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"The Road Not Taken": Unlocking the Conundrums of Transfer Pricing Dispute in Indonesia

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Transfer pricing remains the most controversial area in international tax arena. As OECD expresses, it is not an exact science and requires professional judgment from both tax administration and taxpayer, highlighting its inherent uncertainties.

As one of the top 20 net capital importer countries, Indonesia will naturally endeavour to protect its tax base from transfer mispricing. Since the enactment of Income Tax Law in 1983 and the first issuance of Indonesian transfer pricing audit procedure in 2010, the lengthy process and substantial resources dedicated for transfer pricing assessment have increased the complexity and challenges for both Indonesian taxpayers and tax administration. As a result, the number of transfer pricing disputes in Indonesia inevitably increase.

Indonesian taxation law allows two parallel pathways to resolve dispute: litigation through objection, appeal, and judicial review; or negotiation through the Mutual Agreement Procedure (MAP) and Advance Pricing Agreement (APA). However, the statistics show that Indonesian taxpayers prefer to resolve their transfer pricing dispute through litigation. During 2017-2019 alone, transfer pricing case in Indonesia in court increase by 19.37% and 27.34% respectively. This leads to the increasing cost of handling such a dispute, and uncertainty due to time-consuming settlement process. On the other hand, Indonesia amended its 2014 Mutual Agreement Procedure (MAP) regulation in 2019, which is intended to better align with the OECD BEPS Action 14 minimum standard for effective dispute resolution.

While there are several research on Indonesian transfer pricing dispute mechanism, a study which specifically probes the various pathways of resolving and preventing the transfer pricing dispute is still scarce, especially in the light of Indonesia's newly amended MAP regulation. This study uses the combination of legal review and empirical analysis, which is aimed to evaluate Indonesian transfer pricing dispute resolution mechanism and address various challenges for its way forward. There are three conundrums that will be addressed through this work. Firstly, what constitute the core issues of transfer pricing dispute in Indonesia. Secondly, the taxpayer's conundrum on choosing the more expedient pathway in resolving dispute. Thirdly, the Indonesian tax administration's conundrum in handling unresolved case and providing legal certainty. In answering those questions, this study investigates the theoretical and practical comparison between litigation-based and negotiation-based dispute resolution.

The data collected from 131 randomly selected Tax Court decisions and internal MAP statistics shows that transfer pricing litigation take 38.76 months on average to settle, compared to 27.25 months on average for MAP. In accordance with the statistics, the decision-making analytical model also demonstrates that MAP and APA promote the most time-efficient and cost-efficient way in handling transfer pricing dispute. Furthermore, this study delves into the possibility of implementing of safe harbour in Indonesian tax law to enhance legal certainty, as well as proposing a way to streamline its interaction with traditional Indonesian arm's length principle regime.

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I. Introduction, Issues and Context

1.1. Backgrounds

The development of Multinational Enterprises (MNEs) that can operate in any jurisdictions has encouraged them to minimize their tax burden at the group level. There are many techniques employed by the MNEs, but in general, it is aimed to erode the tax basis or shift the profit to low-or-no tax jurisdictions, or widely known as Base Erosion and Profit Shifting (BEPS). Some of the strategies used by the MNEs encompass transfer pricing or, more precisely, transfer mispricing, artificial avoidance of permanent establishment status, exploiting hybrid mismatch arrangements, financial structuring to get excessive interest deduction, exploitation of organizational form, or treaty shopping[1]. Among the strategies mentioned earlier, transfer pricing is, still, the most controversial area in the international tax avoidance arena. Empirical studies show that transfer pricing is the primary vehicle for profit-shifting[2]. Likewise, Heckemeyer and Overesch found that non-financial shifting technique (i.e., transfer pricing or royalty payment) contribute to 72% of the shifted tax bases[3].

