

SMARTER TRANSFER PRICING

For Global Growth



Table of Contents

3	Introduction — Navigating Global Profits with Precision	15	A Common Risk Scenario in Indonesia
5	What Is Transfer Pricing?	17	Inside the Files: What Goes Into Your TP Documents
8	Why Transfer Pricing Matters for Multinationals	20	Choosing the Right Method (and Why It Matters)
12	Key Concepts You Need to Know	24	How We Help at InCorp Indonesia

Introduction

Navigating Global Profits with Precision

In today's global economy, business doesn't stop at borders. Whether moving goods, providing services, or licensing intellectual property between subsidiaries, what you charge internally—known as your **transfer price**—can impact more than just your internal books. It affects how much tax you pay, where you pay it, and how regulators view you.

Like many jurisdictions, Indonesia has strict rules to ensure internal prices reflect market reality. This principle is called the **arm's length principle**, and failing to follow it could cost your business dearly—through audits, fines, or even double taxation.

That's why **transfer pricing** isn't just a tax issue—it's a strategic function that protects your business as it scales.

IN THIS GUIDE, WE'LL BREAK IT DOWN. YOU'LL LEARN:

- What transfer pricing means (without the jargon)
- Why it matters for companies operating in or with Indonesia
- What documentation and methods are required
- How to stay compliant and still move profitably across markets

Whether you're part of a regional supply chain, a brand licensing your IP across entities, or a holding company managing cross-border services, this eBook is designed to help you expand — **without raising red flags**.

Sidebar: What's at Stake with Poor Transfer Pricing?

ISSUE	POTENTIAL IMPACT
Underreported Profits	Tax underpayment penalties, interest charges
Misaligned Prices	Profit shifting allegations across jurisdictions
Missing Documentation	Immediate tax adjustments + 50% penalty (in Indonesia)
Double Taxation	Two countries taxing the same income
Reputational Damage	Risk of being labeled as non-compliant or aggressive

The bottom line is that even unintentional mistakes can lead to serious tax scrutiny. Staying compliant protects your profits, your reputation, and your growth.

What Is Transfer Pricing?

Transfer pricing refers to the prices for goods, services, intellectual property, or financing exchanged between entities under common ownership or control. In simpler terms, it's the internal pricing between related parties within a multinational group.



Real-World Example

Imagine a Singapore-based tech company that owns a subsidiary in Indonesia. The Indonesian entity provides customer service support, while the Singapore head office handles marketing and strategy. The two entities invoice each other for those services.

Are the prices set between these related entities? That's transfer pricing. These internal prices **aren't just accounting entries**—they directly affect how much profit is reported (and taxed) in each country. That's why governments closely monitor them.

The Main Rule: The Arm's Length Principle

Transfer pricing refers to pricing goods, services, intellectual property, or financial arrangements between companies within the same corporate group. These companies are considered **related parties**, and the prices they assign to their internal transactions—**transfer prices**—have significant tax implications.

Transfer pricing is how you price business within your group.

Practical Example: Internal vs. Independent Pricing

SCENARIO	DESCRIPTION	PRICING APPROACH
No issue of Arm's Length Principle	PT XYZ Indonesia sells automotive parts to its parent in Japan. The price falls within a comparable range to what independent buyers would pay under similar conditions	Within market range
Issue of Arm's Length Principle May Arise	PT XYZ Indonesia sells to its parent at a price significantly below the market range, lowering reported profits in Indonesia	Below comparable range
Result	When prices deviate notably from market norms without justification, the Indonesian tax authority may intervene, reassess the pricing, and impose adjustments	

Prices for non-commodity goods like automotive parts often vary depending on contracts and market conditions. Unlike commodities (which have widely known benchmarks), these transactions need strong documentation to justify the pricing.

Want to know how to apply this in your case? Our specialists can help you assess whether your pricing stands up to the arm's length principle.

The Arm's Length Principle – Explained Simply

The **arm's length principle** is the global standard that underpins all transfer pricing regulations, including those in Indonesia.



Related-party transactions must be priced the same way as they would be between unrelated, independent parties in a comparable situation.

If your business sets prices that **don't reflect market value**, it risks audit adjustments, fines, or even double taxation.

