SAFE HARBOUR: A PREDETERMINED MARGIN METHOD TO REDUCE TRANSFER PRICING COMPLIANCE BURDEN

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Abstract
The safe harbour provision was unpopular since the beginning of transfer pricing (TP) implementation in Indonesia, even though this provision has been well-known in several countries. Indonesia’s existing safe harbour provision has solely governed the threshold on TP documentation obligation that could not offer certainty about tax audit treatment. The TP threshold refers to the total transaction volume per fiscal year with an affiliation that allows taxpayers to get relief from submitting TP documentation. A deemed profit also applies to a certain manufacture contract. With current provisions, the TP burden of taxpayers and tax administration could not reduce because no certainty on the tax audit exemption with the existence of the threshold provision. Therefore, it needs to improve the safe harbour rule to enhance the certainty manufacturer and reduce the administrative burden.

Keywords: transfer pricing, safe harbour provision, arm’s length, international taxation.

Intisari
Ketentuan safe harbour sebagai bagian dari ketentuan transfer pricing (TP) belum populer di Indonesia, meskipun ketentuan tersebut cukup populer di berbagai negara. Ketentuan yang ada di Indonesia saat ini hanya terkait penentuan ambang batas kewajiban pendokumentasian TP yang belum memberikan kepastian hukum terkait pemeriksaan pajak. Ambang batas tersebut diperhitungkan berdasarkan total volume transaksi dengan afiliasi selama satu tahun fiskal yang memungkinkan wajib pajak mendapatkan keringanan dari penyerahan dokumansasi TP. Selain itu, terdapat ketentuan deemed profit (perkiraan keuntungan) bagi perusahaan kontrak manufaktur tertentu. Ketentuan saat ini belum mampu mengurangi kewajiban administratif TP bagi wajib pajak dan otoritas pajak karena tidak adanya kepastian bahwa wajib pajak yang tidak memenuhi ambang batas. Oleh karena itu, diperlukan penyempurnaan atas ketentuan yang berlaku saat ini untuk menciptakan ketentuan safe harbour yang memberikan kepastian dan pengurangan beban administrasi.

Kata Kunci: transfer pricing, ketentuan safe harbour, arm’s length, perpajakan internasional.
A. Introduction

Applying the arm’s length rule to all types of transactions then performing the tax audit may lead to overuse of resources. Organisation for Economic Co-operation and Development (OECD) also noted that the audit should be done on the risky, big and complex transactions.\(^1\) The transfer pricing documentation obligation might become more complex when Indonesia has agreed to adopt consensus globally, implementing three-tier documentation suggested by Base Erosion and Profit Shifting Action (BEPS),\(^1\) in 2015 and effective in 2016. The existing TP regulation is mentioned through Ministry of Finance Regulation No. 213/PMK.03/2016 obliged the entities with special relation to document the master file, local file and country-by-country reporting as the mandatory supplement to the corporate income tax report.\(^2\) Certainly, this new policy will enhance the transaction transparency among entities within a group of multinational enterprises (MNE).\(^3\) However, it will add another new burden to businesses with a certain scale.\(^4\) Therefore, it is suggested to specify certain transactions performed by the small taxpayers or less complex transactions to be exempt from TP documentation obligation.\(^5\) In several countries, they have applied safe harbour or so-called ‘predetermined margin method’ (PMM) and other simplified measures to minimize the challenges and hassle between the tax authority and taxpayer to justify whether the transaction has been considered comparable or on arm’s length price. This method has been assumed able to reduce the burden of ‘audit cost’ significantly.\(^6\) Since the initial safe harbour provisions, it has been acknowledged that applying the arm’s length principle will be a fact-intensive process, then applying the arm’s length rule will require a proper judgement.\(^7\)

Based on the OECD survey in 2012, the responses received from OECD and non-OECD countries, it was found that there has been the intention of TP simplification rule in their domestic tax law. The key drivers of this policy choice might be the high burden disproportionate to the size of the taxpayer’s

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activities, the function is performed, and the risk it bears on the controlled transaction.\(^8\) The categories of simplification rule are the following: (i) exemption of TP adjustment on the TP rule; (ii) simplification of TP method and application of safe harbour such as safe harbour arm’s length ranges/rates and safe harbour interest rates; (iii) exemption from or simplification TP document required; and (iv) simplification from advance pricing agreement (APA) procedures.\(^9\)

It might be said that the developing countries are the group of countries that are still more challenging to deal with TP disputes.\(^10\) Implementing the safe harbour has been considered preventive dispute resolution through an administrative approach to reduce the disputes or the potential of litigation.\(^11\) The safe harbour implementation has followed the nature of presumptive taxation of a particular category of taxpayers.\(^12\)

Since the early stage of TP implementation is effective in Indonesia, the study suggests implementing safe harbour has arisen. Lack of available data before TP report, lack of human resources understanding the TP engaged in Indonesian tax authority (Directorate General of Taxes), then added by

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8. OECD, “Revised Section E on Safe Harbours in Chapter IV of the Transfer Pricing Guideline,” 6.

