



Indonesia Transfer Pricing Alert April 2020

Indonesia releases revised guidance on Advance Pricing Agreements

Following the issuance of the revised Mutual Agreement Procedure (MAP) regulation¹ last year (please refer to [Tax Alert May 2019](#)), the Minister of Finance recently issued a new regulation number 22/PMK.03/2020 (“PMK-22”) on the implementing guidelines for Advance Pricing Agreements (“APA”).

PMK-22 seeks to align the APA regulation with the broader objectives of [Action 14](#)² of the Organization for Economic Co-operation and Development (OECD) and G20’s Base Erosion and Profit Shifting (“BEPS”) project and provides 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, PMK-22 replaces the previous APA regulation and applies to all pending and ongoing APA application. This alert highlights the key features of the new APA guidelines.

¹ Minister of Finance of the Republic of Indonesia Regulation Number 49/PMK.03/2019 concerning The Implementation Guidelines of Mutual Agreement Procedure (“PMK-49”) issued on 26 April 2019.

² OECD (2015), *Making Dispute Resolution Mechanisms More Effective, Action 14 - 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris. <http://dx.doi.org/10.1787/9789264241633-en>.

1. Broadened coverage of the APAs

As one of the most significant features of this new guidance, PMK-22 has broadened the coverage of an APA as follows:

- a. Extends the covered period of bilateral and unilateral APAs to 5 (five) years (compared to 3 (three) years for unilateral and 4 (four) years for bilateral APA under the previous regime);
- b. Reintroduces a roll-back provision whereby prior years can be covered in the APA, albeit subject to meeting certain conditions (detailed in the subsequent sections); and
- c. Allows taxpayers to propose domestic transactions as part of the APA. This is a welcome clarification since it addresses the concerns of domestic business groups with significant domestic related party transactions who have been subject to increasing level of scrutiny lately.

2. Roll-back of APAs

As mentioned above, PMK-22 reintroduces roll-back of both unilateral and bilateral APAs. This is a welcome change, which seeks to align the Indonesian APA framework with the minimum standards in Action 14 of BEPS and will help to avoid potential dispute for the open (unaudited) fiscal years. PMK-22 imposes the following conditions on the proposed years for the rollback to apply:

- a. The facts and conditions of the related party transactions do not differ materially to the facts and conditions of the related party transactions covered in the APA;
- b. The statute of limitation has not passed;
- c. The Corporate Income Tax ("CIT") Assessment Letter for the subject year has not been issued; and
- d. The taxpayer is not under tax crime investigation or charged with taxation crime.

Considering the statute of limitation in the prevailing Income Tax Law, one could assume an APA roll-back for a maximum 5 (five) fiscal years under this new regulation.

3. Additional conditions to apply for APA

Under the previous APA regulation, only taxpayers that have been operating or doing business for at least 3 (three) years were eligible to apply for an APA. PMK-22 has imposed additional conditions, as listed below:

- a. The taxpayer has filed CIT Return for the previous 3 (three) fiscal years prior to the APA application;
- b. The taxpayer has prepared and maintained the Master File and Local File for the previous 3 (three) fiscal years prior to the APA application;
- c. The taxpayer is not under tax crime investigation or charged with taxation crime;
- d. Related party transaction(s) and related party(s) proposed to be included in the APA have been declared by the taxpayer in its Annual CIT Return for the previous 3 (three) fiscal years prior to the APA application;
- e. The proposed transfer pricing is based on the Arm's Length Principle ("ALP") and does not make the taxpayer's operating profit lower than that declared in the Annual CIT Return of the previous 3 (three) fiscal years.

Understandably, the regulation expects taxpayers to be compliant with their transfer pricing requirements during the previous years. Further, it provides an indication that the likely agreement under the APA could not be tax disadvantageous to Indonesia vis-à-vis the previous 3 (three) fiscal years.

4. Simplified application process

Another noteworthy amendment is that PMK-22 has simplified the APA application process. The single-step application under PMK-22 comprises an APA application form that requires information on the following:

- a. Summary of the proposed application of the ALP for the covered related party transaction;
- b. The historical application of the ALP in the last 3 (three) fiscal years;
- c. Relevant transfer pricing dispute history from tax audit stage until tax appeal stage in the last 5 (five) fiscal years, as well as the taxpayer's statements of profit or loss in the last 5 (five) fiscal years; and
- d. Projected statements of profit or loss for the proposed APA period.

