The Transfer Pricing Law Review

Seventh Edition

Editors

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PREFACE

It has been a great pleasure to edit this seventh edition of *The Transfer Pricing Law Review*. This publication aims to give readers a high-level overview of the principal transfer pricing rules in each country covered in the *Review*. Each chapter summarises the country's substantive transfer pricing rules, explains how a transfer pricing dispute is handled, from initial scrutiny through to litigation or settlement, and discusses the interaction between transfer pricing and other parts of the tax code (such as withholding taxes, customs duties and attempts to prevent double taxation).

Other than Brazil, all the countries covered in this *Review* apply an arm's-length standard and adhere, at least to some extent, to the Organisation for Economic Co-operation and Development Transfer Pricing Guidelines (the OECD Guidelines); and Brazil itself is moving towards greater alignment of its TP rules with the OECD norm. However, as the chapters make clear, there remains significant divergence, both in countries' interpretation of the arm's-length standard (e.g., the transactions it applies to, the pricing methods preferred and whether secondary adjustments are imposed) and in the administration of the rules (e.g., the documentation requirements imposed and the availability of APAs). Therefore, transfer pricing practitioners cannot simply assume that the OECD Guidelines contain all the answers, but must engage with their detailed application within each country.

Given their economic importance, transfer pricing rules will be high on the corporate tax agenda (and the broader political agenda) for many years to come, and they are continuing to evolve at a rapid pace. Over the next few years, we expect the following to be among the main areas of focus.

First, as many of the chapters make clear, litigation over transfer pricing disputes is becoming ever more common. Some countries have a long record of transfer pricing litigation and have resolved many of the procedural hurdles in asking a court to rule on exactly where value is created in a multinational; for example, the approach to handling (often conflicting) expert evidence and the challenge of developing factual evidence in a proportionate but comprehensive way. However, this clearly results in lengthy – and costly – hearings before the tax tribunals and many other countries will soon find themselves grappling with transfer pricing litigation for the first time.

Second, the fact-heavy nature of transfer pricing disputes means that they often take many years to reach resolution; for example, the US Tax Court judgment in *3M*, published in February 2023, involved an appeal lasting 10 years, and the UK authorities have confirmed that it now takes five years to agree an 'average' advance pricing agreement, compared to under three years in 2018/19. This can make it difficult to ensure that accurate evidence is available – either because people have left the business or simply due to the vagaries of memory – and make it ever more important that high quality transfer pricing documentation is prepared in real time.

Third, in the *Fiat Chrysler* judgment, published in November 2022, the Court of Justice of the European Union appears to have rejected the European Commission's suggestion that there is an 'autonomous' EU arm's-length standard, holding instead that transfer pricing standards are set at the national level. (We are still waiting, however, for the Court of Justice to confirm whether this means that the €13 billion *Apple* case also needs to be decided against the Commission.) The *Fiat Chrysler* judgment reduces the ability of the European Commission to act as an additional transfer pricing watchdog, but also means that (pending any harmonisation through EU legislation) taxpayers will need to grapple with 27 separate transfer pricing regimes across the European Union.

Finally, the OECD/G20 project to address the tax consequences of digitalisation continues to progress. If it is ever implemented, which looks increasingly unlikely, Pillar One would mark a radical pivot away from the arm's-length standard for large and highly profitable multinationals, so that a portion of their profits (above a 10 per cent hurdle rate) would automatically be reallocated to market jurisdictions. The Pillar Two 'minimum tax' reforms are much more likely to be implemented; for example, the European Union has already adopted a Pillar Two Directive, and the first part of the UK Pillar Two rules is included in the Finance Bill currently before Parliament. Pillar Two, as merely a minimum tax measure, has a less radical impact on transfer pricing than the Pillar One proposals; nevertheless, there will be many issues to work through here in the future. For example, what happens if a transfer pricing adjustment in country A, after several years of debate, finally causes the group's effective tax rate in country A to increase above 15 per cent? Will any countries that have levied Pillar Two tax on the group, through the income inclusion or undertaxed payment rules, be obliged to reverse this Pillar Two charge?

We would like to thank the authors of each of the chapters for their comprehensive and illuminating analysis of each country's transfer pricing rules, and the publishing team at Law Business Research for their diligence and enthusiasm in commissioning, coordinating and compiling this *Review*.

Steve Edge and Dominic Robertson
Slaughter and May
London
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Chapter 5

INDONESIA

Cindy Kikhonia Febby and Veronica Kusumawardani[1]

I OVERVIEW

The legal basis for the arm's-length principle in Indonesia is provided in Article 18(3) of the Income Tax Law (ITL), where it states that the Directorate General of Tax (DGT) is authorised to recalculate taxable income or deductible costs in accordance with the arm's-length principle for taxpayers that have a special relationship with other taxpayers.

