INDONESIA

TRANSFER PRICING LANDSCAPE

1983: Article 18 of the Income Tax law, 1983, allows the Director General of Taxation (DGT) to adjust taxpayer's related party transactions if they are non-arm's length in nature.

December 2007: Government Regulation No. 80/2007 provided that taxpayers engaging in transactions under common control must maintain documentation in order to adhere to the arm's length principle.

December 2010: The DGT issued many important transfer pricing regulations and guidelines as follows:

- Transfer Pricing Guidelines were introduced through Regulation No. 43/2010 (PER-43/PJ/2010), as (further amended by DGT Regulation No. 32/2011 (PER-32/2011))
- Mutual Agreement Procedure (MAP) was introduced through Regulation No. 48/2010 (PER-48/PJ/2010).
- Advance Pricing Agreement Procedures were introduced through Regulation No. 69/2010.

December 2015: Guidelines for the establishment and implementation of APA were introduced through Regulation No. 7/PMK.03/2015.

Introduction

Article 18(3) empowers the DGT to re-determine the amount of taxable income and deductible expenditures for transactions between taxpayers where a 'special relation' exists.

Transfer pricing provisions are applicable to domestic transactions, only for taxpayers that are subject to different tax rate regimes.

Furthermore, PER-43/PJ/2010, as (further amended by PER-32/2011) provides guidance on documentation requirements and insights on specific requirements with respect to the arm's length standard from an Indonesian transfer pricing perspective.

OECD Guidelines

Indonesia is not a member of the Organisation for Economic Co-operation and Development (OECD), although it has been granted 'enhanced participation' status. Indonesian transfer pricing guidelines reconfirms the basic transfer pricing concepts and principles of the OECD Guidelines.

Related party

According to the guidelines, a special relation is deemed to exist when:

- A taxpayer has a direct or indirect ownership of 25% or more capital in another taxpayer or two or more other taxpayers
- The taxpayer controls (directly/indirectly) another taxpayer or where two or more taxpayers are under common control
- Family relationship by blood or marriage.

Arm's length principle

The arm's length principle can be implemented using the following steps:

i. Perform a comparability analysis for identifying comparables

ii. Determine the most appropriate transfer pricing method

iii. Apply the arm's length principle to the tested transaction based on the result of the comparability analysis and the selected transfer pricing method

iv. Document each step of the process used to determine the arm's length price or profit.

Transfer pricing documentation

Exemptions and thresholds

- **Thresholds:** Preparation of transfer pricing documentation is mandatory whenever related party transactions are in excess of IDR 10 billion (approximately USD 769,000). However, this threshold applies to the **total value of all transactions with a single related party.**
- **Exemptions:** There are no excluded transactions. However, tax authorities have the power to impose taxes based on deemed profit for certain industries (marine, aviation, oil and gas, foreign representative offices, etc.) where it may be difficult to establish the actual profit range.

No specific format has been prescribed for documentation but it should include the following information.

- Detailed description of the tested party (organisation structure, operational aspects, competitors, description of business environment, ownership structure, etc.);
- Pricing policies and/or cost allocation policies;
- Results of comparable analysis on characteristic transaction, results of functional analysis, economic conditions, agreements and business strategy;
- Comparability analysis, selection of comparables; and
- Application of transfer pricing methods selected by taxpayers along with reasons for rejecting other methods.

The record keeping i.e. retention of the documentation should be made for up to 10 years.

Submission of documentation

The taxpayer is required to indicate if they have prepared the transfer pricing documentation while filing Income Tax Returns in Form 3A/3B.

Taxpayers are not required to submit documentation on an annual basis. However, it needs to be submitted to tax authorities within seven days of the request, though the regulation provides for time up to 30 days from the day of request.

Selection of method

Guidelines do not give preference to any specific method or methods and the taxpayers are free to choose the most appropriate method, out of the **five** transfer pricing methods, based on the facts and circumstances of each case. Furthermore, PER-32/2011 has abandoned the hierarchy approach and adopted the most appropriate method approach in line with the OECD Guidelines.

Comparable uncontrolled price (CUP) is considered to be the preferred method by DGT.

Selection of comparables

Pan-Asian comparables are also accepted, if adequate domestic comparables are not available.

Certain specific transactions

Intra-group services

Taxpayers need to apply the 'Benefit Test' to substantiate that intra-group services actually received and the quantum of service charge is commensurate with the benefits derived.

