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Globally

120+ COUNTRIES

810 OFFICES

43,000+ STAFF

3,800+ PARTNERS

56 YEARS

$ 5.7 BILLION REVENUE

Indonesia

2 OFFICES

700+ STAFF

40+ PARTNERS

35 YEARS

3rd IN # LISTED ENTITIES AUDITED

When working with RSM, you have access to our global expertise, as well as professionals that have a deep understanding of the local and regional challenges your business may face. We know that one size does not fit all, and so our experts will provide you with skills, insights and resources that suit your business depending on the jurisdictions in which you operate.

ASIA PACIFIC	AFRICA	EUROPE	LATIN AMERICA	NORTH AMERICA	MIDDLE EAST
20 countries	25 countries	44 countries	20 countries	2 countries	9 countries
116 offices	38 offices	195 offices	72 offices	375 offices	15 offices
10,000+ people	1,300+ people	8,700+ people	3,200+ people	18,900+ people	660+ people

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Our Services in Indonesia

Audit

Agreed Upon Procedures | Financial Information Review | General Audit |

Tax

Business Tax | International Tax | Tax Merger & Acquisition| Transfer Pricing |

Consulting

Accounting Advisory | Finance & Accounting Outsourcing |
Governance Risk Control Advisory Services | Management Consulting |
Technology Consulting | Transaction Support Services & Corporate Finance |
Other Consulting |

Our Tax and Consulting Services in Indonesia

TAX

Business Tax

Tax Advisory
Tax Audit & Dispute
Tax Compliance

International Tax

Merger & Acquisition

Tax Due Diligence
Tax Structuring

Transfer Pricing

ASIA TAX AWARDS 2020:
RSM IS SHORTLISTED AS INDONESIA TAX FIRM OF THE YEAR

CONSULTING

Accounting Advisory

Complex Accounting & Financial Reporting
New Accounting Standards & Implementation

Finance & Accounting Outsourcing

Accounting Services
Financial Outsourcing Services
Payroll
Secretarial

Governance Risk Control Consulting Services

Anti Money Laundering
Fraud Prevention, Forensic, Investigation
Process, Risk & Controls
Security Privacy & Risk Consulting
Technology Risk Consulting

Management Consulting

Business Consulting
Operations & Supply Chain
People & Organization
Technology & Digital

Technology Consulting

Application Development & Integration
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Technology Infrastructure

Transaction Support Services & Corporate Finance

Corporate Finance
Corporate Recovery & Insolvency
Restructuring
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Other Consulting

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THURSDAY, 19 NOV 2020

Recent Update and Transfer Pricing Considerations due to COVID-19 Pandemic

Presentation by: Untoro Sejati & Adzka Fikri Fadhilah

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Updated Regulation on APA

- The Minister of Finance recently issued a **Minister of Finance Regulation number 22 year 2020 ("MoF 22/2020") on the implementing guidelines for Advance Pricing Agreement ("APA")**; As an effort of adopting the minimum standards included in Action 14 of OECD/G20 BEPS Project to make dispute resolution mechanisms more effective.
- **MoF 22/2020 seeks to provide detailed guidelines** to ensure greater legal certainty to taxpayers involved in APA process, particularly regarding procedures and timeframe of APA application and the follow-up actions.
- Effective from 18 March 2020, **MoF 22/2020 replaces the previous APA regulation (MoF 7/2015) and applies to all pending and ongoing APA application.**
- One of interesting point to note that elaborate guidelines on the ALP application have been included in MoF 22/2020, which in some cases, deviate from the existing transfer pricing regulations; Regarding **expanded definition of transaction affected by Special Relationship and the definition of arm's length range.**
- **DGT Regulation number 17 year 2020** regarding Guideline on APA application and implementation provides that when applying for APA, **Taxpayer whose profitability are negatively affected by COVID-19 outbreak, may prepare financial report projection that shows adjusted profits as if the Company is in normal condition.**

Updated Regulation on APA (cont'd)

The MoF 22/2020 requires that ALP is applied **not only to the related party transactions but also transaction influenced by special relationship.**

Income Tax Law number 36/2008 ("ITL")