According to Article 18(4) of the ITL, the definition of 'special relationship' applies to circumstances where:

a a taxpayer owns directly or indirectly at least 25 per cent of the equity of the other taxpayer, or a relationship exists between two or more taxpayers through ownership of at least 25 per cent of equity of two or more residents;
b a resident 'controls' another resident or two or more residents directly or indirectly; or
c a family relationship exists through either blood or marriage, within one degree of direct or indirect lineage.

DGT Regulation PER-22/PJ/2013 regarding transfer pricing audit guidelines further specifies the types of transactions covered under Indonesian transfer rules, which include transactions on:

a sales, purchases, alienation and exploitation of tangible assets;
b rendering intra-group services;
c alienation and exploitation of intangible assets;
d loan payments of intra-group loans; and
e sales or purchases of shares.

The recent Ministry of Finance Regulation No. 22/PMK.03/2020 (MOF 22/2020) regarding advance pricing agreements (APA), in addition to regulation on APA procedures, mentions substantive provisions of the arm's-length principle, including an expansion of the transactions covered under Indonesian transfer rules that now also cover independent transactions that are affected by related parties. This is further strengthened by the issuance of Government Regulation No. 55 (GR 55/2022), which was published in December 2022.

In general, the Organisation for Economic Co-operation and Development Transfer Pricing Guidelines (the OECD Guidelines) have been adopted in Indonesian transfer pricing regulations; however, there are several principles related to specific circumstances that are not detailed in Indonesian regulations.

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The ITL also authorises the Minister of Finance to prescribe the expected ratio of a company's liabilities to its equity, which shall be valid for tax purposes. Furthermore, on 9 September 2015, the Ministry of Finance released Regulation No. 169/PMK.010/2015 (MOF 169/2015) regarding the ratio of debt and equity for income tax purposes. The regulation provides that the acceptable debt-to-equity ratio for Indonesian companies must not exceed 4:1, which means that this provision will deny the deductibility of the interest in connection with the portion of debt that exceeds the 4:1 ratio. In addition, debt-related deductions that could also be denied include fees and charges incurred in respect of the debt. Exclusions from the prescribed debt-to-equity ratio are provided for banks, financial institutions, insurance companies, mining companies, oil and gas companies under production-sharing contracts, taxpayers from the infrastructure sector and taxpayers subject to final income tax. GR 55/2022 has further expanded the authority for the Ministry of Finance to issue other interest limitation rules, including earning stripping rules (interest deduction linked to EBITDA ratio) and other unspecified methods.

II FILING REQUIREMENTS

Since tax year 2016, Indonesia has adopted a three-tiered transfer pricing documentation obligation, in line with agreed standards as set out in Action 13 of the OECD Base Erosion and Profit Shifting (BEPS) Action Plan. Transfer pricing documentation obligations are now governed under Minister of Finance Regulation No. 213/PMK.03/2016 (MOF 213/2016). Transfer documentation now consists of a master file, local file and country-by-country report (CbCR).

Master and local file documentation obligations are imposed on taxpayers that have related-party transactions in the current tax year and that meet the following criteria:

a taxpayers with a gross revenue of more than 50 billion rupiahs in the previous tax year;

b taxpayers with related-party transactions in the previous tax year exceeding 20 billion rupiahs or exceeding 5 billion rupiahs if the related-party transaction concerns intangible assets, services and interest payments; or

c if the related-party transaction is conducted with low-tax countries (i.e., jurisdictions with a statutory tax rate lower than 25 per cent).

Master and local files are not required to be filed at the same time as tax return filings. Reporting entities must, however, provide, along with their tax return, a checklist that confirms the availability of master and local files, including the date when this documentation could be made available. When requested by the DGT, reporting entities are required to file the master and local files within one month of the request.

CbCR reporting obligations are imposed on taxpayers that meet the following criteria:

a taxpayers that are considered the ultimate parent entity of a group with a consolidated gross revenue in one tax year of at least 11 trillion rupiahs;[2] or

b taxpayers that are not ultimate parent entities but are member entities of a group with an ultimate parent entity that is tax resident in a country that:
- does not impose an obligation to file CbCRs;
- does not have an exchange-of-information agreement with Indonesia; or

2 This is in line with the BEPS Action Plan 13 required minimum threshold of €750 million.

- despite having a CbCR reporting obligation and an exchange-of-information agreement in place with Indonesia does not make CbCRs available to the DGT.