Transfer pricing occurs in transactions among affiliated parties, including transfer of goods, services, intangibles, or financing activities. The MNEs have capability to deliberately structure their activities, restructure their organization, and even set their trading term to take advantage of their transfer price[4]. The international taxation norm has set the arm's length principle (ALP) as the standard in determining the price between affiliated parties. However, it is often difficult to find a comparable independent transaction to the related party transaction due to the complexity of the MNEs' transaction and structure[5]. Consequently, albeit OECD already designed BEPS Action Plan to tackle the MNEs' tax avoidance strategies, transfer pricing remains being perceived as complex and uncertain. The surveys conducted by Deloitte and EY found that transfer pricing complexity and uncertainty is heightened even in the post-BEPS era[6].

The ALP has been the internationally accepted standard to establish the transfer price. It refers to the price charged between independent parties in the comparable transaction and comparable condition that is ordinarily determined by market forces[7]. This principle gives tax administration authority to adjust the discrepancy between the transfer price and arm's length price. However, as Park and Tillinghast (2004) stated: 'As most tailors know ... arms may have different lengths, and thus tax administrations often diverge dramatically as to what exactly constitutes a proper adjustment to reflect "arm's length" prices.'[8] Furthermore, OECD also stated that "transfer pricing is not an exact science and requires professional judgment from

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1 See OECD BEPS Action Plan 2, 4, 6 and 8-10. See also Peralta, S., Wauthy, X. & Ypersele, T. v., (2006). Should countries control international profit shifting?. *Journal of International Economics*, Volume 68, p. 24–37 and Huizinga, H. & Laeven, L., (2008). International profit shifting within multinationals: A multi- country perspective. *Journal of Public Economics*, Volume 92, p. 1164–1182.

2 See Dharmapala, D. (2014). *What Do We Know about Base Erosion and Profit Shifting? A Review of the Empirical Literature*, University of Chicago Coase-Sandor Institute for Law & Economics Research Paper: Available at: http://ssrn.com/abstract=2373549

3 See Heckemeyer, J. H. & Overesch, M. (2013). Multinationals' Profit Response to Tax Differentials: Effect Size and Shifting Channels, *ZEW Discussion Paper* No. 13-045: http://ftp.zew.de/pub/zew-docs/dp/dp13045.pdf.

4 OECD (2012), *Dealing Effectively with the Challenges of Transfer Pricing*, OECD Publishing. http://dx.doi.org/10.1787/9789264169463-en

5 Ibid, 4

6 See https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-tp-controversy-strategy.pdf and https://assets.ey.com/content/dam/ey-sites/ey-com/en_gl/topics/tax/tax-pdfs/ey-how-profound-change-transparency-and-controversy-are-reshaping-a-critical-business-function.pdf

7 OECD (2017), OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2017, OECD Publishing, Paris. http://dx.doi.org/10.1787/tpg-2017-en

8 Park, William W. and D. R. Tillinghast. (2004). *Income Tax Treaty Arbitration*, Sdu Fiscale & Financiele Uitgevers in Markham, M. (2019). Arbitration and tax treaty disputes, *Arbitration International*, Volume 35, Issue 4, December 2019, Pages 473–504,

both tax administration and taxpayer[9]". This judgment, both by MNEs and tax administration, which used in transfer price determination clearly indicated that uncertainty is inherent in this area.

Both the transfer pricing audit and its dispute require a lot of resources and take such a lengthy process. The dispute itself can take years that result in increased uncertainty for business and the cost of handling the dispute. The tax administration also faces the same problem because the dispute will defer the payment by the taxpayer. Therefore, both the tax administration and business should manage their resources to handle transfer pricing disputes more efficiently.

