

# 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   |    |             |   |