TaxPrime Newsletter 01/2024

# MoFR 172/2023:
## The New Indonesian Transfer Pricing Guidelines

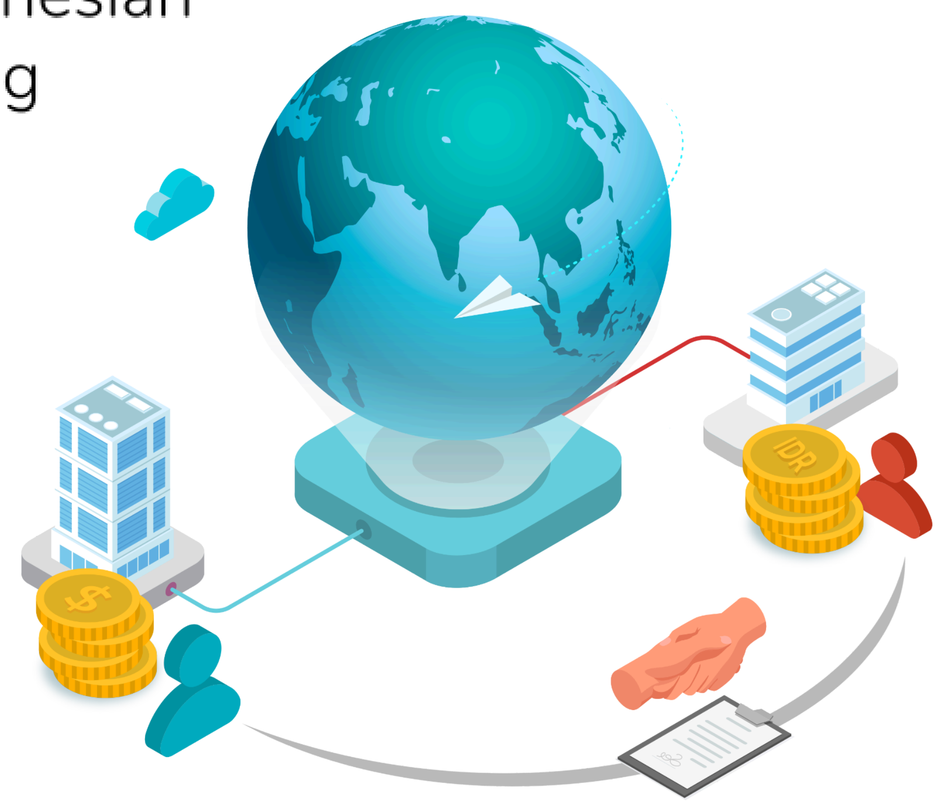


Table of Contents



## Introduction

Indonesia's transfer pricing landscape is poised for a transformation with the introduction of the Minister of Finance Regulation Number 172 of 2023 (MoFR-172). This pivotal regulation, centered on the Implementation of the Arm's Length Principle ("Prinsip Kewajaran dan Kelaziman Usaha/PKKU"), marks a strategic response to recent amendments in the Income Tax Law and the General Provisions and Procedures of Taxation Law. These amendments stem from the harmonization of Tax Regulations Law and its implementing Government Regulations, GR-50 and GR-55 of 2022. MoFR-172 introduces changes in how transfer pricing, Mutual Agreement Procedure (MAP), and Advance Pricing Agreement (APA) are conceptualized and implemented. It signifies a progressive step towards refining tax compliance to enhance fairness in business practices, especially regarding transfer pricing practices and impacts.

## MoFR-172: An Overhaul

MoFR-172 adopts an omnibus approach, unifying various transfer pricing aspects, including compliance, documentation, and the Directorate General of Taxes (DGT) authorities. This sweeping regulation replaces previous guidelines and introduces more precise, more comprehensive directives. MoFR-172 can be aptly described as the new Indonesia Transfer Pricing Guidelines, applicable to both taxpayers and tax authorities.

## Positive Changes for Taxpayers

Fundamentally, MoFR-172 enhances clarity and promotes fairness, particularly in its implementation of the PKKU, a crucial effort to encourage fairness in business transactions. While it may only address some intricacies of transfer pricing challenges, MoFR-172 represents a significant step towards establishing a more equitable and balanced business environment. Let's delve into a more elaborate explanation of the critical changes and updates compared to the previous regulation.

## Key Changes and Updates

### PKKU's Implementation Aspects of MoFR-172

- **Detailed Industry Analysis:** MoFR-172 emphasizes conducting a thorough industry analysis. This involves understanding product characteristics, industry-specific factors, competitive stages, and location advantages. By analyzing these elements, businesses can effectively distinguish between conditions of affiliated and independent transactions, which is crucial for accurate comparability analysis.

- **Selection Criteria for the Tested Party:** The regulation clarifies the criteria for selecting the tested party in transfer pricing analysis. It recommends choosing the entity with simpler functions, assets, and risks (FAR). However, it also allows selecting a more complex entity as the tested party when necessary, considering the method used and data availability. This approach ensures practicality and avoids undue burden in the analysis process.

