INDONESIA

RETURN TO CONTENTS PAGE

Overview

PB Taxand, Taxand Indonesia

PB Taxand is a tax advisory firm based in Jakarta and Surabaya, which offers a full range of tax services that focus on multinational as well as local companies.

PB Taxand's team is equipped to assist in every aspect of transfer pricing services, ranging from (1) compliance and reporting; to (2) analysis, planning and strategy; and (3) disputes and controversy:

- Under compliance and reporting, we cover the preparation of transfer pricing country-by-country reports; master file; and local file documentation.
- With analysis, planning and strategy, we cover business restructuring, the setting up a the Transfer Pricing strategy, and the preparation of transfer pricing policy.
- With disputes and controversy, we cover assistance in transfer pricing audits; objections; appeals; judicial reviews; Mutual Agreements Procedures; and the prevention or resolution of tax disputes, by concluding unilateral, bilateral or multilateral APAs.

General: Transfer Pricing Framework

The Rule of Arm's Length Principle in Indonesia

The arm's length principle is regulated in several domestic regulations in Indonesia, as follows:

- Income Tax Law

  The rule of the arm's-length principle is stipulated under article 18 paragraph 3 and 4 of the Income Tax Law No. 36 of 2008 ("Income Tax Law"). This law has undergone multiple amendments, with the most recent changes being incorporated in Law Number 7 of 2021 regarding the Harmonization of Tax Regulations.

- Value Added Tax Law on Goods and Services

  It is also stipulated in Article 2 of Law Number 8 of 1983, which regulates Value Added Tax on Goods and Services as well as Sales Tax on Luxury Goods, which has also undergone multiple amendments, with the most recent changes being incorporated in Law Number 7 of 2021 regarding the Harmonization of Tax Regulations.

- Government Regulation

  The arm's length principle is further regulated in Articles 32, 33, 35, 36 and 37 of Government Regulation No 55 of 2022.

The rule of Transfer Pricing Documentation in Indonesia

Article 28 of Law No. 28 of 2007 on The Consolidation of General Provisions and Tax Procedures stipulates that Taxpayers are required to maintain bookkeeping for general documentation.

Meanwhile, the Transfer Pricing documentation is stipulated under Article 10 of Government Regulation number 74 of 2011 ("GR 74").

Transfer Pricing Regulation and Guideline in Indonesia

The Minister of Finance provides detailed regulations regarding transfer pricing under Minister of Finance Regulation No. 172 of 2023 (**MOF-172**). MOF-172 consolidates all prior transfer pricing regulations in Indonesia. This includes rules on related-party definitions, the arm's length principle, documentation, primary and secondary adjustments for Income Tax, Value Added Tax VAT adjustments, domestic corresponding adjustments, advance pricing agreements APAs, and mutual agreement procedure MAPs.

While the OECD Transfer Pricing Guidelines are not formally incorporated into Indonesian legislation, the Indonesian Tax Office (ITO) practically adopts them in its local regulations and recognizes them as an internationally accepted guide to explain and clarify the arm's length principle.

Accepted Transfer Pricing Methodologies

Under MOF-172, the accepted methods for applying the arm's length principle consist of:

a) Method of price comparison between independent parties (Comparable Uncontrolled Price method ("CUP"))

b) Resale Price Method ("RPM")

c) Cost Plus Method ("CPM")

d) Other methods, including:

   1) Profit Split Method ("PSM")

   2) Transactional Net Margin Method ("TNNM")

   3) Comparable Uncontrolled Transaction ("CUT") Method

   4) Method in Tangible Asset and Intangible Asset Valuation

   5) Business Valuation

Hierarchy of Methods:

If the CUP/CUT method and any other method offer the same degree of reliability, the CUP/CUT method is preferred. Similarly, if the RPM/CPM and PSM/TNMM offer the same reliability, the RPM/CPM is preferred.

