considerations?

Given that profitability is a major consideration in the evaluation of arm's length pricing of related party transactions in Indonesia, any significant fluctuation in profitability levels is likely to invite detailed scrutiny. While the DGT is cognisant of the economic situation, it would be precarious to assume that it would accept generic arguments attributing significant variations in profit margins to the economic downturn.

In all likelihood, the DGT would be interested in understanding how specific areas of a taxpayer's business has been affected by the economic downturn, and how this impact translates into its financial performance. The onus will be on the taxpayer to explain their arguments and demonstrate them with sufficient evidence.

Apart from some guidance previously issued on Advance Pricing Agreements (APAs), the DGT has yet to release any formal announcement relating to how taxpayers should account for the impact of COVID-19 in their transfer pricing arrangements, or any explanatory notes on DGT's approach to scrutinising transfer pricing arrangements affected by COVID-19.

It can be reasonably expected, however, that the DGT's approach is likely to be broadly in line with the guidance issued by the Organisation for Economic Co-operation and Development (OECD) – which we will use as a reference point for the considerations set out in this article (see 'OECD's Guidance on the Transfer Pricing Implications of the COVID-19 Pandemic').

<sup>1</sup> Sri Mulyani Perkiraan Anggaran Kesehatan Bisa Tembus Rp 300 Triliun Tahun Ini'. KOMPAS.com. 4 August 2021.

# OECD's Guidance on the Transfer Pricing Implications of the COVID-19 Pandemic

In view of the practical challenges in the application of the arm's length principle as a result of the COVID-19 pandemic, the OECD published earlier in December 2020 its 'Guidance on the Transfer Pricing Implications of the COVID-19 Pandemic' ("OECD Guidance").

The OECD Guidance focuses on four priority issues reflecting the main challenges that MNEs encounter in complying with transfer pricing regulations amidst the pandemic:

## 1. Comparability analysis

Given the extenuating economic circumstances, the OECD Guidance recognises that the use of historical data for comparability analysis and price determination may no longer be practical nor reliable. It provides several examples of alternate approaches that taxpayers and tax administrations may consider adopting, including comparability adjustments, budgeted financial information, the use of multiple transfer pricing methods, price adjustment mechanisms built into transfer pricing policies, and reasonable commercial judgement.

In exercising reasonable commercial judgement, the OECD Guidance suggests that MNEs document the best available market evidence – including internal and external comparables specific to their industry or sector – to support them in evaluating the economic impact of COVID-19 on their value drivers, such as demand, production, and supply chain.

## 2. Allocation of losses and COVID-19 specific costs

The OECD Guidance outlines three main points with regards to the allocation of losses and COVID-19 specific costs:

- Firstly, the OECD Guidance reiterates existing guidance set out in the 'OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2017' (OECD TPG) stating that the allocation of risks between parties essentially drive the allocation of losses.

- Secondly, the OECD Guidance reiterates the basic principle that the allocation of costs should be based on an assessment of how independent enterprises operate under comparable circumstances. Additional considerations in this regard include the operating and non-operating nature of such costs, and any potential adjustments that may need to be made for exceptional costs to improve the comparability analysis.
- Lastly, the OECD Guidance emphasises the need to assess the options that are realistically available to the transacting parties in their application of force majeure clauses, revocation, or revision of intercompany agreements, and determination of the allocation of losses and COVID-19 specific costs.



One area of much debate, however, is the allocation of losses for entities operating under limited risk arrangements. For such entities, the question remains as to whether they should be required to shoulder losses suffered by the group.

The OECD Guidance acknowledges that because the functions performed by these limited risk entities, as well as the assets used and risks assumed by them, vary from case to case, it will not be possible to establish a general principle requiring them to bear or not to bear losses. In all circumstances, it will be necessary to consider the specific facts and context when determining whether or not a limited risk entity should incur losses at an arm's length.

In this regard, the OECD Guidance reiterates the principle set out in the OECD TPG stating that "simple or low risk functions in particular are not expected to generate losses for a long period of time". This implies the possibility for simple or low risk functions to incur losses in the short term, and ultimately brings us back to the basic principle that the allocation of risks between parties should essentially drive the allocation of losses.

The OECD Guidance also cautions tax administrations to carefully consider the commercial rationale for any purported change in risks assumed by a party before and after the outbreak of the COVID-19 pandemic. In particular, it would be unreasonable for a limited risk entity that had been historically entitled to limited returns to now assume risks and be allocated a share of losses.

### 3. Government assistance programs

Government assistance programs refer to monetary or non-monetary programs where a government or other public authority provides a direct or indirect economic benefit to eligible taxpayers. Such programs could take the form of grants, subsidies, forgivable loans, tax deductions, or investment allowances.