Such application form should be accompanied with written statements stating that the taxpayer is willing to submit all the required documents during the APA process and would adhere to the APA.

Once the Directorate General of Taxes (“DGT”) confirms the acceptance of the application, certain documents are required to be submitted, including amongst others, the audited financial statements for the last 3 (three) fiscal years, transfer pricing documentation for the last 3 (three) fiscal years, and a document containing detailed explanation regarding the application of ALP for each related party transaction that is proposed to be covered in the APA.

Subsequently, the DGT will conduct material testing (such as site visits, fact-finding, meetings/interviews, etc.) for validation. Additionally, the DGT may direct an audit for other purpose if the proposed related party transaction to be covered in the APA has never been audited in the previous 3 (three) fiscal years prior to the APA application and/or if the APA application covers roll-back years.

The result of the APA negotiation would be in the form of an APA Document for unilateral APA and a Mutual Agreement for bilateral APA.

5. Time-bound process

PMK-22 sets out clear timelines for the required follow-up actions from DGT as well as the taxpayers in relation to the APA application.

- a. *Submission of application* – The application shall be submitted within a period of 12 (twelve) to 6 (six) months prior to the beginning of the proposed APA period. PMK-22 provides definitive timelines for the following follow-up actions after an APA application is received by the DGT:
 - (i) Review the application submitted by the taxpayer and issue a written statement on whether the APA application can be proceeded³;
 - (ii) Submission of required documents by taxpayers;
 - (iii) Receipt of the statement from the treaty partner country for a bilateral APA;
 - (iv) Negotiation process;
 - (v) Submission of unilateral APA application if bilateral APA negotiation results in disagreement or the bilateral APA application has been discontinued by the DGT due to lack of response from the treaty partner country;
 - (vi) Issuance of the decision letter by the DGT for enforcement of APA pursuant to the APA Document/Mutual Agreement.
- b. *Conclusion of negotiation* – The negotiation process shall adhere to the following timelines:
 - (i) Unilateral APA – the negotiation commences at the latest 6 (six) months after the submission of required documents by the taxpayer and is required to be concluded within 12 (twelve) months from the commencement of the negotiation;
 - (ii) Bilateral APA – the negotiation is required to be concluded within 24 (twenty-four) months from the receipt/submission of the written APA application from the treaty partner country.

PMK-22 does not provide for extension to this timeline and is explicit in saying that the APA will result in “disagreement” if an agreement is not reached within the specified timelines.

6. Withdrawal of APA application

PMK-22 sets out the steps, conditions, and consequences of withdrawing an APA application. Essentially, the withdrawal of APA application must be submitted before an agreement is reached and it should state the reason for withdrawal. The DGT then will issue a written statement within 10 (ten) days from receiving the withdrawal of APA application. If the withdrawal of APA application is submitted after the APA negotiation process commences, the taxpayer will not be able to re-submit the APA application for the fiscal years covered in the withdrawn APA application.

³ Within the period of 1 (one) month upon receiving the application.

7. Result of the negotiation: agreement or disagreement

Both APA Document and Mutual Agreement would outline the result of negotiations specifying the conclusions reached. Other than the case discussed above where the negotiation time limit is exceeded, the DGT may disagree to approve an APA in the following circumstances:

- a. The related party transaction lacks economic motive;
- b. The economic substance of the related party transaction is different from its form;
- c. The related party transaction is undertaken with the purpose of minimizing tax burden;
- d. Information and/or evidence or statement submitted by the taxpayer is untruthful or not in accordance with the actual condition;
- e. Information and/or evidence or statement 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
- f. The tax years covered in the proposed APA period or roll-back years has been issued with CIT Assessment Letter.

8. Implementation of APA

PMK-22 requires that taxpayers implement the agreed APA in their Transfer Pricing policy and document the implementation in the Transfer Pricing Documentation for the covered APA period.