9. Silberztein, “International - OECD: Transfer Pricing Safe Harbour,” 63-71. Silberztein resumed the summary of OECD finding about TP simplification, the resume are the following: (i) 33 out of 40 countries have applied TP simplification measure; (ii) almost 75% of available simplification rule is directed to the SMEs, small transaction and low value-adding intra-group services, i.e. transaction with limited risk; (iii) the countries indicating the favourable simplification rule to SMEs are the following: Australia, Belgium, Canada, China, Colombia, Denmark, Estonia, Finland, France, Germany, Hungary, Ireland, Italy, Mexico, the Netherlands, Norway, Portugal, Slovak Republic, Spain, the United Kingdom and the United States; (iv) the countries offering simplification treatment to small transaction consists of Australia, Hungary, Colombia, Denmark, Poland, Portugal, Russia, Spain, Sweden and the United States; and (v) The countries providing simplified systems to low value-adding intra-group services consist of Australia, Austria, Hungary, Japan, the Netherlands, New Zealand, Singapore and the United States.


12. For example, India has applied the safe harbour rule for a certain threshold acceptable to the tax authority. For the eligible taxpayers, they must not maintain the comparability documentation and benchmark. See, S. Sanghvi & S. Sagar, “Managing Tax Disputes – Some Legal and Practical Strategies”, Asia-Pacific Tax Bulletin 20, no. 4 (July 2014): 242-246.
countless numbers of less risky manufacturer operating in Indonesia were the main reasons of that proposal.\(^\text{13}\) The increasing number of tax cases brought to the tax court is another consideration for proposing safe harbour.\(^\text{14}\)

Until decades of TP rule has been effective in Indonesia, current safe harbour rule in Indonesia as governed in domestic TP rule has been solely the threshold of documentation on TP obligation exemption for the certain taxpayers. This provision is based on the Article 3(4) of Directorate General of Taxes Regulation No. 32/PJ/2011. The former research about the implementation of safe harbour provision in Indonesia mentioned that the current safe harbour regulation had not offered the certainty and ease of administration both for the taxpayer and tax auditors.\(^\text{15}\) The detail of the technical aspect on the application of the safe harbour rule has not been established, which should be functioning to increase the degree of certainty.

Further, the discussion to comprehend the safe harbour provision remains on the tax policy makers’ planning without clear progress.\(^\text{16}\) It has not been concluded to what extend the current safe harbour rules should be enhanced, and it has not become one agenda on the improvement of the latest TP regulation.\(^\text{17}\) On the other hand, the tax authority, specifically tax auditors, want to optimize and focus their resources to monitor and handle high-risk transactions or a substantial amount of transactions.\(^\text{18}\) This article intends to discuss the current stage of safe harbour rule in Indonesia, the challenges of

\(^{13}\) Sujahto Ramang, “Analisis Struktur Contract Manufacturing dalam Global Supply Chain Management Perusahaan Multinasional Ditinjau dari Ketentuan Perpajakan Transfer Pricing” (Research Report, Faculty of Economics University of Indonesia, 2010), 78-100.


\(^{15}\) Mikail Jam’an, “Tinjauan atas Ketentuan Transfer Pricing di Indonesia: Studi Banding atas Ketentuan Analisa Kesebandingan & Dokumentasi” (Master Thesis, Faculty of Economics and Business University of Indonesia, 2011), 62-80.


\(^{17}\) After the improvement of TP rule as the act of Indonesia commitment to implement BEPS Project, the former improved TP rules are solely regard to: (i) redefinition of special relation (Ministry of Finance Regulation No. 22/PMK.03/2020), Advance Pricing Agreement (Ministry of Finance Regulation No. 22/PMK.02/2020 and Director General of Taxes Regulation No. PER-17/PJ/2020), Mutual Agreement Procedure (Ministry of Finance Regulation No. 49/PMK.03/2019 and Director General of Taxes Regulation No. PER-16/PJ/2020).

\(^{18}\) Tax Auditor of Large Taxpayer Office, Interview, September 2019.
implementing safe harbour, and the possibility of improving the current ‘safe harbour-like regulation in Indonesia.

This research uses a qualitative approach to analyze social problems through a deep understanding of the problems. The research is qualitative descriptive, and the objective is to provide a specific overview of the condition, phenomenon, or social indications.\textsuperscript{19} Specifically on the discussion of the current stage of safe harbour rule in Indonesia, the challenges of implementing safe harbour and the possibility to improve current safe harbour-like regulation in Indonesia. According to the timeframe of the research, this research is cross-sectional research since it is conducted in a particular period.\textsuperscript{20} This research used qualitative data from the literature review and documentation study. The literature used in this research includes books, articles, and electronic publications. The information was received from the in-depth interview with various parties, i.e. Directorate General of Taxes (DGT), tax practitioners, and the taxpayers.

