

TaxFlash



What's new in the latest Advance Pricing Agreement Rules?

As mentioned in our Tax Flash No.03/2015, the Minister of Finance (MoF) recently issued Regulation No.7/PMK.03/2015 (PMK-7) on 12 January 2015 regarding the formation and implementation of an Advance Pricing Agreement (APA). This regulation will be effective from 90 days after the enactment date (i.e. 12 April 2015) and applicable for all outstanding and future APA applications.

PMK-7 sets out the APA process into the following broad stages:

1. Establishment of the APA which includes the following process:
 - a) Preliminary discussions
 - b) Invitation to file an APA application
 - c) APA application
 - d) Discussions on the APA
 - e) Formally completing the APA document.
2. The implementation stage which includes the evaluation of the APA through an Annual Compliance Report (ACR) and the potential to submit a new APA application for subsequent years.

The stages are relevant for both unilateral (UAPA) and bilateral APAs (BAPA). We understand that an additional Director General of Tax (DGT) regulation will be issued to provide more detailed guidance on the implementation of the APA stages.

Who can apply for APA and what is the validity period?

Under PMK-7, an APA application can be submitted by:

- An Indonesian taxpayer or a foreign taxpayer who has a Permanent Establishment in Indonesia; or
- A taxpayer of a treaty country or jurisdiction through their tax authority.

It should be noted that for an Indonesian taxpayer or a foreign taxpayer who has a Permanent Establishment in Indonesia to enter the APA process, it must have been operating or conducting business activities in Indonesia for at least three years prior to entering the APA process.

In accordance with PMK-7, effectively a UAPA will be valid for a maximum of three years. However, in relation to BAPAs, the validity period can be extended to a maximum of four years.

It is clear in PMK-7 that an APA can only be entered into for future tax years. Taxpayers should not expect an APA to be 'rolled-back' to address any transfer pricing (TP) matters in open years in relation to the same/similar transactions. However, as noted in PMK-240 (refer to our [Tax Flash No. 03/2015](#)), the DGT or the Competent Authority of the treaty partner can request a Mutual Agreement Procedure (MAP), as a follow-up to an APA application, to settle any double taxation in accordance with a relevant treaty.

Establishment stage

Preliminary discussions

The purpose of the preliminary discussions (which includes pre-lodgement meetings) is for the DGT and taxpayer to discuss and understand (among other things):

- The merits of an APA and whether it should be a UAPA or BAPA;
- The taxpayer's business operations, related party transactions and intended TP method;
- TP documentation and support information available to allow the DGT to assess the application; and
- The intended effective period of the APA.

During the preliminary discussions, taxpayers will be required to provide documents and other information to the DGT. The purpose of this information is to allow the DGT to attain a detailed understanding of the taxpayer's business operations and intended TP position. While the documents/information requested appear significant, the request appears reasonable and not disproportionate to details multinational companies would provide to other revenue authorities when entering into an APA.

Furthermore, PMK-7 specifically precludes the DGT from initiating an audit based on the information received during this process and is required to hand back all information received during this process if it does not allow the taxpayer to apply for an APA. However, PMK-7 also states that this does not preclude the DGT from initiating audit proceedings from within its normal right to audit.

In addition to the details included in DGT Regulation No.PER-69/PJ/2010 (PER-69), PMK-7 adds a paragraph requiring that an APA must be:

- Based on a real transaction and/or planned transaction based on the taxpayer's management decision;
- In line with TP guidelines and regulations; and
- Not intended solely for minimising tax cost.

The pre-lodgement meeting request must now be submitted at least six months prior to the beginning of the tax year covered in the APA. As with PER-69, the pre-lodgement meeting does not bind the DGT or taxpayer to proceed to further stages.

Invitation for an APA application request

This stage is newly introduced by PMK-7. PMK-7 now requires the DGT to confirm whether or not a taxpayer can continue to the APA application stage. The timeframe and correspondence product for this confirmation are as follows:

- Where the DGT agrees to continue to the APA discussion stage, it will issue an invitation letter to the taxpayer no later than one month prior to the tax year that will be covered in the APA.
- Where the DGT declines to progress further, the DGT will issue a notification letter to the taxpayer no later than one month before the end of the tax year when the pre-lodgement meeting request was submitted.

Given the timelines provided in the regulation, taxpayers are advised to be prepared well in advance so that they can meet the timelines which will have an impact on the start and duration of an APA.

APA application

The supporting documents required as part of the APA application generally remain the same as in PER-69. Documents required during the APA application stage follow from those prepared and provided during the preliminary discussions. Documents required include detailed descriptions of:

- The outcome/result of the preliminary discussions;
- The proposed TP method including any supporting documentation and conditions forming the TP method;
- How the application of the method satisfies the arm's length principle; and
- Critical assumptions; and
- Any other information or documents which aid in supporting the arm's length nature of the APA.

Of course, taxpayers will need to explain and provide details of the transactions to be covered. PMK-7 does not require all of the taxpayer's transactions to be covered by the APA. However, given the effort taxpayers will put into agreeing an APA, ideally they should consider including most if not all transactions in the APA.

From a timing perspective, PMK-7 requires taxpayers to submit the completed APA application before the start of the tax year to be covered in the APA. If a taxpayer does not lodge an APA Application before the start of the intended APA period, the years to be covered in the APA will be reduced by one year. In relation to BAPAs, the validity period of the APA can be discussed between the Competent Authorities.