CbCR reporting taxpayers or non-reporting taxpayers are all required to file an online notification to the DGT via an online platform. The online notification must identify which entity in the group has a CbCR prepared, including the country where this is submitted. In addition to the online notification, CbCR reporting entities must file the actual CbCR via the same online platform. Taxpayers that have completed the online notification or online submission of the CbCR will receive a receipt. This receipt must be filed along with the tax return.

To provide legal certainty of CbCR reporting obligations by domestic taxpayers that are not ultimate parent entities, the DGT will release a list of treaty partner countries that have a treaty in place containing an exchange-of-information clause, qualifying competent authority agreements (QCAA) and have a QCAA, but their CbCRs are unobtainable by the DGT. Upon the announcement of this list of countries, domestic taxpayers delegated with the CbCR obligation have three months to submit a CbCR. If within that period the taxpayer fails to submit a CbCR, the DGT shall send a formal request letter to the taxpayer and grant a 30-day extension as of the date of the request letter.

III PRESENTING THE CASE

i Pricing methods

In line with the guidance provided in the OECD Guidelines, Indonesia has adopted the 'most appropriate transfer pricing method' principle in selecting the transfer pricing method that will be used in analysing affiliated transactions.

There are six transfer pricing methods stipulated in Indonesia's transfer pricing regulations:

a the comparable uncontrolled price (CUP) method;
b the resale price method;
c the cost-plus method;
d the transactional net margin method (TNMM);
e the profit split method; and
f business valuation methods.

In general, both taxpayers and the DGT have a preference for applying the CUP method if an affiliated transaction is made in connection with the commodity sector. The CUP method is also generally applied in royalty and interest payment on loan transactions.

If the CUP method is not applicable, the taxpayers and DGT will usually apply the TNMM. The use of other traditional transaction-based methods, namely resale price method and cost-plus method, are rarely used in practice except in the case of internal comparables because of the limited availability of detailed gross margin data in commercial databases. The transactional profit method (i.e., profit split method) is also rarely used because of the extensive information requirements regarding the taxpayers' group as a whole. Generally, this is because multinational companies (MNCs) that run their business in Indonesia are subsidiaries, and thus the information concerning the MNC group as a whole is not owned by the subsidiary.

ii Authority scrutiny and evidence gathering

The DGT has specifically issued guidance on audits in relation to transfer pricing disputes.[3] One of the procedures that must be performed by the DGT in conducting transfer pricing audits is to identify the risks in the affiliate transaction performed by the taxpayers. In the risk analysis, the following parameters measuring the risk of transfer pricing are considered by the DGT:

a the significance of the affiliated transaction, measured based on it in proportion to sales or net profit;
b affiliated transactions with entities located in low-tax jurisdictions;
c specific affiliated transactions, such as the transfer of intangibles, payment of royalties, performance of intra-group services and payment of interest;
d the taxpayer's net profit being less than that of other companies in a similar industry;
e the significance of affiliated transactions that are not included in the taxpayers' net profit component, which could be measured based on the affiliated transactions considered in proportion to the taxpayer's net profit;
f interest expense;
g gain or loss on the sale of an asset;
h gain or loss from foreign exchange;
i non-routine affiliated transactions, such as business restructurings that involve or do not involve intangible assets, as well as sales of intangible property; and
j the taxpayer suffering losses for several years.

On 13 August 2018, the DGT issued Circular letter No. SE-15/PJ/2018 (SE-15) concerning tax audit policy. Pursuant to SE-15, various indicators are used in determining taxpayers to be included in the Audit Priority Target List with regard to transfer pricing issues. The following indicators are used:

a taxpayers that have transactions with affiliates that are subject to a zero or low effective tax rate;
b indications that a taxpayer is involved in a transaction scheme involving entities that do not have business substance or do not add economic value (reinvoicing);
c taxpayers that have significant affiliate transactions, particularly in relation to the value of sales;
d the existence of intra-group transactions such as the provision of services, payment of royalties, and cost distribution arrangements;
e the existence of business restructuring transactions such as mergers and acquisitions;
f the taxpayer's financial performance differs from the financial performance of the industry; and
g the taxpayer has had consecutive losses for three tax years out of the previous five years.

Since 1984, Indonesia has applied a self-assessment system in which taxpayers are required to calculate, pay and report their own taxes in accordance with prevailing tax laws and regulations. In connection with affiliated transactions, taxpayers are expected to prepare a transfer pricing report containing the information required by DGT. The role of the taxpayers

3 DGT Regulation PER-22/PJ./2013 and Circular letter SE-50/PJ./2013.

in any tax audit is to assist in the process by appearing for investigation and producing books of accounts, documents or other relevant records as requested by the DGT for inspection within the specified time limit.

