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TRANSFER PRICING AND INTERNATIONAL TAX UPDATES

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TOPICS

1. RECENT UPDATES TO THE MULTILATERAL CONVENTION
2. OECD's FINAL GUIDANCE ON SSA FOR DISTRIBUTION AND MARKETING ACTIVITIES
3. COMMODITIES PRICING
4. RISKS RELATED TO PE, FINANCIAL TRANSACTIONS EMANATING FROM PMK 172
5. RECENT TP AUDIT TRENDS INCLUDING ECONOMIC ADJUSTMENTS AND COVID 19

1

RECENT UPDATES TO THE MULTILATERAL CONVENTION

MULTILATERAL INSTRUMENT ON TAX TREATY (MLI)

Indonesia ratified MLI through the Regulation of the President No. 77 of 2019 initially covering 47 countries

The newly ratified MLI under PR-63 **expands the existing CTAs to include 13 jurisdictions to a total of 58 Covered tax jurisdictions (As SG and UAE new treaties also ratified) .**

❑ Hybrid mismatch

- Art. 3 – Transparent Entities
- Art. 4 – Dual Resident Entities
- Art. 5 – Application of Methods for Elimination of Double Taxation

❑ Treaty abuse

- Art. 6 – Purpose of a Covered Tax Agreement
- Art. 7 – Prevention of Treaty Abuse
- Art. 8 – Dividend Transfer Transactions
- Art. 9 – Capital Gains from Alienation of Shares or Interests of Entities Deriving their Value Principally from Immovable Property
- Art 10 – Anti-abuse Rule for Permanent Establishments Situated in Third Jurisdictions
- Art 11 – Application of Tax Agreements to Restrict a Party's Right to Tax its Own Residents

❑ Permanent establishment

- Art. 12 – Artificial Avoidance of Permanent Establishment Status through Commissionaire Arrangements and Similar Strategies
- Art. 13 – Artificial Avoidance of Permanent Establishment Status through the Specific Activity Exemptions
- Art. 14 – Splitting-up of Contracts

❑ Dispute resolution

- Art. 16 – Mutual Agreement Procedure
- Art. 17 – Corresponding Adjustments

❑ Final provisions

- Art. 35 – Entry into Effect

NEWLY ADDED COVERED TAX JURISDICTIONS IN PR 63

Article in the MLI Convention	Newly added jurisdictions												
	Austria	Belarus	Germany	Jordan	Kuwait	Mongolia	Morocco	Papua New Guinea	Singapore (new)	Sri Lanka	Tunisia	Ukraine	United Arab Emirates (new)
Art. 6 –Purpose of a Covered Tax Agreement	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Art. 7 –Prevention of Treaty Abuse								✓	✓				✓
Art. 8 –Dividend Transfer Transactions	✓		✓						✓			✓	
Art. 9 –Capital Gains from Alienation of Shares or Interests of Entities Deriving their Value Principally from Immovable Property							✓		✓			✓	✓
Art. 12 –Artificial Avoidance of Permanent Establishment Status through Commissionaire Arrangements and Similar Strategies	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Art. 13 –Artificial Avoidance of Permanent Establishment Status through the Specific Activity Exemptions	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Art. 16 –Mutual Agreement Procedure	✓		✓	✓					✓	✓		✓	✓
Art. 17 –Corresponding Adjustments		✓		✓	✓	✓	✓	✓	✓	✓		✓	✓