- Article 18 of the ITL authorizes the DGT to adjust taxpayers' income and costs, where transactions with related party ("special relationship") are not in accordance with the ALP. A special relationship (Art. 18 Par.4) is deemed to exist in the following circumstances:
  a. A taxpayer who owns directly or indirectly at least 25% of equity of other taxpayer; a relationship between taxpayer through ownership of at least 25% of equity of two or more taxpayer, as well as relationship between two or more taxpayer concerned;
  b. A taxpayer who controls other taxpayer; or two or more taxpayers are directly or indirectly under the same control; or
  c. A family relationship either through blood or through marriage within one degree of direct or indirect lineage.
- According to the Minister of Finance regulation number 213/PMK.03/2016 Article 2 Par. 2 and also attachment of DGT regulation number 22/PJ/2013 stated that **the ALP applies only to special relationship transactions.**

MoF 22/2020

According to MoF 22/2020 Article 1 Number 15, transactions affected by Special Relationship are transactions that include:

a. Related party transactions; and/or

b. Third party transactions however the counter third party and transaction price are under control of a related party through one or both the contracting parties.

Potential Dispute

Updated Regulation on APA (cont'd)

Arm's length price or profit can be calculated in the form of a single price/profit or in arm's length range ("ALR"). The comparison of the explanation of ALR in MoF 22/2020 and previous regulation as follows:

DGT Regulation 32/2011 the amendment of DGT Regulation 43/2010	MoF 22/2020
ALR is a range between the first quartile to third quartile point (interquartile range) that must satisfy the following requirements: a. comparable data or transactions used are reliable; and b. supported with evidence and an adequate explanation that a single price/profit can not be calculated.	ALR is a range of two or more comparables which has a different price indicator value, in the form: • minimum to maximum point (full range) in terms of formed from 2 comparables; or • first quartile to third quartile point (interquartile range) in terms of formed from 3 or more comparables.

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Considerations On APA

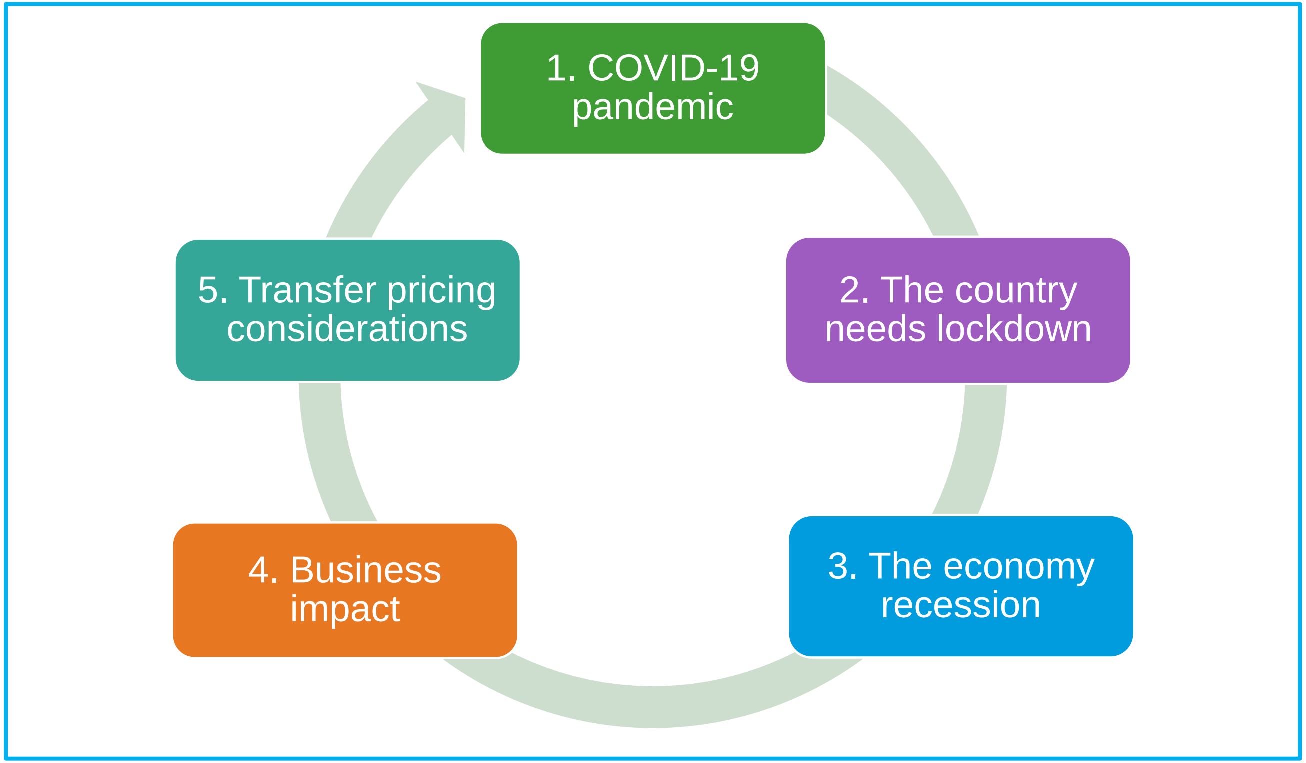
Factors that should be considered on APA:

