Transfer pricing in Indonesia: overview

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A Q&A guide to transfer pricing in Indonesia.

This Q&A provides a high level overview of the key practical issues in transfer pricing, including: international and local legislation, transfer pricing policy, pricing methodologies, regulatory practice and procedure, courts and dispute resolution, case law and revenue authority decisions, pricing adjustments, anti-avoidance, penalties, and proposed reform.

To compare answers across multiple jurisdictions, visit the Transfer Pricing: *Country Q&A tool*.

The Q&A is part of the global guide to transfer pricing. For a full list of jurisdictional Q&As visit *www.practicallaw.com/transferpricing-guide*.

Transfer pricing: general overview

1. What are the main characteristics of transfer pricing law and policy in your jurisdiction?

Transfer pricing is generally regulated under the Income Tax Law (Law No. 36 of 2008). Under this regulation, a tax officer is authorised to redetermine the tax income of a taxpayer with a special relationship with other taxpayers, by using certain calculations (*see Question 8*).

2. What have been the main developments of significance for transfer pricing law and practice in your jurisdiction in the past 12 months?

The government has recently issued Regulation of the Minister of Finance Number 213/PMK.03/2016 regarding types of documents and/or additional information that must be maintained by a taxpayer conducting transactions with an affiliated party and the maintenance procedures (PMK 213). Under PMK 213, a taxpayer who fulfils several criteria must maintain the following documents, to be used to implement the Principle of Fairness and Business Prevalence in Determining Transfer Pricing:

- Master document, containing information on the group company.
- Local document, containing information on the taxpayer.
- Country-by-country report.

Transfer pricing legislation

Federal or national legislation

3. What is the main federal (national) legislation regulating transfer pricing in your jurisdiction?

Primary legislation

Income tax. For income tax, the transfer pricing regulation is in Article 18 and 18(3) of Law No. 7 of 1983 regarding Tax Income, as amended by the Income Tax Law.

Value added tax (VAT). The transfer pricing regulation for VAT is in Article 2 of Law No. 8 of 1983. This was last amended in 2009, by Law No. 42 regarding Value Added Tax on Goods and Services and Sales Tax on Luxurious Goods (VAT Law).

Secondary legislation

The main secondary legislation is:

- Government Regulation 80 of 2007, regarding Implementation Procedures on Taxation Rights and Obligations based on General Tax Provisions and Procedures Law (GR 80/2007). This was last amended in 2011 by Government Regulation 74 (GR 74/2011). It provides that if taxpayers conduct related-party transactions, they must keep documents and/or additional information to show that the transactions are in accordance with the principles of fairness and predominance of business. GR 74/2011 allows the Ministry of Finance to regulate the mutual agreement procedure, the advance pricing agreement, and the exchange of information rules, although these are issued under several Regulations of the Directorate General of Taxation (DGT), among others the DGT Regulation PER-48 and DGT Regulation PER-69.
- Government Regulation 94 of 2010 governs the calculation and settlement of income tax during the fiscal year (GR 94/2010). This clarifies various provisions in the Income Tax Law, including non-interest-bearing loans from shareholders.
- MoF Regulation 258/PMK.03/2008 (MoF Regulation 258). This sets a rate of 25% of the transaction value for taxable gains from a disposal of shares in a foreign company, domiciled in a tax haven country, that is a special purpose vehicle (SPV) holding shares representing 25% or more of the ownership of an unlisted Indonesian company.
- MoF Regulation 140/PMK.03/2010 (MoF Regulation 140) applies the look-through principle to a foreign SPV, owned by a resident taxpayer, that purchases shares in or receivables of another Indonesian tax resident. This

is to prevent u-turn tax planning, and is imposed if the SPV lacks substance and the purchase price is not at arm's length. The shares or receivables are considered assets of the shareholder of the SPV, not of the SPV.

- MoF Regulation 17/PMK.03/2013 on tax auditing (MoF Regulation 17).
- MoF Regulation 240/PMK.03/2014 on the implementation of mutual agreement procedure (MoF Regulation 240).
- MoF Regulation 7/PMK.03/2015 on the procedures and implementation of advance pricing agreement (MoF Regulation 7).
- DGT Regulation PER-22/PJ/2013 (DGT Regulation PER-22). This outlines the procedure and method for transfer pricing auditing, and specific issues regarding intra-group services, intangible transactions and intra-group loans.
- DGT Regulation PER-43/PJ/2010 (DGT Regulation PER-43), as amended by DGT Regulation PER-32/PJ/2011 (DGT Regulation PER-32). This provides basic rules and a framework for transfer pricing. It provides guidance on preparing transfer pricing documentation for taxpayers conducting transactions with related parties. It examines the arm's length nature of transactions. It also introduced the most appropriate method.
- DGT Regulation PER-48/PJ/2010 (DGT Regulation PER-48). This provides the authority to exercise mutual agreement procedures in a tax treaty. It aids investigation of cross-border transfer pricing cases allegedly involving illegal avoidance of Indonesian tax obligations. The DGT forms a transfer pricing team to correct transactions of resident taxpayers, using the adjustment mechanism.
- DGT Regulation PER-69/PJ/2010 (DGT Regulation PER-69). This introduces procedures for obtaining an advance pricing agreement, along with the transfer pricing provisions in Article 18 of the Income Tax Law.
- DGT Regulation PER-39/PJ/2009, as amended by DGT Regulation PER-26/PJ/2013 (DGT Regulation 26). This introduced a new format for the corporate income tax return. A declaration of related-party transactions requires the taxpayer to disclose the transactions in detail in the return.
- DGT Regulation PER-61/PJ/2009 (DGT Regulation 61), as amended by DGT Regulation PER-24/PJ/2010 (DGT Regulation 24). This governs the application procedures for tax treaties.
- DGT Regulation PER-62/PJ/2009 (DGT Regulation 62), as amended by DGT Regulation PER-25/PJ/2010 (DGT Regulation 25). This governs anti-abuse of tax treaty provisions.
- Circular Letter SE-04/PJ/1993 (Circular Letter 04), which has been replaced by Circular Letter SE-50/PJ/2013 (Circular Letter 50). The latter provides technical tax auditing guidance for taxpayers in special relationships, especially in the light of globalisation. National boundaries have become blurred, which impacts how multinational companies carry out investment transactions and cross-border trade. High production costs and overcapacity of domestic markets have also pushed multinationals to expand beyond their jurisdiction. Multinationals generally prefer states with advantages in production cost (location saving) and market share (market premium). Circular Letter 50 provides convenience and uniformity for tax auditors conducting audits of taxpayers with special relationships, and verifies the quality of these audits.
- PMK 213 (*see* *Question 2*).

