



News Alert – February No. 2/2024

## NEW MOF REGULATION ON TRANSFER PRICING

Minister of Finance Regulation No. 172/2023 (“MoF-172”) regarding *Application of the Arm’s Length Principle in Transactions Affected by Special Relationships* was issued on 29 December 2023. The stated rationale for issuing MoF-172 is to provide fairness, legal certainty, and ease in the taxation of transactions affected by a special relationship. Therefore, some adjustments to the implementation of the arm’s-length principle (“ALP”) are needed. However, taxpayers may find that MoF-172 is more burdensome than before. It remains to be seen what the effect of the changes will be when implemented in practice.

MoF-172 covers a number of transfer pricing issues and essentially consolidates, elaborates upon, and makes some important changes to the previous regulations:

No.	MoF Regulation	Title
1	213/PMK.03/2016	<i>The Types of Additional Documents and/or Information that Must Be Maintained by Taxpayers Conducting Transactions with Related Parties, and the Procedures for Their Management (TP documentation)</i>
2	49/PMK.03/2019	<i>Procedures for Implementation of Mutual Agreement Procedure (MAP)</i>
3	22/PMK.03/2020	<i>Procedures for Implementation of Transfer Pricing Agreements (APA)</i>

With the issuance of MoF-172, these earlier regulations are revoked.

### Executive Summary

Most of the issues relating to the application of the ALP were previously covered in MoF-22, which basically dealt with advance pricing agreement (“APA”) procedures. However, since these are now covered in MoF-172, with a few changes, by implication these rules should apply in general. It remains to be seen what effect this change will have on taxpayers in practice. However, companies which have related party transactions must pay attention to ensure that they meet the ALP requirements, in particular when preparing the transfer pricing documentation that was previously regulated in MoF-213.

Whereas secondary adjustments were addressed in the elucidation to Article 18.3 of the HPP Law and Government Regulation No. 55/2022, corresponding adjustments were never sufficiently explained. MoF-172 now provides more guidance on secondary adjustments and corresponding adjustments. However, it should be noted that any primary adjustment that is made will affect the original price of the counterparty. The tax office shouldn’t reassess the arm’s-length price after the counterparty makes the corresponding adjustment because this could result in a never-ending cycle of dispute. Therefore, more guidance will be needed to ensure these adjustments are implemented fairly.

# News Alert

February No. 2/2024

Although most of the content of the revoked regulations remains substantially the same in MoF-172, the new regulation updates and highlights certain matters that were previously covered and also makes a few significant changes to the transfer pricing rules, including:

- More detailed guidelines for applying the ALP are provided.
- More technical details are provided with respect to applying the split profit method.
- The preliminary stage analysis has been widened for certain transactions and should be fairly addressed in the local file.
- Secondary adjustments and corresponding adjustments are specifically addressed; this also includes adjustment on output VAT.
- More detailed information and analysis are to be included in the local file.

Below we highlight a few of the significant points covered in MoF-172.

## Definition of Special Relationship

Affiliated parties are those which have a special relationship, which includes ownership, control or family relations. MoF-172 defines "control" in this context as:

- One party controls or is controlled by the other party, directly or indirectly.
- Two or more parties are under common control, directly or indirectly.
- One party controls or is controlled by the other party through management or use of technology.
- The same person is directly or indirectly involved in managerial or operational decision-making in two or more parties.
- Parties are commercially or financially known or represent themselves to be in the same business group.
- One party declares itself to have a special relationship with the other party.

According to MoF-172, a special relationship also includes transactions conducted between parties having no special relationship but an affiliated party of one or both parties conducting the transaction determines the counterparty and transaction price.

Taxpayers have to take care and assess whether each transaction constitutes a related party transaction that should be included in the transfer pricing documentation.

## Transfer Pricing Methods and Comparability Analysis

Additional guidance is provided on the transfer pricing methods and comparability analysis. In particular, the following points should be noted.

### *Transfer pricing method*

The transfer pricing method chosen is based on the accuracy and reliability of the method, which is based on a number of criteria. However, as a general matter, traditional transaction methods are preferred over transactional profit methods.