What It Means in Daily Operations

IF YOU...	THEN YOU MUST...
Sell goods or services between group entities	Use a price based on market rates or comparable third-party transactions
License trademarks or patents	Apply fair royalty fees backed by external benchmarking
Share group-wide functions (e.g., IT, HR)	Allocate costs reasonably using measurable factors
Provide intercompany loans	Charge interest based on actual market lending rates

The tax office doesn't object to related-party deals. It objects when those deals don't reflect reality.

Why Transfer Pricing Matters for Multinationals

For growing businesses, cross-border operations often mean internal transactions between subsidiaries, branches, or affiliates.



These transactions may seem routine—but for tax authorities, they raise important questions:

- ✓ Are the profits fairly distributed between countries?
- ✓ Is one entity underreporting income by shifting it to a lower-tax jurisdiction?
- ✓ Are companies abusing internal pricing to reduce their overall tax burden?

This is why **transfer pricing** has become a global compliance priority—and why multinational companies operating in or with Indonesia must get it right from day one.

What Happens When It Goes Wrong?

RISK AREA	WHAT CAN GO WRONG
Tax Exposure	Adjustments to reported income, back taxes, interest, and steep penalties
Cash Flow	Additional tax liabilities are due immediately, often without advance notice
Reputation	Viewed as non-compliant or aggressive by regulators and partners
Audit Time & Cost	Lengthy tax investigations with heavy documentation demands
Double Taxation	Two or more countries taxing the same income without relief

Why This Especially Matters in Indonesia

Indonesia's Directorate General of Taxes (DGT) has recently increased enforcement around transfer pricing. Businesses with cross-border or related-party transactions face greater scrutiny, especially if:

- You operate as a **PT PMA** under a foreign parent
- You **import or export** through related companies
- You charge **royalties, service fees, or interest** across borders
- You have **thin profit margins** or tax losses despite high revenue

If your company does business across borders, Indonesia's tax office wants to understand—and challenge—how you price it.

Strategic Reason: It's Not Just About Compliance

Appropriately handled, transfer pricing is also a strategic tool. It allows you to:



Manage **profit allocation** across jurisdictions



Avoid costly mistakes during tax audits



Build a structure that's scalable, compliant, and ready for growth



Maintain investor and regulatory trust

Sidebar: Do You Need Transfer Pricing Documentation?

If your business meets any of the criteria below, Indonesian regulations may require you to prepare **transfer pricing documentation**:

- ✓ You have transactions with **related parties**, domestic or international
- ✓ Your company is a **PT PMA** (foreign-owned)
- ✓ You import or export **goods or services** to affiliated entities
- ✓ You pay or receive **royalties, management fees, or interest** from group companies
- ✓ Your gross **revenue exceeds IDR 50 billion**
- ✓ Your total related-party transactions exceed:
 - **IDR 20 billion** (for tangible goods), or
 - **IDR 5 billion** (for services, interest, royalties, or other intangibles)
- ✓ You transact to the related party that located in country or jurisdiction with lower income tax rate than the income tax rate as referred to in the provisions of laws and regulations in the field of income taxes

Even if you don't meet the thresholds, documentation is still recommended if you're doing related-party transactions—it states that you already fulfill the obligation in the field of taxation related to transactions influenced by a special relationship.

Key Concepts You Need to Know

Before exploring regulations and documentation, it's essential to understand the core building blocks of transfer pricing.

These aren't just tax terms—they shape how your business is assessed and audited.



Let's break down the essential concepts every multinational should know.

Controlled Transactions

A **controlled transaction** is transactions conducted by a Taxpayer with Affiliated Party, whether within the same country or across borders.

THIS INCLUDES:

- Sale or purchase of goods
- Service fees (management, IT, HR)
- Royalties for intellectual property use
- Intercompany loans or financing
- Cost-sharing agreements

If both parties are part of the same group—even indirectly— if it meets the related parties' requirements, it's considered a **controlled transaction**, and pricing must follow the arm's length principle.

Related Parties

In transfer pricing terms, “**related parties**” go far beyond parent and subsidiary. Under Indonesian tax law, two parties are considered related if:

RELATION TYPE	DESCRIPTION
Ownership	One entity directly or indirectly owns at least 25% of the other
Management	Same individual(s) control both entities or influence decision-making
Family Ties	The individuals or shareholders are closely related
Business Dependency	One entity relies significantly on the other (e.g., exclusive supplier/distributor)

Even if the companies are legally separate, **the presence of control or influence** can make them “related” in the eyes of the tax authority.