State or local transfer pricing legislation

4. What additional regional (local state) legislation and revenue authorities are relevant to transfer pricing in your jurisdiction?

There is no separation of federal and state legislation in Indonesia.

International transfer pricing treaties and agreements

5. What are the main international treaties and agreements that apply in your jurisdiction?

International institutions such as the Organisation for Economic Co-operation and Development (OECD), the UN, and the Association of Southeast Asian Nations (ASEAN) have significantly influenced the content of Indonesia's tax treaties. When negotiating its tax treaties, Indonesia tends to follow the UN or the ASEAN model, depending on the type of treaty partner involved.

6. What impact do international treaties and agreements have in your jurisdiction?

Indonesian transfer pricing rules have adopted many key concepts from the OECD Guidelines. However, Indonesia's regulations are not as detailed and complete as the OECD Guidelines or UN Transfer Pricing Manual. For example, cost contribution agreements are mentioned as falling within the transfer pricing rules. However, the regulations do not provide any further guidance on the application of the arm's length principle.

Transfer pricing policy

7. What is the overall national transfer pricing policy in your jurisdiction?

Directorate General of Taxation's (DGT) Circular Letter No. SE-15/ PJ/2014 outlined a 2014 tax audit revenue goal of IDR24 trillion, a 30% increase from the DGT's 2013 target. Based on its 2014 target, the DGT can issue tax audit instruction letters focusing on risk for taxpayers who do any of the following:

- A transaction with domestic related parties, including individuals related to the transaction.
- A transaction with related parties (transfer pricing audit, apart from a normal tax audit due to tax overpayment).
- Engage in the oil and gas sectors.
- Are subject to a joint audit between the DGT and external parties.

8. What are the main transfer pricing methodologies that are used to determine an arm's length price in your jurisdiction?

Under PER-32, the following transfer pricing methods are used to determine the arm's length price in Indonesia:

- Comparable uncontrolled price method (CUP).
- Resale price method (RPM).
- Cost-plus method (CPM).
- Profit split method (PSM).
- Transactional net margin method (TNMM).

The tax authorities can adjust a taxpayer's taxable income for related party transactions not carried out on an arm's-length basis (*Article 18, Income Tax Law*). The definition of related parties is met in any of the following circumstances:

·A taxpayer, directly or indirectly, participates in 25% or more of the capital of another taxpayer. Also, if a company participates in 25% or more of the capital of two taxpayers, the two taxpayers are also considered related.

·A taxpayer, directly or indirectly, controls another taxpayer, or where there are two or more taxpayers under common control.

·A family relationship by blood or marriage between the taxpayers.

The five arm's length pricing methodologies from the OECD Guidelines should be used to set or review transfer prices (*Article 18(3), Income Tax Law*). If the arm's length principle is not followed, the Directorate General of Taxation (DGT) can recalculate the taxable income or deductible costs from a transaction, by applying the arm's length principle.

PER-22 of 2013 and SE 50/2013 allow other transfer pricing methods to be used to determine the arm's length price for transactions between related parties, especially if the transaction involves intangible assets. These methods are based on cost, market or profit approaches. However, the regulations do not provide further examples or explanations on when or how to use these methods.

9. To what extent, if any, does your jurisdiction follow the OECD transfer pricing guidelines?

Since Indonesia is not a member country of the OECD, the OECD Guidelines are used only as a reference. Recommendations made by the OECD Guidelines are not necessarily followed by revenue officers. The Directorate General of Taxation normally follows or takes into account the OECD recommendations, as long as they do not conflict with Indonesian tax law.

10. Is it possible to obtain any clearances or advance pricing agreements from the revenue authorities in respect of transactions?

Clearances
See below, *Advance pricing agreements*.

Advance pricing agreements
Advance pricing agreements involve the following stages.

Preliminary meeting of the Directorate General of Taxation (DGT) and taxpayer. This is to:

- Discuss the need for an advance pricing agreement and its proposed scope.
- Allow the taxpayer to explain the proposed method.
- Discuss an advance pricing agreement involving authorities in other countries.
- Discuss the taxpayer's documentation and analysis, a time frame for the agreement and its formation and implementation.

MoF Regulation 7 and DGT Regulation 69 require the following documents when requesting a preliminary discussion:

- Description of the reasons for the application.
- The taxpayer's articles of association.
- Overview of the taxpayer's business plan and its business activities.

- The taxpayer's corporate structure, including group, ownership and organisational structures.
- The taxpayer's shareholders, and the nature of their related-party transactions.
- Other related parties, and the nature of their related-party transactions.
- The transactions to be covered by the agreement.
- The method and documentation.