The DGT starting point of analysis is based on the information provided in the transfer pricing documentation as prepared by the taxpayers. However, if taxpayers do not provide transfer pricing documentation and its explanation, the DGT may establish the facts and analysis based on information available to the DGT. If this is the case, the DGT has the authority to propose a transfer pricing adjustment by issuing an *ex officio* tax underpayment assessment letter, and the burden of proof is on the taxpayer to demonstrate that the assessment letter is incorrect.

IV INTANGIBLE ASSETS

According to Indonesia's transfer pricing regulation, the transactions involving intangible assets between related parties are considered to be at arm's length if:

a the utilisation of intangible assets has actually occurred;
b there is an economic or commercial benefit received by a licensee; and
c the royalty rate applied in related-party transactions should be comparable to the royalty rate applied in independent transactions in comparable circumstances.

In line with recent developments on the issue of transfer pricing on intangible assets, in practice, DGT also emphasised the analysis of the development, enhancement, maintenance, protection and exploitation (DEMPE) functions of intangibles. The party performing the DEMPE function in this regard shall be deemed as a party that is entitled to the remuneration of income derived from the DEMPE functions.

In identifying and determining which party performs the DEMPE functions, the DGT will generally consider which parties:

a booked research and development expense as well as marketing expense;
b performed research and development and marketing functions;
c had borne research and development risks as well as marketing risks;
d had employees or personnel with specific capabilities, employed in marketing or manufacturing functions, who contributed to the success of a product in the market; and
e had a distribution channel and customer list.

Furthermore, now, under PMK 22/2020, 'market access' or 'level of market share' is recognised as a comparability factor. This inclusion is arguably in line with the developments in the OECD BEPS project, which is a further step towards more market jurisdiction taxing rights. PMK 22/2020 has not, however, provided additional guidance, while further guidance is urgently needed to prevent multi-interpretation issues in practice.

Concerning the determination of arm's-length royalty payment for the licensing of intangibles, DGT and taxpayers commonly use the CUP method. However, in the application of the CUP method, both taxpayers and DGT face the same limitations regarding the availability of reliable comparable, including the comparability of the type of intangible itself and the exclusivity rights; therefore, in some cases of dispute resolution, the TNMM is also commonly used to confirm the application of the CUP method.

In addition, several other issues surrounding intangibles that often increase the risk of disputes between taxpayers and DGT concern the taxpayers who make royalty payments but recorded losses, or taxpayers who booked an increase in the rate of royalty payments.

V SETTLEMENTS

There are three instruments that may be used by taxpayers in transfer pricing disputes: APA, the mutual agreement procedure (MAP) and appeals to the Tax Court, which can extend to Supreme Court civil review requests.

The process of tax litigation in Indonesia takes 12 months each for objection and appeal, while civil review takes six months. However, in appeals and civil review processes, some periods can be longer than stipulated.

The MAP may be used by taxpayers as a form of alternative dispute resolution, in accordance with the rules contained in the tax-treaty clauses between Indonesia and the partner countries included in the transactions, and can be initiated by taxpayers or the DGT. As a general rule, the MAP process could be commenced if an action of the contracting state results or will result in taxation not in accordance with the provision of a tax treaty. In practice, taxpayers can initiate a MAP following the issuance of notification of a tax audit; therefore, the exhaustion of domestic dispute resolution remedies is not necessary to commence a MAP.

In domestic proceedings, it is possible to request the commencement of a MAP (i.e., a simultaneous MAP request) when the taxpayer is involved in a litigation process challenging the DGT in court (i.e., filing an objection or tax appeal). Pursuant to Law No. 7 of 2021, the MAP decision is considered the basis for tax returns or tax collection. This may be interpreted (pending to further implementing regulations) that the taxpayer can split disputes of one tax assessment letter (a tax assessment may contain tax audit findings related to transfer pricing, but also other issues) to be remedied through both MAP (findings related to transfer pricing) and the domestic resolution process (findings related to other issues).

In contrast, previously, if the Tax Court had decided on the appeal case, the DGT would have stopped the MAP process. After the issuance of Law No. 7 of 2021, the DGT can still continue the MAP process even though the Tax Court or Supreme Court decision has been issued. Any mutual agreement request does not postpone taxpayers' obligations to pay the assessed tax if they have received an assessment notice, regardless of whether they request a MAP.

