Indonesia

New Development and Analyses on Indonesia's Transfer Pricing Regulation

T. Qivi Hady Daholi[*] **and**
Andreas Rossi Dewantara[**]

Issue: Asia-Pacific Tax Bulletin, 2020 (Volume 26), No. 4
Published online: 17 December 2020

In the beginning of 2020, Indonesia released the amendment for advance pricing agreement regulation which included transfer pricing provisions. In this article, the authors briefly review the transfer pricing aspect of the new regulation, analyse its key features, and highlight tax court decisions.

1. Introduction

On 18 March 2020, the enactment of Minister of Finance Regulation No. 22/PMK.03/2020 (PMK-22/2020) on advance pricing agreement (APA) fundamentally reformed transfer pricing in Indonesia. The first part of the regulation replaces the previous APA regime in Minister of Finance Regulation No. 07/PMK.03/2015 (PMK-7/2015) so as to be more in line with the BEPS Action 14 Minimum Standard.[1]The second part of PMK-22/2020 addresses the application of arm's length principle (ALP) so as to be more in line with BEPS Actions 8-10[2]and OECD Transfer Pricing Guidelines 2017.[3]This article will look at the impact of the regulation on transfer pricing in Indonesia.

2. Brief History on Transfer Pricing Regulation in Indonesia

The transfer pricing regulation in Indonesia was first enacted in Indonesian Income Tax Law 1983 (IITL), which was last amended in 2008. It authorized the Indonesian tax authority (Directorate General of Taxation, DGT) to recalculate income and deductions or to reclassify debt as equity, for the purposes of computing income tax, arising from transactions between an Indonesian taxpayer and another party, if they are in a special relationship.[4]

The application of ALP consequently refers to ordinary business practice or sound business principle, using the recognized transfer pricing methods: comparable uncontrolled price (CUP) method, resale price method (RPM), cost-plus method (CPM), or other method (profit split method (PSM) or transactional net margin method (TNMM)).[5]

The guidelines for transfer pricing were only released in 1993 through Director General of Taxes Decree No. 1/PJ.7/1993 (KEP-01/1993) and its supplementary Director General of Taxes Circular Letter No. 4/PJ.7/1993 (SE-04/1993). In 2010, the DGT distributed its internal transfer pricing audit guideline by Letter of Director of Tax Audit and Collection No. 153/PJ.4/2010 (S-153/2010), followed by regulation for ALP in the Director General of Taxes Regulation No. 43/PJ/2010

---

* **M.Sc in International Accounting and Finance, Birmingham Business School, Senior analyst of Mutual Agreement Procedure and Advance Pricing Agreement as well as specialist in international tax and transfer pricing in the Directorate General of Taxes (DGT) of Ministry of Finance of the Republic of Indonesia, as well as Part-Time Lecturer in Polytechnic of State Finance-STAN. Qivi is a Founding Member of the Indonesian Institute of International Tax Studies (INFINITE). The view expressed here is strictly personal and does not reflect the institution he works for or is associated with. The author can be reached via email at qivi.hady@gmail.com .**

** **B.App.Sc in Accounting, Polytechnic of State Finance STAN, Senior Analyst of Mutual Agreement Procedure and Advance Pricing Agreement as well as specialist in international tax and transfer pricing in the Directorate General of Taxes (DGT) of Ministry of Finance of the Republic of Indonesia. Andre is a Founding Member of INFINITE. The view expressed here is strictly personal and does not reflect the institution he works for or is associated with. The author can be reached via email at andreas.dewantara@gmail.com .**

1. *OECD/G20, Making Dispute Resolution Mechanisms More Effective – Action 14: Final Report* (OECD 2015), Primary Sources IBFD.
2. OECD/G20, *Aligning Transfer Pricing Outcomes with Value Creation – Actions 8-10: 2015 Final Reports* (OECD 2015), Primary Sources IBFD.
3. *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (OECD 2017), Primary Sources IBFD [hereinafter *OECD Guidelines* (2017)].
4. Art. 18 para. (4) IITL states that a special relationship is deemed to exist if there is:

   (a) direct or indirect ownership by another taxpayer of at least 25%;

   (b) direct or indirect control by other taxpayers, or under the same control; and/or

   (c) family relationship through blood or marriage.
5. Id.

(PER-43/2010) which mainly adopted the OECD Transfer Pricing Guidelines 1995.[6]In response to the 2010 Transfer Pricing Guidelines,[7]PER-43/2010/2010 was then amended by Regulation No. 32/PJ/2011 (PER-32/2011) which covers inter alia the steps to apply the ALP, obligation to prepare transfer pricing documentation, and the adoption of the "most appropriate" transfer pricing method. In 2013, the provision for transfer pricing audit was enacted via Directorate General of Taxes Regulation No. 22/PJ/2013 (PER-22/2013) and Circular Letter No. 50/PJ/2013 (SE-50/2013). There were no specific transfer pricing provisions issued after 2013 until PMK-22/2020 was released. Even though PMK-22/2020 is titled as an APA regulation, it encompasses two major chapters, which are the administration of APA itself and an additional transfer pricing provision.

