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## A revision of transfer pricing regulation

The Director General of Tax (DGT) has issued PER-32/PJ/2011 dated and effective 11 November 2011 (PER-32). This regulation serves as a revision of PER-43/PJ/2010 regarding the application of the Arm's Length Principle (ALP) in a Related Party Transaction (PER-43). Outlined below are the key changes which may have a significant impact on taxpayers.

### Scope of the regulation

#### *The application of the regulation*

The scope of the application of the ALP covers:

- International related party transactions conducted by domestic taxpayers or Permanent Establishments (PEs) in Indonesia.
- Domestic related party transactions, if they are carried out with a motive to enjoy different tax rates. Examples mentioned in this regulation include taxpayers who are subject to final-tax, oil and gas contractors, or taxpayers who are subject to Luxury Sales Tax.

#### *The threshold on transaction amount to implement ALP*

Previously, the threshold to implement ALP was IDR 10 million (i.e. approx. USD 1,100). Now, the threshold has become IDR 10 billion (i.e. approx. USD 1.1 million) for each counter transacting party per year.

### ***The reporting in the annual corporate income tax return***

This regulation seems to require taxpayers to attach the transfer pricing documentation when the related party transactions are disclosed in the annual corporate income tax return. This may create practical problems for taxpayers to have sufficient time to update their yearly transfer pricing documents readily available as an attachment to their annual corporate income tax return.

There is also some tension between PER-32 and the tax return transfer pricing disclosures (Form 3A and 3A1). There is ambiguity regarding whether all related party transactions still have to be listed in Form 3A and 3A1 if no documentation is required under PER-32. It appears that disclosure may still be required but further clarification is needed in this area.

### **Addition of certain definitions**

The regulation also provides guidelines for Trade and Marketing Intangibles.

### **Comparability analysis**

In comparability analysis, incidental independent transactions can only be treated as comparable to test incidental controlled transactions.

Furthermore, an internal comparable is preferred over external comparables. The external comparables can be obtained from a commercial database or other databases.

In performing the functional analysis, manufacturing companies must be able to characterize the company as being a toll manufacturing, contract manufacturing, or fully fledged manufacturing company.

The regulation also states that a contractual arrangement can be determined based on the actual activities of the related parties, if no written contractual arrangement exists.

### **Selection of transfer pricing methods**

While PER-43 strictly requires the use of a hierarchy in selecting the most appropriate methods, PER-32 has abandoned this requirement and has adopted the most appropriate method approach. However, it still requires the following considerations:

- a. The strength and weakness of each transfer pricing method.
- b. The appropriateness of the method based on the nature of the related party transaction, determined by a functional analysis.
- c. Availability of valid information (on independent transactions) to apply the selected method.
- d. 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.

Furthermore, PER-32 no longer puts the Transactional Net Margin Method (TNMM) as the method of last resort. It also provides the conditions under which the TNMM can be adopted.

### **Cost Contribution Arrangements**

PER-32 outlines the definition of Cost Contribution Arrangements (CCAs). A CCA is a framework agreed among business entities to share the costs and risks of developing, providing or obtaining assets, services, or rights and to determine the nature and extent of the interests of each participant in those assets, services or rights. It is unclear whether the intention of this definition is to attract research and development activities in Indonesia.

## DGT authority to conduct investigation

PER-32 deletes the clause under PER-43 where it gives the DGT the authority to investigate a company that has a related party transaction with a company that is indicated to have conducted a tax criminal act.

## Correlative Adjustments

The regulation includes that a correlative adjustment resulting from a primary adjustment made by the DGT now also applies to a PE.

### Your PwC Indonesia contacts

**Abdullah Azis**  
abdullah.azis@id.pwc.com

**Adi Pratikto**  
adi.pratikto@id.pwc.com

**Ali Mardi**  
ali.mardi@id.pwc.com

**Ali Widodo**  
ali.widodo@id.pwc.com

**Anthony J. Anderson**  
anthony.j.anderson@id.pwc.com

**Anton Manik**  
anton.a.manik@id.pwc.com

**Antonius Sanyojaya**  
antonius.sanyojaya@id.pwc.com

**Ay-Tjhing Phan**  
ay.tjhing.phan@id.pwc.com

**Carmen Cancela**  
carmen.x.cancela@id.pwc.com

**Engeline Siagian**  
engeline.siagian@id.pwc.com

**Gadis Nurhidayah**  
gadis.nurhidayah@id.pwc.com

**Hendra Lie**  
hendra.lie@id.pwc.com

**Irene Atmawijaya**  
irene.atmawijaya@id.pwc.com

**Ita Budhi**  
ita.budhi@id.pwc.com

**Ivan Budiarnawan**  
ivan.budiarnawan@id.pwc.com

**Jim McMillan**  
jim.f.mcmillan@id.pwc.com

**Laksmi Djuwita**  
laksmi.djuwita@id.pwc.com

**Mardianto**  
mardianto.mardianto@id.pwc.com

**Margie Margaret**  
margie.margaret@id.pwc.com

**Nazly Siregar**  
nazly.siregar@id.pwc.com

**Paul Raman**  
paul.raman@id.pwc.com

**Parluhutan Simbolon**  
parluhutan.simbolon@id.pwc.com

**Ray Headifen**  
ray.headifen@id.pwc.com

**Sutrisno Ali**  
sutrisno.ali@id.pwc.com

**Suyanti Halim**  
suyanti.halim@id.pwc.com

**Tim Watson**  
tim.robert.watson@id.pwc.com

**Tjen She Siung**  
tjen.she.siung@id.pwc.com

**Triadi Mukti**  
triadi.mukti@id.pwc.com

**Yuliana Kurniadjaja**  
yuliana.kurniadjaja@id.pwc.com