However, if taxpayers do not lodge an APA application within the first year of the intended APA period, the APA application will not continue to the APA discussion stage.

APA discussion

Once a taxpayer has entered into the APA discussion stage, the DGT will form an APA discussion team. PMK-7 sets out the duties of this discussion team.

The topics of the APA discussion stage will be as follows:

- a. Scope of the transaction and tax year to be covered by the APA;
- b. Comparability analysis, selection, and determination of comparable;
- c. Determination of a proper TP method;
- d. Conditions and factors affecting the critical assumptions in determining the TP method; and
- e. Explanation on whether or not a double taxation exists.

Where the APA is a BAPA, the discussions will occur with the taxpayer but also between the Competent Authorities.

In the case where presumably a UAPA may lead to the potential for double taxation (due to the nature of the transaction or the intended application of the TP method), the DGT can:

- Request a MAP application to the tax authority of a treaty country or jurisdiction; or
- Accept an APA application that is filed by a taxpayer of a treaty country or jurisdiction through their tax authority.

This shows that the DGT may initiate the MAP process which seeks to reduce the potential for double taxation in accordance with the general principles of the APA program and MAP.

The recommendation based on the analysis and evaluation result of the APA Discussion team will be submitted to the DGT and will be discussed together with a DGT quality assurance team.

The APA discussion stage should be undertaken within one year of the APA Application. However, the DGT has acknowledged that in some cases an extension may be required. In relation to BAPAs, the APA discussions will be undertaken in accordance with the timeframe under the MAP proceedings.

The APA discussion phase can result in:

- An agreement with a taxpayer - the APA application is continued to the drafting of an APA document.
- Disagreement with a taxpayer - the APA application is deemed void.
- Agreement with a tax authority of a treaty country or jurisdiction
- Disagreement with a tax authority of a treaty country or jurisdiction can result in either:
 - The APA discussion will only be conducted with the Indonesian taxpayer or a foreign taxpayer who has a Permanent Establishment in Indonesia (i.e. a BAPA reverting to a UAPA); or
 - The APA discussion is terminated.

APA document

The APA document will include all aspects of the APA including transactions to be covered, tax years covered, agreed TP method and its application and critical assumptions.

Implementation stage

The APA is implemented starting the tax year when the APA script is agreed. In the case of an APA involving a tax authority of a treaty country or jurisdiction, the APA is implemented in accordance with the Mutual Agreement.

Evaluation

For evaluation purposes, an ACR shall be submitted within four months of the end of the relevant tax year. The ACR should provide a detailed description of the taxpayer's adherence to the APA document including how the agreed method has been applied and whether any critical assumption has been breached. The ACR content requirement is also the same, which includes:

- the compliance of the taxpayer with the TP method as described in the APA
- a detailed explanation concerning the accuracy and consistency of the TP method application
- a detailed explanation of the accuracy of factors affecting the critical assumptions in determining the TP method.

In the case of a BAPA, the ACR must be submitted within four months after the month of the signing of the APA document.

Where factors affecting the critical assumptions in determining the TP method exist, the taxpayer must notify the DGT. Failure to do this may result in the DGT reconsidering or cancelling the APA. In the case these factors occur, the taxpayer may request for reconsideration or a cancellation of the APA within 30 days from the occurrence of these factors.

PMK-7 provides some items which should be include as critical assumptions including references to changes in or to:

- The taxpayer's business operations;
- The law/regulations or government policies;
- Economic conditions including market forces caused by new competition which have a significant impact on sales volumes, market share, production units; and
- Exchange rates.

While a list of critical assumptions is included in PMK-7, it is not exhaustive; critical assumptions listed in PMK-7 should be carefully considered in conjunction with other matters specific to each taxpayer's position.

Submission of a new application for subsequent years

The provisions relating to submitting a new application for subsequent years in PMK-7 are new and were not previously included in PER-69. The new APA application can be carried out in the last tax year covered in the APA. This new application of the APA is treated similarly to an APA application under the establishment stage.

However, the DGT will consider the agreements made in the existing APA in processing the new APA application. Assuming there are no significant changes to the taxpayer's business operations and it has fulfilled its commitments under the existing APA, you would assume that the new APA application process will be less intensive than the initial APA application.

Key takeaways

PMK-7 provides some additional details to the APA process and additional clarity to taxpayers. The MoF and DGT should be commended for issuing two regulations relating to its international engagement on behalf of Indonesia's taxpayers, especially given the continued global debate around Base Erosion and Profit Shifting.

While we are seeking some clarification on the practical implementation of the APA process as detailed in PMK-7, it does provide a clear process for taxpayers and the DGT to follow. The process and documentation/information requirements should be familiar to most multinationals. With clear timeframes provided in PMK-7, we envisage a faster resolution of APA issues, which is a real positive for taxpayers.

The potential of a new APA application for subsequent years should also add comfort to taxpayers. While APAs are relatively new to the Indonesian tax community, many multinationals have been successfully using APAs for many years to manage their TP position outside of Indonesia.

The issuance of PMK-7 provides taxpayers with an additional avenue to manage their TP position in Indonesia. This includes taxpayers seeking certainty in the future that have traditionally been subject to tax audits in the past.

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