3. Transfer Pricing Chapter in Indonesian APA Regulation

3.1. "Related party" and "special relationship"

The definition of related party constitutes the cornerstone in transfer pricing analysis.[8]Prior to PMK-22/2020, the requirement to apply the ALP was primarily regulated by article 18 paragraph (3) of the IITL, with article 18 paragraph (4) of the IITL serving as a deeming provision, which may be considered narrow, as it is based on the formal/legal recognition of decision-making power through shares or votes.

However, a condition may occur when an enterprise is not formally or legally attributed such power, but is nevertheless capable of affecting the decisions taken by the other enterprise.[9]Article 4, paragraph (1) of PMK-22/2020 therefore emphasizes the primacy of article 18, paragraph (3) of the IITL by defining special relationship as "condition of dependency with the other entity",[10]and that the deeming provision of article 18, paragraph (4) of the IITL is not meant to be exhaustive. Other special relationships may exist insofar as one or more entities are "not being independent when conducting their business or activities".[11]For example, PMK-22/2020 provides some situations not previously elucidated in the IITL, such as "parties are known or declare themselves to be under the same business group" or "declaration by one entity that it has a special relationship with other entity".[12]This allows the Indonesian tax authority to better utilize information obtained from spontaneous EOI or from CbC reporting, even though the Indonesian entity does not declare the other party as a related party in its tax return.

3.2. De facto interpretation in "transaction influenced by special relationship"

One fundamental reform in PMK-22/2020 is the introduction of "transaction influenced by special relationship", used instead of "related-party transaction" which had been used in previous regulations, such as transfer pricing documentation regulations.[13]

Pursuant to article 4, paragraph (2) of PMK-22/2020, "transaction influenced by special relationship" covers not only the related-party transactions, but also transactions between non-related parties insofar as "a related party of one or both of the parties is involved in determining the counterpart of the transaction and the price of transaction".[14]For example, a transaction between X1 (subsidiary of X) and Y1 (subsidiary of Y) is within the ambit of PMK-22/2020 if, even though unrelated, X and Y are able to direct its respective subsidiary to transact and also determine the price. This view is further employed in the definition of independent transaction which is not merely as a transaction between "non-related parties", but also "must not be affected by special relationship".

Careful reading on "transaction influenced by special relationship" reflects a de facto interpretation of control in PMK-22/2020. "Control" for transfer pricing purposes is interpreted by de jure and de facto control.[15]If de jure interpretation prescribes special relationship existence merely based on "control" recognized by relevant law, de facto approach uses broader scope in interpreting "control" as the cause for special relationship and associated enterprise, beyond the ownership or management

---

6. A.T. Phan & M. Mu, *The New Transfer Pricing Regulations* , 17 Asia-Pac. Tax Bull. 3 (2011), Journal Articles & Papers IBFD. *See also* *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (27 June 1995), Primary Sources IBFD [hereinafter *OECD Guidelines* (1995)].
7. *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (OECD 2010), Primary Sources IBFD.
8. *See* G. Cottani, *Italy - Transfer Pricing & Business Restructuring* , Country Tax Guides IBFD (accessed 13 Apr. 2020).
9. C. Rotondaro, *The Notion of "Associated Enterprises": Treaty Issues and Domestic Interpretations – An Overview* , 7 Intl. Transfer Pricing J. 1 (2000); Cottani, *supra* n. 8 .
10. Art. 4(1) PMK-22/PMK.03/2020 on Implementation Guidelines on Advance Pricing Agreement (APA), available at https://jdih.kemenkeu.go.id/fullText/2020/22~PMK.03~2020Per.pdf (accessed 1 Dec. 2020).
11. Art. 4(2) PMK-22/2020.
12. Art. 4(4) PMK-22/2020.
13. PMK-213/PMK.03/2016 on Additional Documents and/or Information Compulsarily Retained by Taxpayers Conducting Related Party Transactions and Its Administration Procedures, available at https://www.pajak.go.id/sites/default/files/2019-08/PMK-213-2016%20-%20TP%20Documentation%20-%20English%20Version.PDF (accessed 1 Dec. 2020).
14. Art. 4(2) PMK-22/2020 and art. 1(15) PMK-22/2020.
15. Rotondaro, *supra* n. 9 .

participation.[16]By using d *e* facto interpretation, a special relationship arises as long one entity controls the other entity in decision making, or in conducting their business and activities, even without any formal appointment.[17]