Therefore, where the methods are considered equally reliable, the comparable uncontrolled price (CUP), comparable uncontrolled transaction (CUT), resale price method (RSM) or cost plus method (CPM) should be used (calculated based on the price and gross margin) over the transactional profit methods, such as transactional net margin method (TNMM) and profit split method (PSM). Although CUT is now specifically mentioned, in practice, it has already been used for certain transactions valued on a specific basis, such as interest rate, commission and royalty.

More technical details are provided with respect to application of the profit split method (PSM) for parties which make unique and valuable contributions to the related party transactions. Unique and valuable contributions are defined as contributions that are (i) more significant than those made by an independent party under similar conditions, and (ii) are the main source of actual or potential economic benefits in the business activity. In addition, the distribution of combined profits can now be made at the gross profit or net operating profit level and more specific guidance is given on how to calculate the distribution of combined profit under both the contribution analysis and the residual analysis.

## Comparability analysis

- The period for comparable financial data should now be based on a *single year*. However, multiple years can be used if the taxpayer can show this enhances comparability. In either case, the comparable data used is that which is available and closest to the time of the transfer price or the occurrence of transactions influenced by a special relationship.
- The use of ranges to determine the arm's-length price has been changed. Now, the full range (minimum to maximum value) can be used if only two comparables are available. The interquartile range is still used if there are three or more comparables.
- Where more than one external comparable exists and they are equally reliable, those from the same jurisdiction as the tested party should be used as the comparable.
- The tested party is determined by assessing which has the simpler function, assets and risk in the related party transaction.

It is important to note that the implementation of the above is affected by various factors, such as the availability of information, type of related party transactions, and level of comparability.

## Preliminary Stage Analysis

The purpose of the preliminary stage analysis is basically to assess the substance of the transaction. The taxpayer must prove that there is an actual transaction for which the recipient receives a benefit.

The preliminary stage analysis is to be performed with respect to the following transactions:

- Service transactions
- Transactions related to the use or right to use intangible assets
- Loan related financial transactions
- Other financial transactions (*new*)
- Asset transfer transactions
- Business restructuring
- Cost contribution agreement

Some changes to the previous regulation have been made with respect to service transactions. Among the points to be proven are that the services are not for the benefit of shareholders. Shareholder activities now include the following:

- Administration of the parent entity
- Reporting obligations of the parent entity
- Acquisition of funds or capital used for the acquisition of ownership by the parent entity
- Parent entity's compliance with applicable laws and regulations (*new*)
- Protection of the parent entity's capital ownership in subsidiaries (*new*)
- Overall governance of the group (*new*)

For transactions covered by "other financial transactions," the preliminary stage analysis requires proof of:

- Conformity of the financial transactions with the substance and actual circumstances
- The type of transaction
- Economic and legal recognition by the parties to the transaction
- Motive, purpose, and economic rationale of the transaction
- The expected benefit

The proof of benefit includes increased sales, decreased costs, protection of commercial positions, or meeting other commercial activity needs, including activities to earn, collect, and maintain income. Taxpayers should now be sure to provide the required proof for each type of transaction.

The preliminary stage analysis must be properly addressed in the local file. If the requirements are not met, the transaction is considered not to be arm's length and the Director General of Taxes ("DGT") can assess its comparability and make a correction.

## Secondary Adjustment on Deemed Dividend and VAT

If the DGT's redetermination of the amount of the related party transaction to an arm's-length price is different from the taxpayer's reported price/margin, the difference between the taxpayer's reported price and the arm's-length price can be treated as profit distribution to an affiliated party (dividend).

The DGT's adjustment in the taxpayer's corporate income tax (the primary adjustment) gives rise to a withholding tax obligation for dividends (the secondary adjustment). This applies to both domestic and cross-border transactions. MoF-172 also now makes it clear that this does not just apply to shareholders, but to parties which have a special relationship.

The withholding tax is payable at the time such income is paid, is provided for, or matures, whichever is earlier. For cross-border transactions, the withholding tax rate can be reduced by tax treaty in accordance with the prevailing tax regulations.

**The secondary adjustment will not apply if:**

- There is an addition or return of cash or cash equivalent amounting to the difference, and this is before a tax assessment letter (SKP) is issued; and/or
- The taxpayer agrees to the DGT's primary transfer pricing adjustment.