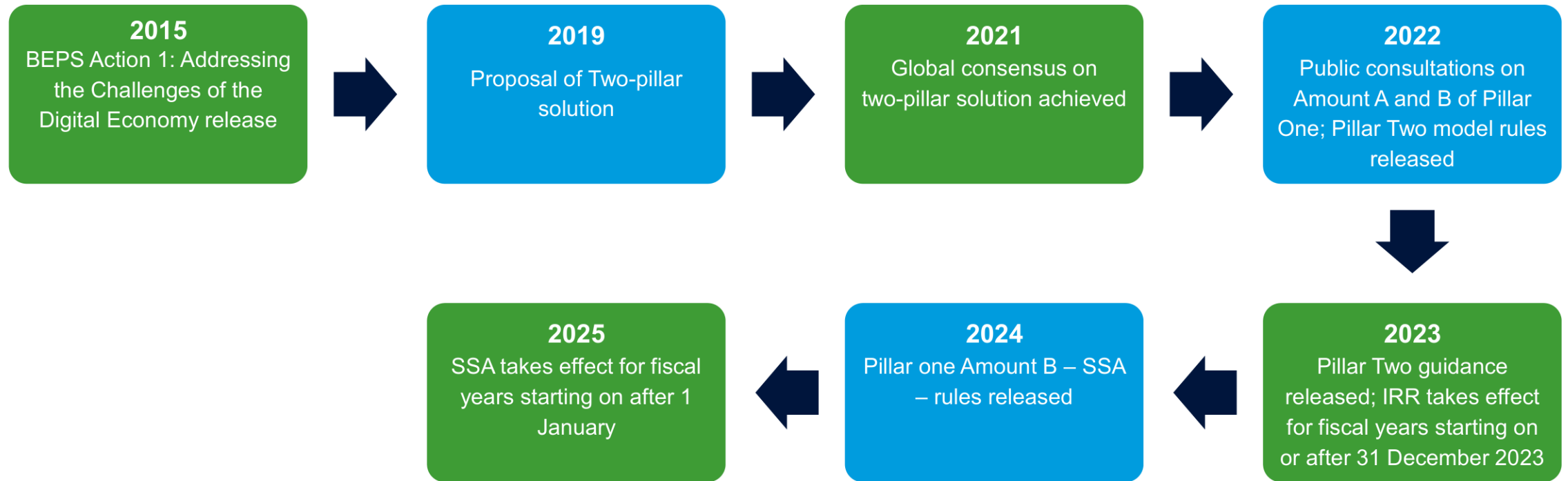


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|---------------------------------------|--------------------|--------------------------------|
| 1. Australia | 25. Croatia | 48. Austria |
| 2. Brunei Darussalam | 26. Finlandia | 49. Belarus |
| 3. Canada | 27. Italy | 50. Germany |
| 4. China (People's Republic of China) | 28. Norway | 51. Jordan |
| 5. France | 29. Poland | 52. Kuwait |
| 6. Hongkong | 30. Qatar | 53. Mongolia |
| 7. India | 31. Slovakia | 54. Morocco |
| 8. Japan | 32. South Africa | 55. Papua New Guinea |
| 9. Lao PDR | 33. Turkey | 56. Singapore (new) |
| 10. Luxembourg | 34. Armenia | 57. Sri Lanka |
| 11. Malaysia | 35. Bulgaria | 58. Tunisia |
| 12. Netherlands | 36. Czech Republic | 59. Ukraine |
| 13. New Zealand | 37. Denmark | 60. United Arab Emirates (new) |
| 14. Philippines | 38. Egypt | |
| 15. Singapore | 39. Hungary | |
| 16. Seychelles | 40. Mexico | |
| 17. Republic of Korea | 41. Pakistan | |
| 18. Switzerland | 42. Portugal | |
| 19. Thailand | 43. Romania | |
| 20. United Kingdom | 44. Russia | |
| 21. United Arab Emirates | 45. Serbia | |
| 22. United States of America | 46. Spain | |
| 23. Vietnam | 47. Sweden | |
| 24. Belgium | | |



② OECD's FINAL GUIDANCE ON SSA

THE OECD'S TWO-PILLAR SOLUTION



THE OECD'S TWO-PILLAR SOLUTION

PILLAR ONE

Amount A

Reallocates profits over 10% to market jurisdictions where nexus test met

Revenues of at least €20bn and profit of at least 10%

Amount B

Sets formulaic approach to reward baseline distribution activities

Potentially all entities within transfer pricing rules

Amount C

Remunerates additional local activities and provides dispute resolution mechanisms