### Transfer Pricing Methods and PKKU Compliance

- **Single Year vs. Multi-Year Data:** MoFR-172 advocates for using single-year data but also accommodates using multi-year data to enhance the comparability of comparable transactions.

- **CUP and CUT Methods:** When all transfer pricing methods are deemed equally reliable, the regulation prefers the Comparable Uncontrolled Price (CUP) and Comparable Uncontrolled Transactions (CUT) methods. This amendment addresses an issue in previous regulations, which implicitly indicated a disparity in reliability between the Comparable Uncontrolled Price (CUP) method and the Comparable Uncontrolled Transaction (CUT) method, despite their similar characteristics.

- **More guidance on PSM implementation:** The regulation offers a more comprehensive explanation of the Profit Split Method (PSM), including detailed steps for its implementation. This, *inter alia,* encompasses clarification on 'unique contributions' and provides specific guidance on data to substantiate PSM analysis.

## Primary, Secondary, and Corresponding Adjustments

- **Primary Adjustment Authority:** The Directorate General of Taxes (DGT) is empowered under MoFR-172 to recalculate income and deductions to ensure compliance with PKKU. This authority specifically targets cases where taxpayers fail to apply PKKU correctly, do not comply with procedural steps, or incorrectly determine transfer prices. Crucially, MoFR-172 also mandates the DGT to rigorously apply this regulation in executing its authority to determine transfer prices in primary adjustments.

- **Secondary Adjustment and Possible "Repatriation":** As regulated in the previous regulation, differences between income that complies with the PKKU and reported income are treated as dividends and subjected to taxation (secondary adjustment). This tax treatment applies to both domestic and international transactions. However, MoFR-172 provides that secondary adjustment is not required if the income discrepancy is repatriated to the taxpayer or if the taxpayer agrees to the primary transfer pricing adjustment made by the Director General of Taxes. In cases of repatriation, the taxpayer must return the difference in cash or cash equivalents before the issuance of the tax assessment letter. While further clarity on this practice is needed, this regulation provides crucial relief for taxpayers, preventing severe penalties in transfer pricing cases as long as they can facilitate repatriation.

- **Value-added tax (VAT) Implications of Primary Adjustments:** Primary adjustments to related party transactions may also be subject to VAT. If the selling price is less than the fair market price at the time of taxable product or service delivery, the VAT adjustment is computed using that price. Additional VAT is levied when the DGT can allocate adjustments to individual transactions. Importantly, buyers retain the ability to credit VAT-Input based on the initial value stated in the original tax invoice, even when the DGT performs VAT adjustments.

- **Corresponding Adjustments:** The regulation allows for corresponding adjustments in both domestic and international transactions. This is a significant update, as it clarifies the possibility of such adjustments through revision of tax returns, tax audits, or revision of tax assessment letters (SKP) in domestic transactions, which was previously ambiguous.

## MAP

While MoFR-172 primarily focuses on implementing PKKU, it also incorporates MAP-related provisions. MoFR-172 goes beyond merely addressing transfer pricing and delves into the technical implementation rules governing MAP implementation, including taxpayers' ability to choose between domestic and MAP routes for dispute resolution along with its technical details and impacts. This aligns with the provisions established in the Harmonization of Tax Regulations Law.

## APA

- MoFR-172 introduces notable updates in the context of APA. One significant change is the expansion of administrative conditions for taxpayers seeking an APA. While the previous regulation only disallowed taxpayers undergoing tax crime investigations from applying for an APA, MoFR-172 adds further criteria. Taxpayers still in the preliminary evidence examination phase or already in the process of prosecution, trial, or serving a criminal sentence related to taxation are also ineligible for APA requests. While the latter conditions are understandable, the prohibition of taxpayers from filing an APA due to preliminary evidence examination raises questions about the presumption of innocence.

- In addition to these conditions, MoFR-172 introduces provisions to address various scenarios. If a taxpayer successfully submits an APA but becomes involved in the legal processes mentioned above during the negotiation phase, the DGT is authorized to halt the APA proceeding.

- On a positive note, MoFR-172 clarifies the possibility of filing for a multilateral APA, streamlining the process for taxpayers seeking international agreements. It also allows taxpayers withdrawing their bilateral or multilateral APA requests to apply for a unilateral APA as a 'second chance.'

Furthermore, the regulation extends the timeframe for submitting APA renewal requests, providing taxpayers more time to prepare.

- Lastly, MoFR-172 introduces an explicit provision for exempting penalties on the application of agreed APAs for previously covered years and the rollback period, which may involve additional tax payments. This provision enhances the attractiveness of APAs for taxpayers seeking certainty and compliance.

### Effective Date

MoFR-172 took effect on 29 December 2023. This enactment simultaneously repealed previous related regulations, including MoFR-22, MoFR-213 (concerning Transfer Pricing Documentation), and MoFR-49 (regarding the MAP). As a result, MoFR-172 is now the governing regulation for both taxpayers and the DGT. It's important to mention that, specifically for the requirements to maintain and provide transfer pricing documentation, MoFR-172 will be applicable from the fiscal year 2024.