B. Fundamental Aspect of Safe Harbour on TP Rule

The safe harbour rule implementation has received considerable attention from many countries during the past years. The OECD also has analyzed the possibility, the benefit and the drawback of this rule.\textsuperscript{21} Following the OECD in Revised Section E on Safe Harbours in Chapter VI of the Transfer Pricing Guidelines 2013, it defines safe harbours as the following. This definition is the approved definition by OECD to be inserted in section E Chapter IV of OECD Transfer Pricing Guidelines.\textsuperscript{22}

“A safe harbour in transfer pricing regime is a provision that applies to a defined category of taxpayers or transactions and that relieves eligible taxpayers from certain obligations otherwise imposed by a country’s general transfer pricing rules. A safe

harbour substitutes simpler obligations for those under the general transfer pricing regime. Such a provision could, for example, allow taxpayers to establish transfer prices in a specific way, e.g. by applying a simplified transfer pricing approach provided by the tax administration. Alternatively, a safe harbour could exempt a defined category of taxpayers or transactions from the application of all or part of the general transfer pricing rules. Often, eligible taxpayers complying with the safe harbour provision will be relieved from burdensome compliance obligations, including some or all associated transfer pricing documentation requirements.”

The scope of the safe harbour rule generally covers the following: (i) it may apply to the small transactions and is categorized as routine activities with low value-adding, and (ii) it should not involve a complex transaction, valuable intangible or core transaction.23 Thus, it could be said that the initiative proposed by United Nations (UN) and OECD is to apply a simplification to the LVAS (means the transaction a supportive form to the whole business activities, not part of substantial value creation to an MNE group or not a core activity, not a part of exploitation to intangibles bearing significant economic value).24

Following the safe harbour discussion draft, the basic benefit of the safe harbour is the following:

a. Simplified compliance rules and costs for the eligible taxpayers in determining the documentation for qualifying controlled transactions.

b. Providing certainty to the eligible taxpayer, performing qualifying controlled transactions with the amount acceptable to the tax authority. For those transactions, the tax authority will exempt the TP audit.

c. Allowing the tax administration to reduce its audit resources to less risk transaction

Therefore, the provision of the safe harbour may take different forms. For example, the safe harbour is applied if the transaction reported was based

on a pre-specified TP method that is connected with an associated level or range of financial indicators for a defined category of transactions, such as the cost-plus method with a not less than 5% net profit margin or another method that could be considered has been fulfilled the TP regime.\textsuperscript{25} However, the several identified main concern discussed in the safe harbour draft need to take note such as: (i) implementation of a safe harbour in a given country possibly leading to taxable income being reported that is not by the arm’s length principle; (ii) safe harbour may increase the risk of double taxation or double non-taxation when adopted unilaterally; (iii) safe harbour potentially open avenues for inappropriate tax planning; and (iv) safe harbours may raise issues of equity and uniformity of tax treatment.\textsuperscript{26}

Safe harbour application will provide more benefits to the tax authority’s work in the countries that apply safe harbour provisions where taxpayers are incorporated. On the other hand, the existence of safe harbour provisions will not benefit similar to the tax authorities of counterparties because there will be a possibility of a decrease in income or the reported profit undertaken by taxpayers solely to meet the safe harbour provisions in the country applying safe harbour. This will raise the issue of a profit shifting between tax jurisdictions. Suppose the tax authority in the counterparty transaction assumed an indication of a profit-shifting behaviour existed. In that case, it might drive the tax authority of the opposite party to conduct a test of the reasonableness of the transaction carried out. Therefore, there is a possibility for a correction that results in the taxpayer being subjected to double taxation. The possibility of double taxation for taxpayers, who choose to apply safe harbour provisions, will only be recognized by the counterparty taxpayer if the taxpayer can prove that the results of fulfilling safe harbour requirements are acceptable according to the principle of business fairness and arm’s length.\textsuperscript{27}

Every country will always desire that tax revenue in his country will


\textsuperscript{27} OECD, \textit{Transfer Pricing Guidelines for Multinational Enterprises and Tax Administration 2017}, 212.
not outflow to another country.\footnote{Ibid.}

About the practical aspect, on the OECD discussion, there were general agreement on the implementation of safe harbour to low-risk manufacturing, low-risk distributing services activities, low-risk financial services and low-risk Research and Development (R&D) services.\footnote{OECD, “Revised Section E on Safe Harbours in Chapter IV of the Transfer Pricing Guideline”, Annex; Cardoso & Petruzzi, “Simplifying the Transfer Pricing Analysis: An Illusory Chimaera or a Realistic Ambition?”, 12, mentioned that for the remuneration, the range of margin could be determined by undertaking the benchmarking considering the geographical circumstances or industrial types to make the simplification more widely accepted. It might be important to highlight that a limited risk R&D located in India may have a different allocation of remuneration to the activities in Norway, as cost of labour may be quite different in these two regions.} On the other side, another opinion about the selected industry types subject to the safe harbour rule was also raised. Then, the selected types of the industry should also need to reclassify which activities are considered as core in one industry and may not be core on other activities.\footnote{Silberztein, “International - OECD: Transfer Pricing Safe Harbour,” 70.}