Application to be confirmed – may align with Amount B

PILLAR TWO

Multinational Top-up Tax

Income Inclusion Rule Under taxed Profits Rule

Top-up tax to increase effective rate in territory to 15%

Domestic Minimum Tax

Equivalent to MTT to collect top-up tax locally

Often set at 15% but local rates may vary

Subject to Tax Rule

Applies a minimum level of tax to payments between related parties through a withholding tax where source jurisdiction below minimum rate. Application to be confirmed – may align with Amount B

QUALIFYING ACTIVITIES

BASELINE DISTRIBUTION ACTIVITIES

- Core distribution functions
- Purchase product from related parties for sale to third parties who are not end customers
- Routine activities – appropriate for one-sided transfer pricing method
- Unique and valuable intangibles excluded

QUANTITATIVE FILTER

- Ratio of operating expenses to sales
- Not lower than 3%
- Not higher than 20%-30%

EXCLUSIONS

- Distribution activities can be in separate entity or alongside other functions where streaming possible
- Exclusions for the following (above 20% de minimis)
- Retail sales
- Services
- Digital sales
- Sale of commodities

01

Industry Grouping

Determine appropriate industry grouping from the three categories provided. If more than one industry is present and represents over 20% of sales, results should be streamed and all relevant categories used

GROUP 1

- Industry categories which have a statistically significant relationship to lower levels of return
- Examples include perishable foods, grocery, household consumables, construction materials and supplies, plumbing supplies and metal

GROUP 2

- Industry categories which do not show a statistically significant relationship to levels of return
- Examples include domestic vehicles, IT hardware and components, pharmaceuticals, various electrical plastics and chemicals and any sectors not listed under the full Group 1 and 3 listings published by the OECD

GROUP 3

- Industry categories which have a statistically significant relationship to higher levels of return
- Examples include medical machinery, industrial machinery including industrial and agricultural vehicles, and industrial tools and components

02

Factor intensity

Determine factor intensity classification based on the distributor's weighted average results of the previous three years two factors used

OAS

Net operating asset Intensity*Net operating assets : net revenue*

OES

Operating expense Intensity*Operating expense : net revenue*

03

Pricing matrix

Identify an appropriate return from the OECD's pricing matrix (between 1.5% and 5.5%), or a weighted average where goods in more than one industry are distributed. Qualifying territories may adjust matrix values based on sovereign debt rating.

Industry Grouping Factor intensity	Industry Grouping 1	Industry Grouping 2	Industry Grouping 3
[A] High OAS / any OES >45% / any level	3.50% +/- 0.5%	5.00% +/- 0.5%	5.50% +/- 0.5%
[B] Med/high OAS / any OES 30% - 44.99% / any level	3.00% +/- 0.5%	3.75% +/- 0.5%	4.50% +/- 0.5%
[C] Med low OAS / any OES 15% - 29.99% / any level	2.50% +/- 0.5%	3.00% +/- 0.5%	4.50% +/- 0.5%
[D] Low OAS / non-low OES <15%/10% or higher	1.75% +/- 0.5%	2.00% +/- 0.5%	3.00% +/- 0.5%
[E] Low OAS / low OES <15% OAS / <10% OES	1.50% +/- 0.5%	1.75% +/- 0.5%	2.25% +/- 0.5%

IDENTIFY AND OBTAIN DATA

Country	Indonesia
Currency	IDR
Qualifying jurisdiction?	Yes
Sovereign credit rating	BB+
Product category	1

	2023	2022	2021	2020
Turnover	2.723.513.683.000	3.138.153.955.000	2.519.223.821.000	1.907.194.560.000
Cost of goods sold	2.427.870.041.000	2.836.230.757.200	2.121.878.600.000	1.671.212.706.000
Gross profit	295.643.642.000	301.923.197.800	397.345.221.000	235.981.854.000
Operating expenses	235.184.163.000	198.863.167.000	179.626.448.000	191.579.194.000
Operating profit	60.459.479.000	103.060.030.800	217.718.773.000	44.402.660.000
Return on sales	2,22%	3,28%	8,64%	2,33%

