NEWS ALERT

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- DGT Circular Letter No. SE-15/PJ/2018

Tax Audit Policy

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As further implementation of Minister of Finance ("MoF") Regulation No. 17/PMK.03/2013 as last amended by MoF Regulation No. 184/PMK.03/2015 regarding Implementation of Tax Audit, the Director General of Tax ("DGT") issued Circular Letter SE-15/PJ/2018 ("SE-15") in an effort to provide more consistency in approach, transparency, and effectiveness in the implementation of audits.

This Circular revokes DGT SE-06/PJ/2016 and SE-25/PJ/2015 and consolidates previous tax audit policies in order to adjust to the current needs regarding how tax audits are conducted and to support the bureaucratic reform undertaken by the DGT, in particular in arrangement of a compliance map and list of priority targets for potential tax revenue in each tax office. SE-15 covers audit policies for:

- All taxes, including land and building tax (PBB) and stamp duty
- Joint audit for Oil & Gas Production Sharing Contracts (PSC) with cost recovery scheme as stipulated in MoF Regulation No. 34/PMK.03/2018

The stated purpose of SE-15 is to:

- Improve the administration of audits
- Provide uniformity in the steps for conducting audits
- Improve the quality of selection of taxpayers subject to audit
- Improve the quality of tax audits
- Increase tax revenue derived from audits

The DGT recognizes the need to improve its audit policies, especially regarding the selection of potential taxpayers for audit. To that end, the DGT has revitalized the audit business process in order to:

- Improve the quantity and quality of tax audits to encourage the sustainable growth of tax revenues
- Improve the on-going compliance of taxpayers
- Prevent tax avoidance by taxpayers
- Achieve effective audits. This is identified as meeting the following criteria:
  - ✓ Audits are completed on time and disbursement of tax assessments is optimized in order to reach the revenue target and minimize tax arrears.
  - ✓ Quality is improved, which will minimize the legal remedies of taxpayers. The aim is to reduce the number of tax disputes due to more reliable audit results.
  - ✓ Better control over preliminary tax refunds for taxpayers that meet the stipulated criteria.
  - ✓ Create on-going/sustainable compliance by taxpayers.

Preparation of Map of Compliance and List of Priority Targets

At the beginning of each year, a Map of Compliance and a List of Priority Potential Targets for Extraction (DSP3/"Potential Targets") will be prepared to help each tax office ("KPP") better identify potential taxpayers to be selected for audit.

Taxpayers in those industries which have a low level of compliance will be one area of focus. The ultimate aim is for the DGT to obtain optimal revenue from audit activities and better disbursement of tax assessment letters in the current year.

The variables that are to be used to determine which taxpayers will be considered Potential Targets are:

1. High indication of non-compliance
2. Engage in certain types of non-compliance
3. Identification of potential tax value
4. Identification of taxpayer's ability to pay tax assessment
5. Other considerations which the DGT deems appropriate

These are discussed in more detail below.

1. Indication of non-compliance is high

Tax non-compliance is indicated if there is a discrepancy between the tax profile (based on the tax return) and the actual economic profile. The actual economic profile can be determined from internal, external or field observation data. The indications of non-compliance are distinguished based on where the taxpayer is registered:

(i) regional tax office (35 Execution Unit ("35UP2")) or

(ii) primary tax office.

The indicators are summarized in the following table:

No.	Indicator of Non-Compliance	Regional Tax Office-35UP2	Primary Tax Office	
			Corporate taxpayer	Individual taxpayer
1	Result of comparison between (i) corporate tax to turnover ratio (CTTOR), gross profit margin (GPM) and/or net profit margin (NPM) and (ii) benchmarking analysis result > 10%.	✓		
2	Result of comparison between (i) CTTOR, GPM and/or NPM and (ii) benchmarking analysis (comparable companies registered in the relevant regional tax office) > 20%.		✓	
3	Having affiliated transactions mostly with offshore affiliates where the tax rate is lower than Indonesia.	✓	✓	
4	Having intra-group transaction with value > 50% of total transaction value.	✓	✓	
5	Having intra-group transaction with a group member which has a tax loss carry forward.	✓	✓	

No.	Indicator of Non-Compliance	Regional Tax Office-35UP2	Primary Tax Office	
			Corporate taxpayer	Individual taxpayer
6	Never audited for all taxes in the last 3 years.	✓	✓	✓
7	Taxpayer issued tax invoices to customers with Tax ID No. 000 is > 25% of total tax invoices issued within one month (one tax period).	✓	✓	
8	Result of analysis of Information, Data, Report and Complaint (IDLP) and/or Center for Tax Analysis (CTA) is available.	✓	✓	✓
9	Not in compliance on payment and tax return reporting.		✓	✓
10	Discrepancy between tax return profile and economic profile (business and assets). For individuals, this includes the lifestyle and loan profile of the taxpayer.		✓	✓

2. Types of non-compliance

The head of the KPP will identify those taxpayers who evidence certain methods of non-compliance. This identification is to help the tax auditor determine the scope and depth of the audit. The methods of non-compliance considered include:

a) Taxpayer does not report actual turnover

b) Taxpayer improperly charges costs

c) Taxpayer has non-compliance in VAT reporting

d) Taxpayer performs aggressive tax planning (e.g. debt-to-equity ratio > 4:1, has a controlled foreign corporation, transfer pricing risk)

e) Taxpayer engages in tax treaty abuse

f) Taxpayer does not report the actual value of the assets transferred in a liquidation, merger, consolidation, expansion, splitting or acquisition

g) Taxpayer does not report the actual acquisition or sales value in an exchange of assets

3. Identification of potential tax value

The head of the KPP will identify the potential value of tax to be assessed. A Potential Target taxpayer should have a large potential tax value. This may include the value of any preliminary refund, tax loss carry forward stated in the tax return, or discrepancy of value in a fixed assets revaluation.

4. Identification of collectability

The head of the KPP is to assess the taxpayer’s ability to pay the tax assessment, i.e. whether or not the tax assessment can be collected from the targeted taxpayer (collectability). This takes into consideration the sustainability of the taxpayer’s business and assets, existence of the business, and the existence of the party responsible for the tax.

Determination of Targets for Audit

Based on the above considerations (in particular, the revenue target from the tax audit, its collectability, and history of tax audit), the DGT will determine those taxpayers to be listed as Potential Targets. These taxpayers will be subject to routine or special audit for all taxes.

From that list, the head of the KPP will decide which taxpayers will be included in the List of Priority Targets for Audit (DSPP/"Priority for Audit"). Activities of taxpayers who are not listed as a Priority for Audit will still be monitored by the KPP, and if necessary may be subject to special audit for one or several types of tax.

Other

- Based on the Priority for Audit, the tax audit instruction for routine audit and special audit will be issued in the beginning of May, August and November.
- It is suggested that the tax auditor utilize software for tax audit purposes and internal databases of the DGT, such as SIDJP, Apportal, Approweb, and conduct a digital forensic analysis with the relevant expert.
- As before, the tax auditor will involve the functional tax officials. However, now the structural tax auditor officials will also be involved, i.e. Head of Tax Audit Division, Head of Supervision and Consultation Division, and Head of Extensification and Counseling Division, including the Account Representatives.

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