The request for a preliminary meeting must be submitted at least six months before the start of the tax year to be covered by the agreement.

There is no limit on how many times the preliminary meeting can be conducted. Its main purpose is for the DGT to consider whether the agreement is needed, and whether a bilateral advance pricing agreement with another contracting state is required. If the DGT decides that the application can proceed, it will send an invitation letter to the taxpayer, so that the taxpayer can request a formal advance pricing agreement. This was introduced in MoF Regulation 7 of 2015. If the DGT decides that the agreement cannot proceed, it will send a letter notifying the taxpayer of this.

Formal request. This must be in Indonesian addressed to the DGT, in this case the office of Peraturan Perpajakan II (Tax Regulations II). Form APA-2 needs to be completed, with:

- A summary of the preliminary meeting.
- The method proposed by the taxpayer, and documentation explaining the reasons for it.
- The conditions used for determining the method.
- Explanation and documentation on the method, showing that it is consistent with the arm's length principle.
- Critical assumptions analysis.

This must also include the following critical assumptions:

- Tax law and regulation changes.
- Tax rates and customs duty changes.
- Industry regulation changes.
- Force majeure events.
- New competitors with a significant impact on market price structure.
- New government regulations with a significant impact on the taxpayer's business activities.
- Economic conditions with a significant impact on sales volume, production units or market share.
- Changes of taxpayer's business activities, such as company restructuring.
- Significant changes in relevant foreign exchange rates.

The request and its supporting documents must be received by the end of the financial year before the year to be covered by the agreement. The DGT will then create an advance pricing agreement team for the discussion with the taxpayer.

Discussion. The DGT and the taxpayer discuss certain topics, including:

- Scope of transactions and tax year of the advance pricing agreement.
- Comparability analysis, through selection and determination of comparable data.
- Appropriate method selection.
- Conditions and factors that impact the method.
- Requirement to have an advance pricing agreement with other countries.

If the discussion results in double taxation, the DGT can request an advance pricing agreement with the tax treaty partner, or receive an agreement request from it. The discussion with the tax treaty partner will be conducted under the mutual agreement procedure.

Discussion carried out up to one year from the agreement request is considered. An extension can be granted for up to one year from expiry of the discussion period, due to filing of another audit for analysing and evaluating the request.

The advance pricing agreement team will send their recommendation to the DGT, based on the results of the discussion. The DGT will analyse the recommendation with the quality assurance team. They will then agree or disagree with the recommendation.

Issue of advance pricing agreement letter. The DGT and taxpayer will create a formal advance pricing agreement, including at least:

- Name, tax ID number and address of the taxpayer and related parties covered by the agreement.
- Scope of transactions.
- Scope of tax years.
- General provisions.
- Agreed selection of transfer pricing method.
- Factors that impact critical assumptions, in relation to implementing the method.
- Arm's length range of prices or profits for each type of goods, services or transactions.
- Obligations relating to implementation and compliance reporting.
- Legal consequences.
- Confidentiality.
- Limitation and reconsideration.
- Problem-solving mechanism.
- Conditions that allow the DGT to evaluate or annul the agreement.

Implementation and evaluation. To implement the agreement, a taxpayer must submit the following:

- Taxpayer's compliance regarding application of the transfer pricing method.
- Accuracy and consistency of application.
- Critical assumptions for implementation.

11. Where the revenue authorities make a transfer pricing adjustment, what is the effect of that adjustment on the other party to the transaction?

A corresponding adjustment to the other party to the transaction will be done if the tax authority believes that the adjustment will increase tax revenue. If the other party does not agree to this adjustment, then they can apply for an objection to the Tax Court. For the complete procedure, see *Question 13*.

12. What are the reporting and other administrative obligations that apply to help the authorities evaluate transfer prices?

See *Question 2*.

Transfer pricing courts and dispute resolution

National courts and transfer pricing dispute resolution

13. What are the relevant national courts and what dispute resolution mechanisms exist for transfer pricing issues in your jurisdiction?

Tax Court

Tax disputes are first heard in the Tax Court. This was established to settle tax disputes under Law No. 28 of 2007 regarding the Third Amendment on Law No. 6 of 1983 on the General Provisions and Guidelines on Taxations (General Provisions). The Tax Court has jurisdiction over:

- The appeal process, brought by a taxpayer objecting to a decision issued by the Director General of the Tax Office.
- The lawsuit process.

Taxpayers can bring a lawsuit in the Tax Court in relation to:

- Implementation of a coercive warrant, notice of seizure, or notice of auction.
- A prevention decision, in the framework of tax collection.
- Decisions on execution of tax decisions, other than those stipulated in paragraph (1) of Article 25 and Article 26 of the General Provisions.
- A notice of tax assessment or a decision on objection, which is not in accordance with the procedure stipulated by law.

Supreme Court
This conducts a civil review of some tax dispute settlements issued by the Tax Court.

Both parties can use references or resources used as evidence to support their arguments, as laid down in the Tax Court.

International courts and transfer pricing dispute resolution

14. What international dispute resolution methods are available in your jurisdiction, and which are preferred for transfer pricing issues?

International options can be found in tax treaties. Even though a mutual agreement procedure can be effective for resolving conflicts between two contracting states, the number of cases involving it are rare. Indonesia's domestic tax laws and tax treaties usually remedy disputes.

Most tax treaties do not allow for an arbitrator to remedy a dispute where the mutual agreement procedure does not reach a clear decision. However, a decision by the Tax Court can terminate the requirement for a mutual agreement procedure under certain conditions.