Stock	753.770.299.000	981.025.846.000	687.063.236.000	463.594.559.000
Debtors	408.131.368.000	358.341.544.000	343.147.135.000	301.052.978.000
Creditors	72.088.215.000	154.621.290.000	61.434.653.000	178.956.633.000
Working capital	1.089.813.452.000	1.184.746.100.000	968.775.718.000	585.690.904.000

Fixed Assets	162.182.693.000	166.580.852.000	184.131.741.000	87.084.711.000
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KEY CONSIDERATIONS

- ❑ P&L and balance sheet data is required for the most recent three available years - for this example, the required data is in the green boxes, shown for the 2020, 2021, 2022 and 2023 financial years.
- ❑ This gives us enough to calculate OAS and OES and identify whether any of the scoping checks or adjustments apply.

EXAMPLE CALCULATION

Apply the Pricing Matrix

Determining the return (Section 5.1)

This section calculates the amount B return, and whether any adjustment any is needed

	2023
Turnover	2.723.513.683.000
Cost of goods sold	2.427.870.041.000
Gross profit	295.643.642.000
Operating expenses	235.184.163.000
Operating profit	60.459.479.000
Return on sales	2,22%
Categories per Section 5.1:	B1
Adjustment return on sales	3,00%
Adjustment needed?	Yes
Amount of adjustment	- 11.245.931.571

If the RoS is more than 0.5% at variance from the pricing matrix return, an adjustment may be needed

if no adjustment needed, stop here

The adjustment should be added to or subtracted from CoGS

Calculated revised P&L after Section 5.1 Calculation

	2023
Turnover	2.723.513.683.000
Cost of goods sold	2.416.624.109.429
Gross profit	306.889.573.571
Operating expenses	225.184.163.081
Operating profit	81.705.410.490
Return on sales	3,00%

This calculation adjust to the exact rate, rather than to +/-0.5%

Calculation Steps

- We already know that our company is Group 3 (medical devices).
- We calculate its OAS at 42.00% and Its OES at above 7.54%, which indicates the target return is based on B1 in the matrix
- This indicates a target return on sales of 3.00%.
- The actual return on sales is 2.22%, more than 0.5% below the target, so we calculate an adjustment to decrease cost of goods sold.

EXAMPLE CALCULATION

Data Availability Mechanism

Data availability mechanism calculation (Section 5.3) *A further adjustment may be needed for companies operating in qualifying jurisdictions*

Adjustment needed? Yes

Revised Return on Sales	3,29%	
Amount of adjustmet	- 8.006.852.106	The adjustment should be added to or subtracted from COGS

Calculated revised P&L after Section 5.3 calculation

	2023
Turnover	2.723.513.683.000
Cost of goods sold	2.408.617.257.323
Gross profit	314.896.425.677
Operating expenses	225.184.163.081
Operating profit	89.712.262.596
Return on sales	3,29%

Calculation Steps

- For the purpose of this example, we assume Indonesia is a qualifying jurisdiction. A final adjustment is therefore required
- The resulting adjustment is calculated using the country's sovereign credit rating (in this example BB+) and the company's OAS to increase the target return on sales.* This leads to a slightly higher return on sales of 3.85%, and an additional adjustment is required to further reduce cost of goods sold.



THA SSA IN PRACTICE – ILLUSTRATING THE CHALLENGE

Characterization

Requires a common understanding of the fact pattern and the qualification criteria

Return on sales

Differences in expectation of tax authorities where principal territory does not accept SSA matrix

Dispute resolution

SSA may swap disputes over benchmarking for disputes over characterization and calculation

Tax authority resource

Will jurisdictions be able to implement successfully and commit time to SSA dispute resolution mechanisms?