The OECD Guidance points out that because COVID-19-related government assistance programs may potentially offset quantifiable risks, they should be taken into account in the transfer pricing analysis. The relevance and impact of government assistance on controlled transactions and comparability analysis should be determined in consideration of various factors, including the extent to which the government assistance is an economically relevant characteristic or can be qualified as a local market feature, its potential impact on the pricing of a controlled transaction, and any potential modification of the allocation of risks in a controlled transaction.

### 4. APAs

APAs are agreements signed between taxpayers and their tax administration on intercompany pricing policies for future periods that are based on historical economic conditions and comparability analysis. With COVID-19 resulting in material changes to the economic conditions assumed under APAs covering FY2020 and subsequent periods, there is the need to determine the extent to which this will affect the application of existing APAs.

Generally, APAs contain critical assumptions about the operational and economic conditions that would determine or influence the basis of the agreement with respect to covered transactions. There is therefore the possibility that material changes to economic and market conditions following the COVID-19 outbreak may have resulted in potential breaches of some critical assumptions.

However, as the pandemic's impact may vary significantly depending on the industry or sector in question, the OECD Guidance emphasises that any assessment of potential breaches in critical assumptions should be done on a case-by-case basis, taking into account the individual circumstances of the taxpayer and their commercial environment.

The OECD Guidance also provides guidance on how taxpayer and tax administrations should respond to breaches in critical assumptions, including the necessary procedures to undertake and possible outcomes of revision, cancellation, and revocation of APAs.

For APAs that are currently under negotiation, the OECD Guidance encourages taxpayers and tax administrations to adopt a flexible and collaborative approach in determining the impact of current economic conditions. It suggests considering several practical measures, such as agreeing to a short-term APAs, conducting annual analysis and reporting of the COVID-19 impact, and term-testing for the entire period covered under the APA.

# Key transfer pricing considerations

Based on the general direction set out by the OECD, we can expect that several transfer pricing aspects typically examined by the DGT in ordinary circumstances are likely to undergo even more detailed scrutiny in light of the current COVID-19 situation:

- **Business facts**

Discussions centred on the current business situation, industry-specific economic circumstances, risk analysis, and contractual terms are expected to be at the forefront of any transfer pricing audit. Much of the business impact will likely depend on the industry or sector that the business is operating in, the nature of its business model, and whether its supply chain is global or local.

- **Group level impact**

The DGT is likely to be concerned with the impacts of COVID-19 on the group level – including its effects on the supply chain, group financials, and parent or principal entity's third-party buy and sell contracts – and how these cascade down into individual subsidiaries. To obtain financial, qualitative, and supply chain information about group companies, the DGT has also been increasingly leveraging the use of exchange information frameworks and other resources.

- **Limited risk entities**

Limited risk entities are likely to be subject to greater scrutiny, and any significant changes in their profitability levels will therefore need to be carefully analysed in consideration of the specific business facts, function and risk allocation matrices, pre-COVID-19 arrangements, and contractual terms.

- **Business restructuring**

As MNEs reorganise their business operations to adapt to the evolving circumstances, they should consider whether such reorganisation or right-sizing efforts and renegotiations may constitute a business structuring that would warrant an exit charge or indemnification.

- **APAs**

Indonesia's APA regulations require taxpayers who have signed APAs to prepare certain documentation on an annual basis to explain their compliance with APA terms. In view of the COVID-19 situation, it is therefore important for taxpayers to carefully evaluate whether they would be able to achieve the levels of profitability agreed under the APA. If the levels are found to be untenable given the breach of any critical assumptions – such as the assumption of a stable business environment – a review of the APA should be initiated as early as possible to avoid potential corrections.

Specifically, for the APA, the Indonesian government has issued guidelines for taxpayers whose businesses are negatively impacted by COVID-19 pandemic. The guidelines require taxpayers to provide an explanation of how and the extent to which the business' P&L has been impacted, and a reconciliation of this impact with financial projections.

This would entail a presentation of the P&L projections for the period covered under the APA, as well as adjusted financial projections to align with normal operating conditions, in the following prescribed format: a side-by-side comparison of projected financials and adjusted numbers; and explanations of adjustments made at each level for revenue, cost of goods sold, operating expenses, and other income/expense, where applicable.

- **Financing and liquidity**

Amidst falling market interest rates, the DGT is likely to intensify its focus on intercompany financing arrangements. To ensure that they reflect current market conditions and the costs that subsidiaries are paying for financing are arm's length, taxpayers may also need to revisit their financing arrangements.