## Important Constants: Areas to Keep an Eye On

### Broad Scope of Special Relationships

MoFR-172 broadens the definition of special relationships, encompassing capital participation, family ties, and control through management or technology. This expansion reflects the evolving nature of modern business relationships and aligns with MoFR 22 of 2020 (MoFR-22) principles and the explanation of Article 18 of the Income Tax Law.

### Evaluation of Separate and Combined Transactions

Article 5 of MoFR-172 strongly supports analyzing transactions individually in line with the arm's length principle rather than through aggregation analysis. However, the regulation allows for an aggregated approach in certain cases where transactions are significantly influenced by other related party transactions, enabling a pragmatic application of the arm's length principle when individual analysis is insufficient. This approach aligns with the OECD TPG Para. 3.9 and continues the principles in Article 11 of MoFR-22. The analysis approach should be grounded in actual substance, and a one-size-fits-all aggregation approach may not be adequate.

### Ex-ante Approach for Comparability Analysis

In line with OECD TPG Para. 3.69, Art. 17 of MOFR-172 mandates that taxpayers use an ex-ante approach for comparability analysis in transfer pricing. This involves utilizing reasonably available information when the transactions commence to set transfer prices that comply with the PKKU ("arm's length price-setting" approach).

### Introduction of New Transfer Pricing Methods

Enhancing transfer pricing methods, MoFR-22, reinforced by MoFR-172, introduces three new transfer pricing methods: CUT, Asset Valuation, and Business Valuation. These methods are designed to enhance accuracy in evaluating specific financial criteria, tangible and intangible asset transactions, and complex business restructurings.

### Two-Step Analysis of the PKKU

The regulation has established a framework for transfer pricing that involves a two-step process:

- Preliminary analysis phase. This phase aims to support and economically justify specific intra-group transactions.

- Implementation of PKKU. In this phase, businesses need to adhere to PKKU, ensuring that their intra-group transactions are comparable to those between independent parties.

### Local File Segmentation Based on Business Characterization

When a taxpayer operates multiple business activities, each with distinct characteristics, the local file (LF) must be segmented to reflect the unique business characterizations owned by the taxpayer. This ensures that the documentation accurately represents the diverse nature of each business unit or activity.

## Concluding Remarks

**MoFR-172** marks a positive change for taxpayers involved in transfer pricing practices. Its comprehensive approach addresses various aspects of transfer pricing, from industry analysis to VAT implications and possible “repatriation”. The regulation provides more clarity and encourages businesses to engage in fair and transparent transactions.

As a leading tax consulting firm, we are dedicated to assisting our clients in understanding and implementing these changes. We encourage businesses to proactively adapt to these regulations to maintain compliance and leverage the opportunities they present for more equitable business practices.

# Upcoming Event

We invite you to learn more about the regulation by attending **our webinar on January 26, 2024.** The webinar is free, and you can register by [clicking here.]

**Join us** for valuable insights into the impact of MoFR-172 and how you can mitigate, plan, and overcome your transfer pricing risk

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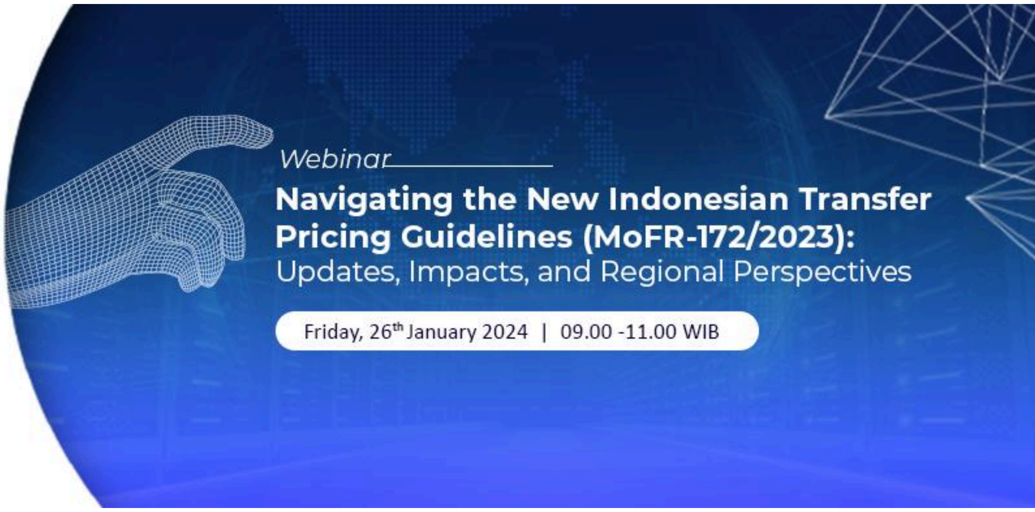


# Contact Us

For personalized guidance on how MoFR-172 affects your business, feel free to reach out to our advisors.




Emanuel Dewo A.W.
dewo@taxprime.net

Muhamad Noprianto
noprianto@taxprime.net

Bayu Rahmat Rahayu
bayu@taxprime.net

Bobby Savero
bobby@taxprime.net

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