The use of de facto approach in PMK-22/2020 is in line with the Indonesian Tax Court decision in case No. Put.42750/PP/M.I/16/2013 (Put.42750), concerning the proceeds from the sale of a business division between Indonesian taxpayers, PT Siemens Indonesia (PT SI) and PT Nokia Siemens Network (PT NSN), formerly established as PT Nokia Networks (PT NN).[18]DGT considered that there was a special relationship between PT SI and PT NSN, so DGT had the authority to recalculate the value of transaction based on ALP. The taxpayer argued that there was no special relationship at the time of sale of the business division, rendering the transfer pricing adjustment illegitimate.[19]

The tax court's verdict was in favour of DGT. The judges' rationale was that a special relationship already existed even a year before transaction, when the original framework agreement was signed by Siemens AG Germany and Nokia Corp Finland (as the majority shareholder of PT SI and PT NN respectively). The taxpayer insisted that the agreement merely acted as an Memorandum of Understanding (MoU) which could be revoked before being executed.

Nevertheless, judges decided that the original framework agreement had binding legal force by "*pacta sunt servanda*". Furthermore, based on the "substance over form" principle, the agreement was not merely an MoU. Accordingly, the terms and conditions of sales between the Indonesian taxpayers had already been determined and influenced by their shareholders, and met the criteria of "under the common control" of the IITL.[20]The panel of judges concluded that the DGT transfer pricing adjustment should stand.

De facto interpretation on associated enterprises, as used in Put-42750 and PMK-22/2020, can put an independent transaction influenced by their respective related parties under the DGT's scrutiny.[21]However, this approach could give rise to double taxation if the treaty partner uses a different interpretation on associated enterprise, i.e. relies on the narrow legal approach for the definition of "control".[22]

3.3. Determination of arm's length price and "*ex ante*" approach

The implementation of ALP in PMK-22/2020 mainly adopts the OECD Guidelines (2017) in determining arm's length price. Prior to PMK-22/2020, e.g. in the elucidation for TNMM in PER-22/2013, the arm's length profit for taxpayers whose result is outside the interquartile range is adjusted to median.

Now, if more than one comparable exists, PMK-22/2020 does not automatically assume the adjustment to median, but to the most appropriate point based on its comparability with independent transaction (e.g. minimum/maximum, or first/third quartile). Only if the most appropriate point cannot be determined is the adjustment then set on the median.

In line with the *ex ante* approach (arm's length price setting) as applied in Indonesian transfer pricing documentation regulation,[23]PMK-22/2020 also obliged that the ALP implementation shall be carried out at the time the transfer price is determined or when the transaction influenced by special relationship occurred.

3.4. Comparability analysis – Inclusion of "market" as comparability factor

In performing comparability analysis PMK-22/2020 principally follows the OECD Guidelines (2017). It is worth noting that PMK-22/2020 includes "market access" or "level of market share in Indonesia" as one of the comparability factors under the definition of "non-financial asset used". Previous regulation did not take the market factors into consideration when performing comparability analysis, particularly in doing FAR analysis.

There is no guidance as of yet on how to take into account market factors for the entity's arm length remuneration, e.g. marketing intangibles, which may entail additional remuneration such as location rent or the application of the PSM. Further guidance is needed to clarify such issues, unless there will be ample room for different interpretations. Such market inclusion can also increase its own complexity when it comes to bilateral APA negotiations when the counterpart jurisdiction does not consider market as a comparability factor. Despite this, the inclusion of market as a factor in profit allocation has been applied

16. Cottani, *supra* n. 8 .
17. Rotondaro, *supra* n. 9 .
18. ID: PP (Tax Court), 2013, Put.42750/PP/M.I/16/2013, Indonesian Tax Court Decision; F. Karyadi & P. Wicaksono Sungkono, *Issue of Common Control in Recent Transfer Pricing Cases* , 21 Intl. Transfer Pricing J. 3 (2014), Journal Articles & Papers IBFD; G. Tobing, *Sengketa Pengertian Hubungan Istimewa* , Inside Tax: Media Tren Perpajakan, 38-43 (2014).
19. ID:PP (Tax Court), 2013, Put.42750/PP/M.I/16/2013, Indonesian Tax Court Decision.
20. Karyadi & Wicaksono Sungkono, *supra* n. 18
21. Id.
22. Cottani, *supra* n. 8 .
23. Art. 3 para. 1 PMK-213/PMK.03/2016, available at https://www.pajak.go.id/sites/default/files/2019-08/PMK-213-2016%20-%20TP%20Documentation%20-%20English%20Version.PDF (accessed 1 Dec. 2020).