The Directorate General of Taxation (DGT) can stop a mutual agreement procedure and refer the matter to dispute resolution, if a party files an appeal letter. If the taxpayer has filed an objection letter and it did not annul the process, the DGT will deny the mutual agreement procedure. In 2003, the International Fiscal Association clarified the format of tax treaty arbitration with the DGT.

An advance pricing agreement (*see Question 10*) is an alternative tool for international dispute resolution, especially transfer pricing. Taxpayers and the tax office will agree in advance acceptable transfer pricing results for a fixed number of years. It can be:

- Unilateral, between the taxpayer and one jurisdiction only.

- Bilateral, between the taxpayers and both jurisdictions.
- Multilateral, where several tax jurisdictions are involved.

An advance pricing agreement is only allowed for three years, and can be rolled back for prior years, subject to certain conditions.

Transfer pricing case law

15. What are the most significant case law developments on transfer pricing in your jurisdiction?

In 2015, the Tax Court decided a case on the transfer pricing method for a related-party transaction (*Verdict number Put-63637/PP/M.XIA/15/2015*). It involved a member company of a Japanese based multinational manufacturing consumer electronic products in the financial year 2008. The taxpayer used the transactional net margin method, while the tax authority used the cost plus method for the transfer pricing analysis.

Since the dispute related to 2008, the tax authority used reference materials available at the time of the dispute, and concluded that the cost plus (gross profit) method should apply. However, the panel of judges stated that a provision and/or rules that do not exist at the time of the tax audit but exist at the time of an objection and appeal can be enforced, under the principle that a later law repeals an earlier law (*lex posterior derogate legi priori*).

The taxpayer argued that subsequent interpretation materials issued by the OECD Guidelines should also be taken into account, as the correct application of cost plus (gross profit) is difficult, due to comparability issues. The taxpayer also presented other countries' experience of the cost plus (gross profit) method to the Tax Court, and convinced the Tax Court that the cost plus (gross profit) method was not appropriate.

In the taxpayer's transfer pricing documentation during the audit and objection stage, the taxpayer contended that its entity characterisation was a contract manufacturer. In the tax hearing process, the taxpayer changed its position and stated that it should be characterised as a fully fledged manufacturer. This change was allowed by the court, which agreed with the taxpayer and allowed its method to be used.

Transfer pricing adjustments

Adjustments and penalties

16. Where the revenue authorities make an adjustment of the transfer prices for tax purposes, can any other penalties also be imposed in addition to that adjustment?

If the tax authorities issue an underpaid tax assessment letter (SKPKB) to the taxpayer, it can include any of the following administrative penalties:

- Interest at 2% per month, for a maximum of 24 months.
- A 50% surcharge for income tax liability.
- A 100% surcharge for withholding tax liability.
- A 100% surcharge for VAT and luxury sales tax (LST) liabilities.

Transfer pricing development and reform

17. Are there any current trends, developments or reform proposals that have or will affect the area of transfer pricing in your jurisdiction?

The government is committed to combat base erosion and profit shifting (BEPS) practices in Indonesia (in line with the BEPS project conducted by the OECD). This can be seen with the issue of a new regulation on submitting additional documents in transfer pricing transactions (*see Question 2*).

Tax avoidance: general overview

18. What have been the main national and international trends affecting tax enforcement and anti-avoidance practice in your jurisdiction in the past 12 months?

A recent case between the government and Google (*see Question 24*) made the government realise that it needs to issue a specific regulation for companies like Google, so that their income in Indonesia can be taxed.

19. How does your jurisdiction make the distinction between abusive tax avoidance and legitimate tax planning?

Tax planning

Tax planning can be described as certain acts to legally minimise income tax payable to the Indonesian authorities. It usually uses loopholes in existing laws and regulations. There are many ways or instruments that are part of tax planning, which can be divided into national tax planning and international tax planning.

National tax planning. Examples include:

- Establishing a company which fulfils the criteria under the Tax Holiday Regulation to enjoy certain benefits.
- A company whose payable income tax is more than IDR100 million can change the distribution of allowances not in the form of money (*natura*) to an employee into allowances, in the form of money.
- A company with losses can change an employee's allowances from money into distribution of natura, since natura is not an object of Article 21 of the Income Tax Regulation.

International tax planning. This also takes into account tax treaties. An important consideration is "treaty shopping". This popular method aims to achieve the greatest possible benefit from international tax treaties. In general, taxpayers use treaty shopping to claim:

- An otherwise unavailable reduction or exemption of withholding taxes in the source state of the income.
- An otherwise unavailable tax exemption in the residence state.
- A tax sparing credit.

For example, a person resident in country B sets up an entity in country A, to receive income as a dividend from an offshore company in country C. The aim is to receive the income in a more tax-beneficial way, due to a tax treaty between A and C. In conducting their tax planning, entrepreneurs should ensure that:

- The tax planning does not violate any obligations under the prevailing tax laws and regulations.
- The tax planning is reasonable (in the long or short term), in the commercial view of the business.
- There is sufficient supporting evidence that the action was tax planning.

Abusive tax avoidance

There is no clear definition of abusive tax avoidance in Indonesian laws and regulations. There are numerous different interpretations of tax avoidance by taxpayers and the tax authorities. This has resulted in legal uncertainty regarding the correct tax practice.

Many tax practitioners define abusive tax avoidance as tax planning that violates the prevailing tax laws and regulations, separate from legal tax planning (*see above, Tax planning*). Further, DGT Regulation PER-62/PJ/2009 states that a tax treaty will abuse Indonesia's domestic legislation where:

- A transaction has no economic substance, using a structure/scheme with the sole aim to obtain tax treaty benefits.
- A transaction has a structure/scheme where the legal form differs from the economic substance, with the sole aim to obtain tax treaty benefits.
- The recipient of the income is not the beneficial owner.