Following the premise that TP may never be precise since it is not an exact science, it needs to fairly distribute the profit allocation as accurate as possible. Reflecting the unified approach of the OECD, the TP rule on the predetermined margin must comply with the reasonable and accurate profitability margin. Thus, the predetermined margin must compensate for tangible and intangible and consider the routine and non-routine profit. This consideration will not sufficiently relate to the detail of the specific taxpayer but the characteristics of the taxpayer on the group contribution.\footnote{Neto, “Transfer Pricing and Deemed Arm’s Length Approaches: A Proposal for Optional Safe Harbour Method based on Accurate Predetermined Margins of Profitability,” 12.}

To keep the calculation as objective as possible, it needs to establish certain measurable aspects of a predetermined margin. The proxy to realize the predetermined margins list would depend on several variables, specifically the identified variables such as the following: (i) the safe harbour’s extension; (ii) the peculiarities of countries and the market dynamics in that prevailing country; (iii) tax policy and related issues arose; and (iv) the level of accuracy to pursue by implementing the safe harbour. The list of fixed margins should be as detailed as necessary. It also needs to thoroughly consider maintaining the
balance between accuracy, simplicity and practicability. The applicability of the rules to distinguish routine and non-routine profits could also be adopted. A particular country could establish different profit margins per economic sector or business line or even differentiate between particular goods or services to offer the fairer estimation.\textsuperscript{32}

After establishing the predetermined margin variable, it also needs to maintain the accuracy of the predetermined margins by periodically updating the variables following the trend of business and market. The list of variables applied to set the predetermined margin would probably not be as accurate as it is supposed to be. However, a periodical updated list would likely present a more advanced level of accuracy, with additional help ascertain accuracy provided by the certain mechanism of predetermination. Further, on a practical aspect, some sectors and activities may require more updates than others, but it would still be advisable to review all sectors from time to time. However, how often these margins should be reviewed is a matter for case-by-case analyses.\textsuperscript{33}

An accurate PMM to get a safe harbour formula could become an efficient tool for addressing these concerns, such as strengthening the defence and countering BEPS opportunities. Before deciding whether a safe harbour rule is available to the taxpayers, it needs to evaluate whether: (i) the actual margin earned from its entity should be within the safe harbour margin; (ii) before the application is made, the taxpayer has maintained detailed transaction documentation with reliable evidence; and (iii) the transaction should not fall substantially below the safe harbour margin.\textsuperscript{34} Further, such a safe harbour allows transparency and induces compliance. In short, it can be said that the proposed regulation for the safe harbour provision was to be available only if an eligible taxpayer uses a suitable method for valuation of an eligible position on its applicable financial statement and elect to apply for safe harbour.\textsuperscript{35}

\textsuperscript{32} Ibid.
\textsuperscript{33} Ibid., 18.
\textsuperscript{34} Vijay Krishnamurthy, “India Aims to Reduce Transfer Pricing Dispute through Safe Harbour Rules,” \textit{Bulletin for International Taxation} 68, no. 1 (December 2013): 47-52.
C. Assessing the Safe Harbour in Indonesia

The safe “harbour like” rule has been applied in Indonesia by determining certain business thresholds is governed by DGT regulation. It is mentioned through Article 3(4) of DGT Regulation No. PER-32/PJ/2011 (then is called PER-32/PJ/2011)\(^{36}\) that certain taxpayers performing a transaction less than IDR 10 billion within the group\(^{37}\) be exempted from the TP filing obligation documentation.\(^{38}\) However, on that regulation, it has not been explicitly stated that the taxpayer who performed transactions less than IDR 10 billion within the related party did not submit the TP Documentation. Due to the threshold requirement, the TP documentation will be exempted from the TP audit. The rule might be interpreted that even though there is no obligation to submit the TP documentation report, it does not mean that the tax administration will automatically accept the transaction price. Similarly, no certainty to the treatment of price of transaction disclosed by the taxpayer will be adjusted by the tax authority. The illustration of ‘safe harbour like’ in Indonesia is the following.

Figure 1. The Implementation of TP Exemption in Indonesia

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36 Basically, PER-43/PK/2011 regulate the determination of domestic tax subject and foreign tax subject.

37 1 USD = 14.000 IDR.

38 After the adoption of BEPS Action 13 Country-by-country reporting in 2016 through Minister of Finance Regulation No. 213/2016, the threshold to submit the master file is enacted if the transaction with a related party within a year are one of the following: (i) gross turnover in the previous year is more than IDR 50 B; (ii) transactions of intangible goods delivered in the previous year is more than IDR 20 B; and (iii) transaction of services, royalties and other deliveries are more than IDR 50B.
Figure 1 illustrates that the tax authority will focus on the transaction made by PT A and X Coy, which could not be exempted from the safe harbour threshold. Even though every transaction was below the threshold, the total transaction volume has been more than IDR 10 Billion. At the same time, they were not obliged to submit TP Documentation for transactions performed by PT C and Y Coy. However, the tax authority will still be able to audit the financial transaction even though it seems these entities will not on their attention due to the lack of comprehensiveness of the current safe harbour regulation. Thus, they still have to maintain the transaction record following the principle of arm’s length transaction. The difference between those groups is PT. B – X Coy and PT. C- Y Coy is solely obligated to submit the TP documentation with their annual income tax return. The following Table 1 will illustrate the status of Indonesia current safe harbour rule reflected in OECD Transfer Pricing Guidelines.

