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A NEW CHAPTER ON TRANSFER PRICING SCRUTINY

TRANSFER PRICING DOCUMENTATION

Minister of Finance Regulation 213/PMK.03/2016

Indonesia continues to focus on transfer pricing as an area of potential revenue. Over the past few years the tax authorities have become increasingly sophisticated and are aggressively scrutinizing related party transactions.

Indonesia is the first Southeast Asian country to apply the OECD BEPS Action 13 guidelines for transfer pricing documentation. With the issuance of MoF Regulation No. 213/PMK.03/2016 ("MoF-213"), dated and in effect from 30 December 2016, companies which meet certain criteria are now required to maintain a three-tiered documentation structure:

- *Master file: High-level overview of the multinational's global operations*
- *Local file: Detailed information on specific transactions*
- *Country-by-country report: Aggregate information on revenue, profits and taxes for all entities*

The intention is to reduce the level of subjective reporting and it should help taxpayers focus on their transfer pricing issues when setting prices with related parties. It will also create greater transparency and provide information which will assist tax officials to assess transfer pricing risks and combat BEPS (base erosion and profit shifting).

In practice, this regulation significantly expands the scale and scope of transfer pricing documentation required. In addition, many more companies will be required to prepare transfer pricing documentation than in the past as the threshold criteria for compliance are broader than before. Companies must ensure their transfer pricing documentation is in order as the cost of non-compliance is significant.

MASTER FILE AND LOCAL FILE

Who Is Required To Prepare?

Previously, there was a counterparty based threshold and transfer pricing documentation was required if the aggregate value of transactions with any one related party exceeded IDR 10 billion. Under MoF-213 the criteria are much broader. A company is now required to maintain both a master file and a local file if it has related party transactions and:

- Gross turnover for the last tax year exceeded IDR 50 billion (approx. USD 3.75 million);
- Related party transactions in the last tax year exceeded:
  - IDR 20 billion (approx. USD 1.5 million) for transactions involving tangible goods; or
  - IDR 5 billion (approx. USD 375,000) for each service transaction, payment of interest, utilization of intangible goods or other related party transaction; or
- The related party is located in a country or jurisdiction with a lower income tax rate than Indonesia's rate (currently 25%). There is no threshold amount, so even a small transaction will trigger the obligation.

When Are Files To Be Prepared?

The master file and local file are to be available by the end of the fourth month after the end of the tax year.

The standard form of a summary of information or content of the files, along with a statement as to when the master file and local file are available, must be attached to the annual corporate income tax return and signed by the taxpayer or proxy. However, it is unclear what happens if the taxpayer has an extension to file the tax return. The summary is due by the end of the fourth month after the end of the tax year; therefore, absent further clarification, an extension to file the tax return does not delay the preparation of these files.

If a taxpayer is audited and submits an application relating to a dispute on assessment, etc. these files will be requested. The files must be provided within the time period stipulated in the tax regulation. If the taxpayer fails to comply within the deadline, the taxpayer can be considered as not maintaining proper documentation. In that case, the tax authorities may ignore the documentation and can calculate the tax due as they deem appropriate.

What Information Is Required?

The *master file* must include the following information about the business group:

- Organization and ownership structure along with the country or jurisdiction of each company
- Business activities of each company
- Intangible assets owned by the group
- Financial and financing activities
- Parent company's consolidated financial statement and tax information on the related party transactions

The *local file* is to include the following information about the Indonesian taxpayer:

- Identity and description of business activities
- Information on related party and independent transactions
- Application of the arm's length principle
- Financial information
- Non-financial events or facts which affect the price setting or profit level.

If the taxpayer has more than one type of business characterization, the local file is required to be prepared based on a segmented income statement, which may not be straightforward. In addition, a company may engage in various business activities, such as manufacturing, distribution, service provider, etc. Without detailed guidance, each taxpayer should consider and decide an appropriate cost allocation to determine the correct profit level of each segmented business activity.