Financial information

Will local accounting information be detailed / set up appropriately for streaming?

Customs Duty

Will transfer pricing expectations align with Customs Duty requirements, especially where SSA pricing 'baked in'

Foreign exchange

Under SSA distributor would not bear forex risk, but in territories with more volatile currencies this is not always the case

Qualifying criteria

Operating expenses must be within 3%-30% range - business models in some territories may not fall within this range

KEY ISSUE

Is the SSA a benefit?

If we have the option of the SSA as a safe harbour, should we take it? Would restructuring be needed to meet the requirements?

How do we support our conclusions?

What evidence should we provide? And is this more or less than before?



Do we have a clear understanding of characterisation?

Is the group's business model consistent with SSA expectations, eg high volume/low margin?

Does our pricing need to be 'baked in'?

SSA is based on outcome testing – will a traditional TNMM policy with a year-end adjustment be robust?

Interaction with Customs

Will pricing to meet SSA values be consistent with Customs requirements?



ACTIONS AND NEXT STEPS



3 COMMODITIES PRICING

COMMODITIES PRICING

In the 2022 Transfer Pricing Guidelines, the OECD provides guidance regarding the use of the CUP method in commodity transactions, including the following :

- a. The CUP method is the most suitable method for commodity transactions. (Paragraph 2.18 - 2.19)
 - The CUP method would generally be an appropriate transfer pricing method for establishing the arm's length price for the transfer of commodities between associated enterprises
- b. Use of Quoted Commodity Prices as a reliable price reference in determining affiliate transaction prices. (Paragraph 2.18, 2.19, and 2.22)
 - Quoted Commodity Price is a commodity market price obtained from domestic and international commodity exchanges which generally reflects an agreement between independent parties.
- c. Comparability of commodity products. (Paragraph 2.20)
 - Reasonably accurate adjustments should be made to ensure that the economically relevant characteristics of the transactions are comparable. For commodities, the economically relevant characteristics include, among others, the physical features and quality of the commodity; the contractual terms of the controlled transaction, such as volumes traded, period of the arrangements, the timing and terms of delivery, transportation, insurance, and foreign currency terms.
- d. Compensation for contributions of other entities in a supply chain of commodity transactions. (Paragraph 2.20)
 - The contribution of other entities in a supply chain which is realized in the form of functions performed, assets used, and risks borne must be compensated in line with value creation.
- e. Documentation and important documents in commodity transactions that need to be prepared by taxpayers. (Paragraph 2.21)
 - Taxpayers must prepare Transfer Pricing Documents accompanied by reliable evidence and documents to assist tax authorities in carrying out audits based on information.
- f. Consistent application of pricing dates. (Paragraph 2.22)
 - If the Taxpayer can provide sufficient relevant evidence (e.g. a proposal and acceptance of that proposal, a contract, or other documents setting out the terms of the arrangement) relating to the actual pricing date agreed upon by the affiliated parties, the Tax Authority should approve the use of the transfer price of the affiliate transaction for the commodity product.

COMMODITIES PRICING

In **Government Regulation (*Peraturan Pemerintah*) GR-15/2022**, there are specific regulations on how to determine the selling price of Coal, both for affiliated and independent transactions.

The application of GR-15/2022 to coal sales transactions is carried out using a price index calculation hierarchy, where sales to affiliates and independent parties use a higher price between:

- a. lower price between HPB or Coal price index at the time of transaction; and
- b. the actual or supposed price received or obtained by the seller.

PMK 172 2023 Article 9 paragraph (12) states that:

“If the methods referred to in paragraph (1) subparagraph a or paragraph (1) subparagraph d number 3 and other methods may be used and have **equivalent reliability**, the methods referred to in paragraph (1) subparagraph a or paragraph (1) subparagraph d number 3 shall take precedence over other methods.”

Methods referred to in:

- paragraph (1) subparagraph a: CUP Method
- paragraph (1) subparagraph d number 3: CUT Method

From these provisions it can be understood that in the condition that the CUP or CUT methods and other methods are equally reliable, the CUP or CUT methods should be given priority rather than other methods.