<table>
<thead>
<tr>
<th>Safe Harbour Aspects</th>
<th>Explanation based on OECD TP Guideline</th>
<th>Indonesia existing rule</th>
</tr>
</thead>
</table>

Source: Illustrated by the author from PER-32/PJ/2011
<table>
<thead>
<tr>
<th>Compliance relief</th>
<th>The availability of safe harbour provision will ease the taxpayer to comply with the TP rule due to the exemption provision of submitting TP documentation.</th>
<th>The taxpayer performing the transaction within a related party less than IDR 10 B per fiscal year is not obliged to submit the TP documentation.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Certainty</td>
<td>To assure the certainty for the particular taxpayer that the intra-group transaction value reported has been accepted by the tax authority under arm’s length range or has been considered fair. Thus, the tax authority will not conduct the TP audit.</td>
<td>The tax authority could not automatically accept the transaction with intra-group as an acceptable value. There is no guarantee that the tax authority will not audit the transaction solely due to the amount of threshold eligible to the safe harbour rule. The simplicity offered by the existing rule is merely not to submit the TP report.</td>
</tr>
<tr>
<td>Administrative Simplicity</td>
<td>To ease the tax authority burden because the existence of this provision will enable the tax authority to focus on their energy and attention to risky transactions or transactions with a considerable amount. On the other hand, the certain eligible taxpayer also will ease the compliance burden.</td>
<td>The existence of threshold IDR 10 B will enable the tax authority to focus their attention on the segmented taxpayer and certain transactions.</td>
</tr>
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</table>

**Source: Elaborated from PER-32/PJ/2011**

Implementing safe harbour in most countries, including Indonesia, would not be a simple topic even though this method is still an alternative to reduce the compliance cost of TP provision. The existence of ‘safe harbour like’ in Indonesia by applying a certain threshold is intended to minimize the possibility of double taxation and double non-taxation because the current safe harbour rule has not stated a certain fix rate to a certain transaction.\(^{39}\) On

\(^{39}\) E.A. Lubis, “Analisis Penerapan Ketentuan Safe Harbour dalam Transaksi Transfer Pricing di Indonesia” (Research Report, Faculty of Social and Political Science, Department of Fiscal...
the other hand, this provision has not been preferred or prohibited by certain sectors since the initiation of this provision offers the ease of TP compliance to small taxpayers that aim to reach the global market. Therefore, it has been expected that this provision will not be exploited solely for tax planning due to the small amount of threshold. Further, for the large taxpayer, no pretension of limiting the transaction solely to escape from TP documentation obligation.

However, regarding the current safe harbour provision, the determination of improper safe harbour formula will result in unnecessary and less valuable existing provisions which taxpayers could not utilize to reduce the compliance burden. In addition, this inaccurate threshold is considered a lack of benefit to the tax authority because the administrative burden to monitor the TP compliance that the tax authority must carry out has not been considerably reduced. Establishing safe harbour provisions must be undertaken as evaluating fair prices or determining the range of arm’s length to make it more effective and applicably useful for taxpayers and tax administration. To obtain a safe harbour value close to the factual conditions of the business situation, it is necessary to collect sufficient data to compare and analyze them by reflecting the development of market prices at regular intervals that are close to the value of the arm’s length. Thus, special research and measure need to be done to determine the value of an accurate safe harbour to meet the principle of business in a particular sector. The Indonesia Tax Authority must carry out in-depth research, the DGT, to determine the safe harbour’s value or related provisions, which taxpayers can utilize to significantly reduce the burden of compliance monitoring the tax authority.

Specifically, for the manufacturing sector, the Indonesian Government, in 2002 and enforced since 2003, has released the presumptive profit for contract manufacturer which produces toys for children. Minister of Finance

\[\text{Administrative Science Universitas Indonesia, 2013).}\]
\[40 \text{Tax Officer, Interview, 2013, at E.A. Lubis, “Analisis Penerapan Ketentuan Safe Harbour”, (2013).}\]
\[42 \text{Ibid.}\]
Stipulation No. 543/KMK.03/2002 regarding Deemed Profit for Contract MNEs Manufacturing for Toys Production. The taxpayers which entitled to this provision as mentioned in Article (1) taxpayers carrying out international contract manufacturing services are domestic corporate taxpayers who produce or assemble goods in the form of children’s toy products, with materials, specifications, technical instructions and determination of service fees from the subscriber domiciled abroad and has a special relationship with the taxpayer. The deemed profit has been enacted with a 7% rate based on the amount of all the cost of making or assembling goods does not include the cost of using raw materials (direct materials). This provision shall apply if the taxpayer has not applied the APA.