Under the current MAP regime, the implementation of a MAP carried out through consultation between the Indonesian tax authorities and the authorities in a tax-treaty partner country may take a maximum of two years, commencing from the first consultation. It is not very clear whether this period may be extended following an agreement between the Indonesian tax authorities and authorities in the tax-treaty partner country if the MAP does not yield a mutual agreement. MOF 49/2019 states that if the time limit of negotiation is exceeded, then the DGT has the authority to terminate the MAP. MOF 49/2019 is now also complemented with implementing regulation in DGT Regulation No. PER-16/PJ/2020 that specifically governs the procedures to request MAP, DGT procedures in handling MAP requests, procedures to revoke MAP requests and procedures to implement agreed MAPs.

APAs can be concluded unilaterally or bilaterally, and, recently, also multilaterally under GR 55/2022. Unilateral and bilateral APAs can cover a period of up to five tax years. By MOF 22/2020, APAs can now also cover a rollback period for tax years that have not yet expired for assessment by the DGT (i.e., five years under the current regulations). In addition to MOF 22/2020, DGT Regulation No. PER-17/PJ/2020 has been intentionally enacted to specify procedures on application settlement, implementation and evaluation APA.

Multilateral APAs are presumably to accommodate the TNMM method in APA negotiations where the controlled transaction is with multiple-related parties in different jurisdictions.

VI INVESTIGATIONS

Tax audits concerning assessment of the arm's-length nature of related-party transactions falls within the normal tax audit procedure.[4] A tax audit is automatically triggered for taxpayers that file a tax return claiming a refund position. A tax audit may also be triggered as a result of risk profiling conducted by the DGT to identify transfer pricing risks. The risk profiling takes into account, inter alia, perpetual losses, significance of related-party transactions, transactions with low-tax countries and industry profitability benchmarks. Tax audits that include assessments on transfer pricing issues are conducted by the DGT through a field audit, which has a time limit of six months. This six-month period can be extended a maximum of three times.

During the tax audit process, the DGT has broad authority to request information. Taxpayers are required to provide the documents and information requested by the tax auditors within one month. Failure to provide the documents and information within this time limit may result in the tax auditor assessing tax liabilities on a deemed profit basis. If documents and information are not supplied within the one-month period, they cannot be used as evidence at a later stage.

Although tax audits are conducted in relation to overall tax compliance and not specifically subject to transfer pricing transaction, the DGT has issued audit guidelines specifically for transfer pricing.[5] The stated purpose of the audit guidelines is to provide 'simplicity and uniformity for the DGT in performing audits on taxpayers that have special relationships, to ensure the quality of the audit'. The audit guidelines serve as a best-practice toolkit for tax auditors, which is especially necessary since tax auditors throughout the country may have different levels of expertise in handling transfer pricing cases.

The audit procedure ends with a closing conference meeting. During closing conference stage, the tax auditor will provide the taxpayer with written notification of the tax audit findings. The taxpayer must state whether it agrees or disagrees for each item of audit findings. Taxpayers who disagree with the proposed tax audit findings can ask the regional tax office for quality assurance. The quality assurance procedure will re-examine the tax audit findings. The end result of a tax audit is an issuance of a tax assessment letter (or SKP letter). There are three types of SKP letter: the overpaid tax assessment letter (the SKPLB letter), the underpaid tax assessment letter (the SKPKB letter) and the nil tax assessment letter (the SKPN letter).

4 Ministry of Finance Regulation No. 17/PMK.03/2013 as last amended by Ministry of Finance Regulation No. 18/PMK.03/2021.

5 DGT Regulation PER-22/PJ./2013 and Circular letter SE-50/PJ./2013.

VII LITIGATION

i Procedure

Disputes will typically arise following the issuance of an SKP letter by the DGT with items of adjustments with which the taxpayer does not agree. A taxpayer who does not agree with a tax assessment letter can submit an objection to the tax office within three months of the issue date of the assessment letter. In accordance with the General Provisions and Tax Procedure Law, following receipt of an SKPKB letter, the taxpayer must pay at least the amount agreed during the closing conference before filing the objection. An objection decision letter must be issued by the DGT within 12 months; if a decision letter is not issued within 12 months, the objection is automatically deemed accepted in favour of the taxpayer.

The next stage of the dispute resolution process is the appeal (banding). Taxpayers who do not agree with an objection decision can file a letter of appeal to the Tax Court within three months of the receipt of the objection decision letter. To be eligible for the appeal to be heard at the Tax Court, the taxpayer must pay at least the tax due as agreed by the taxpayer during the closing conference. Therefore, if the taxpayer has not agreed to any items of the adjustments imposed during the closing conference, there is no obligation to pay tax before having the appeal heard by the Tax Court.