# Preparing for a transfer pricing audit

As they prepare for a potential transfer pricing audit, taxpayers should consider some of the following actions:

- **Revisit transfer pricing arrangements and agreements**

Taxpayers may need to revisit their intercompany pricing policies and agreements to ensure that they are aligned with current market conditions. Here, the key is to critically evaluate how third parties would respond under similar circumstances, bearing in mind the financial impacts and legal implications for all parties involved, as well as the potential responses from tax authorities in the event of an audit.

Possible scenarios to consider could include a renegotiation of the remuneration model and intercompany agreements, or the invocation of force majeure clauses by contracting entities. In determining whether an invocation of the force majeure clause is permissible, an accurate delineation of the controlled transaction – one that takes into account not only the legal agreement, but also the conduct of all parties – will be required.

- **Build a robust defence file**

In anticipation of a transfer pricing audit, taxpayers should build a robust defence file with tangible and demonstrable facts, qualitative and quantitative analyses, and documentary evidence. Taxpayers should also identify and delineate specific areas of the business which have been affected by the pandemic and their corresponding impacts on financial statements. Rather than waiting for the statutory deadline to approach, taxpayers would also do well to consider developing this supporting transfer pricing documentation contemporaneously.

- **Conduct ex-ante analysis**

Indonesia's transfer pricing regulations emphasise the use of an ex-ante approach, that is, the use of data and information available at the time at which intercompany transactions are conducted. As a corollary, an acceptable technical approach could be to test transfer pricing policies and budgets, conduct detailed P&L analyses, and document the reasons for any deviation of results from budgets. These could be further supplemented with statistical analyses, such as linear regressions or Monte Carlo simulations, to extrapolate the inter-quartile range of comparable companies.

- **Tailor the documentation approach**

In situations where it is not be feasible to conduct the testing of transfer pricing policies, some economic adjustments – such as adjustments to capacity utilisation rates, working capital, foreign exchange losses, and other extraordinary costs – may need to be made to isolate the impact of the pandemic and derive the real operating profits.

Other examples of viable options also include:

- Using multi-year data: The use of multi-year data and averages helps to mitigate year-to-year accounting differences, and thereby ensure more accurate measurement of the test party's profitability based on its business and product life cycles, as well as greater reliability of comparative analyses conducted with comparables.

- Relaxing certain screening criteria: In some instances, it may be necessary to relax certain screening criteria; for example, loss-making comparables that satisfy the comparability data for a particular case should not be rejected solely on the basis that they are making losses in periods where they have been affected by the COVID-19 pandemic.
- Adopting a transaction-by-transaction approach: In some cases, a transaction-by-transaction approach may be deemed to be more appropriate for the testing of group level profitability than an aggregation approach.
- Re-evaluating transfer pricing method: If the impact of COVID-19 is significant, there may be the need to apply more than one transfer pricing method to corroborate the arm's length price for a controlled transaction.

- **Evaluate controversy management options**

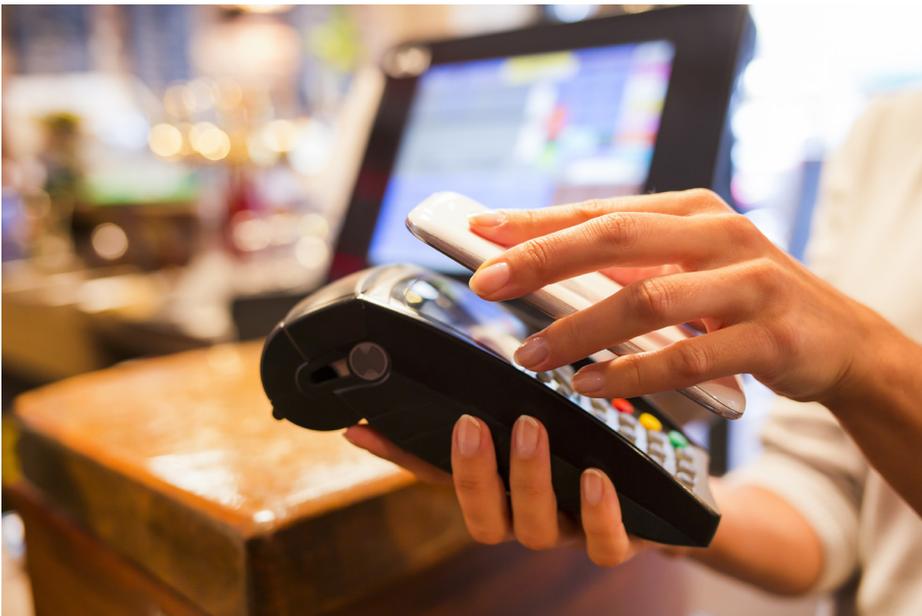
As taxpayers prepare for a transfer pricing audit, they should carefully evaluate their controversy management strategies. While the domestic appeal option is always on the table, it comes with the drawback of a potentially prolonged timeframe and possibility of litigation at the Supreme Court level.

