

Advance Pricing Agreement – an update

The Ministry of Finance (MoF) recently issued a Regulation No.22/PMK.03/2020 (PMK-22) regarding the Procedure for implementation of Advance Pricing Agreement (APA).

PMK-22 is effective from 18 March 2020 and revokes the previous APA regulation (MoF Regulation No.7/PMK.03/2015 (PMK-7)).

This TaxFlash highlights the key items in PMK-22 with a specific focus on the changes from PMK-7.

A. Eligibility and Scope

PMK-22 allows an Indonesian taxpayer to submit an APA application to the Directorate General of Taxation (DGT) for its related party transactions. A taxpayer can apply for a Unilateral APA or Bilateral APA. Interestingly, an APA can also be agreed in relation to purely domestic related party transactions. In all cases, the APA period can be up to maximum of five years. This brings Indonesia's APA period in line with many other countries and is longer than the period previously included in PMK-7.

Similar to PMK-7, the APA may cover either all or specific related party transactions. PMK-22 also introduces the potential for the APA's conclusions to be 'rolled-back' to open years, albeit on a limited basis. Specifically, PMK-22 stipulates that a roll-back shall be applicable, so long as:

- a) The facts and conditions of related party transactions do not materially differ with facts and conditions of related party transactions already agreed upon in APA;
- b) The covered fiscal year is not expired based on the statute of limitation;
- c) A Corporate Income Tax Assessment Letter has not been issued; and
- d) Criminal investigation is not being conducted or taxation criminal proceedings is not being conducted.

PMK-22 arguably provides for an expanded definition of a 'special relationship' to which the arm's length principle needs to be applied. In addition to the traditional definition of special relationship linked to ownership and a family relationship, PMK-22 arguably extends the definition by reference to 'dependence or affiliation' and to parties which are 'not independent in doing business or performing activities'. These along with an extended definition of control to include indirect control arguably result in previously independent third-party transactions being considered as a 'special relationship'. An example on this is the case of an independent trading company acting as a conduit between two related parties wherein one or both related parties was responsible for the price setting of the independent party transaction. In which case, the independent trading company is considered a related party and the trading transaction as a related party transaction.

B. Application Procedure

An Indonesian taxpayer must submit an application to the DGT through the tax office where the taxpayer is registered. Many of the items required to be submitted to the DGT as part of the application process are similar to those in the past and include audited financial statements, Corporate Income Tax Return (CITR), transfer pricing documentation and of course the intended application of the arm's length principle to the transactions to be subject to the APA.

PMK-22 changes the eligibility criteria and provides some clarification on which taxpayers are eligible.

Below are the requirements to apply for an APA. A taxpayer must:

- a) have fulfilled the obligation to submit its Annual CITR for three fiscal years prior to the fiscal year for which the APA is being applied;
- b) have been obligated and has fulfilled the obligation to prepare and maintain Transfer Pricing Documentation in the form of master file and local file for three fiscal years prior to the fiscal year for which the APA is being applied;
- c) not be subject to a criminal investigation or taxation criminal proceedings;
- d) only include related party transactions that have already been reported by the Taxpayer in the Annual Income Tax Return (AITR); and
- e) apply the Arm's Length Principle to the related party transactions AND the application of the arm's length principle would not result in a situation where operating profit of Taxpayer is lower than operating profit already reported in the AITR.

Therefore, under the new PMK-22, APAs can only apply to existing transactions and thus taxpayers seeking clarity on business changes or new transfer pricing policies can not do so via an APA. The requirement that the APA not result in a lower operating profit also requires additional clarification as there are cases where the Indonesian taxpayers is earning an operating profit that is above an arm's length amount.

The DGT has publicly stated that it is committed to the APA program and is keen to streamline the APA process. For example:

- Taxpayer does not have to undergo the APA application pre-filing process anymore. Instead, an APA application using the form attached in PMK-22 can be submitted to the DGT 12 months at the earliest and six months at the latest from the start of the APA covered period.
- The DGT will have to issue a notification to the taxpayer that the APA application is eligible for follow-up/discussion no later than one month

from receipt of the APA application. If the DGT did not issue such notification, the APA application is deemed eligible for follow-up.