If it is deemed necessary, during the hearings in the appeal process, the Tax Court may (on the suggestion of either the DGT or the taxpayer) summon a third party before the court[6] and also allow the use of expert witnesses in the appeal process.[7] It should be noted that the cost incurred shall be borne by the party who suggests it.[8] Should there be conflicting testimonies, judges are free to examine and determine the weight of each testimony.[9] However, judges are endorsed to exhaust written evidence before turning to other forms of evidence such as testimony from expert witnesses.[10]

As Indonesia adopts a civil law system, the courts do not operate based on precedence and their decisions are not fully published. Instead, the Tax Court provides a summary of a Tax Court decision, which is available on its website.[11] However, the decision of the Tax Court is final with full legal force. The only legal remedy left for a taxpayer is to file a civil review request to the Supreme Court.

ii Recent cases

There are several common disputes in Indonesian transfer pricing. The first one is dispute of the bright-line test on marketing expenses. Tax Court Decision No. 009083.15/2019/PP/M.IB Year 2021 decided in favour of the taxpayer. DGT challenged the transfer pricing of the taxpayer by arguing that the taxpayer had performed marketing activities that enhanced the value of the trademark that is owned by its affiliate, and therefore the taxpayer should have been compensated by the trademark owner. The transfer pricing adjustment proposed by DGT is by not allowing deduction on the marketing expenses incurred by the taxpayer. The Tax Court decided that based on the applicable laws, DGT does not have the authority

6 Article 33(2) of Tax Court Law.

7 Article 69(1)(b) of Tax Court Law.

8 Elucidation of Article 33(2) of Tax Court Law.

9 Elucidation of Article 76 of Tax Court Law.

10 Elucidation of Article 69(1) of Tax Court Law.

11 Available at www.setpp.kemenkeu.go.id/risalah.

to propose transfer pricing adjustment on independent transactions because adjusted transactions, namely the marketing expenses, are independent transactions. In addition, the law only provides authority to DGT to propose transfer pricing adjustment on related party transactions, and therefore DGT authority is only limited to existing-related party transactions and does not extend to creating fictional-related party transactions that should have happened according to the DGT.

The second common dispute concerns the selection of the most appropriate transfer pricing method. DGT was of the opinion that cost-plus method was more appropriate compared to TNMM used by the taxpayer. Tax Court Decision No. PUT-096911.15/2012/PP/M.XVB Year 2020 agreed with the application of TNMM by taxpayer on the basis that there is limited reliable information in the database to ensure the comparability on gross profit level.

The third common dispute concerns the testing of commodity transaction. DGT applied transaction-by-transaction test on sales of taxpayer's palm oil to related party compared to the market price. However, the taxpayer used the combined method using the arm's-length range of market price in one year compared to the average sales price in one year. Tax Court Decision No. PUT-117593.15/2011/PP/MXVIA Year 2021 ruled in favour of the taxpayer citing domestic regulation and OECD Guidelines to use the combined method for commodity transactions under long-term contracts.

The last common dispute concerns transfer pricing adjustments in domestic transactions. On the basis of Decision No. PUT-000053.15/2021/PP/M.XIIIB/Year 2022, the Tax Court cancelled the proposed transfer adjustments by the DGT solely because the DGT had failed to follow up with a corresponding adjustment. According to the Tax Court, the absence of a corresponding adjustment, which is an obligation of the DGT and under the scope of authority of the DGT, had resulted in double taxation that was unfair to the taxpayer.

VIII SECONDARY ADJUSTMENT AND PENALTIES

The authority of the DGT to impose a secondary adjustment is now regulated specifically under Article 22(8) of PMK 22/2020. Stemmed from the concept of 'secondary adjustment' recognised in audit guidelines in connection with related-party transactions,[12] the provision states that 'excess profits by a transfer pricing adjustment that are not represented in the actual accounts of the Company will be treated as deemed dividend distribution'.

In practice, secondary adjustments are imposed on deductible payments to related parties (e.g., royalties and services), where the excess of the arm's-length amount will be considered as deemed dividends. The amount considered as deemed dividends is not deductible, while still subject to withholding tax at the applicable rates according to domestic tax law or tax treaties. Previously, the application of secondary adjustments by the DGT was quite rare in practice, but recently it has become increasingly common for transfer pricing adjustments to be followed by secondary adjustments. Another recent trend is for secondary adjustments to also be applied for VAT purposes (i.e., because, under domestic law, imports of services and royalties are subject to VAT, when imported services or royalties are adjusted for transfer

12 For reference, the concept of secondary adjustment is previously explained in DGT Regulation PER-22/PJ./2013 and Circular letter SE-50/PJ./2013.

