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Transfer pricing – documentation to be attached to annual tax returns

- Reg. 32/2011 requires that transfer pricing documentation be attached to the annual CITR filed with the tax office
- Detailed guidance is awaited

MAP – objections and appeals are no longer a deal breaker

- MAP may be pursued simultaneously with tax objections or appeals
- If an appeal decision is issued before a mutual agreement is achieved, the DGT will immediately terminate the MAP
- Reference should be made to the relevant tax treaty for the time limit within which MAP can be pursued

APA – one way to mitigate the risk of transfer pricing disputes

- Taxpayer and the DGT may agree in advance the transfer prices for certain related party transactions in an APA
- Taxpayers are considered complying with the ALP if they satisfy the criteria agreed in the APA.

Transfer pricing

Documentation to be attached to annual tax returns

Transfer pricing documentation must be attached to the annual corporate income tax return (CITR) submitted to the tax office. That is part of the wording of Reg. 32 issued in late 2011 about the application of arm's length principle (ALP) on related party transactions. The regulation amended Reg. 43/2010 issued in 2010.

Reg. 32 adds that the documentation should consist of a master file and a set of enclosures. No further elaboration is provided. Detailed guidance may be covered in the regulation dealing with the 2011 CITR yet to be issued.

Until last year, as far as transfer pricing is concerned, companies were only required to disclose certain information about related party transactions and state the level of documentation they had in the CITR. This approach is similar with the one applied by many other countries. The new requirement may make Indonesia one of few countries, if any others, calling for transfer pricing documentation submission in annual tax filing.

Many countries require that annual tax returns present arm's length results of related party transactions. However, instead of requiring submission of transfer pricing documentation upon annual tax return filing, they call for contemporaneous documentation by the time the annual tax return is filed.

Even so, several countries do not require strictly contemporaneous documentation. Rather, they provide that taxpayers may be freed from some or all penalties resulting from a transfer pricing correction if contemporaneous documentation is available by the time the annual tax return is filed. Delivery of the documentation is required only during the tax audit, generally within a strict time period, e.g., 30 days of the request date.

Reg. 32 may does create an additional burden, especially to companies whose book year ends on 31 December as they have to file 2011 CITRs by 30 April 2012. However the regulation has also given some relief now that domestic related party transactions, with a few exceptions, and cross-border transactions worth less than IDR 10 billion a year with a single related party are excluded from the transfer pricing documentation requirement.

In sum, in light of Reg. 32, 2011 transfer pricing documentation needs to be prepared and completed before CTR filing date. Please note that failure to provide any required documents, including transfer pricing documentation, may render the CTR incomplete which may further result in the rejection of the CTR filing.

Mutual agreement procedure

Objections and appeals are no longer a deal breaker

Mutual agreement procedure (MAP) is the procedure available under a tax treaty to solve problems facing a taxpayer pertaining primarily to (potential) double taxation arising from the actions of one or both contracting states concluding the tax treaty. This may be initiated by the taxpayer presenting his case to the competent authority of the contracting state of which he is a resident.

Until last year, MAP was only available for cases not brought to an objection or an appeal. If an objection or an appeal is underway for a particular case, MAP could only be pursued if the objection or the appeal is cancelled.

This is no longer the case under Government Regulation (GR) No. 74/2011 issued in late 2011 and came into force in January 2012. As MAP and objections or appeals may go on simultaneously, MAP may serve as an alternative or a complement to the remedy provided by domestic tax legislation. However, if the tax court issues an appeal decision before a mutual agreement is achieved, the DGT will immediately terminate the MAP.

MAP provisions of a tax treaty generally require the competent authorities to follow up a MAP request filed by a taxpayer with a view to finding an acceptable solution to his problem. If the case is considered eligible for MAP, the tax authority concerned may proceed to deal exclusively with the taxpayer alone or go through negotiations and dealings with the competent authority of the other country.

Under GR 74, if a mutual agreement is ultimately achieved and accepted by the taxpayer, the DGT may revise the tax assessment letter or tax objection decision letter related to the case covered in the MAP. If no mutual agreement is reached, then the tax assessment letter or the objection decision letter (in dispute) should prevail. In this regard, the taxpayer may still have recourse to the objection or appeal.

Companies facing tax disputes related to the application of tax treaty provisions may consider pursuing MAP while an objection or an appeal of the same case is underway. Transfer pricing corrections may be one of the issues that potentially give rise to such problems.

Please note, however, that MAP must be pursued in a specified time period, normally within two to three years of the date of notification of the action giving rise to the problem. We suggest checking at the relevant tax treaties.

Advance pricing arrangement

One way to mitigate the risk of transfer pricing disputes

The traditional approach to deal with a transfer pricing issue is to deliberately establish the arm's length character of the related party transaction concerned. This is transfer pricing documentation is all about. The next step is to present the transfer pricing documentation to the tax authority (DGT), normally during a tax audit, or in light of Reg. 32, attach the documentation to the CITR filed with the tax office.

Unfortunately, there is no guaranty that the DGT will approve the conclusion covered in any transfer pricing documentation. If the DGT's conclusion is different, this may entail a transfer pricing correction. It is from this point that a transfer pricing disputes may arise between the taxpayer and the DGT.

While an objection and an appeal (possibly in combination with MAP) offer a remedy should the potential dispute materialize into a tax assessment, taxpayers may consider an agreement with the DGT in advance of the envisaged transactions. This is an advance pricing arrangement (APA) is all about.

GR 74 outlines the APA format. Basically an APA is binding on the DGT and the taxpayer and, if agreed by the parties concerned, the tax authority of a particular treaty partner country whose resident is involved in the related party transaction. It also states that the DGT cannot make any corrections on areas agreed in the APA.

The DGT has provided the procedure to pursue an APA by Reg. 69/PJ/2010 issued in 2010 which may be revised pursuant to the issuance of GR 74. This includes the following stages:

- *Application for a pre-lodgment discussion.* The taxpayer is to apply in writing for a preliminary discussion with the DGT. If the DGT approves, discussions between the DGT and the taxpayer may follow. Within 3 months of the receipt date of the application, the DGT is to notify the taxpayer in writing whether or not the discussion can be continued to the next stage. If the DGT states that it cannot be continued, the taxpayer is allowed to reapply a pre-lodgment discussion.

- *Filing an official application for APA.* If the DGT states in its notification to the taxpayer that the preliminary discussions may be continued to the next stage, the taxpayer is to file an official application for APA.
- *Discussion of the APA.* After an official application for APA is filed, the taxpayer and the DGT will hold intensive and comprehensive discussions with a view to achieving an agreement on the transfer pricing of the related party transactions under consideration. At this stage, they may discuss and decide whether or not to involve the tax authorities of other countries. The regulation does not specify the time limit during which the discussion should go on.
- *Issuance of an APA document.* Within 20 days after the completion of the APA discussion, a written APA document must be prepared and signed by the taxpayer and the DGT. The APA may be in force prospectively for a maximum of 3 years. However, the DGT is also open to a roll back application of the MAP.
- *Implementation and evaluation of the APA.* Once agreed, an APA must be implemented. In essence, the taxpayer is considered in compliance with the arm's length principle if he satisfies the criteria agreed in the APA. Annual compliance report is required from the taxpayer at this stage.

It may be worth pursuing APA for some particular related party transactions. A higher degree of certainty may be gained than that achievable through a traditional approach for some related party transactions for which determining the arm's length price is difficult due primarily to the absence of comparables.

Care should be taken, however, that a unilateral APA may give rise to a double taxation if the tax authority of the other country does not agree with the APA. It may therefore be worth involving the tax authority of the other country.

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