The COVID-19 outbreak may affect the settlement or negotiating of the APA. Tax authority will seek more information whether the APA is proposed by the following circumstances:

- The related party transaction lacks economic motive;
- The economic substance of related party transaction;
- The related party transaction is undertaken with the purpose of minimizing tax burden;
- Information and/or evidence submitted by taxpayer is untruthful or not in accordance with the actual condition:
- Information and/or evidence requested by the DGT for the purpose of material testing is not provided within 14 (fourteen) days from the date of the written request; and/or
- The tax years covered in the proposed APA period or roll-back years has been issued with CIT Assessment Letter.

Further, the hard to identified or settle the critical assumptions during pandemic may affecting the APA negotiations.

Current Situation due to COVID-19 Pandemic



Current Situation Due To COVID-19 Pandemic

- The rapid global scale outbreak of the novel coronavirus (COVID-19) has taken the world by storm. This disease has transformed into a global pandemic disrupting lives, crumbling healthcare systems, crushing livelihood, dwindling financial markets, and devastating world economies alike in geometric progression.

- The immediate impact of the pandemic is known to mankind, this accelerating crisis has already engulfed the world economy by a temporary shutdown of industries, restricting the free-flow movement of goods, services, people, money.

- COVID-19 is unlike a typical supply chain disruption since it has taken a global proportion and compelled companies to respond immediately to address the near- term sustainability of their existing businesses. One can easily witness a massive strain on MNEs' current operations as well as significant future risk and exposure from a business, tax, and legal perspective.

- The catastrophic impact of the COVID-19 pandemic will be far reaching, and the serious implications for many multinational groups' transfer prices, analysis and documentation is yet another thing to consider. During crisis due to COVID-19, most of companies incur losses or earn very low profit.

COVID-19 Impact On Business

1. **The economic impact experienced by the company:**
    - A prolonged shut down of commercial operations;
    - A drastic change in customer priorities and a resultant lack of demand;
    - A disruption in the traditional distribution channel;
    - Inventory obsolescence;
    - A considerable reduction in people’s productivity; and
    - Tightened cash flow and liquidity with a stretched working capital.

COVID-19 Impact On Transfer Pricing

Transfer pricing issues that emerge due to COVID-19 pandemic:

Pricing Policy

- Should losses share between routine and non routine entity?
- Amend the interest rate on loan agreement?
- Amend the intra-group services transactions and licensing of IP?

Supply Chain

- Change in functional profile of entities due to performance of additional value-adding functions.
- Bearing on entity's economic characterization.
- Temporarily affect profit allocation between group entities in line with their FAR profile.

Comparables Selection

- Comparables may not be available in real time.
- Comparables may suffer losses due to COVID-19 outbreak.

Comparability Adjustment

- Evaluate the possibility of economic adjustments to reflect the pandemic's impact.
- Adjustments may be required to account for differences in capacity utilization, logistics costs, financing costs, cost for enabling work from home capabilities etc.

Contemporaneous

- Delay in ascertaining financial data of comparables on database.