pricing purposes by the DGT, the corresponding VAT cannot be credited as input VAT). However, the secondary adjustment provision is silent on whether such deemed dividend distribution is subject to the precondition of existence of a share ownership relationship.[13]

There is no specific penalty regime for transfer pricing. Penalties imposed as consequence of transfer pricing adjustments follow the general applicable laws on taxation.[14] In transfer pricing cases, generally, penalties are imposed when, as a consequence of a tax audit, an SKPKB letter is issued by the DGT. In this case, a penalty is calculated by the monthly interest rate stipulated by the Ministry of Finance and shall be imposed for a maximum of 24 months.[15] An additional 30 per cent penalty will apply if:

a the taxpayer files an objection;
b the taxpayer has not paid the underpaid tax prior to filing an objection; and
c the objection decision does not rule in favour of the taxpayer.[16]

A 60 per cent penalty will be applied instead of the 30 per cent penalty if:

a the taxpayer files an appeal to the Tax Court (after objection);
b the taxpayer has not paid the underpaid tax prior to filing an objection; and
c the Tax Court decision does not rule in favour of the taxpayer.[17]

Failure to maintain a transfer pricing documentation could be regarded as a failure to maintain appropriate bookkeeping. In accordance with the General Provisions and Tax Procedure Law, failure to maintain appropriate bookkeeping could be imposed with an additional 50 per cent penalty of the underpaid tax.[18]

IX BROADER TAXATION ISSUES

i Consecutive losses

Previously, consecutive losses experienced by the taxpayer were only regarded as one of several risk assessment factors for the DGT to supervise compliance. DGT Circular letter SE-15/PJ/2018 specifies that taxpayers with losses for three years in a row may be prioritised for investigation during the relevant years, whether in the form of supervision or audit.

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13 In contrast, the elucidation of Article 4(1)(g) Income Tax Law while recognising the concept of deemed dividends states that 'dividend is the share of profit received by shareholders'. In Tax Court Decision No. Put-58181/PP/M.IIB/13/2014, the Tax Court recognises deemed dividends to the indirect shareholder (grandparent company), thereby quoting the Income Tax Law. However, crucially to be noted here is that share ownership relationship is still required. Arguably therefore is whether deemed dividends could still be recognised for adjustment in transactions between entities under common control (sister companies) or transactions with independent companies influenced by special relationship, where no share ownership relationship exists at all.

14 For an overview of the general applicable penalty regime see the chapter on Indonesia by David Hamzah Damian and Ganda Christian Tobing in *The Disputes and Litigation Review* (Law Business Research, London: 2019) p. 18.

15 Article 13(2) General Provisions and Tax Procedure Law as the latest amended on Law No. 7 of 2021 concerning Harmonisation of Tax Regulations.

16 Article 25(9), ibid.

17 Article 27(5d), ibid.

18 Article 13(3), ibid.

Under GR 55/2022, consecutive losses are not merely a risk assessment factor but are now elevated to a standalone specific anti avoidance rule (SAAR). The occurrence of continuous losses for three years for taxpayers who have been in business for five years triggers the DGT authority to recalculate the taxpayer's taxable profit based on a benchmark with other taxpayers in the same industry. It is still unclear if this legislation functions as an independent SAAR or as a component of the transfer pricing regulation. Only transactions involving parties who are affected by a special relationship are covered by this new SAAR.

ii Double taxation

Taxpayers seeking to resolve double taxation issues as a result of transfer pricing adjustments can make use of MAPs. All Indonesian income tax treaties contain a MAP article, similar to that contained in the OECD and UN models, although without an arbitration clause (except in the case of the tax treaty with Mexico). The Ministry of Finance has issued detailed regulations on how taxpayers can apply for the MAP.[19]

There have been a number of tax cases that have been resolved through MAPs. Since 2017 (for reporting period 2016), Indonesia has released its MAP statistics through the OECD website, from which the latest report that can be accessed is MAP report for 2021.[20] The DGT has also recently launched a specific website for MAPs and APAs, containing a range of information on the procedural and regulatory aspects of MAPs and APAs in English, including the most recent statistics.

X OUTLOOK AND CONCLUSIONS

Indonesia is actively changing its regulations on transfer pricing to be more in line with the OECD BEPS package. As a result, transfer pricing documentation requirements in Indonesia have become more comprehensive and are now applicable to almost every taxpayer who is part of a multinational group. It is therefore expected that the role of transfer pricing documentation will become even more critical for the following year when the first tax audits under the new documentation rules will take place.