in several countries, inter alia India, which includes market access as one factor of marketing intangibles[24]and China, which takes marketing intangible and location-specific advantages into account in determining Chinese entities remuneration.[25]The OECD's Unified Approach in Pillar One arguably follows the similar principle on taxing automated digital service and consumer-facing business based on Amount A, which is intended to expand the taxing rights of market jurisdictions over a share of residual profit of the MNE.[26]

3.5. Segregation vs aggregation approach

Article 11 of PMK-22/2020 follows paragraph 3.9 of the OECD Guidelines (2017) in that the arm's length principle should be applied on a transaction-by-transaction basis. However, in the event that the transactions affected by a special relationship are so closely linked and interdependent that a separate application of ALP cannot be applied reliably and accurately, PMK-22/2020 allows for a combined or aggregate application of ALP. Prior regulation such as PER-32/2011 only provided guidance that taxpayers may submit segmented financial statements, while PER-22/2013 only stipulated that aggregated analysis may be appropriate in closely linked or continuous transactions, but did not provide further elaboration. Taxpayers may then be inclined to apply TNMM on aggregate, on a whole entity basis, rendering various related-party transactions to be at arm's length, so long its net profit is within the range of comparables.

However, PMK-22/2020 does not define the criteria nor give examples of what circumstances would cause transactions to be considered "closely linked and interdependent". Paragraphs 3.9-3.11 of the OECD Guidelines (2017) instead cite examples of transactions which may be aggregated.

Wittendorff cited economical coherence as an indicator of whether transactions are "closely linked and interdependent" and therefore appropriate to be examined aggregately.[27]Contractual arrangements could indicate interdependence between transactions, e.g. in a package deal that is intended to be simultaneously accepted, so that one party cannot obtain goods or services from a non-contracting party without breaking the contract. Another analysis could be taken on whether parties would be better off in aggregated pricing or separate pricing, taking into account options realistically available. Nevertheless, PMK-22/2020 does suggest that "closely linked and interdependent" be interpreted as a mere prefatory clause, as it emphasizes on the inability to "reliably and accurately apply ALP in separate basis" as the condition where aggregated approach could be applied.

3.6. Selection of transfer pricing method

Previous iteration of the IITL, for example in the elucidation of article 18(3) of the 1994 IITL, did not specify any transfer pricing method. It only stated that several approaches can be used, i.e. "using comparable data, profit allocation based on the function or participation of taxpayers who have special relations, as well as other indications and data". The outline of specific TP methods came in KEP-01/1993 and SE-04/1993. Both mentioned CUP, the RPM, and CPM. Although SE-04/1993 further mentions comparable profit and return on investment, these methods did not carry over to subsequent regulations. The 2008 amendment of the IITL was the first instance that both PSM and TNMM were explicitly recognized as "other methods" in Indonesian tax regulation.[28]

In PMK-22, in addition to CUP, CPM, RPM, PSM and TNMM, comparable uncontrolled transactions (CUT) and two valuations method are introduced in "other methods". Furthermore, the guideline for PSM is expanded to take into account the development in the Additional Guidance on Profit Split, i.e. shared assumptions of significant economic risks or separate assumption of closely related risks. Such further explanation on selecting transfer pricing methods will provide more certainty for both DGT and taxpayers, as well as reducing potential disputes.

As argued in an Indonesian tax court decision,[29]the specific mention of PSM and TNMM under "other methods" in IITL does not necessarily construe an exhaustive list of transfer pricing methods exists. In the case of *PT SIM v. DGT* , the tax auditor adjusted the taxpayer's royalty rate in fiscal year 2012 from 3.5%-5.5% of sales to 25% of operating profit.[30]The dispute revolved around the legal basis of other TP methods beyond the recognized five methods. DGT had to resort to the argument that 25:75 splitting of operating profit was tantamount to PSM. In this regard, PMK-22/2020 reinforces the notion that there are "other methods" even if the IITL does not explicitly mention them.

---

24. S. Wagh, *Transfer Pricing Aspects of Marketing Intangibles: An Indian Perspective* , 69 Bull. Intl. Taxn. 9 (2015), Journal Articles & Papers IBFD.
25. J. Li, *China and BEPS: From Norm-Taker to Norm-Shaker* , 69 Bull. Intl. Taxn. 6/7 (2015), Journal Articles & Papers IBFD.
26. OECD, *Tax Challenges Arising from Digitalisation – Report on Pillar One Blueprint: Inclusive Framework on BEPS* , OECD/G20 Base Erosion and Profit Shifting Project (OECD Publishing, Paris 2020), available at https://doi.org/10.1787/beba0634-en (accessed 1 Dec. 2020).
27. J. Wittendorff, *Transfer Pricing and the ALP in International Tax Law* (Kluwer Law International 2010); *see also* the case of *Glaxosmithkline Inc. v. The Queen* and *Bausch & Lomb, Inc. v. Commissioner* , 933F. 2d 1084 (2nd Cir. 1991).
28. Elucidation of art. 18(3) IITL.
29. ID: PP (Tax Court), 21 Feb. 2019, *PT SIM v. Directorate General of Taxes (DGT)* , Put.101927.15/2012/PP/M.XIIIA, Indonesian Tax Court Decision.
30. Id.