In addition, if the primary adjustment on the income from delivery of goods or services makes the arm's-length price higher than the actual price transacted with the related party, the DGT can also adjust the output VAT. Therefore, the effect is not only on the corporate income tax return, but also on the VAT returns. However, the DGT should be able to allocate the adjustment on certain affected transactions. From the purchaser or service recipient's side, this additional input VAT cannot be credited; the creditable input VAT is as was stated in the original VAT invoice.

These secondary adjustments could result in additional tax costs. Although the secondary adjustment of deemed dividends is not applicable in certain cases (see above), these conditions could be difficult to meet in practice. Taxpayers need to be aware of these new rules and carefully review their related party transactions.

## Corresponding Adjustment for Domestic and Cross-border Transactions

MoF-172 regulates corresponding adjustments for both cross-border and domestic related party transactions. For cross-border transactions, the adjustment should use the mutual agreement procedure ("MAP").

The primary adjustment on domestic related party transactions has resulted in double taxation due to the absence of a corresponding adjustment mechanism. The mechanism is now available under MoF-172 and the domestic counterparty can make the corresponding adjustment.

However, to take advantage of this, the domestic party subject to the primary adjustment must:

- agree with the DGT's adjustment, **and**
- not challenge the adjustment by filing an objection to the transfer pricing adjustment concerned.

The corresponding adjustment is carried out by the domestic counterparty through three mechanisms/procedures:

Situation	Mechanism for Corresponding Adjustment
<b>Not audited</b>	Revise the corporate income tax return
<b>During audit</b>	Tax assessment letter (SKP) is issued which includes primary adjustment
<b>After audit</b>	Tax assessment letter (SKP) is revised by the DGT <i>ex officio</i>

Note, however, that because the taxpayer must agree with the DGT's adjustment, careful analysis of the adjusted historical and future transactions as well as planning is required before agreeing to the corresponding adjustment.

## Other Issues to Note

### *Transfer pricing documentation*

One change is that gross turnover is to be calculated based on income received or earned in connection with the main or other business activity of the taxpayer **after** deducting discounts, rebates and other deductions. Previously this was calculated before deductions.

A country-by-country report must now be prepared if the consolidated gross turnover of the business group is at least IDR 11 trillion in the fiscal year *preceding* the reported fiscal year. Previously the IDR 11 trillion was based on the fiscal year at issue. MoF-172 is now in line with BEPS Action 13.

Local and master files must now be provided within *one month* of the DGT's request in an audit or for compliance monitoring and within the time specified in the relevant legislation for other cases. In addition to sanctions being imposed if the taxpayer fails to comply, the consequences are:

- Transfer pricing documents submitted after the deadline: Treated as data only (not considered as transfer pricing documents)
- No transfer pricing documents submitted: Tax office assesses comparability by conducting its own analysis.

### *Ex-ante principle*

The *ex-ante* principle was already in MoF-213, although there was no clear explanation as to what was meant by the term. Consequently, in practice, this has been a dispute between taxpayers and the DGT. MoF-172 provides no further clarification and simply offers the same explanation as in MoF-213, i.e., local and master files are to be prepared based on the data and information available *at the time the related party transactions are conducted*.

Therefore, it is likely that the application of the *ex-ante* principle will continue to be disputed and it is hoped there will be further clarification as to how it should be implemented in practice.

### *Mutual agreement procedure (MAP)*

Although there are no major changes to the previous MAP regulation, a few points should be noted.

- MAP can be conducted at the same time as domestic dispute resolution processes, which now include lawsuits and judicial review. If no request for judicial review is submitted, the appeal decision will be the consideration for the MAP negotiation or to halt the negotiation, if the issue is the same for MAP and the dispute.
- As before, the MAP request does not postpone the tax payment or tax collection process. However, MoF-172 now also states that it does not postpone the refund of a tax overpayment.
- The negotiation deadline for the MAP request can be extended one time, for up to 24 months.
- The DGT can prepare its position on the issues in the negotiation. If no decision on the MAP has been reached, but the Tax Court verdict or Supreme Court verdict has been issued, the DGT may:
  - Continue the MAP negotiation if the court dispute issue is not related to the MAP request.
  - Use the Tax Court verdict as its position in the negotiation or terminate the negotiation if there is no application submitted for judicial review and the dispute issue is related to the MAP request.
  - Use the Supreme Court verdict as its position in the negotiation or terminate the negotiation if the dispute issue is related to the MAP request.
- The DGT should issue written notification within 14 calendar days from the date the MAP is approved.
- If a taxpayer submits a request to withdraw the MAP request, the DGT should issue its decision within 21 calendar days from the date the request is received.
- Under MoF-172, if the MAP decision is issued after a domestic dispute has been decided, the basis for tax payable for sanctions should also take into account the tax stated in the MAP decision. This is in line with BEPS Action 14.