On the other hand, by assessing the trend of TP audits performed by the tax authorities in Indonesia, it would be easier to improve the current safe harbour rule to reach its inherent objectives. On the other side, the TP audits have been driven by one or more accumulated by the following factors:

a. The important consideration to undertake a TP audit in Indonesia is that the MNEs submitted the annual corporate income tax return with loss position and/or overpayment of income tax payment. However, from a global perspective, it needs to align the group’s value creation and intra-group transactions such as transactions related to intangibles, the group’s risk management, assessment of profit allocation and the location of value creation.

b. The Indonesian tax authority has emphasized the transaction within affiliation subject to transfer mispricing. In contrast, from

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43 In the Preamble Section of Minister of Finance Stipulation No. 543/KMK.03/2002 mentioned that “whereas the international scale contract manufacturing service is undertaken by certain taxpayers has special characteristics so that the taxation obligations need to be regulated separately in accordance with the authority granted to the Minister of Finance.”

44 Article (2) of Minister of Finance Stipulation No. 543/KMK.03/2002 mentioned that “Specific Calculation Norms for calculating net income in the form of rewards for international printing services received/obtained by Taxpayers as referred to in Article 1 are set at 7% (seven percent) of the total cost of manufacturing or assembling goods excluding the cost of using raw materials (direct materials).”

a global perspective, it may need to consider the assessment of
the transaction with certain jurisdictions with which a particular
country’s TP rule has not been matching the origin country’s TP
rule.46

c. About intra-group financing, the Indonesian tax authority focuses
on the amount of deductible-nondeductible or characteristics
of financial instrument used. In contrast, the global perspective
discusses guarantee fees, captive insurance, cash pooling and
hedging arrangement.

By optimizing the current database gathered by DGT about the MNEs
profile, it should be able to determine the profit margins of certain industrial
sectors, both in Indonesia or the nearest region, for several years as the basis
to the safe harbour improvement regulation. If the analysis found significant
variants between industry sectors, the application of different fair values of
safe harbour regulation per industry sector can be considered. To provide
certainty and fairness, it is necessary to open options for taxpayers to choose
to apply for safe harbour or to apply the general TP provision (opt-in/opt-out).
So that this feature is not misused, if the taxpayer has chosen the safe harbour,
it should not be moved to general rules unless it could prove reasonable
arguments and proves.47

Several countries have succeeded applied the safe harbour to reduce
the tax authority and taxpayer. Referring to the safe harbour provision in
India, a developing country that has advanced safe harbour rule, the Indian
Government opened the discussion on safe harbour rule in 2001,48 then has
introduced a provision in 2013,49 and lastly has been revised in 2017 to align
with OECD BEPS Project as the measure to offer friendly climate business.50

46 For example, Peru has applied a safe harbour provision of 5% for intra-group management
services whereas those rules have not been accepted in Indonesia.
47 Andikara, “Meminimalisiasi Sengketa Transfer Pricing melalui Safe Harbour.”
48 Vatika Bhatnagar, “Safe Harbour Rules: Are They Really Safe from a Taxpayer Perspective?”
49 The initiation to formulate the Safe Harbour Rules was due to the significant increase of TP audit
   and massive proposal to Advance Pricing Agreement starting from the fiscal year 2008/2009.
   See, Mansi Agrawal, “One Step Toward a Non-Adversarial Tax Regime: Safe Harbour Rules in
50 Agrawal, “One Step Toward a Non-Adversarial Tax Regime: Safe Harbour Rules in India,” 515-
The implementation of the safe harbour could be considered an appreciated measure to reduce TP audit and similarly has created a positive impact on taxation climate in India.\textsuperscript{51} With the availability of this provision, the taxpayer has been given the choice of whether to apply according to their business choice. The tax authority in India would have reviewed the safe harbour every five years, starting from the fiscal year 2013/2014.\textsuperscript{52} To appropriately apply the safe harbour rule, it needs to clarify the scope and definition of “the eligible taxpayers” and “eligible transaction” to avoid overlap.

The eligible taxpayer and transaction must respect the following criteria: (i) taxpayer providing software development services, IT-enabled services/knowledge processing outsourcing service with insignificant risk; (ii) taxpayer engaging in providing contract R&D service with insignificant risk, that wholly or partly relate to software development or generic pharmaceutical drugs; (iii) taxpayers that give loan to an intra-group entity if the loan sourced from India with fixed loan payment period and the taxpayers are not engaging in any financial services for performing lending and borrowing activities; (iv) taxpayers have declared the guarantee for its subsidiary with short-term borrowing; and (v) taxpayers engaging in manufacturing and export for non-core automotive components, that 90% of total annual turnover generated from original manufacturer sales. This provision shall not apply to the transactions made with associate enterprises located in low-tax countries. For example, a country with a tax rate is less than 15%.\textsuperscript{53}

In the 2013 provision, the safe harbour rule on the minimum operating expenses has applied for certain categories of international transactions undertaken by industries such as software development services, information-technology-enabled services, contract R&D, manufacturing and export of automotive components. The rules also apply to a particular group of financial


\textsuperscript{52} Krishnamurthy, “India Aims to Reduce Transfer Pricing Dispute through Safe Harbour Rules,” 47-52.