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COVID-19 Impact On Transfer Pricing (cont'd)

Evaluating pricing policy of intra-group transactions:

1. **Existing transfer pricing policies will be put under pressure with any economic downturn.** Covid-19 outbreak effecting supply demand of the product in market significantly. Hence, the business forecast set at the beginning of the year will be very difficult to achieve. Further, Company may suffer losses.
2. **Transfer pricing models may need to be adjusted.** Specifically to the pricing policy of intra-group transactions, comparability adjustment made should considering 5 (five) comparability factors i.e.:
   - The contractual terms of the transaction;
   - The functions performed by each of the parties to the transaction, taking into account assets used and risks assumed, including how those functions relate to the wider generation of value by the MNE group to which the parties belong, the circumstances surrounding the transaction, and industry practices;
   - The characteristics of property transferred, or services provided;
   - The economic circumstances of the parties and of the market in which the parties operate
   - The business strategies pursued by the parties

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COVID-19 Impact On Transfer Pricing (cont'd)

Factors that should be considered on evaluating pricing policy:

1. **Contractual Terms.** Step of re-visiting the pricing policy from contractual terms i.e. (i) Prepare revised agreements; (ii) Prepare very thorough reasoning and calculation for the new Transfer Price; and (iii) Prepare a thorough documentation of COVID-19 related condition and action taken as part of Master File and Local File. Further, in terms of amending the contractual terms, factors should be considered i.e. Changes in pricing terms, Changes in payment terms, Changes in responsibilities/nature and extent of services/quality and quantity of goods and Change in termination or force majeure.
2. **Functional Analysis.** Re-arrange the remuneration of entity involved in supply chain of the MNE group based on functions, assets, and risks analysis. Factors that should be considered in re-arranging the remuneration starts from determine the remuneration for entity perform routine and non-routine function.
3. **Industry Analysis.** Step of re-visiting the pricing policy from industry perspective i.e. (i) analyzing key value drivers within the business; (ii) A high-level assessment of key profit drivers; (iii) Interviews with key operational personnel to understand the disruption in the value chain due to COVID-19; (iv) Evaluate potential losses due to the global lockdown and financial exposure in terms of changes in working capital position; (v) Research and review on how the relevant industry has been impacted.

COVID-19 Impact On Transfer Pricing (cont'd)

Factors that should be considered on evaluating pricing policy for specific transactions:

Loan Transactions. Taxpayers and its related party could amend the loan agreement with considering the economic situations during covid-19 outbreak i.e. postpone the interest payment, decreasing the interest rate with considering incentive given by the Government.

With respect to their intercompany debt financing arrangements, MNEs should be aware of the following:

- Corporate debt markets are changing daily as illustrated in the above background. Thus, it is important to obtain and analyze the most up-to-date information and data before proceeding with any intercompany debt transaction.
- For new intercompany debt with a speculative grade borrower, it will be important to appropriately analyze and document the financial strength of the borrower in order to argue that the company would be able to issue debt at arm's length.
- To the extent circumstances exist requiring a need to unwind or restructure certain intercompany debts, consideration should be given to the impact of the current lending environment.

COVID-19 Impact On Transfer Pricing (cont'd)

Factors that should be considered on evaluating pricing policy for specific transactions:

1. **Loan Transactions.**
   - Where relevant, consideration should be given to industry nuances in the lending environment when assessing the arm's length terms and conditions of the debt.
   - Due to low government interest rates, there may be opportunities with respect to intercompany debts which accrue interest at a safe harbour rate (e.g., the Applicable Bank Indonesia Rate), because these rates are generally determined in reference to government securities.
   - Where a related party borrower is in breach of certain covenants or unable to meet interest payments, due consideration should be given to the remedies being observed in similar arm's length circumstances given the current unique environment.

COVID-19 Impact On Transfer Pricing (cont'd)

Factors that should be considered on evaluating pricing policy for specific transactions:

2. Intra-Group Services Transactions. Amending the service agreement by considering the cost structure in determining the remuneration of service providers. With respect to the intra-group services transactions, MNEs should be aware of the issue of the following services:

- shareholder activities services,
- duplication services,
- incidental benefit services,
- and on-call services.