The CUT method is a method comparing prices/profits of transactions affected by special relationships and independent transaction using a certain basis (which are commercially valued using the aforementioned basis). This includes interest rates, discounts, provisions, commissions, and percentages of royalty towards sales or operating profit. PMK-22/2020 tries to distinguish CUP (which is generally measured in unit price), and CUT (which is generally measured in percentage). Nonetheless, some applicability of CUT may need to be clarified. For example, cost-based TNMM arguably could also reliably apply for transactions involving provisions and commissions.[31]On the other hand, finding comparables for royalty that use a percentage of operating profit may also be more difficult compared to those using a percentage of sales. Nonetheless, a profit-based royalty rate may be appropriate in certain circumstances to avoid hindsight, based on what independent parties would have agreed to in comparable circumstances.[32]

PMK-22/2020 also introduces “tangible asset and intangible asset valuation” and “business valuation” as applicable methods. The former is used for transfer of tangible assets and/or intangible assets, property lease, the use or right to use intangible assets, exploitation rights of mining areas and/or other similar rights, and rights in connection with the cultivation of plantations, forestry, and/or other similar rights. The latter is used for business restructuring, transfer of non-cash assets as substitutes for shares or equity participation; and transfer of non-cash assets to the shareholders, partners, or members of the corporation, partnership or other entity.

Valuation may also overlap with other TP methods. For example, transaction involving the use/right to use intangible assets may also be applicable for CUT (e.g. royalty or licence fee), and transfer of tangible assets may also be applicable for CUP. Therefore clearer guidelines, such as appropriate valuation for hard-to-value-intangibles or where comparables could not be found, would provide greater certainty for both taxpayer and tax administrator.

3.6.1. A return to hierarchical?

The hierarchy of TP method first came in the OECD 1979 Report.[33]Beside the “traditional transaction methods” (CUP, RPM and CPM) the OECD 1979 Report also recognized “other methods”, i.e. the profit methods (PSM and comparable profits method) and the global formulary apportionment.[34]The Report favoured the traditional methods, in particular CUP as the most direct way of determining an arm’s length price.[35]The reference to other methods was only considered as an indication for further investigation, e.g. as a sanity check (for profit comparison) or a negotiation (as a profit-split solution).[36]

Under the OECD Guidelines (1995), the “other method” was renamed as “transactional profit method”[37]alongside the admonition of global formulary apportionment and recognition of other methods as long as they conform to the ALP (comparable profits method and modified cost-plus/resale price methods).[38]Ahmadov noticed that paragraphs 1.68-1.69 of the OECD Guidelines (1995) provided the door to a non-hierarchical approach,[39]albeit there was a limitation by labelling the profit-based methods as “last resort methods” to be used in exceptional circumstances only.[40]In its 2017 Guidelines, the OECD seemed to espouse a semi-hierarchical approach, i.e. using the term of “most appropriate method”, in order to ensure a more direct and closer relationship to the transaction under review while on the other hand preferring a traditional transaction method over a transactional profit method if both can be applied in an equally reliable manner. Ahmadov considers this a half-hearted position towards a complete abolition of hierarchy.[41]

Historically, the hierarchy of TP method in Indonesia came in S-153/2010. In the guideline, the tax auditor was required to first start with the CUP method. If there was a difficulty or unreliability in applying CUP, the auditor might apply RPM or CPM. If there was further difficulty, the auditor might select TNMM or PSM. However, in applying RPM or CPM, S-153/2010 required the auditor to review the reliability of the application of ALP using the aforementioned methods by comparing post-adjustment net profit with the net profit and taxable profit of other businesses in the same sector. In other words, net profit-based indicators are still employed as a “sanity check”, similar to the 1979 OECD Report.