Royalty

Taxpayers need to justify the existence of the intellectual property, its value in generation of profits to the licensee, the ownership of the intellectual property with the licensor and the arm's length nature of the royalty rate.

The DGT generally challenges the arm's length nature of royalty paid by the deeming licensee to be contract manufacturers.

Financial transactions

Thin capitalisation regulation is applicable (effective fiscal year 2016) through Regulation No. PMK 169/PMK-010/2015. The rules state that the maximum debt to equity ratio should be 4:1 and in the event of a taxpayer having zero balance of equity or less than zero, the entire costs of loan (i.e. interest expense) would not be deductible for tax purposes.

Reporting and compliance

Income tax return

An income tax return needs to be filed within four months from the end of the fiscal year. The details of a related party transaction such as the type of transaction, value of transaction, related party, transfer pricing method applied, reason for application of method, whether transfer pricing documentation is prepared, etc. must be disclosed with the annual corporate tax return.

Transfer pricing audit/assessment

The taxpayer is selected for assessments based on risk indicators, such as:

- Application of tax refund;
- A large number of related party transactions;
- Oil and gas and coal mining industry;
- Continuous operating losses;
- Related parties in tax havens;
- Significant related party transactions;
- An increase in gross revenue/receipts but no change in net profit;
- Reporting low profit compared to the industry average or that of other similar enterprises.

APA, MAP and Safe harbour provisions

No safe harbour provisions are available.

Unilateral and bilateral APAs are available. The roll-back provision is available only for one year, if that relevant year is not under assessment or appeal (Regulation PER-69/2010). Furthermore, for the formation and implementation of an APA, the Ministry of Finance issued PMK-7 (enactment date 12 April 2015). An APA is valid for three years (four years for bilateral APAs).

The following taxpayers can request for an APA:

- Indonesian entities that have operated for at least three years
- A Permanent Establishment (PE) that has operated for at least three years in Indonesia
- Foreign taxpayers that reside in tax treaty countries (through the respective country's competent authority).

APA is at a nascent stage and no APA has been concluded till date in Indonesia.

A taxpayer may also apply for a Mutual Agreement Procedure (MAP) within the time limit as may be applicable as per relevant tax treaty.

Penalties and other consequences of non-compliance

No specific transfer pricing penalties have been stated. However, inappropriate disclosure of information pertaining to related party transactions by a taxpayer in a corporate income tax return could lead to an administrative penalty of up to 400% of the unpaid tax and three months to six years of imprisonment if criminal action is involved. A penalty of 2% per month up to 48% shall be imposed on the underpayment of tax arising from adjustments to related party transactions based on the assessment.

Time limits to complete an assessment

There is no separate statute of limitation for transfer pricing, but an assessment must be concluded within five years of the relevant fiscal year.

BEPS/CbC applicability

The DGT has informally announced that it intends to implement CbC reporting, however, no formal regulations have been issued yet. The DGT is aware of the BEPS developments and is actively enforcing it in its transfer pricing rules and regulations.

SUMMARY OF TRANSFER PRICING REQUIREMENTS

Effective from	December 2010
Compliance requirements	• Transfer pricing documentation is mandatory for transactions with a total value of IDR10 billion (USD 740,000) or more. There are no exemptions and thresholds limits available. • Tax authorities have the power to impose taxes based on deemed profit for certain industries (marine, aviation, oil and gas, foreign representative offices, etc.). • Transfer pricing documentation required before submission of the Income Tax Return.
Penalties	No specific transfer pricing penalties, however inappropriate disclosure may lead to an administrative penalty of up to 400% of the unpaid tax and three months to six years of imprisonment in case of criminal actions.
Method and preference for comparable	Five methods as defined by the OECD without any hierarchy. Pan-Asian comparables also accepted, if adequate domestic comparables are not available.
Peculiar features	Comparable uncontrolled price (CUP) is considered to be the preferred method by the tax authorities.
Safe harbour and APA	No safe harbour provisions available. Unilateral (valid for three years) and Bilateral APA (valid for four years) are available. Roll-back provision is available only for one year and only if that relevant year is not under assessment or appeal.
BEPS/CbC applicability	No formal regulations for adoption of BEPS and CbC in place. However, there are certain measures being actively enforced in the transfer pricing rules and regulations in line with with BEPS and CbC.

*The conversion rate considered is as on 23 May 2016

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