20. Do the revenue authorities in your jurisdiction offer any guidance on the distinction between legitimate tax planning mechanisms and abusive or aggressive tax avoidance?

The revenue authorities do not offer guidance on the distinction between legitimate tax planning mechanisms and abusive or aggressive tax avoidance.

Tax anti-avoidance provisions

21. Can you identify any direct or indirect impact in your jurisdiction of the OECD or other recent international initiatives to combat abusive tax avoidance?

The Indonesian tax treaty has been influenced by the models of several international institutions, including the OECD, the UN and ASEAN. In negotiating tax treaties, Indonesia tends to follow the UN model and the ASEAN model (depending on the treaty partner).

Between 1970 and 1999, Indonesia negotiated tax treaties with 26 OECD member countries (The Netherlands, Japan, Belgium, Germany, the UK, Canada, France, Switzerland, Denmark, New Zealand, South Korea, the US, Australia, Austria, Finland, Italy, Norway, Spain, Sweden, Czechoslovakia, Luxembourg, Poland, Hungary, Mexico, Slovakia and Turkey).

During negotiations, the following were included as the reference of tax treaty policy in Indonesia:

- Permanent establishment.
- Business profit.

- Shipping, inland waterways transport, and air transport.
- Dividends, interest, and royalties.
- Capital gains.
- Other income.

In relation to the definition of a permanent establishment, only four tax treaties have followed the OECD Model (those with Australia, Belgium, South Korea, and the UAE).

Indonesia has also referred to the UN Model's tax rates of 5%, 10%, 12.5%, 15% and 20% (not including Saudi Arabia) for the taxation of dividends, interest and royalties. For capital gains on movable property, Indonesia has followed the OECD Model supported by 20 countries, not the UN Model that no longer exists.

As part of an agreement with 15 other countries, Indonesia requires the taxation of gambling and prizes at their source. For other countries, the right to tax is granted to the residence state for six countries. Otherwise, Indonesia's tax treaty is consistent with the OECD Model, not the UN Model.

The government has signed the US Foreign Account Tax Compliance Act with the US government, and has committed to conduct automatic exchange information with the other 94 jurisdictions, starting from September 2018.

22. Does your jurisdiction have GAAR designed to prevent or reduce abusive tax avoidance?

Indonesia does not have a general anti-avoidance rule or related regulations. The rules and regulations are in several specific anti-avoidance provisions. The only provision that clearly discusses combating illegal or abusive tax avoidance is Article 32A of the Income Tax Law. This grants the government powers to enter into international treaties, providing that "in efforts of promoting economic and trading relationships with other countries, it is necessary to have a special set of law (*lex specialis*) which regulates the taxing rights of each country covered in the law to provide legal certainty, to avoid double taxation and to prevent tax evasion. The form and substance of such law refer to the international convention, other regulations, and also the national tax regulation of each country".

Specifically, the main anti-avoidance rules in Indonesian tax law are in Articles 2.6, 4, 18 and 26 of the Income Tax Law. Among other things, these cover:

- Debt-to-equity ratios, that is, thin capitalisation rules.
- Constructive dividends.
- Foreign controlled corporations.
- Transfer pricing and advanced pricing agreements.
- The factual condition of tax residence.
- Substance over form rules.

- Wide definition of taxable objects.
- Beneficial ownership definition and tests.
- Indirect transfer of shares. There is a specific regulation for a transfer of shares between a special purpose company or conduit company, as regulated under MOF Regulation 258/PMK.03/2008 dated 31 December 2008. The estimated net income will be subject to 20% income tax, and the amount of the net income is 25% of the selling price (MOHF Regulation 258/ PMK.03/2008).

The tax authorities usually issue specific regulations or circulars to attack specific transactions they deem abusive tax avoidance practices. Among other things, these uncodified circulars include:

- DGT Regulation on the interpretation of the term beneficial owner in relation to dividends.
- Circulars on the interest and royalties paid to non-resident taxpayers from tax treaty countries.
- Circulars on the unilateral increase of withholding tax on interest paid to Netherlands taxpayers.
- Regulation on what non-interest bearing loans are permitted.
- Automatic exchange of information with 94 other jurisdictions.

The regulations relating to transfer pricing also apply to abusive tax avoidance cases, where relevant (*see Question 3*).

Further, the current framework of Indonesia's tax laws (influenced by US tax law) adopts the principle of substance over form, in particular:

- **Definition of taxable income.** The Income Tax Law defines taxable income broadly to include income in whatever name or form. Tax can be imposed on any economic gain received or earned by a taxpayer, that can be used for consumption or for increasing the taxpayer's wealth. It relates to whether the taxpayer has received an economic gain, rather than the particular source of the gain. It assumes that the earning or receipt of an economic gain is the best measure of what the taxpayer should contribute to government funds.
- **Records and bookkeeping.** Article 28 of the General Provisions and Procedures of Taxation Law in Indonesia states that all tax records and bookkeeping should follow Indonesian accounting standards, unless any tax regulations require otherwise. These standards apply the substance over form principle.

Tax officials frequently refer to the principle of substance over form in conducting tax audits and investigations. This also applies in the Tax Court, since most of its judges are former tax officials. The enforcement of this principle is not always consistent, since it can be subjective. There is no clear and general guidance on how to implement the principle of substance over form in Indonesian tax practice.

23. What are the legislative provisions that are designed to reinforce GAAR and any other abusive tax avoidance provisions?

See *Question 22*.

24. Identify and discuss any case law of interest concerning GAAR and any other cases dealing with abusive tax avoidance in your jurisdiction.