- Taxpayer is required to submit a complete APA application within two months from the date of the notification, or after one month from date of APA application submission in the case of DGT's failure to issue a notification.
- It is clear that the DGT will also focus its limited resources to those APAs where the parties are equally committed. For example, in the event the DGT issues a notification regarding a Bilateral APA to a Competent Authority of a Treaty Country and does not receive a written response within eight months after the date of written notification, the DGT will issue a written notification terminating the APA process.
- For Unilateral APA, the negotiation must start no later than six months from the date of complete application submission and must be completed no later than 12 months from the start date of the negotiation. Meanwhile, the process for Bilateral APA negotiation shall follow the prevailing MAP regulation.

A "complete" APA application should contain the following (at the minimum):

- a) Financial statement that has been audited by public accountant for the last three fiscal years prior to the fiscal year for which the APA is being applied;
- b) Transfer Pricing Documentation for the last three fiscal years prior to the fiscal year for which the APA is being applied; and
- c) Document containing detailed explanations (in Attachment B of PMK-22) of application of the Arm's Length Principle for every Related Party Transaction being suggested to be covered in the APA, written in Bahasa Indonesia.

In the event that the completeness of APA application is not fulfilled by the taxpayer, the DGT will issue a notification regarding the termination of APA process to taxpayer and Competent Authority of Treaty Country (for Application of Bilateral APA).

For some reason, PMK-22 includes a lot of general transfer pricing material already stipulated in other transfer pricing related regulations. In addition, PMK-22 continues to allow the DGT to undertake an 'audit for other purposes' to confirm information submitted by the Taxpayer. Whilst the term 'audit' is used, we understand the reference is to the DGT's ability to gain comfort as to the authenticity of the information (such as Functions, Assets and Risks of taxpayer), rather than an audit of the Taxpayers taxes which could lead to an adjustment.

Overall, the implementation process is similar to PMK-7 albeit with some differences in timelines. Of particular note, however, is that the DGT will allow a taxpayer to apply for a Unilateral APA in the scenario where a Bilateral APA could not be negotiated/finalised.

For APAs currently in the process of submission or negotiation with the DGT, the further processing of those APAs will be undertaken in accordance with PMK-22. Taxpayers should discuss their specific situation with the DGT, however given the overall similarity of the implementation process with PMK-7, this should not (in most cases) result in a significant delay to the APA.

C. APA Application Withdrawal and Renewal

Taxpayer may file a withdrawal of the APA application (using the form attached in PMK-22) before the APA negotiation has been completed. However, once the APA has been withdrawn, Taxpayer could not re-

submit the APA application for the fiscal years previously covered in the withdrawn APA application.

Conversely, a Taxpayer may submit an APA renewal application to the DGT within a period of 12 months up to six months before the last fiscal year in the previous APA Period.

D. Others

PMK-22 stipulates other provisions which include:

- The DGT shall not make any Transfer Pricing correction on the covered transactions that were conducted in accordance with the agreed terms of the finalised APA.
- APA process will be terminated if taxpayer has become a subject of tax crime investigation or is undergoing tax crime proceedings.
- Taxpayer's documents and information used during the APA process cannot be used by the DGT for other purposes.

E. Application to Existing APA Requests/Negotiations

- PMK-22 applies to all applications and renewals submitted after the issuance of the regulation.
- For pre-filing of APA application requests received by the DGT prior to PMK-22, the APA application can be submitted based on the provisions of PMK-22.
- For APA applications and APA renewals already in process prior to PMK-22, the provisions of PMK-22 shall apply.
- APA finalised prior to PMK-22 shall be implemented based on the provisions of PMK-22 but will be evaluated.

Concluding Comments

An APA continues to be a viable solution to manage a Taxpayer's Indonesian transfer pricing position. Whilst the express inclusion of roll-back provisions and the DGT's commitment are welcomed, the new PMK-22 regulation does not materially alter a Taxpayer's decision as to whether an APA is a suitable alternative to navigating the Indonesian transfer pricing landscape.

As in the past, Taxpayers should undertake a feasibility analysis to assess whether the APA is suitable to their position and whether they themselves are ready to apply for and implement an APA in their organisation.

PwC has been involved in the negotiation of many APAs and is uniquely positioned to assist Taxpayers navigating the APA process from the initial feasibility analysis, through to the final agreement of the APA.

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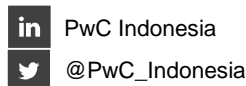
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