The Arm’s Length Principle (Revisited)

You know the rule: your internal prices must match what two unrelated companies would agree to in similar conditions.

This is where **benchmarking and comparability analysis** help you justify your pricing decisions. We'll explore these methods in the following few chapters.

Transfer Pricing Documentation Types

Indonesia follows the **three-tiered documentation** approach recommended by the OECD:

DOCUMENT	PURPOSE	WHO MUST PREPARE IT
Master File	Describes the global group's business, structure, and transfer pricing policies	Entity that meets the threshold's requirement
Local File	Contains detailed info on local transactions, methods, and comparables	Entity that meets the threshold's requirement
Country-by-Country Report (CbCR)	High-level report of income, tax, and business locations across jurisdictions	Indonesian entity as the parent company with the consolidated revenue > IDR11 trillion from the previous fiscal year

Indonesia requires **all documents to be prepared contemporaneously** and ready upon request. If it is not prepared, a company is considered not to comply with the arm's length principle and by authority, The **Director General of Taxes will redetermine** the amounts of income or deduction to calculate the taxable income.

A Common Risk Scenario in Indonesia

Scenario: Importing from a Foreign Parent with Low Local Profit

You're operating a **foreign-owned company (PT PMA)** in Indonesia and import key products from your group's head office overseas. Sales are handled locally, but the profit margins booked in Indonesia are very slim—most of the value is attributed to the parent.

At first glance, this looks like regular business. But to Indonesia's tax authority, it raises questions.

***Disclaimer:** The company name mentioned is a fictional creation intended to reflect real-life scenarios and situations.*

CASE

A subsidiary of an overseas manufacturing group, imports products from its parent and sells them locally. The pricing of these imports results in **relatively low profits** being reported in Indonesia compared to the scale of local sales.



WHAT GOES WRONG

The Directorate General of Taxes (DGT) may review the company's filings and compare its profitability with similar independent distributors. If the profit level appears significantly below market expectations without proper justification, they may challenge the pricing and make adjustments.

RISK TRIGGERS

- ⚠ Purchase surpasses the average price
- ⚠ Margins below industry average
- ⚠ No precise method used to set transfer price
- ⚠ Acknowledge loss for several consecutive years

HOW IT SHOULD BE HANDLED

- ✓ Apply the **Resale Price Method** or **Transactional Net Margin Method (TNMM)**
- ✓ Benchmark similar distributor margins internally or externally
- ✓ Prepare the Master File and Local File

Even if your pricing makes internal sense, it must be backed by external, market-based evidence—or the tax office (by authority) may rewrite your numbers.

Inside the Files: What Goes Into Your TP Documents

Once you've identified that your business needs to comply with transfer pricing rules, the next step is to prepare the proper documents.

In Indonesia, the tax office doesn't just want to see *that* you've priced your transactions reasonably – they want to know *how* you arrived at those prices.



Master File: The Global Picture

The **Master File** provides an overview of your entire multinational group and helps the tax authority understand how your business operates across borders.

WHAT IT SHOULD INCLUDE

- Organizational structure and group entities
- Global business operations and value chain
- Transfer pricing policies and methods applied group-wide
- Intangible assets (ownership and use)
- Group financial and tax position

Based on PMK 172/2023, the Master File is prepared by the entity if the threshold has been met.

Local File: The Indonesian Focus

The **Local File** focuses specifically on your Indonesian entity and its transactions with related parties. The Directorate General of Taxes (DGT) scrutinizes this document most during transfer pricing reviews.

WHAT IT SHOULD INCLUDE

- Description of the Indonesian entity and its management structure
- Functional analysis (functions performed, assets used, and risks assumed)
- Details of related-party transactions (type, counterparties, and values)
- Transfer pricing methods applied to each transaction
- Comparable data and benchmarking studies
- Local financial results and reconciliation with group accounts

Based on PMK 172/2023, the Local File is prepared by the entity if the threshold has been met.

Want to confirm how these rules apply to your group? Our team can help assess your obligations and prepare compliant documentation.

Country-by-Country Report (CbCR): High-Level Overview

The **CbCR** summarizes key financials and tax positions for all group entities, broken down by jurisdiction.