Google case

This is in early stages, since the tax authority has just conducted an investigation into Google's tax affairs through its office in Indonesia. Google has an Indonesian subsidiary that performs marketing activities in Indonesia, while all contracts and payments for transactions are conducted online directly to Google Singapore. The dispute relates to the amount of profits booked and taxable in Indonesia. The tax authority claims that the tax paid by Google should be calculated using the total earnings generated from its advertising activities in Indonesia.

The tax authority has issued circular letter of the Directorate General of Taxation No. SE-06/PJ/2015 regarding the withholding of income tax on e-commerce transactions. This provides that obligations to withhold income tax in e-commerce transactions apply to payment for specified services, among others the provision of time and/or place of mass media and intermediary services relating to the online marketplace, classified advertising, daily deals, and online retail businesses. For a foreign company like Google that does not have a permanent establishment in Indonesia, it will be subject to a tax rate of 20% on its revenue sourced from Indonesia through these services (or based on the rate stipulated in the tax treaty between Indonesia and their country of jurisdiction, if any).

As a reaction to this case and to combat tax avoidance, the tax authority will probably issue a separate regulation, to categorise Google's activity as e-commerce activities that trigger a permanent establishment. It is not clear when this regulation will be issued. By establishing a permanent establishment, the government will require all companies similar to Google to pay 25% corporate income tax on all of their revenue earned from Indonesia.

Supreme Court Decision No. 2239 K/PID.SUS/2012

This relates to tax evasion by the tax manager of Asian Agri Group. It caused the state to lose about IDR1,259,977,695,652. Specifically, the following methods of tax evasion were alleged.

International financial engineering. Exports were manipulated, so that products were sent directly to the end buyer, while the financial documents for the export (letters of credit and invoices) recorded that the products were sold to companies in Hong Kong. The products were then sold to a company in Macau or the British Virgin Islands (Intermediary Companies) before they were finally sold to the end buyer. The Intermediary Companies were proven to be SPVs used as facilitators to support the transaction, and accommodate different sales prices. There was under-invoicing to the Intermediary Companies compared to the alleged sales price to the end buyer. Therefore, the profit obtained by the seller in Indonesia was lower.

Domestic financial engineering. There were certain markups of fees to decrease the tax owed by the company. These included:

- **Jakarta fee.** The markups were conducted by the accused party in the company's Jakarta's office, and did not contain any real economic value. They were simply made to allocate expenditures of the company's account affiliated with Asian Agri Group to certain bank accounts.
- **Hedging fee.** This false fee involved creating losses as a washout/hedging loss. The loss was made by creating a fictitious contract for the export of crude palm oil (OH/CPO) to companies in Hong Kong, where the delivery of the products was made on a later date. Before the date of delivery, there was a washout at a higher price by an affiliated company of Asian Agri Group. The difference between the sales price and the purchase price was then calculated as a hedging fee loss.
- **Management fee.** This false fee was imposed as a general and administrative fee on a contract between the affiliated companies of Asian Agri Group (offshore or onshore). However, the progress and performance of the management services was hardly seen, or there was no evidence that the services were provided. This practice ultimately created a loss to minimise income tax.

The panel of judges in the Supreme Court ruled that the accused was guilty of submitting an inconsistent report whose substance was incorrect or incomplete. The accused was sentenced to a probationary imprisonment for two years on condition that, within one year, Asian Agri Group's 14 affiliated companies paid a fine of twice the indebted underpayment amount.

Case law on abusive tax avoidance

A key case involved the issue of notes to Indah Kiat Pulp & Paper Tbk (IKPP). After Indah Kiat BV (the issuer) defaulted in May 2001 and IKPP refused to honour its obligations as the guarantor of the payments, the noteholders took legal action in the State of New York against IKPP and Indah Kiat BV. Although the case was already before the courts in New York and the indenture and underwriting agreements provided New York courts with exclusive jurisdiction, IKPP commenced a separate lawsuit in Indonesia. This was done to declare the transaction documents in relation to the issue of the notes (including the indenture and underwriting agreements, intercompany loan, and collateral documentation in Indonesia) null and void.

Several arguments were set out by IKPP that the transaction was a legal manipulation and an engineered transaction that invalidated the transaction documents. The reasons included the:

- Unlawful issue of notes by an SPV.
- Concept of a trust, which was unknown in Indonesia.
- Non-compliance with the collateral laws of Indonesia.
- Laws of the jurisdictions concerned in this structure.
- Evasion of tax through treaty shopping.

The case was filed at the District Court of Bengkalis (*Civil case registration number 05/Pdt.G/2003/PN.BKS dated 13 November 2003*). In the decision (*No. 05/PDT.G/2003/PN.BKS*) issued on 29 September 2004, the following was held:

- The court approved IKPP's claim in part.
- The court declared that the defendants (US Bank National Association et al.) had committed a tort.

- The contracts relating to the issue of the notes were a tort and therefore null and void. According to the court, a tort is an act that causes loss to others or an act that meets the following criteria:
  - an act that is against the law;
  - an act that causes loss;
  - an act wrongfully performed; and
  - a relationship between the act and the loss;
- The court also added that, according to certain jurisprudence of the Supreme Court, meeting one of the above criteria is sufficient to find a tort (meeting all four criteria is unnecessary).

Further, an act satisfying the following conditions is deemed to be against the law:

- Against the legal obligation of the person committing the act.
- Violating the subjective rights of the other person.
- Violating ethical principles and/or norms.
- Against the principles of appropriateness, care and prudence, which parties should uphold when interacting with others.

The court nullified the agreements because the transaction documents relating to the issue of the notes were entered into without any legal cause, and did not meet Article 1320 of the Civil Code in relation to the basic legal conditions for an agreement to be valid under Indonesian law.