\textsuperscript{53} Ibid., 48.
transactions, such as intra-group loans,\textsuperscript{54} guaranteeing associated enterprises under certain circumstances.\textsuperscript{55} The technical implementation has been applied until 2016/2017, then revised in 2018/2019 are described in Table 2.

<table>
<thead>
<tr>
<th>Eligible Transaction</th>
<th>Provision until 2016/2017 FY</th>
<th>After the revision of the 2016/2017 provision</th>
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<tbody>
<tr>
<td></td>
<td>The limit of the threshold</td>
<td>Safe harbour margin</td>
</tr>
<tr>
<td>Transaction related to software development services (other than contract R&amp;D) with insignificant risk</td>
<td>Up to INR 5 billion</td>
<td>20% or more on operating cost</td>
</tr>
<tr>
<td></td>
<td>Above INR 5 billion</td>
<td>22% or more on total operating costs</td>
</tr>
<tr>
<td>Provision of information technology-enabled services (ITeS)</td>
<td>Up to INR 5 billion</td>
<td>20% or more on total operating costs</td>
</tr>
<tr>
<td></td>
<td>Above INR 5 billion</td>
<td>22% or more on total operating costs</td>
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</tbody>
</table>

\textsuperscript{54} Since the enactment of 2017 safe harbour rule in India, for intra-group guarantee or interest generated due to intra-group loan, for the purpose of safe harbour, it must be approved by CRISIL, a global analytical company providing ratings, research & risk and policy advisory services or other reliable company. See, Sunny Kishore Bilaney, “New Safe Harbour Rules for Intra-Group Loans and Guarantee: How Safe is the New Harbour?”, Derivatives & Financial Instrument 19, no. 6 (2017): 1-5.

<table>
<thead>
<tr>
<th>Provision of specified contract R&amp;D services wholly or partly relating to software development with insignificant risks</th>
<th>No threshold</th>
<th>30% or more on total operating costs</th>
<th>Up to INR 2 billion</th>
<th>24% or more on total operating costs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Provision of specified contract R&amp;D services wholly or partly relating to generic pharmaceutical drugs with insignificant risks</td>
<td>No threshold</td>
<td>29% or more on total operating costs</td>
<td>Up to INR 2 billion</td>
<td>24% or more on total operating costs</td>
</tr>
<tr>
<td>The margin on total operating cost – Employee to operating cost: 24% or more – 60% or more; 21% or more – 40% or more but less than 60%; 18% or more – 40% or less.</td>
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<tr>
<td>Provision of knowledge process outsourcing (KPO) services with insignificant risks</td>
<td>No threshold</td>
<td>25% or more on total operating costs</td>
<td>Up to INR 2 billion</td>
<td></td>
</tr>
<tr>
<td>Manufacture and export of core auto components</td>
<td>No threshold</td>
<td>12% or more on total operating costs</td>
<td>No threshold</td>
<td>12% or more on total operating costs</td>
</tr>
<tr>
<td>Activity</td>
<td>Threshold 1</td>
<td>Threshold 2</td>
<td></td>
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<tr>
<td>Manufacture and export of non-core auto components where 90% or more of the total turnover during the relevant previous year is of the nature of original equipment manufacturer sales</td>
<td>No threshold</td>
<td>8.5% or more on total operating costs</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Intra-group loans to a wholly-owned subsidiary</td>
<td>Up to INR 500 million</td>
<td>Interest rate $\geq$ base rate of State Bank of India (SBI) on 30 June of the relevant year plus 150 basis points</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Above INR 500 million</td>
<td>Interest rate $\geq$ base rate of SBI on 30 June of the relevant year plus 300</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Explicit corporate guarantee to a wholly-owned subsidiary</td>
<td>The amount guaranteed does not exceed INR 10 billion</td>
<td>Commission or fee at 2% or more per annum of the amount guaranteed</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>The amount guaranteed does not exceed INR 10 billion</td>
<td>Commission or fee at 1% or more per annum of the amount guaranteed</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Receipt of intra-group services</td>
<td>Not applicable</td>
<td>Not applicable</td>
<td>INR 100 million</td>
<td>Cost-plus 5% markup</td>
</tr>
</tbody>
</table>

Further, the method of cost pooling (i.e. the exclusion of shareholder costs and duplicate costs from the cost pool and the overseas group entity) is required to be certified by an accountant reasonableness of the allocation keys used for the allocation of costs to the taxpayer by

**Source:** Mansi Agrawal, “One Step Toward a Non-Adversarial Tax Regime: Safe Harbour Rules in India,” 2017

To align with BEPS Action 8, India also accepts the low value-adding services (LVAS) proposed by the OECD, mark-up 5% for such services. The Indian Government has defined the scope of LVAS consisting of: (i) the service inherently solely support services; (ii) the service should neither be part of core business nor economically significant contribution to the MNE;

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56 Ibid., 515-519.
(iii) the service should not duplication or for shareholders’ interest; (iv) the service should not need the unique intangibles; (v) the service should not inherently bear the risk; (vi) no reliable external comparable to the transaction. Then, the following must be included from LVAS, such as: (i) R&D services; (ii) manufacturing and production services; (iii) information technology (software development) services; (iv) business process outsourcing services; (v) purchasing activities of raw materials or other materials that are used in the manufacturing or production process; (vi) sales, marketing and distribution activities; (vii) financial transactions; (viii) extraction, exploration or processing of natural resources; and (ix) insurance and reinsurance.