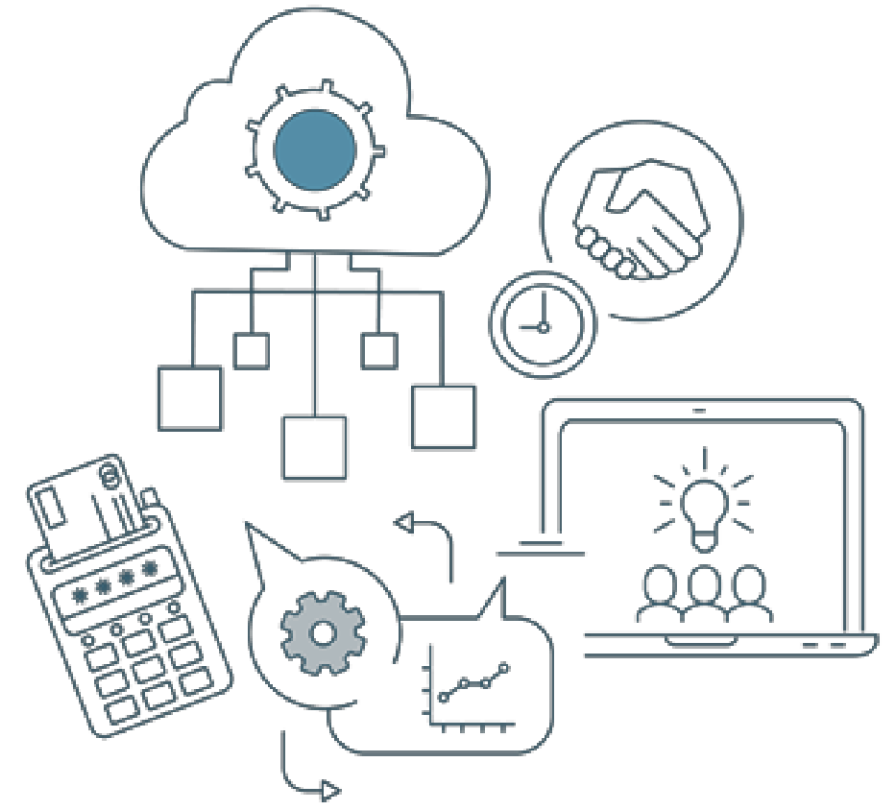
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RISKS RELATED TO PE, FINANCIAL TRANSACTIONS EMANATING FROM PMK 172

ALP FOR PE

MOFR-172 requires domestic taxpayers that are Permanent Establishments to submit all data and information related to transactions carried out by the affiliated party abroad which are related to the business or activities of the Permanent Establishment in Indonesia. If this is not complied, the tax officer has been empowered to apply the arm's length principle *Suo Moto* to adjust the PE's income.

