39.

Indonesia

Introduction

Indonesia has adopted the arm's-length standard for transactions between related parties. As the tax system is based on self-assessment, the burden of proof lies with the taxpayer, not with the tax authorities.

Statutory rules

For income tax purposes, the legislation dealing with transfer pricing is found in Article 18 of the 1983 Income Tax Law, as revised by the 1991, 1994 and 2000 Income Tax Laws and further by Income Tax Law No. 36/2008.

Article 18 states that the tax authorities may adjust a taxpayer's taxable income for related party transactions that were not carried out on an arm's-length basis. Related parties are deemed to exist in the following circumstances:

- Where a taxpayer directly or indirectly participates in 25% or more of the capital of another taxpayer, or where a company participates in 25% or more of the capital of two taxpayers, in which case the latter two taxpayers are also considered to be related.
- Where a taxpayer directly or indirectly controls another taxpayer or where two or more taxpayers are under common control.
- Where there is a family relationship by blood or marriage.

In September 2008, Parliament passed Income Tax Law No. 36/2008, which came into effect 1 January 2009. Article 18 (3) of the Income Tax Law provides that the five arm's-length pricing methodologies from the Organisation for Economic Co-operation and Development (OECD) Guidelines should be used to set or review transfer prices.

For value-added tax (VAT), a virtually identical provision is included in Article 2 of the 1983 VAT Law, as revised by the 1991, 1994 and 2000 VAT Laws and further revised by VAT Law No. 42/2009.

Other regulations

Government Regulation No. 80/2007, which was issued 28 December 2007 and effective from 1 January 2008, explicitly states that taxpayers engaging in transactions under common control must maintain documentation which proves their adherence to the arm's-length principle.

The 2007 tax administration law states that documents requested in a tax audit must be delivered within one month of the request. This could mean that transfer pricing documentation submitted after 30 days can be ignored.

In late 2010, the Indonesian Director General of Taxation (DGT) issued several important transfer pricing regulations, laying the foundation for a new era of transfer pricing development in Indonesia. The transfer pricing regulation, PER-43/PJ/2010 (PER-43), represents the first specific transfer pricing guidance to Indonesian taxpayers since transfer pricing documentation became mandatory 1 January 2008.

PER-43 was amended by PER-32/PJ/2011 (PER-32) on 11 November 2011 which provides additional guidance on comparability analysis required in the transfer pricing documentation, preference towards internal comparables over external comparables and application of the most appropriate method as compared to the hierarchical approach in selecting transfer pricing methodology under PER-43. The regulation also mentioned that PER-32 is only applicable to transactions exceeding 10 billion Indonesian rupiah (IDR) with a single related party. Domestic related party transactions are also covered in the purview of the transfer pricing (TP) regulation if the related parties are effectively not taxed on the same basis.

The above amendment was in addition to the regulations released in 2010 on the Mutual Agreement Procedure (MAP), PER -48/PJ/2010 (PER -48), and the Advance Pricing Agreement, PER-69/PJ /2010 (PER -69).

Implementation of arm's-length principle

PER-32 indicates that the arm's-length principle should be implemented using the following steps:

- Perform a comparability analysis and identify comparables.
- Determine the most appropriate transfer pricing method.
- Apply the arm's-length principle to the tested transaction based on the result of the comparability analysis and the selected transfer pricing method.
- Document each step of the process used to determine the arm's-length price or profit.

The regulation notes that taxpayers are not required to comply with these steps for transactions with related parties who earn income, or incur expenses, of less than IDR 10 million. In practice, not many taxpayers are able to take advantage of this exemption.

Selection of transfer pricing methods

PER-32 has abandoned the hierarchy approach and adopted the most appropriate method approach, though from a practical perspective, the DGT still considers the comparable uncontrolled price (CUP) to be the most preferred method. The selection of the most appropriate method requires the following considerations:

- The strength and weakness of each transfer pricing method.
- The appropriateness of the method based on the nature of the related party transaction, determined by a functional analysis.
- Availability of valid information (on independent transactions) to apply the selected method.
- The comparability level between related party transactions with independent transactions, including whether any appropriate adjustments would need to be made to eliminate any material differences between the compared transactions or enterprises.

Comparability analysis

The comparability analysis outlined in PER-43 which has been amended by PER-32, is based upon the five comparability factors contained in the OECD Guidelines. These are as follows:

- Characteristics of property or services.
- Functional profile of parties involved.
- Contractual terms.
- Economic conditions.
- Business strategies.

Guidance is provided on how each of these comparability factors should be analysed. The guidance is consistent with explanations of the comparability factors in the OECD Guidelines. It is common practice for regional benchmark studies to be leveraged in Indonesian transfer pricing studies.

The Indonesian TP regulation also provides detailed guidelines on assessing the arm's-length nature of intragroup services (IGS) and intangible property (IP) transactions. Rigorous tests must be applied in a hierarchical manner to prove the arm's-length nature of IGS and IP transactions.