For manufacturing activities, the Mexican Government under maquiladoras has seem implemented the PMM. Maquiladoras refer to a term referring to assembling or manufacturing in which the raw materials are imported, then the assembled product will be exported. The maquiladoras entity mostly is not in the form of permanent establishment. Under this system, for the company performing toll manufacturing to produce products ordered by subsidiaries out of Mexico, the safe harbour rule may apply for the profit reported below 9,6% of operating assets or 6,5% of operating costs, whichever is lower.57 These percentages were determined based on the industrial economic activities trend concerning the accounting system recognized in Mexico.58

Whereas the Brazilian Government has focused on import and export transactions on commodities on an annual basis that has been effective since 2013. The Brazilian Government has stipulated a safe harbour gross margin of 20% for importer distributors in Brazil and 60% for importer manufacturers.59 For export activities, the safe harbour margin is in the range of 90% of the average domestic sales price.60 Alternatively, in another country, such as Australia, the safe harbour rule has been applied to determine the allowable

59 Mitra, “Safe Harbours – Can they calm the troubled waters for captive service providers for MNCs in India?”, 405.
60 Ibid., 406.
deductible calculation for interest expenses as a further measurement to enforce the thin capitalization rule.\textsuperscript{61} This rule emphasized the balance between the compliance cost and protection to Australia tax base by setting an upper-interest deduction limit.\textsuperscript{62}

D. Remarks on Safe Harbour Provision

Assessing the deemed profit provision has been applied by the Indonesian Government to contract manufacturers through Minister of Finance Stipulation No. 543/KMK.03/2002 regarding Deemed Profit for contract MNEs manufacturing for Toys Production, it seems similar to the safe harbour applied by the Mexican Government. However, the safe harbour provision applied to the Mexican has set a certain mark-up to determine the minimum income that taxpayers must report. The current rule in Indonesia is solely the provision that governs the calculation of net income for contract manufacturer service, which constitutes a deemed profit arrangement, not a mark-up for the only manufacturer of toys products. With this current step, it should be easier for the Indonesian tax authority to set a safe harbour rule.

Further, for a more comprehensive safe harbour, as India has applied, the governance on an industrial basis is worth considering. For better formulation, specifically on practical aspect by referring to the India experience, the fixed margin might not be feasible to each taxpayer in a similar industry every year during a particular period.\textsuperscript{63} While implementing the safe harbour, after years of experience, the recent research shows the several aspects needs make clear to reduce the unintended issues as the consequence of the safe harbour rule: (i) the most critical thing is the availability of the concept of “insignificant risk” based on domestic circumstances; (ii) the rationale behind the selected eligible industry, financial limit, the rules applicable to R&D entity; (iii) a clear domestic definition of “transaction”, “close the linked transaction” and to what extent a transaction could be categorized as a close linked

transaction; (iv) the determination of core and non-core of manufacturing for export purposes; (v) the alignment of safe harbour rule with another mode of negotiation such as Mutual Agreement Procedure (MAP).  

E. Conclusion

The most effective way to deal with TP obligation both from the taxpayer and tax administration side has become more of a concern. The proposal on safe harbour provision has been one alternative to reduce the tax compliance burden and similarly reduce the potential of a tax audit or tax litigation. This concern also has been an agenda of OECD as it has released the document concerning the practical guideline to implement safe harbour. The OECD members and TP have also been an important issue in developing countries due to its role as part of MNEs operation.

For Indonesia, the safe harbour provision has not been enacted comprehensively even in decades of TP rule enforcement. The current safe harbour like provision seems to need to improve because it cannot practically reduce the burden of taxpayers and tax administrators. With the current provision, the administrative burden of the so-called eligible taxpayer has not been certainly eliminated since the taxpayer still has to keep the arm’s length record of the transaction. The eligible taxpayer still can be audited by the tax authority. Similarly, the tax authority has not been explicitly allowed to exempt the eligible taxpayer from the tax audit treatment.

Former ‘safe harbour like’ has been applied through the deemed profit provision explicitly implemented to contract manufacturers. It has also been limited to entity producing toys. Thus, the similar ease of tax obligation should be enlarged to other sectors. With larger targeted taxpayers within certain selected sectors, it might be able to reduce the tax administration burden of taxpayers and tax authorities.

For safe harbour rule improvement, Indonesia could consider enhancing current provision by setting a certain mark-up for certain industries such as the Mexican Government has done or Indian with more comprehensive provision.

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The current information gathered by the Indonesian tax authority will be the basis for the determination of the safe harbour formula, the eligible taxpayer and/or eligible transaction for the selected business sectors. The review on a predetermined margin could be undertaken on a periodical basis following the business dynamic.

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