Further, within 1 (one) month from the issuance of the DGT's decision letter on the enforcement of the APA, the taxpayer shall revise the CIT Return(s) that become(s) underpaid because of APA and yet to be audited for the year(s) covered in the APA. However, if a tax audit has been initiated for the year(s) covered in the APA, the DGT can either issue the CIT Assessment Letter or revise the issued CIT Assessment Letter to implement the APA.

9. Evaluation and judicial review of the APA

Unlike the previous regime, PMK-22 does not require submission of annual compliance report by the taxpayer to the DGT; however, the regulation expects APA compliance to be documented in the Transfer Pricing Documentation. PMK-22 allows the DGT to conduct an APA evaluation, by exercising similar authority the DGT has for material testing. Based on the evaluation result, the DGT may conduct APA judicial review or cancellation of APA before the APA period ends.

The APA judicial review can also be conducted upon the request of the taxpayer due to the changes in the critical assumptions. The result of APA judicial review negotiation would be in the form of revised APA Document / Mutual Agreement.

The result of APA evaluation can be the cancellation of APA, if it is identified that the taxpayer has submitted false information and/or evidence or description that are either not consistent with actual conditions; and/or has not submitted the information and/or evidence or description that can have an impact on the APA agreement. In such a case, the taxpayer will not be able to re-submit APA application for the APA period covered in the cancelled APA and may consequently result in tax audit, initial evidentiary assessment and/or investigation.

10. Renewal of the APA

PMK-22 allows renewal of existing APA for one consecutive APA period⁴ if the facts and conditions in the previous APA remain the same. The application for APA renewal should be submitted in a prescribed format within a period of 12 (twelve) to 6 (six) months before the beginning of the last year of the existing APA period. Upon such application, the DGT will directly conduct material testing as opposed to the previous regulation that treated renewal of APA as a new APA application.

⁴ Referring to the fiscal years covered in the existing APA.

11. Guidelines on the application of the ALP

It is interesting to note that elaborate guidelines on the application of ALP have been included in PMK-22, which in some cases, deviate from the existing transfer pricing regulations. These guidelines include *among others*, expanded definition of transactions affected by Special Relationship, the use of “an arm’s length point” or “a point within the arm’s length range”, detailed explanations on each comparability factor, the use of valuations as a transfer pricing method and hierarchy of transfer pricing methods.

While these guidelines provided in the PMK-22 are expected to have more weight during APA negotiation, it will be interesting to see how these will be implemented in case of any potential contradictions with the existing regulations. In any case, this regulation mentions that a separate DGT regulation on the application of ALP guidance will be issued in due course.

12. Other considerations

PMK-22 reaffirms the position that an APA shall not prevent the DGT to conduct audit, initial evidentiary assessment, or crime investigation in taxation. In the case such process is initiated, the DGT could not make any transfer pricing correction on the transactions covered in the APA. This however will not be applicable in the case where the taxpayer:

- a. Has submitted an annual CIT Return for which the transfer pricing is inconsistent with the APA;
- b. Has not submitted the required revision of the annual CIT Return for the purpose of APA implementation within the prescribed timeline;
- c. Has submitted the required revision of the annual CIT Return for which the transfer pricing is not consistent with the APA; or
- d. Has not submitted any annual CIT Return for the tax year covered in the APA period.

PMK-22 provides that if the APA process does not result in an agreement, all the taxpayer’s documents used during the APA process would be returned to the taxpayer and will not be used as the basis to conduct audit, initial evidentiary assessment, or crime investigation in taxation. PMK-22 clarifies the application of the secondary adjustment whereby the difference between the value of the transactions affected by Special Relationship and the arm’s length value would be considered as dividend that is subject to Income Tax. Further guidance on the APA implementations would be issued under a separate DGT Regulation.

13. Our comments

The experience in several countries has shown that APAs can play an instrumental role in minimizing transfer pricing disputes and provide more certainty to businesses, especially since BEPS implementation and adoption of Country-by-Country reporting requirements have led to increased audit activity in many countries. In these circumstances, detailed and elaborative guidance under PMK-22 is a welcome move by the Indonesian Government, which will help to eliminate the uncertainty surrounding the process and timelines. The expanded coverage and reintroduction of the “roll-back” is of course the cherry on the cake!

The simplified and strengthened APA framework surely deserves closer evaluation when multinational groups design their controversy management strategies in Indonesia.

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