During tax examinations, the ITO must evaluate the taxpayer's approach and methodology selection first. However, the taxpayer must substantiate why the chosen method is the most appropriate given the specific facts and circumstance

Transfer Pricing Documentation Requirements

Article 28 of the Consolidation of General Provisions and Tax Procedures Law and Article 10 of Government Regulation 74 (GR 74) requires taxpayers to document all intercompany transactions to support its arm's length nature. The provision requires Indonesian taxpayers to document the transactions conducted with related parties, which includes both cross-border and domestic transactions.

With regards to the obligation to prepare Transfer Pricing Documentation, under MOF 172, MNEs and Domestic companies are obligated to prepare Master files and Local files and Country-by-country reports, if certain threshold criteria are met.

If Taxpayers do not meet the threshold, it does not prevent the Tax officer from auditing the related parties' transactions and issuing tax assessment accordingly if the transactions deviate from the arm's length principle.

Local Jurisdiction Benchmarks

Comparable selection depends on the applied TP method. For benchmarking purposes, the Taxpayers may use local and overseas comparables if they fulfill a sufficient level of comparability.

As there are limited number of local comparables published in the commercial database, ITO would accept an overseas comparable when applying the arm's length principle in Indonesia.

Focus on Financial Transaction in Indonesia

Indonesia has tightened its transfer pricing framework for related-party financial transactions through MOF-172, aligning closely with the 2022 OECD Transfer Pricing Guidelines. The rules apply to intercompany loans, and other financing arrangements.

Taxpayers must prove that related-party financing is commercially rational by substantiating the transaction's purpose, debt volume, repayment structure, and the actual functions performed, assets used, and risks assumed by each party before setting the arm's length interest rate. This requires a comprehensive transfer pricing analysis, including accurate delineation of the transaction, functional analysis, creditworthiness assessments, and benchmarking.

Tax auditors frequently scrutinize whether a loan should be reclassified as equity, whether the borrower could have realistically obtained independent financing, whether the pricing is arm's length, and whether the lender possesses the economic substance to control the underlying financial risks.

Advance Pricing Agreement ("APA") Overview

Under MOF 172, the Taxpayer may submit a Unilateral APA, Bilateral APA or Multilateral APA application to the ITO for the related party transactions. APA may also be applied to domestic related party transactions in Indonesia. An APA can cover up to five prospective fiscal years, and taxpayers may also request a roll-back period. The roll-back period is subject to approval from ITO and certain criteria as follows: the requested roll back period is still within the 5 years statute of limitation; it has not been audited or if it is ongoing a tax audit process, then the audit has not been concluded; or such year is not subject to the criminal investigation.

Below are the requirements to apply for an APA.

a) The Taxpayer must have fulfilled the obligation to submit its Annual CITR for three fiscal years prior to the APA application period;

b) The Taxpayer must have met and fulfilled the obligation to prepare and maintain Transfer Pricing Documentation of master file and local file for three fiscal years prior to APA application period;

c) The Taxpayer must not be under any taxation criminal investigations or proceedings;

d) The application must only include related-party transactions that have already been disclosed in the taxpayers' Corporate Income Tax Return.

e) The application of the arm's length principle must not result in an operating profit lower than what was originally reported in the taxpayer's CITR.

The implementation of the APA must be documented in the taxpayer's transfer pricing documentation on an annual basis

Transfer Pricing Audits

Transfer pricing audits are typically handled as part of a general corporate tax audit or a specific audit focused on Income Tax or VAT. The ITO aggressively scrutinizes intercompany transactions, focusing primarily on:

- Company that incurs a loss for several years or reports unusually low profit
- Special related party transactions, such as use of intangible assets, intragroup services, and intercompany loans

Secondary Adjustment

Under the elucidation of article 18 paragraph 3 of Income Tax Law, the ITO will apply a secondary adjustment after the Primary tax adjustment during the tax audit. The secondary adjustment will be treated as a deemed dividend regardless of whether the transaction is conducted with shareholder or other affiliated party as the counterparty.