To achieve higher levels of certainty, a forward-looking APA could prove to be a more efficient option in terms of time and cost. With Indonesia's recent efforts to strengthen its APA framework, APAs look set to become an even more attractive controversy management tool for taxpayers. Other options could also include the Mutual Agreement Procedure (MAP), which enables taxpayers to seek relief from double taxation in parallel to the domestic dispute process.

# No one-size-fits-all solutions

While the pandemic has raised many questions on transfer pricing, most – if not all – of its fundamental principles remain unchanged. In particular, transfer pricing remains grounded in the consideration of how independent parties can be expected to transact when put under similar circumstances. Ultimately, there are no one-size-fits-all solutions, and taxpayers

must tailor their defence strategy to specific facts within their context – all while bearing in mind the need to carefully weigh their options and maintain a delicate balance between their prior positions, present approach, and impact on the years ahead.



**Roy D. Kiantiong**  
**National Transfer Pricing Leader**  
Deloitte Touche Solutions  
rkiantiong@deloitte.com

**Shivaji Das**  
**Transfer Pricing Senior Technical Advisor**  
Deloitte Touche Solutions  
shivdas@deloitte.com

**Rahul Batheja**  
**Transfer Pricing Technical Advisor**  
Deloitte Touche Solutions  
rbatheja@deloitte.com

**Edwin Akbar Lubis**  
**Transfer Pricing Manager**  
Deloitte Touche Solutions  
elubis@deloitte.com

# Contact Us

**Claudia Lauw Lie Hoeng**

**Country Leader**

clauw@deloitte.com

**Melisa Himawan**

**Tax & Legal Leader**

mehimawan@deloitte.com

**Balim**

**Transfer Pricing Partner**

bbalim@deloitte.com

**Sandra Suhenda**

**Transfer Pricing Partner**

ssuhenda@deloitte.com

**Business Leaders**

**Elisabeth Imelda**

**Audit Leader**

Imelda & Rekan

eimelda@deloitte.com

**Rosita Uli Sinaga**

**Assurance Service Leader**

PT Deloitte Konsultan Indonesia

rsinaga@deloitte.com

**Edy Wirawan**

**Financial Advisory Leader**

PT Deloitte Konsultan Indonesia

ewirawan@deloitte.com

**Roy D. Kiantiong**

**National Transfer Pricing Leader**

rkiantiong@deloitte.com

**Shivaji Das**

**Transfer Pricing**

**Senior Technical Advisor**

shivdas@deloitte.com

**Brian Indradjaja**

**Risk Advisory**

PT Deloitte Konsultan Indonesia

bindradjaja@deloitte.com

**Iwan Atmawidjaja**

**Consulting Leader**

PT Deloitte Consulting

iatmawidjaja@deloitte.com

**Irawati Hermawan**

**Legal Leader**

Hermawan Juniarto & Partners

irahermawan@hjplaw-deloitte.com



Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited (“DTTL”), its global network of member firms, and their related entities (collectively, the “Deloitte organization”). DTTL (also referred to as “Deloitte Global”) and each of its member firms and related entities are legally separate and independent entities, which cannot obligate or bind each other in respect of third parties. DTTL and each DTTL member firm and related entity is liable only for its own acts and omissions, and not those of each other. DTTL does not provide services to clients. Please see [www.deloitte.com/about](http://www.deloitte.com/about) to learn more.

Deloitte Asia Pacific Limited is a company limited by guarantee and a member firm of DTTL. Members of Deloitte Asia Pacific Limited and their related entities, each of which are separate and independent legal entities, provide services from more than 100 cities across the region, including Auckland, Bangkok, Beijing, Hanoi, Hong Kong, Jakarta, Kuala Lumpur, Manila, Melbourne, Osaka, Seoul, Shanghai, Singapore, Sydney, Taipei and Tokyo.

#### **About Deloitte Indonesia**

In Indonesia, services are provided by Imelda & Rekan, Deloitte Touche Solutions, PT Deloitte Konsultan Indonesia, PT Deloitte Advis Indonesia and KJPP Lauw & Rekan.

This communication contains general information only, and none of Deloitte Touche Tohmatsu Limited (“DTTL”), its global network of member firms or their related entities (collectively, the “Deloitte organization”) is, by means of this communication, rendering professional advice or services. Before making any decision or taking any action that may affect your finances or your business, you should consult a qualified professional adviser.

No representations, warranties or undertakings (express or implied) are given as to the accuracy or completeness of the information in this communication, and none of DTTL, its member firms, related entities, employees or agents shall be liable or responsible for any loss or damage whatsoever arising directly or indirectly in connection with any person relying on this communication. DTTL and each of its member firms, and their related entities, are legally separate and independent entities.