Burden of proof

Indonesia operates on a self-assessment system, with companies setting their own transfer prices. The burden of proof lies with the taxpayer to prove that the original price has been set at arm's length. In a tax audit context, if a taxpayer does not have documentation to support its position, there is a high risk that the Indonesian Tax Office (ITO) will make substantial adjustments, such as the denial of all deductions for management services fees or royalties paid to related parties.

Tax audit procedures

Audits are a significant feature of tax administration in Indonesia because of the self-assessment system. For the years preceding 2007, the tax office has ten years (but no later than 2013) within which to audit and issue assessments (and additional assessments if new facts, previously undisclosed, are found). For the years from 2008 onwards, the time span for the issuing of underpaid tax assessment letters has been reduced to five years.

So far, the tax authorities have not undertaken any audits specifically relating to transfer pricing. Nevertheless, tax audits conducted in relation to overall tax compliance will invariably focus on inter-company transactions, especially transactions involving non-residents. Where there appear to be price discrepancies between intragroup transactions and third-party transactions, corrections of transfer prices will be included in the audit findings.

The ITO has been strictly enforcing the 30-day rule in tax audits. In practice, if a taxpayer has not prepared transfer pricing documentation prior to receiving a request in an audit, it is likely to find it difficult to provide a satisfactory response within the 30-day timeframe.

Tax audits are conducted through desk reviews as well as visits to company premises by the tax authorities. These may involve meetings or correspondence, and settlement of the transfer pricing audit may in many cases take place through formal negotiation and appeal at the tax court. The conduct of the taxpayer may influence the outcome.

The tax authorities also have the power to perform investigations. Investigations are generally used only where fraud or evasion is suspected. Experience has shown that the main trigger of an investigation by the tax authorities has been information obtained by them through their information network or provided to them by informants, such as disgruntled former employees.

Selection of companies for audit

Indonesia has an extensive system of tax audits. Taxpayers claiming refunds are automatically subject to tax audits. A tax return that indicates a loss generally also triggers a tax audit. In addition, the ITO has recently commenced a risk-profiling exercise designed to identify high-risk candidates for transfer pricing audits. Risk factors include losses (or poor profit performance compared to industry norms) and high volumes of related party transactions.

The provision of information and other duties of a taxpayer

The tax authorities have wide-ranging statutory powers to call for information relevant to an audit, such as accounting records, agreements, supporting documents and tax returns.

Tax objections and the appeals procedure

Tax auditors adjust related party transactions where they do not believe an arm's-length price has been used. Taxpayers have the right to object to assessments made by the tax office. The objection must be lodged in writing within three months of the issuance of the assessment and should be addressed to the DGT at the particular office from which the assessment was issued. The DGT has 12 months to issue a decision in relation to the objection.

Under the 2007 Tax Administration Law, which was effective from 1 January 2008 (and applies to tax years beginning on or after this date), taxpayers are required to pay only an amount agreed with the tax auditors during the tax audit's closing conference. If the taxpayer does not agree with any of their corrections, it need not pay anything at this point.

However, taxpayers need to take care when deciding how much to pay, because an unfavourable DGT decision on their objection results in an administrative penalty of 50% of the underpaid tax. The penalty increases to 100% if an appeal is lodged and the decision is not in the taxpayer's favour.

Taxpayers may appeal to the Tax Court against DGT decisions on their objections. To have the Tax Court hear the appeal, the taxpayer must pay 50% of the total tax assessment. There is uncertainty over the minimum amount to be paid for filing an appeal. According to the 2007 Tax Administration Law, the same rule should apply: taxpayers pay only as much as agreed in the closing conference. However, the Tax Court Law, which governs tax appeals, demands a minimum payment of 50% of the tax due. Notwithstanding the above, we note from some experiences of taxpayers, the court judges did not throw out taxpayers' cases on a technicality when the 50% minimum payments have not been satisfied.

Currently, the Tax Court gives taxpayers their best chance of receiving a fair hearing. If an appeal to the Tax Court is still unsuccessful, taxpayers can appeal to the Supreme Court, provided that certain criteria are met.

It is worth noting that Indonesia has a civil law system in which the courts do not operate on the basis of precedence and their decisions are not published. Furthermore, tax cases cannot be appealed beyond the Tax Court or Supreme Court or in any civil court other than the State Administrative Court. This court deals with complaints by persons adversely affected by government decisions and has rarely, if ever, been used in tax cases.

Tax penalties

Penalties of 2% per month are imposed for late payment of tax, up to a maximum of 48% of the unpaid tax. In criminal cases, fines of 200%-400% of the unpaid tax are possible, as is imprisonment.

A team within the central tax office specialises in transfer pricing issues. Generally, tax auditors who handle the day-to-day aspects of a tax audit are not transfer pricing specialists, although they usually have some training in the area. Transfer pricing related inquiries are undertaken by the relevant tax audit department, without assistance from external advisors.