Under MOF-172, this deemed dividend (and the associated withholding tax) may be avoided if the taxpayers set up an account receivable and the counterparty physically remits the cash adjustment back to Indonesia within a specific statutory window.

INDONESIA

Corresponding Adjustment

MOF-172 regulates corresponding adjustments as a domestic mechanism to prevent double taxation.

The corresponding adjustment can be applied to the counterparty if the audited taxpayer accept the Transfer Pricing Assessment and waives its rights to file an Objection.

For international transactions, the MAP can be utilized to avoid double taxation issue as an alternative dispute resolution.

Hot Local Topics and recent Updates

As a capital-importing country, Indonesia sees a high volume of specialized transactions driven by overseas head offices or regional hubs to their local subsidiaries. Consequently, the ITO heavily scrutinizes transactions involving intangibles, intercompany services, and intercompany loans.

The Burden of Proof in Transfer Pricing: Theory versus Practice

Because Indonesia operates on a self-assessment tax system, the legal burden of proof rests on the taxpayer. However, during an audit, the ITO holds the authority to make adjustments. In practice, the tax office must demonstrate that its assessment aligns with local regulations and the OECD Guidelines. During formal dispute resolutions, both sides are required to substantiate their arguments regarding the arm's length nature of the transactions.

Documentation threshold

Master File and Local File	Criteria to Prepare Master File and Local File
The Taxpayer has related party transactions with:	The taxpayer has related-party transactions and meets **at least one** of the following criteria: a. a gross revenue in the previous fiscal year of more than IDR 50 billion, or b. a related party transaction amount in the previous fiscal year of: - more than IDR 20 billion for tangible goods transactions; or - more than IDR 5 billion for each provision of service, payment of interest, use of intangible goods, or other related party transactions, or c. The related party is domiciled in a country or jurisdiction with a tax rate lower than the prevailing tax rate in Indonesia (the current tax rate in Indonesia is 22%).
CbCR	Criteria to Prepare Country-by-Country Reports a. Consolidated group turnover of at least IDR 11 trillion in prior year, or b. A Taxpayer who is a member of a Business Group, with a parent entity that is a Foreign Taxpayer, is required to file a Country-by-Country Report if the country or jurisdiction where the parent entity is domiciled: - does not require the filing of Country-by-Country Report, or - does not have any exchange of tax information agreement with Indonesia, or - has an exchange of tax information agreement, but the Indonesian Government fail to receive the Country-by-Country Report from the related country/jurisdiction.

Submission deadline

Master file	Must be available within **four months** after the fiscal year-end and submitted only upon request by the ITO.
Local file	Must be available within **four months** after the fiscal year-end and submitted only upon request by the ITO.
CbCR report	Must be submitted within 12 months after the fiscal year-end.
CBCR notification	Must be submitted within 12 months after the fiscal year-end.

INDONESIA

RETURN TO CONTENTS PAGE

Penalty Provisions

Documentation – late filing provision	The transfer pricing documentation must be submitted within one month after ITO formally request for TP documentation during Tax Audit process. If the Taxpayer submits the transfer pricing documentation after the required timeframe, ITO may reject submission of the transfer pricing documentation and consider the Taxpayer does not comply with the regulation. The ITO will treat the TP Documentation as other documents rather than formal defense documentation.
Tax return disclosure – late/ incomplete/no filing	The administrative sanction for late filing of annual corporate tax return is IDR1million. If tax returns are deemed to be incomplete, ITO will request for the Taxpayers to amend the returns. If Taxpayers fail to file a tax return, there will be a potential tax audit by ITO. For tax assessment letter that resulted in tax underpayment, the underpaid amount is subject to a tax surcharge of Reference Interest Rate Issued Monthly by the Minister of Finance (MoF) plus uplift of 5% or 10% divided by 12 months for a maximum of 24 months, or a surcharge of 75%, depending on the case.
CbCR – late/ incomplete/no filing	Failure to file the CbCR triggers administrative sanctions aligned with the corporate tax return disclosure penalties outlined above.

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