The court declared that the attachment of the collateral was enforceable and valid, and held that claims relating to compensation must be rejected.

Some other considerations of the court were:

- In addition to the loan agreement between IKPP and Indah Kiat BV (where IKPP was the debtor of Indah Kiat BV), IKPP also acted as a guarantor on the payment obligations of Indah Kiat BV. The court considered both of the above transactions as essentially one transaction, and that IKPP had acted both as a debtor and guarantor in the same transaction. The court held that this breached Article 1820 of the Civil Code, which prohibits the borrower from guaranteeing its own debt. Under Article 1820, a guarantee is an agreement where a third party agrees, for the benefit of the creditor, to fulfil the obligations of the debtor if the debtor fails to fulfil its repayment obligations. A borrower cannot guarantee its own obligations, and cannot act as the guarantor in the same transaction.
- Indah Kiat BV (deemed an SPV) was established for the sole purpose of circumventing tax regulations and avoiding tax obligations in Indonesia. Indah Kiat BV was deemed an SPV because it had no business activities or investments, no offices, office equipment or employees other than its directors, and its paid-up capital was only US$2. The court stated that, based on the Indonesia-The Netherlands tax treaty, treaty protection is provided to companies with trading and investment activities. As Indah Kiat BV had no trading or investment activities, its purpose other than an SPV could not be established.
- The structure also enabled Indah Kiat BV to issue the notes and avoid the Indonesian domestic requirement that notes issued were subject to approval from the Capital Markets Regulatory Authority (BAPEPAM).

The subsequent decision of the High Court of Pekanbaru (*No. 40/PDT/2004/PTR*) dated 16 June 2005 affirmed the decision of the District Court of Bengkalis. The Supreme Court's decision (*No. 381K/ Pdt/2006*) upheld the decisions of both the District Court and High Court. The Supreme Court did not address any evidentiary issues but instead considered whether there had been a misapplication of the law, a violation of prevailing laws, a failure to meet conditions required by laws and regulations which should nullify the decision, and the competency of the courts. Although the Supreme Court's decision has permanent legal force, a judicial review can re-examine the decision if new evidence comes to light.

The main reasons that IKPP used the Dutch SPV to issue the notes were:

- If the notes had been issued directly by IKPP, the applicable withholding tax rate would have been a maximum of 20%. This rate could have been reduced, depending on the countries of residence of the noteholders and the applicable tax treaty provisions. Under the financing scheme, the tax that IKPP was required to withhold on interest payments made in relation to the loan from Indah Kiat BV was reduced to 10%, based on the Indonesia-The Netherlands tax treaty. The payment of interest by the Dutch SPV to various international noteholders was not subject to withholding tax, as The Netherlands generally does not levy withholding tax on interest payments.
- If the notes had been issued directly by IKPP, the profits earned by various foreign noteholders from the disposal of notes would have been subject to withholding tax on capital gains at 20%. The structure using the Dutch SPV circumvented Indonesian capital gains withholding tax, unless the noteholders were Indonesian tax residents or had a permanent establishment in Indonesia.
- Avoiding Indonesian public offering requirements, by making the issues abroad.

Tax avoidance penalties

Civil and administrative penalties for abusive tax avoidance

25. What civil and administrative penalties can be imposed in abusive tax avoidance cases in your jurisdiction?

The administrative sanctions which can be imposed on taxpayers violating tax laws include a fine, an interest payment, and an increase in the amount of tax due.

Criminal penalties for abusive tax avoidance

26. What criminal penalties can be imposed in abusive tax avoidance cases in your jurisdiction?

The criminal sanctions that can be imposed on taxpayers include:

- Imprisonment.
- Confinement (*kurungan*).
- A fine.
- Additional penal sanctions, that is, revocation of certain rights and/or forfeiture of certain goods.

Tax avoidance developments and reform

27. Are there any current trends, developments or reform proposals that have or will affect the area of tax avoidance in your jurisdiction?

On 1 April 2014, the Minister of Finance issued Regulation No. 60/ PMK.03/2014 (PMK-60). This further regulates the exchange of information procedure, and applies to international tax agreements, such as the:

- Double taxation agreement (DTA/tax treaty).
- Tax Information Exchange Agreement (TIEA).
- Convention on Mutual Administrative Assistance in Tax Matters (Convention), whether or not the Convention takes place before or after the effective date of PMK-60.

PMK-60 stipulates that exchange of information can be carried out through several channels, by a unit under the authority of the Directorate General of Taxation (DGT) or a country/jurisdiction partner (foreign request). It includes:

- **On request.** This can be triggered by a suspicion of tax avoidance or tax treaty shopping in cross-border transactions. For foreign requests, PMK-60 requires reciprocity, where the country partner must also provide the information requested by Indonesia under similar circumstances. The Indonesian authority can reject such a request if the information gathering requires administrative conduct that contradicts the prevailing regulations.
- **Spontaneous.** The DGT can provide information spontaneously without any exchange of information request, as a follow-up action from a tax audit, preliminary tax audit or tax investigation. This can lead to the following:
    - an indication of significant tax loss in the country partner;

  - payments to a country partner suspected to not be reported there;
  - a tax incentive available in Indonesia enjoyed by the foreign taxpayer that can increase its tax obligation in its home country; and
  - transactions between domestic and foreign taxpayers structured to minimise tax due in Indonesia and/ or the country partner.

- **Automatic.** This is information maintained periodically by the DGT, such as changes in a taxpayer's place of domicile, dividends, interest, royalties, capital gains, salary and remuneration.