WHAT IT COVERS

- Revenues, profits, income taxes paid, and accrued
- Number of employees
- Main business activities
- Country-level allocation of income

Must be submitted if Indonesian entity as the ultimate parent entity exceeds IDR11 trillion in consolidated revenue.

Common Mistakes to Avoid

MISTAKE	RISK
Copy-pasting group-wide policies without local context	Fails local file requirements
Benchmarking using outdated or foreign-only comparables	May lead to tax adjustment
Missing documentation when requested	50% penalty on adjusted income
Preparing documents after the audit starts	Considered non-contemporaneous

Choosing the Right Method (and Why It Matters)

Transfer pricing documentation is not just paperwork – it's the way businesses prove they comply with the arm's length principle.



Your chosen method determines how clearly you can demonstrate that your pricing and profits with related parties are in accordance to the arm's length principle.

USING THE RIGHT APPROACH HELPS

- ✓ Show compliance with the tax authority
- ✓ Minimize audit risks and disputes
- ✓ Support your business structure as it grows internationally

Indonesia applies internationally recognized methods to review whether your transactions reflect what independent parties would agree to. Selecting and using the right one is not just about following rules – it's a strategic step to secure your operations.

What Are Transfer Pricing Methods?



Transfer pricing methods are **frameworks that test whether transactions between related parties align with the arm's length principle.**

They evaluate not only the price charged but also the **profit gained** compared to what independent entities would earn under comparable conditions.

THE CORRECT METHOD DEPENDS ON SEVERAL FACTORS

- The **nature of the transaction** (tangible assets or intangible assets)
- The **business characteristic** (service provider, distributor, and manufacturer)
- **Availability of comparable data** (internal or external comparables)

Commonly Used Methods

We won't go too deep here – because what works for one business might not apply to another – but here's a quick look at the most common approaches:

METHOD	BEST FOR	KEY IDEA
Comparable Uncontrolled Price (CUP)	Commodities, IP, finance	Compare prices to third-party deals for the same product/service
Resale Price Method	Distributors	Compares resale price to margin earned by independent resellers
Cost Plus Method	Manufacturers , service providers	Adds a market-based markup to the cost base
Transactional Net Margin Method (TNMM)	Complex or service-heavy models	Uses net profit margins from comparable companies

Choosing the wrong method – or failing to apply it correctly – is one of the fastest ways to trigger audit adjustments.

Where InCorp Indonesia Comes In



Getting the method right isn't just technical. It involves the acknowledgement of the company's business flow and tax policy.

That's where we support our clients as a dedicated **transfer pricing advisory partner**.

✓ **Arrange the documentation of business process as a whole group in Master File**

✓ **Disclose the tested party's implementation of the arm's length principle in the Local File**

✓ **Prepare the Country-by-Country-Report**

Let our experts handle the complexity – so you can stay focused on running your business.

How We Help at InCorp Indonesia

At InCorp Indonesia, we understand that transfer pricing isn't just a box to check – it's a critical part of how your business operates and scales internationally.

From choosing the proper method to preparing documentation that stands up to scrutiny, our role is to **protect your business from audit risks while giving you confidence to grow across borders.**

Our Transfer Pricing Advisory Services

Whether you're just starting with related-party transactions or preparing for a tax review, our team of specialists helps you stay one step ahead. We offer:

✔ Transfer Pricing Risk Assessment

We help you identify exposure areas before the tax office does

✔ Functional & Economic Analysis

Deep dives into your business functions, assets, and risk allocation

✔ Method Selection Support

We recommend the most appropriate method for each transaction type – tailored to Indonesian rules and global best practices

✓ **Benchmarking Studies**

Access to local and regional comparables for reliable pricing defense

✓ **Documentation Preparation**

Master File, Local File, and CbCR – built to meet DGT expectations and OECD standards

✓ **Audit Support & Dispute Resolution**

In case of a challenge, we stand by you with technical defense and representation

Who We Work With



Foreign-owned companies (PT PMA) across industries



Regional HQs coordinating intra-group pricing



Importers/exporters with cross-border goods flow



Service-based groups sharing costs or IP across jurisdictions

Whether you're pricing software licenses, shared services, or tangible goods, we ensure that your structure is compliant, practical, and future-proof.

CONTACT US

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