---

31. *GAP International Sourcing (India) Pvt. Ltd v. ACIT* [ITA Nos. 5147/Del/2011 (FY 2006-07) and 228/Del/2012 (FY 2007-08)].
32. Para. 49 Annex II to Chapter IV *OECD Guidelines* (2017).
33. OECD, *Transfer Pricing and Multinational Enterprises* (1979), Primary Sources IBFD. This is the first report of the OECD published as guidelines to multinational enterprises and tax administrations dealing with the allocation of income and expenses between associated enterprises.
34. J. Ahmadov, *The “Most Appropriate Method” as the New OECD Transfer Pricing Standard: Has the Hierarchy of Methods Been Completely Eliminated?* , 18 Intl. Transfer Pricing J. 3 (2011), Journal Articles & Papers IBFD.
35. Id.
36. Id.
37. Ahmadov, *supra* n. 34 ; OECD Ctr . for Tax Policy and Admin., *Proposed Revision of Chapters I-III of the Transfer Pricing Guidelines – 9 September 2009 to 9 January 2010* (OECD 2010), Primary Sources IBFD.
38. Ahmadov, *supra* n. 34 .
39. Id.
40. Para. 3.50 *OECD Guidelines* (1995).
41. Para. 2.3 *OECD Guidelines* (2017); Ahmadov, *supra* n. 34 .

The hierarchical approach is maintained in article 11(3) of PER-43/2010. If transactional methods were deemed appropriate, the affiliated transaction is subject to analysis to know if PSM is appropriate, i.e. whether: (i) the transactions are so closely linked that it is not possible to conduct separate analysis; or (ii) there exist unique intangibles that cause difficulties in finding comparables. Only if these conditions were not met, according to article 12 of PER-43/2010, would TNMM become the method of last resort.[42]In its development, PER-32/2011 removed the hierarchy and replaced it with the "most appropriate method" concept.[43]Consequently, TNMM was no longer a method of last resort.

Article 13(11) and (12) of PMK-22/2020 reiterates the OECD Guidelines (2017) in applying the form of semi-hierarchy in selecting the TP method. If CUP and any other methods can be applied in an equally reliable manner, then CUP is preferred;[44]and if CPM, RPM, PSM, and TNMM can be applied in an equally reliable manner, then CPM or RPM are preferred. PMK-22/2020 is inexplicably silent on the position of CUT and valuation methods.

In PMK-22/2020 hierarchy also exists between internal comparable and external comparable; as well as between comparable from the same country/jurisdiction as the tested party and foreign comparable. If they have the same level of comparability and reliability, then internal is preferred over external comparable, and domestic over foreign comparable.

In the authors' view, the hierarchy of methods begs another question. If we suppose that all methods can be applied in an equally reliable manner, then any chosen method would nevertheless result in the same arm's length price or profit. Even if they result in different prices or profits, a range would arguably follow from those various points. Consequently, every point within that range is at arm's length, as the application of transfer pricing method has been established to be reliable.

In a similar vein, if the selected comparables are equally reliable, the origin should not necessarily matter. Internal comparable is favoured due to the a priori assumption that it may have a more direct and closer relationship to the transaction under review, e.g. by virtue of having identical accounting standards and practice.[45]Similarly, domestic comparable is preferred due to the a priori assumption that arm's length prices may vary across different markets even for transactions involving the same property or services, making domestic comparable less likely to have materially different economic circumstances to the transaction under review.[46]

3.7. Application of ALP for special transactions

3.7.1. Preliminary step for special transactions – Substance over form?

Article 14 of PMK-22/2020 considers transactions involving service, use of or the rights to use intangibles, cost of debt, transfer of property, business restructuring, and cost contribution arrangement (CCA) to be special transactions that warrant a preliminary step. Basically, the preliminary step establishes that a taxpayer must first demonstrate that (i) the form of transaction matches with its actual substance, and (ii) the transaction is economically rational, i.e. providing benefit such that an independent enterprise in comparable circumstances would have been willing to pay or enter into the transaction. PMK-22/2020 intends to provide the Indonesian tax administration with tools to prevent artificial arrangements that lack economic substance. If the preliminary step is not performed for special transactions, they are then automatically considered to not be at arm's length.[47]

Besides the usual "existence test" and "benefit test", PMK-22/2020 requires more extensive proof. For intangibles, the taxpayer needs to identify the legal owner, economic owner, and parties performing development, enhancement, maintenance, protection, and exploitation (DEMPE) functions. For debt, the taxpayer needs to first establish its substance as a debt, using criteria in the same vein as Australian Effectively Non-Contingent Obligation (ENCO),[48]such as maturity date, obligation to repay the principal and interest, periodic payment in accordance with the agreement, ability to seek out loan from independent creditor or to pay principal and interest similar to independent debtor, covenant, legal consequences for defaulted borrower, and the lender's right to call on the debt.