Taxpayers should consider transfer pricing documentation as the first line of defence in the event of an audit. Ultimately, robust transfer pricing documentation can serve well to reduce disputes with the DGT. A major change adopted in its approach to tax audits is the DGT's focus on inter-company pricing policies (*ex ante* approach), and not only on testing the arm's-length principle after the transaction has occurred.

Although the number of tax audits has remained high over the past three to four years, there is also a growing trend for APAs in Indonesia as a means of avoiding disputes or of reaching settlements. Although the APA programme is relatively new, the prospect for APAs is nevertheless promising, since it is reported that Indonesia has already successfully concluded many bilateral APAs with major trading countries.

It is further anticipated that Indonesia will continue to update its transfer pricing regulations; the latest update in PMK 22/2020 and GR 55/2022 has added significant, new concepts such as 'independent transactions influenced by special relationship' and 'market access' as comparability factors, but no further guidance on how to implement these new

19 MOF Regulation PMK-49/PMK.03/2019.

20 Available at http://www.oecd.org/tax/dispute/2021-map-statistics-indonesia.pdf (accessed on 23 April 2023).

concepts in practice has yet been issued. PMK 22/2020 has now also endorsed secondary adjustment but is silent on corresponding adjustments; additional guidance is especially needed for transfer pricing adjustment in domestic transactions. In practice, this has already resulted in many domestic double taxation cases: tax office A transfer pricing adjustment is not followed by tax office B as corresponding adjustment, even though tax office A and B are under the same DGT organisation. GR 55/2022, however, has expanded Indonesia's anti-avoidance rules to include a GAAR and other SAARs, including earning stripping rules and recalculation of taxable profits for taxpayers with consecutive losses.

The covid-19 outbreak and following pandemic have significantly accelerated Indonesian policymaking with regard to digital tax. Weeks before the outbreak, Indonesia was still talking about the importance of a global consensus in this area with the G20 and OECD.[21] A month later, ETT was introduced. However, the regulation has not yet been implemented because the US Trade Representative (USTR) has raised preliminary concerns that ETT is discriminatory, not in line with the international taxation principles and creates a burden for US commerce. On the basis of those grounds, USTR could potentially retaliate in the form of tariffs on Indonesian products.

However, VAT on digital transactions has also been introduced and is currently implemented without any significant interference. This is because, unlike with income taxes, there is already a general international consensus with regard to VAT, namely the 'destination principle'. As such, the newly introduced VAT on digital transactions could be viewed as an administrative breakthrough only, and not so much as a change in the allocation of taxing rights between countries.

With regards to the implementation of VAT on digital transactions, the Ministry of Finance Regulation No. 48/PMK.03/2020 (MOF 48/2020) was issued and governs procedures for appointing foreign or non-resident companies for collection and depositing, as well as reporting VAT on the use of intangible taxable goods or taxable services (or both) from outside the customs area but that is used within the customs area through electronic systems.[22]

In responding to the covid-19 pandemic, the government has taken several measures, including issuing numerous facilities and incentives[23] to stabilise the economy and community productivity, which have been greatly affected by the pandemic. The most recent incentive has been reinstated in Ministry of Finance Regulation No. 9/PMK.03/2021 (MOF 9/2021) regarding tax incentives for taxpayers who have been affected by the covid-19 pandemic.

Other than the pandemic, another issue that should be highlighted is the enactment of Omnibus Law on Job Creation that accommodates taxation matters. On the basis of Articles 111–114, the Act amended four taxation laws, namely the Income Tax Law, Value Added Tax, the Law on Goods and Services and Sales Tax on Luxury Goods, the Law on General Provisions and Tax Procedures, and the Regional Tax and Retribution Law. One of the fundamental provisions is the addition of an exemption for dividends in the case of significant shareholdings. The exemption applies as long as dividends are reinvested in the

21 See https://news.ddtc.co.id/kata-menkeu-g20-kebut-kajian-proposal-prinsip-untuk-pajaki-google-cs-19157.

22 Article 2 (1) (2) Ministry of Finance Regulation No. 48/PMK.03/2020 (MOF 48/2020).

23 Available at https://www.pajak.go.id/covid19.

territory of the Republic of Indonesia for a certain period of time.[24] The introduction of a dividend exemption regime will mean that Indonesia to a certain degree has moved from a worldwide-based income tax system into a partially territorial income tax regime.

On the BEPS Pillar Two front concerning a global minimum tax, Indonesia is still silent as to whether a qualified domestic minimum top-up tax will be introduced. The Indonesia government is still analysing the impact of Pillar Two implementation on Indonesian tax facilities.

24 Article 4(3)(f)(1) General Provisions and Tax Procedure Law as latest amended on Omnibus Law on Job Creation.