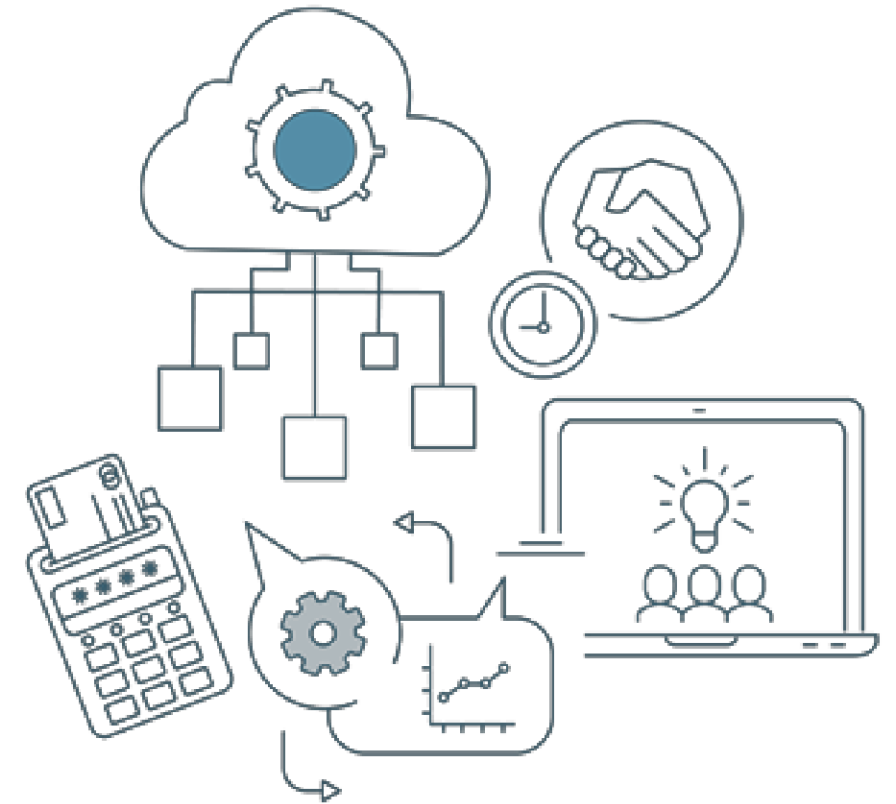
ARTICLE 15



DEFINITION

Transfer Pricing as referred to in **PMK 172 Article 9**, is the determination of prices in transactions influenced by special relationships.

Income Tax (*Pajak Penghasilan or PPh*) according to **Income Tax Law Number 7 of 2021** is the tax imposed on taxpayers based on income received or earned during the tax year.



PRELIMINARY STAGES-FINANCIAL TRANSACTIONS RELATED TO LOANS

ARTICLE 13

Financial Transactions Related to Loans

Proof that the loan:

- in accordance to the substance and actual circumstances;
- is needed by the borrower;
- is used to obtain, maintain, and collect income (3M) in accordance with tax regulations;
- meets the characteristics of a loan;
- provides economic benefits to the borrower.

Key Loan Characteristics:

- a. the loan has a maturity date
- b. there is an obligation to repay the principal of the loan
- c. there are payments scheduled for both the principal and its interest

Notes:

1. Borrower have to provide the financial statement of lender to prove that loan has been acknowledged
2. The characteristic must be clearly stated in the contract
3. Have to provide proof that the company has the ability to obtain loan and repay the loan at the time of obtaining loan
4. Does it mean that the loan must have interest?

FINANCIAL TRANSACTION – LOAN INTEREST

Preliminary Stages – Financial Transactions Related to Loans (PMK172/2023)

Provisions in PMK172/2023, required the Taxpayer to proof that the Loan:

1. In accordance with the substance and actual circumstances;
2. is needed by the borrower;
3. is used to obtain, maintain, and collect income (3M) in accordance with tax regulations;
4. meets the characteristics of a loan;
5. provides economic benefits to the borrower.

Indonesian Tax Regulations in Relation to Non-Interest-Bearing Loans (PP-94/2010)

Provisions in PP 94/2010, required the Taxpayer to proof that:

1. The loan is from the shareholder's funds and not from other parties
2. The capital that is supposed to be paid by the shareholder as the lender has been entirely paid
3. The shareholder acts as the lender are not suffer losses
4. The limited liability company that receives the loan is having financial difficulties in relation to business continuity

5

RECENT TP AUDIT TRENDS INCLUDING ECONOMIC ADJUSTMENTS AND COVID-19

- Overuse as a default of TNMM without considering relevant comparability adjustments
- Quality of facts and details in the assessment order
- Relief mechanism at the Tax Objection Stage
- Covid-19 Guidance paper vs Ex-ante provisions in PMK 213

(Covid-19 Guidance suggests price adjustments on impacted industries, outcome testing, corroborative analysis and other approaches to alleviate the impact of pandemic)



DISCLAIMER

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