3.7.2. "The best option out of other available options"

Another interesting feature of the preliminary step is the inclusion of "the best option out of other available options" clause for transfer of property and business restructuring. "The best option out of other available options" is conceptually akin to the "options realistically available" (ORA) in which all methods that apply the ALP can be tied to.[49]ORA dictates that commercially

42. Compare to *OECD Guidelines* (1995), where PSM is deemed the method of last resort instead.
43. Art. 11(1) PER-32/2011. PER-32/2011 also removed art. 12 of previous regulation deeming TNMM as last resort method.
44. Para. 2.3 *OECD Guidelines* (2017).
45. Para. 3.27 *OECD Guidelines* (2017).
46. Para. 1.110 *OECD Guidelines* (2017).
47. Art. 14(9) PMK-22/2020.
48. AU: Subdivision 974-B Income Tax Assessment Act 1997.
49. Para. 1.40 *OECD Guidelines* (2017).

rational entities will only enter into the transaction if they see no alternative that offers a clearly more attractive opportunity to meet their commercial objectives. Since transactions involving transfer of property and business restructuring are appropriate for valuation method based on article 13, it is interesting to inquire whether PMK-22/2020 intends "the best option out of other available options" to be used only in the context of valuation methods, similar to the US Tax Cuts and Jobs Act amendment to section 482 for intangible property transfer.[50]

The challenge is in designing the proof or documentation to be submitted by the taxpayer in preliminary steps. Although PMK-22/2020 does not specify any, Parekh (2015)[51]and Amici (2020)[52]proposed various approaches to identify, value, and determine ORA, inter alia: capital budgeting (e.g. discounted cash flow),[53]opportunity cost,[54]best alternative to a negotiated agreement (BATNA),[55]risk simulation,[56]or bargaining power theory and game theory.[57]However, Sattertwaithe (2019) found that it can be exceptionally difficult to translate the complexities of reality into the few variables the model demands.[58]Other, less sophisticated methods may be more viable to the taxpayer, such as tactical decision making commonly documented in managerial accounting, e.g. make-or-buy decision and keep-or-drop decision. Analyses based on budgeted cost[59]or anticipated profit[60]are also generally available for the management and could arguably be applicable as a proof of "best option out of other available option" in the preliminary step for special transaction.

3.8. Secondary adjustment

Secondary adjustment is based on the fact that the excess profits represented by the adjustment are not consistent with the result that would have arisen were the controlled transactions at arm's length.[61]The IITL and subsequent Indonesian TP regulations[62]unequivocally assert DGT's authority to make secondary adjustment, and this has been confirmed by a tax court decision.[63]

Secondary adjustment ensures that full effect is given in the books of account of taxpayers had the affiliated transaction been undertaken under the arm's length price,[64]by treating them as having been transferred in some other form, e.g. constructive dividends, constructive equity contributions, or constructive loans.[65]While previous regulations did not have specific rules on how to treat the excess profits, and went only so far as to provide elucidation of treating excess profits as dividends, article 22(8) of PMK-22/2020 explicitly considers excess profits to be dividends.

Using constructive dividends can be complicated when one party in the affiliated transaction does not have direct capital ownership in the other, for example, in the transaction between sister companies, or between parties in a special relationship through the existence of the same person in managerial or operational decision-making but with no clear ownership link.

Tax court decision No. Put.58181 upheld the authority of the DGT to make secondary adjustments even in the absence of any direct ownership.[66]The panel of judges used a broad interpretation of dividend, as referred in paragraphs 28 to 29 of the Commentary on Article 10 of the OECD Model Tax Convention (2010),[67]which included benefit in money or money's worth (i.e. disguised profit distribution).[68]The decision also reiterates the Commentary whereby such distribution also constitutes dividend

---

50. The changes in section 482 by US TCJA read: "For purposes of this section, the Secretary shall require the valuation of transfers of intangible property (including intangible property transferred with other property or services) on an aggregate basis or the valuation of such a transfer on the basis of the realistic alternatives to such a transfer, if the Secretary determines that such basis is the most reliable means of valuation of such transfers."
51. S. Parekh, *The Concept of "Options Realistically Available" under the OECD Transfer Pricing Guidelines* , 22 Intl. Transfer Pricing J. 5 (2015), Journal Articles & Papers IBFD.
52. D. Amici, *In-Depth Analysis of the Concept of Options Realistically Available in Transfer Pricing* , 27 Intl. Transfer Pricing J. 2 (2020), Journal Articles & Papers IBFD.
53. R.A. Brealey, S.C. Myers & F. Allen, *Principles of Corporate Finance* ch. 5 (11th ed., McGraw-Hill 2014).
54. A. Bullen, *Chapter 19 The Commercial Rationality Exception: General Scope* , in *Arm's Length Transaction Structures: Recognizing and restructuring controlled transactions in transfer pricing* (IBFD 2011), Books IBFD.
55. Amici, *supra* n. 52 .
56. Parekh, *supra* n. 51 .
57. Amici, *supra* n. 52 .
58. B.M. Sattertwaithe, *Nash Bargaining Theory and Intangible Property Transfer Pricing* . Tax Notes Federal (30 Sept. 2019).
59. Para. 8.29 *OECD Guidelines* (2017).
60. Id., para. 6.69.
61. Id., para. 4.68.
62. DGT, Directorate General of Taxes Regulation No. 22/PJ/2013 (30 May 2013) and Circular Letter No. 50/PJ/2013 (24 Oct. 2013).
63. ID: PP (Tax Court), 4 Dec. 2014, Put. 58181/PP/M.I B/13/2014, Indonesian Tax Court Decision.
64. A. Dugar & L. Bhandari, *Secondary Adjustment: A Potential Wave of New Transfer Pricing Litigation* , 23 Asia-Pac. Tax Bull. 4 (2017), Journal Articles & Papers IBFD.
65. Id.
66. *Supra* n. 63 .
67. *OECD Model Tax Convention on Income and on Capital* (22 July 2010), Treaties & Models IBFD.
68. *Supra* n. 63 .