### *Advance pricing agreement (APA)*

As with MAP, there are few changes to the APA procedures. Some items to note are:

- Multilateral APAs are now permitted, allowing multiple jurisdictions to negotiate the APA. Before, only unilateral and bilateral APAs were considered.
- Some additional requirements for domestic taxpayers to apply for an APA are that they not be undergoing a preliminary evidence investigation, tax crime prosecution or tax crime trial.
- Another new provision is if an APA application is submitted by a taxpayer whose business has been negatively affected by a national disaster determined by the Central Government, the profit level in the projected financial statements is the profit level resulting from adjustment to normal conditions.

- During the materiality testing for the APA, the DGT is now permitted to obtain information by:
  - Requesting an exchange of information
  - Obtaining information from financial services institutions or other entities
  - Requesting an appraisal
- As before, the DGT is authorized to monitor the implementation of the APA. MoF-172 provides more guidance and explains that this is done by:
  - Evaluating compliance with the APA
  - Evaluating conformity of the transfer pricing criteria with the agreement in the APA

Based on the evaluation result, the DGT can:

- Conduct a review of the APA, to the extent that there are material changes to the facts and conditions of the affiliated transactions covered by the APA with the critical assumptions agreed in the APA.
  - Cancel the APA, if the taxpayer has failed to sufficiently explain information that the DGT considered incorrect or inconsistent with the actual condition.
- If during the APA or APA rollback period there is an amendment of a tax return for which the taxpayer hasn't been audited, or issuance of or amendment to a tax assessment letter (SKP) by the DGT, the administrative sanctions do not apply.
  - If a taxpayer has requested that an APA application be withdrawn but the DGT fails to issue a decision within 14 calendar days, the request is considered approved.
  - If the withdrawal of a bilateral or multilateral APA has been approved, the taxpayer can submit an application for a unilateral APA through the relevant tax office within 14 calendar days after the written notification of the approval to withdraw is issued by the DGT.

### Transitional provisions

With MoF-172 the following transitional provisions apply:

- Any MAP or APA process that was underway pursuant to MoF-49 or MoF-22, respectively, but not completed when MoF-172 came into effect are to be followed up in accordance with MoF-172.
- Transfer pricing documentation for 2024 onward is to be prepared in accordance with MoF-172.

No provision says that MoF-172 applies to dispute resolution for the years prior to 2024 and, from a legal point of view, dispute resolution matters that have not yet been concluded should refer to earlier regulations because MoF-172 should not be applied retroactively. However, the DGT might take a different position in practice.

#### For additional information, please contact us:

**Sony B. Harsono**, Chairman  
sony.harsono@harsono-strategic.com

**Dwi Ary Retnani**, Managing Partner  
dwiary.retnani@harsono-strategic.com

**Julius Hardianto**, Senior Partner  
julius.hardianto@harsono-strategic.com

**Suhartono Maridjan**, Senior Partner  
suhartono.maridjan@harsono-strategic.com

**Budi Harnata**, Partner  
budi.harnata@harsono-strategic.com

**Richard William**, Partner  
richard.william@harsono-strategic.com

**Roedy Andrianto**, Director  
roedy.adrianto@harsono-strategic.com

**Sandy Tanu Utomo**, Director  
sandy.utomo@harsono-strategic.com

**Yosua Anggadi**, Director  
yosua.anggadi@harsono-strategic.com

**Terri Shreve**, Technical Advisor  
terri.shreve@harsono-strategic.com

**Kentaro Dan**, Technical Advisor  
kentaro.dan@harsono-strategic.com



**Harsono Strategic Consulting**  
Sudirman Plaza, Plaza Marein 9th Floor  
Jl. Jend. Sudirman Kav. 76-78  
Jakarta 12910, Indonesia  
ph. +62 21 5793 6777  
fax. +62 21 5793 6778  
[www.harsono-strategic.com](http://www.harsono-strategic.com)