Further, in connection with intra-group services, **should routine service providers bear some of the group's losses?**

COVID-19 Impact On Transfer Pricing (cont'd)

Re-arrange the supply chain to mitigate the overall loss:

1. MNEs may consider re-examining their global structures and functional profiles of entities, reallocating significant functions, risks, and assets to lesser affected jurisdictions and bring about business restructuring to mitigate the overall loss. The transfer pricing impact of such business restructuring will need to be assessed and taken into consideration while realigning the transfer pricing structure.
2. Business restructurings may often involve the centralization of intangibles, risks, or functions with the profit potential attached to them. Refer to OECD Par 9.3 Business restructurings can also consist of the rationalization, specialization or de-specialization of operations (manufacturing sites and/or processes, research and development activities, sales, services), including the downsizing or closing of operations.

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COVID-19 Impact On Transfer Pricing (cont’d)

Factors that should be considered in business restructuring:

1. Assess the business impact areas and the magnitude of such impact for the group
   - Analyze key value drivers within the business;
   - A high-level assessment of key profit drivers;
   - Interviews with key operational personnel to understand the disruption in the value chain due to COVID-19;
   - Evaluate potential losses due to the global lockdown and financial exposure in terms of changes in working capital position; and
   - Research and review on how the relevant industry has been impacted.

COVID-19 Impact On Transfer Pricing (cont'd)

Factors that should be considered in business restructuring:

2. Evaluate solutions to address the impact for the group

- Analyze the business need of making changes in the supply chain model of the group from a transfer pricing perspective;
- Revisit pricing policies prevalent in the group for various functional and risk profiles, such as intercompany financing, captive service providers, contract manufacturers, limited risk distributors, R&D services, strategic management services, etc. in light of the COVID-19 impact;
- Examine other terms of intercompany agreement(s) to assess the potential requirement for re-negotiation, amendment;
- Assess the potential consequences of business restructuring on account of the crisis;
- Evaluate the possibility of economic adjustments to reflect the pandemic's impact;
- Conduct a benchmarking analysis to identify appropriate comparable companies and adjust their results, taking into consideration the COVID-19's effect ; and
- Determine the nature of documentation to be maintained to substantiate the changes in functional/risk profile and pricing policies.

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COVID-19 Impact On Transfer Pricing (cont'd)

Factors that should be considered in preparing transfer pricing documentation:

1. **Selection of Comparables.** Unavailability of financial reports this year or comparables that recorded losses will be difficult to use in transfer pricing analysis. Therefore, financial reports previous years could be an alternative in benchmarking analysis.

   In some cases, taxpayers establish transfer pricing documentation has been comply with ex ante approach. In other words, the comparables was prepared earlier or comparables used based on financial data previous year, hence there might be different economic situations compared to the current situations.

   Taxpayers should be able to explain the reason of selection of comparables with strong and complete evidence in transfer pricing documentation. Moreover, specific data and evidence maintained by companies will bolster the argument that multiple-year data should be considered in comparability analyses.

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COVID-19 Impact On Transfer Pricing (cont'd)

Factors that should be considered in preparing transfer pricing documentation:

2. Comparability Adjustment. To be comparable means that none of the differences (if any) between the situations being compared could materially affect the condition being examined in the methodology or that reasonably accurate adjustments can be made to eliminate the effect of any such differences. The comparison between tested transactions and comparables maybe hard to be applied since factors affecting financial result between those companies differ.

Although every case is different and will need a detailed analysis, adjustments might have to be considered to reflect:
1) idle capacity; 2) extraordinary expenses (advertising expenses, inventory cancellations, cost restructuring);
3) fluctuations in exchange rates; 4) changes in the solvency of entities, etc.

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COVID-19 Impact On Transfer Pricing (cont'd)

Factors that should be considered in preparing transfer pricing documentation:

3. Contemporaneous Documentation. In connection with contemporaneous, Taxpayers should be able to prepare and document the impact of COVID-19 to their business. Taxpayers should be able to quantify and demonstrate the impact of COVID-19 on financial result during and post COVID-19. Further, Taxpayer should consider the details of comparison current and post COVID-19 related party transactions, the deviations of pricing policy, and other changes to the company's operations as a result of the pandemic.

Maybe contemporaneous is hard to be applied during the COVID-19 outbreak. Hence, term testing could be on of solution for transfer pricing analysis. Taxpayer need to be clearly explained to tax authority how the term testing apply on assessing the arm's length principle on their related party transactions.

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