Risk transactions or industries

There are no excluded transactions. For certain industries where it may be difficult to establish levels of actual profit arising in Indonesia, tax authorities have the power to impose taxes based on deemed profit. Marine or international aviation companies, oil and gas drilling companies, and foreign representative offices are included under this principle/regulation (Article 15 of the 1983 Income Tax Law, as revised by the 1994 and 2000 Income Tax Law and further by Income Tax Law No. 36/2008).

Although most of the transfer pricing issues challenged in tax audits in Indonesia have focused on cross-border transfer pricing, the law also covers transfer pricing that takes place within the country. Examples of where the tax office may use these provisions are in respect of luxury sales tax imposed on domestically produced luxury goods, transactions subject to VAT, or profit shifting to utilise losses.

Companies must disclose transactions with related companies in their annual income tax returns. The disclosures are quite detailed and include information such as whether transfer pricing documentation has been prepared.

The statement requires taxpayers to disclose the following details about their transactions with related parties:

- With whom the transaction is made and the nature of the taxpayer’s relationship with the counterparty.
- The type of transaction.
- The value of the transaction.
- Which method was applied in determining the relevant transfer price (one of the five arm’s-length transfer pricing methods recognised in the OECD Guidelines must be disclosed for each transaction), and the rationale for the choice of that method.

For 2009 and later tax years, taxpayers must also make detailed disclosures about whether they have prepared transfer pricing documentation, such as:

- Company profile and ownership structure.
- Types of transactions and any similar transactions with independent parties.
- Analysis of OECD comparability factors.
- Selection and application of the most appropriate transfer pricing method.

It is currently unclear whether the tax authorities will use these disclosures to select candidates for transfer pricing audits, as has been the practice in other countries where disclosures are required.

Limitation of double taxation and competent authority proceedings

The competent authority process has been increasingly used in Indonesia, because transfer pricing assessments have become more common over the last few years.

The ITO had received a number of competent authority requests arising from transfer pricing assessments raised in the previous year. Given the increase in transfer pricing audit activity and assessments raised by the ITO, it is likely that the number of competent authority cases will continue to increase in the future. An Indonesian resident taxpayer may file a MAP request with respect to transfer pricing adjustments. The request for MAP must be submitted in written form to the DGT through the head of the relevant tax office by providing the information specified in the prevailing regulation. If the request can be further processed by consultation with an authorized official in the tax treaty partner country, the DGT sends a written request for MAP to this official.

The DGT terminates the MAP process if the Indonesian resident taxpayer or the Indonesian citizen that has been a resident taxpayer in the partner country that makes the request for MAP:

- submits a cancellation of the MAP request to the DGT
- does not agree with the content of the mutual agreement draft
- does not meet all the requirements for information or documents as required by the DGT
- gives false information to the DGT.

With the issuance of Government Regulation No. 74/2011 (GR 74) taxpayers can apply for a MAP and simultaneously pursue local dispute resolution mechanism. The local dispute resolution includes applying for a tax objection, appealing to the Tax Court and requesting for a reduction or cancellation of administrative sanctions.

However, MAP application shall be discontinued if an appeal decision is declared by the Tax Court prior to the finalisation of the MAP. If one of the parties is not satisfied with the Tax Court decision, a judicial review by the Supreme Court is still allowed.

Advance pricing agreements (APAs)

As from 1 January 2001, the Indonesian Income Tax Law includes a provision that authorises the Indonesian DGT to enter into an APA, which is valid for agreed periods and is renegotiable. As is the case in many other countries, unilateral or bilateral APAs can be an advantageous way of resolving transfer pricing uncertainties before they become acrimonious disputes.

On 31 December 2010, the DGT released APA regulation No.69/PJ/2010 (PER 69). The coverage period for an APA is three fiscal years from the conclusion of the agreement.

A rollback to previous years is possible, provided that the following criteria are met:

- The taxpayer's corporate income tax return for the relevant tax year has not been audited.
- The taxpayer has not filed any tax objection regarding the tax return.
- There is no indication of tax crime.

The rollback of an APA to prior years is not automatic and will be subject to negotiation between the taxpayer and the ITO.

GR-74 stipulates that any documents used during the negotiation of an APA should be returned to the taxpayer if no agreement is reached and the documents cannot be used by the Indonesian Tax Office (ITO) as the basis to conduct a tax audit or audit for preliminary evidence.

Anticipated developments in law and practice

It is anticipated that further regulations concerning MAP and APA will be issued in the near future. It is also anticipated that the tax authorities will continue to conduct extensive transfer pricing audits in the next few years.

Liaison with customs authorities

Although the income tax authorities and customs authorities both fall under the Minister of Finance (MOF), there does not appear to be a routine exchange of information between them.

Joint investigations

No information is available on the DGT's willingness to participate with tax authorities from foreign countries in joint investigations of taxpayers. However, the DGT, according to the 'Exchange of Information' article in double-taxation agreements, is not precluded from carrying out investigations.