Other Issues

There are a number of issues to be aware of:

- The company's and parent company's audited income statement and/or consolidated income statement may not be ready by the fourth month after the end of the tax year.
- The transfer pricing database, such as Oriana or Orbis, may not be updated with the data of comparables for the year concerned by the fourth month deadline.
- Subject to further clarification, there is no extension of the fourth month deadline even if the taxpayer files an extension to lodge the corporate income tax return.
- For the first year of the master file, the Indonesian taxpayer should anticipate obtaining the master file from the parent company. However if the master file has not been prepared or is not required in the parent company's jurisdiction, the taxpayer will need to inform and cooperate with the parent company to meet the requirements in MoF-213.

- Information on independent transactions is to be disclosed in the local file. It is unclear what this means in practice. Therefore, it will require interpreting what the tax office is actually seeking and balance that against the practicality of gathering and disclosing such information.
- The scope of the master file is unclear. Theoretically, it appears that the master file should be provided by the ultimate parent company. However, the overall purpose of the tax office requesting this is to assess the Indonesian activities of the taxpayer so, arguably, the master file should be tailored to the Indonesian activities. It remains to be seen which entity in the global structure the tax office will expect to prepare the master file.

COUNTRY-BY-COUNTRY REPORT

Who Is Required To Prepare?

A country-by-country report is required, together with the master file and local file, if the Indonesian taxpayer (i) is the parent company of a business group, (ii) prepares consolidated financial statements, and (iii) has consolidated gross turnover of at least IDR 11 trillion (approx. USD 827 million) in the relevant tax year.

If the Indonesian taxpayer is a member of a business group and the parent company of that group is a non-resident taxpayer, the Indonesian taxpayer has the obligation to submit the country-by-country report if the country or jurisdiction where the parent company is domiciled:

- Has no obligation to provide the country-by-country report;
- Has no agreement with the Indonesian government in relation to the exchange of tax information; or
- Has an agreement with the Indonesian government in relation to the exchange of tax information, but the country-by-country report cannot be obtained by the Indonesian government from that country.

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When Are Files To Be Prepared?

The country-by-country report is to be available no later than 12 months after the end of the tax year and submitted with the tax return of the following tax year. The information contained in the report is to be based on information available at the end of the tax year.

What Information Is Required?

The country-by-country report must provide the following information for each entity in the group:

- List of members/entities in the group
- Type of business activities
- Country or jurisdiction
- Gross income including independent and related party transactions (excluding payment considered as a dividend by the taxpayer's jurisdiction)
- Net profit (loss) before tax
- Income tax withheld/collected/paid by each member of the group
- Total income tax payable reported in the financial statement
- Capital
- Accumulated retained earnings
- Number of permanent employees
- Tangible assets other than cash and cash equivalents

If the country-by-country report is not available or is not required in the jurisdiction of the parent company, the Indonesian taxpayer will need to coordinate with the parent company to prepare the report.

Other Issues

There are a number of issues to be aware of:

- The information provided in the country-by-country report will make the value chain and profit recognition of the global enterprise more transparent. Thus, companies which have transactions with related parties located in lower tax jurisdictions which record a high profit could come under more intense scrutiny. This could potentially result in more tax disputes.
- The country-by-country report for companies with a 31 December year end must be available by 31 December 2017. This means country-by-country reporting appears to have been in effect since 1 January 2016. This is the first year any country has introduced country-by-country reporting and, given the extent of the information required for the report, more notice from the MoF would have been expected. Companies will find it difficult to comply with country-by-country reporting, especially if the ultimate parent company has not yet been required to prepare such a report by its local tax authorities. Some type of exemption from the first year reporting requirement for such companies would be reasonable to expect.

LANGUAGE

Transfer pricing documents must now be prepared using Bahasa Indonesia. If the taxpayer has been approved to perform bookkeeping using a foreign language or currency other than Rupiah, the transfer pricing documents can be prepared in accordance with the foreign language permitted. However, a translation to the Indonesian language will still be required.

ACTION REQUIRED

The master file and local file are to be prepared by the end of the fourth month after the end of the tax year. Thus, for companies with a 31 December year end, this would mean as early as April 2017. Quick action is needed. The cost of non-compliance is that the taxpayer would be considered as not complying with the arm's length principle and not meeting its obligation to prepare and maintain proper transfer pricing documentation.

We would be pleased to discuss any questions you may have and assist you with the preparation of the necessary reports.

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