PMK-60 has given more tools to the DGT to combat tax avoidance. More regulations providing the government with tools to combat tax avoidance will probably be issued in the near future. This is in line with the government's aim to combat illegal tax avoidance in Indonesia.

In 2016, the government issued PMK 213 to strengthen supervision of transfer pricing practices in Indonesia, to combat tax avoidance through transfer pricing practices (*see Question 2*).

The regulatory authorities

Directorate General of Taxation
T +62 21 5250208
F +62 21 584792
E *pengaduan@pajak.go.id*
W *www.pajak.go.id*

Outline structure. A directorate general under the Ministry of Finance.

Responsibilities. Drafting and implementing tax policies and technical standards in Indonesia.

Procedure for obtaining documents. Requests can be made in writing by mail or e-mail, to the relevant authorities under the Directorate General of Taxation.

Ministry of Finance
T +62 21 3500849
F +62 21 3500847
E N/A

W *www.kemenkeu.go.id*
Outline structure. A ministry in Indonesia which reports to the President.

Responsibilities. It is in charge of financial affairs and managing national wealth.

Procedure for obtaining documents. Requests can be made in writing by mail or e-mail (through the form provided on the website) to the relevant authorities in the Ministry of Finance.

Online resources

Ministry of Finance
W *www.kemenkeu.go.id*

Description. This is the official website of the Ministry of Finance. It is up to date and official in Bahasa Indonesia.

Secretariat of the Tax Court, General Secretary of the Ministry of Finance, Indonesia
W *www.setpp.depkeu.go.id*

Description. This is the official website of the Secretariat of the Tax Court. It is up to date and official in Bahasa Indonesia.

Directorate General of Tax
W *www.pajak.go.id*

Description. This is the official website of the Directorate General of Tax. It is up to date and official in Bahasa Indonesia.

Supreme Court of Indonesia
W *https://putusan.mahkamahagung.go.id*

Description. This is the official website containing information regarding cases decided in Indonesia, including cases in the Tax Court. It is official in Bahasa Indonesia.

Contributor profiles

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Professional qualifications. Indonesia, Solicitor; Law, University of Indonesia, 1998

Areas of practice. Capital markets; M&A; investment; property; natural resources; tax; banking and project finance; private equity; venture capital; tech start-up; mining.

Non-professional qualifications.

- Economics (Hons.), Trisakti University, Jakarta, 1997.
- LLM in International Tax, Leiden University, 2002.
- MBA, Peking University, 2015.

Recent transactions

- Advising Keppel Land in a site acquisition in West Jakarta.
- Representing Wedabay Nickel in its tax dispute at the Indonesian Supreme Court.
- Representing the founders of Arena Group in fundraising from CLSA.
- Advising Sequoia in its investment in GO-JEK.
- Advising Indonesian public-listed coal company PT Resources Alam Indonesia Tbk on its acquisition of PT Khatulistiwa Hidro Energi, which holds a 95% stake in hydro-energy company PT Bias Petrasia Persada.
- Representing PT Toba Sejahtra on its divestment of majority shares in PT Toba Bara Sejahtra Tbk, an Indonesian public-listed coal company.
- Representing Mitsui Corporation and Fujimori in relation to the indirect acquisition of PT Champion Pacific Indonesia Tbk (2016).

Languages. English, Indonesian

Professional associations/memberships

- PERADI (Indonesian Advocates Association).
- HKHPM (Indonesian Capital Market Legal Consultants).
- AAI (Association of Indonesian Advocates).
- IKPI (Indonesian Tax Consultant Association).
- IFA (International Fiscal Association).
- IFAC (International Federation of Accountants).

Publications

- *ICLG, Corporate Tax 2016 Indonesia.*
- *Getting the Deal Through: Tax in Inbound Investment 2017.*
- *Lexis Nexis: Mergers & Acquisitions Law Guide 2017.*
- *IBFD Derivatives and Financial Instruments, BEPS Effect in Indonesia.*
- *IBFD Asia Pacific Tax Bulletin, Case note Criminal Tax Evasion (the Asian Agri Case).*
- *IBFD International Transfer Pricing Journal, Issue of Common Control in Recent Transfer Pricing Cases.*
- *International Tax Review, Indonesia Relaxes Tax Holiday Rule and Introduces Debt-to-equity Ratio.*
- *International Tax Review, Indonesia to Optimise Tax Revenue and Separate Tax Authority from the Ministry of Finance.*

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Professional qualifications. PERADI (Indonesian Advocates Association)

Areas of practice. General corporate; anti-trust; intellectual property rights; pharmaceutical and food industry matters; commercial litigation.

Non-professional qualifications. LLM in Corporation Law, New York University, 2016

Recent transactions

- Acting for Aavishkaar Frontier Fund (AFF) in their investment in an Indonesian company.
- Assisting IDN Media in the restructuring process and Series A Investment in the company.
- Assisting Mizuho in their investment in a hospital in Indonesia.
- Assisting Spinnaker in the bankruptcy proceeding of PT Hero Krida Utama.
- Representing PT Bank Mandiri (Persero) Tbk, an Indonesian public-listed bank and the biggest commercial bank in Indonesia, in establishing a joint venture company in multi-finance business,

together with other prominent business players in the automotive distribution industry, such as PT Tunas Ridean Tbk and PT ASCO Investindo.

Languages. Indonesian, English

Professional associations/memberships. PERADI (Indonesian Advocates Association)

Publications

- *Getting the Deal Through: Tax in Inbound Investment 2017.*
- *Lexis Nexis: Mergers & Acquisitions Law Guide 2017.*
- *International Tax Review: New Transfer Pricing Requirements in Indonesia.*
- *International Tax Review: New Income Tax for REIT Schemes Enacted.*

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