

Benchmarking: how low can you go?

A tax audit is an unpleasant process for most, if not all, companies. The timing of some tax audits can be accurately predicted. For instance, if you file an overpaid CITR now, the DGT will respond to it with a tax audit in the next three to six months. Filing a loss CITR may also trigger a tax audit; however the timing of such is harder to predict. There are still situations when you get a surprise audit.

It must be in the interest of taxpayers to know in advance that a tax audit will be coming, in a predictable time frame. The DGT indicated recently their preliminary steps, the taxpayer's response to which will determine whether or not an audit will be conducted.

These steps rely on so-called "benchmarking". As the name implies, this is a type of standard against which taxpayers' performance can be compared. The benchmarking covers several parameters classified into four types of ratio:

- Operating performance ratios (e.g. operating profit margin, pretax profit margin, corporate tax to turnover ratio, etc.)
- VAT ratio (annual creditable input tax compared to annual turnover)
- Input ratio (eg. salary to turnover ratio, interest to turnover ratio, etc.)
- Non-operating ratio (non-operating income to sales ratio)

As set out by the DGT in SE-96/PJ/2009, benchmarking is intended as a preliminary diagnostic tool to flag up areas of potential irregularities. A taxpayer with performance below the benchmark will typically receive a Clarification Order Letter (COL) from the DGT. A COL is a type of order to a taxpayer to clarify alleged irregularities.

A counselling session has been specified as an official forum for the taxpayer to clarify to the DGT whether or not the alleged irregularities do exist. If the taxpayer and the DGT agree after counselling that the alleged irregularities do not exist, the case would typically be closed and therefore no further action would be required. However, if the taxpayer acknowledges the existence of irregularities, they would be required to rectify their tax returns within a specified time limit. The case would be closed if the taxpayer complies with this undertaking. However, if they fail to take the required action, the DGT may proceed to conduct a tax audit.

The benchmarking has been based on internal DGT data (i.e. tax returns and corresponding financial statements submitted to the DGT) and at present covers only the years 2005-2007. At the present time, the DGT has managed only to provide benchmarking for only 20 business lines out of more than 1500. These include cigarettes, pulp and papers, pharmaceutical, plastic packaging, automotive, etc. Benchmarking for other business lines will be introduced in due course.

Taxpayer benchmark ratios – where do you stand?

All Indonesian taxpayers should be aware of new approaches being taken by the Indonesian Director General of Taxation (“DGT”) in identifying taxpayers which may be subject to a tax audit.

Whilst tax audits are generally automatic in tax refund cases, the DGT is now adopting a more sophisticated approach to audit case selection in other cases.

As part of this approach, the DGT has recently expanded the range of industries for which it has collated and published benchmark ratios, primarily in relation to profitability and expenditure. These benchmarks are used by the DGT to assess whether a taxpayer’s affairs require further examination, which in turn may lead to a formal tax audit. This is in line with audit case selection methodologies commonly used by revenue authorities in many other countries.

The first set of benchmarking guidelines were released on 5 October 2009, when the DGT issued SE - 96/PJ/2009 which contains a series of benchmark ratios for twenty different industries (based on its business type ie, KLU classification) in respect of the 2005 – 2007 income years and based on information obtained from Corporate Income Tax Returns. On 1 February 2010, the DGT issued SE - 11/PJ/2010 which contains the same financial ratio analysis for an additional 31 industry groups, taking the total to 51.

These two regulations apply in conjunction with PER – 1 70/PJ/2007, which sets out the DGT’s approach to discussions with taxpayers about variances between the benchmarking ratios and the taxpayer’s own circumstances. They provide a mechanism for the Indonesian Tax Office account representatives to assess the likely tax compliance level of a corporate taxpayer based on comparisons with the financial performance of the taxpayer’s industry peers.

Where a taxpayer falls below one of the benchmark criteria for its industry, this may prompt a follow up from the account representative for a further explanation of the discrepancy. If the investigation of the discrepancy reveals non-compliance with the tax law, the account representative will usually request that the tax return be amended. If the taxpayer disagrees with the suggested amendment and does not amend their return, the account representative would then recommend that taxpayer be subject to a tax audit.

The regulations provide that this benchmarking information is to be used as a tool in assessing a taxpayer’s likely compliance with the tax laws, and a variance in respect of any particular ratio does not in itself prove non-compliance by a taxpayer.

It is not clear from the information provided in the regulations how current year data will be compared to prior year data, particularly if there is a variance in the comparable benchmark percentage over each of the 2005 – 2007 income years. Further, it is not clear how much of a discrepancy will actually trigger a request for further information.

Taxpayers that are in any of the 51 industries published in the regulations should compare how their financial profitability and expenditure ratios compare to the DGT’s published industry average. In the event that a taxpayer is aware that they have fallen below a particular benchmark level, consideration can be given in advance regarding how to deal with a likely follow up from the DGT.

A list of the 51 industries follows:

No	KLU	Industry	No	KLU	Industry
1	15141	Food oil from plant and animal sources	27	20211/20212	Manufacture of plywood/ laminated plywood, including decorative plywood
2	15144	Cooking oil from palm oil	28	20213	Other wood panel manufacture
3	15410	Bread and its equivalents	29	20294	Kitchenwear from wood, rattan, and bamboo
4	15432	Food made from chocolate and candy	30	22210	Printing
5	16002	Clove cigarette	31	24131	Artificial resins and plastic raw material
6	16003	White cigarette	32	24221	Paint
7	21010	Pulp and paper	33	24241	Soap and household purifier, including toothpaste
8	22120	Newspaper, journal, and magazine publishing	34	24242	Cosmetics
9	24232	Pharmaceutical	35	25111	Tyre manufacture (including tyre tube)
10	25205	Plastic packaging	36	25201	Pipe and plastic interval
11	32300	Radio, television, voice and picture recording tools, and its equivalent.	37	26411	Cement
12	34100	Manufacture of four-wheel (or greater) vehicles	38	29302	Household electrical appliance manufacture
13	35911	Manufacture of motorcycle and its equivalent	39	31300	Phone and electrical cable
14	45000	Construction	40	35912	Motorcycle (and equivalent) components
15	50101	Carwholesale	41	50401	Wholesale of motorcycles along with spare-parts and accessories
16	51391	Household tools and equipment wholesale	42	51220	Wholesale of food, beverages, and tobacco
17	51430	Construction material wholesale	43	55210	Restaurants
18	52111	Retail trading of various items mainly food, beverages, or tobacco in a supermarket	44	55260	Catering
19	70101	Owned or rental real estate	45	65121	Foreign exchange bank
20	85113	Private hospital service	46	65910	Leasing
21	15211	Dairy	47	66020	Pension fund
22	15331/15332	Fish/animal ration or animal feed ration	48	66030	Non-life insurance
23	15421	Sugar	49	74210	Architectual consultancy and engineering services
24	15423	Other sugar	50	92132	Private radio broadcasting
25	15540	Soft drink	51	92132	National private television broadcasting
26	19201	Manufacture of footwear for daily use			