even if it be made available to non-shareholders, when there was a legal relationship between the recipient and the company, and the dividend recipient was closely related with a shareholder (i.e. member of the same group).[69]

Such secondary adjustment admittedly has its own drawbacks. A secondary adjustment could lead to unresolved double taxation,[70]especially since there will be no clear obligation of the other jurisdiction to provide such relief for the withholding tax.[71]It may also be unfair to minority shareholders not parties to the controlled transaction and who did not necessarily enjoy the excess cash to be considered recipients of a constructive dividend.[72]

3.9. Permanent establishment clause

Article 5(1) of the IITL stipulates that the tax base of a permanent establishment (PE) basically concerns its business income, force of attraction rule and branch profit tax. The IITL further allows no deduction for royalties (or other payments paid in respect of the use of properties, patents, or other rights); management services or other services; and interest (except in banking).

In the authors' opinion, article 24 of PMK-22/2020 convolutes the determination of profits for PE. Article 24(2) of PMK-22/2020 stipulates that if a domestic taxpayer in the transaction qualifies as a PE, it would be also deemed a PE based on prevailing regulation and be required to submit all data and/or information related to transactions conducted by its foreign affiliate connected to the business or activity of the Indonesian PE. The data and/or information is then used to determine the value of transactions conducted by the PE. If the PE does not submit the data, the value of transactions will be determined using the ALP.

Although Indonesia does not apply "functionally separate entity" in accordance with the Authorized OECD Approach (AOA), prior regulation such as PER-32/2011 nonetheless requires PEs to apply the ALP.[73]Some Indonesian tax treaties, such as the Indonesia-Australia tax treaty, already require the application of ALP for calculating PE expenses.[74]It is not clear how this would interplay with the attribution principle used to determine the profit allocation of a PE.

PMK-22/2020 may also lead to scenario where a subsidiary is determined as a PE, resulting in both PE and subsidiary existing at the same time. Article 24, paragraph (7) of PMK-22/2020 states that the taxation rights and obligations previously fulfilled by domestic taxpayers are taken into account in the fulfilment of taxation rights and obligations of the PE. However, its method of application is unclear (for example whether the PE is then given partial tax credit from subsidiary). Further, while it seems that PMK-22/2020 aims to apply the direct attribution method if the PE submits all data and/or information, it is unclear how the DGT would apply ALP in the absence of such data.

4. Conclusion

Indonesia's current transfer pricing regulation (PMK-22/2020) can be perceived as the Indonesian government's attempt in improving its transfer pricing regime. It comprises implementation of ALP, comparability analysis, selection of transfer pricing method, and consideration for special transactions, which mainly follow the OECD's Transfer Pricing Guidelines 2017.

The key features of this rule are the emergence of the new term "transaction influenced by special relationship", the inclusion of market as a comparability factor, the recognition of CUT and valuation as transfer pricing method, the adoption of "substance over form principle" as well as "options realistically available" notion in the domestic transfer pricing regime, and the basis for using constructive dividend as secondary adjustment. Furthermore, the authors are of the view that PMK-22/2020 effectively reintroduces a form of semi-hierarchical selection of transfer pricing method, even though it is not explicitly stated in the regulation. Finally, after careful analysis of the evolution and development in Indonesia's transfer pricing provisions, the authors conclude that further detailed and clear guidance on PMK-22/2020's key features is inevitably needed to provide certainty, as stated in the preamble of the rule, for both taxpayer and tax authority.

69. *Supra* n. 63 .
70. Para. 4.70 *OECD Guidelines* (2017).
71. Paras. 4.70 and 4.71 *OECD Guidelines* (2017).
72. Para. 4.72 *OECD Guidelines* (2017).
73. Art. 2 PER-32/PJ/2011 states that a PE must apply the ALP and may be required to submit transfer pricing documentation.
74. *Agreement between the Government of Australia and the Government of the Republic of Indonesia for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income* art. 7(3) (22 Apr. 1992), Treaties & Models IBFD.