As one of the top 20 net capital importer countries, Indonesia will naturally endeavour to protect its tax base from any tax avoidance strategy, particularly in transfer pricing. Hence, Indonesia's transfer pricing rule is as old as the Indonesian Income Tax Law ("Income Tax Law"), which was enacted in 1983. Similarly, the dispute settlement pathway was also enacted in the same year, but in different law, Indonesian Law of General Provisions and Taxation Procedure ("General Provisions Law"). While transfer pricing has long history in Indonesian tax law, the first recorded transfer pricing dispute occurred in 2008, or almost 25 years after the stipulation of the law. And, it takes nearly seven years until the dispute be settled in the Indonesian Tax Court[10]. This sample of case could reflect how transfer pricing disputes require many resources, both from tax administration and taxpayer.

The Indonesian taxation law gives two parallel pathways to resolve transfer pricing dispute: litigation or negotiation. Litigation involves objection to Indonesian tax administration (Directorate General of Tax / DGT), appeal to Tax Court, and judicial review to Supreme Court. While negotiation procedure shall take the form of Mutual Agreement Procedure (MAP), included Advance Pricing Arrangement (APA). However, based on the data collected, this works found that the taxpayers tend to resolve their dispute through the litigation pathway, even though the lengthy period it takes. This condition led to the backlog escalation on unresolved transfer pricing disputes and increased uncertainty for taxpayers and the Indonesian tax authority.

1.2. Methodology

Based on those aforementioned grounds, this article will mainly focus on addressing the challenge in handling transfer pricing disputes in Indonesia, both from taxpayers and the Indonesian tax administration viewpoint. Therefore, the main questions are:

Q1: "*What are the core issues of transfer pricing dispute in Indonesia*?"

Q2: "*What is the most efficient pathway for taxpayers to handle transfer pricing dispute resolution in Indonesia*?"

Q3: "*How Indonesian tax authority could handle and prevent the transfer pricing dispute and provide more tax certainty in this area*?"

In answering those questions, this article will elaborate on the transfer pricing and dispute settlement regulation in Indonesian domestic law, particularly the newly amended MAP regulation released in 2019. This study also collects 131 transfer pricing-related tax court decisions to obtain the core issues of the disputes in Indonesia. The data collected will then be compared with MAP statistics to discern the most efficient pathway. Furthermore, this work develops a decision-making model that demonstrates the most time-efficient and cost-efficient way of handling transfer pricing disputes.

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9 Para 1.13 of OECD TPG, in OECD (2017), OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2017, OECD Publishing, Paris. http://dx.doi.org/10.1787/tpg-2017-en

10 See Risalah Put.54374/PP/M.XA/15/2014 in http://www.setpp.kemenkeu.go.id/risalah

This research used both a combination of literature review and empirical data. We analyze the literature from several academic journal providers, including IBFD, e-Journal of tax research, SSRN, and OECD reports. This work also used information gathered from the tax court secretariat website to obtain the tax court decision related to transfer pricing and make statistical data regarding the average period taken to settle the disputes in tax court. Part of the information we used is collected through an internal conference in the Indonesian tax authority, Directorate General of Taxation (DGT) and some of them are unpublished.

This article consists of seven parts. After explaining the backgrounds and methodology, we elaborate on the regime on transfer pricing and dispute settlement in Indonesia, then evaluate the related regulation in Part II and Part III. Then, Part IV identifies the core issues in the Indonesian transfer pricing dispute. Part V provides the decision-making model to determine the most advantageous alternative to hasten the transfer pricing dispute resolution. Part VI will afterward explore the possibility of implementing safe harbor policy in Indonesia tax law as the solution in facing the increasing trend on transfer pricing disputes. Finally, Part VII concludes all of the findings.

II. Indonesian Transfer Pricing Regime

2.1. Overview on Indonesian Transfer Pricing Regulation in Pre-BEPS Era

In Indonesia, transfer pricing rules are found in Indonesian Income Tax Law[11], Value Added Tax Law ("VAT Law")[12], and various lower-level regulations in the Ministry of Finance Decree, Director of General of Taxation Decree, and Director of General of Taxation Circular Letter. All Indonesian Double Tax Avoidance Agreement also contains Article 9 (1) (Associated Enterprise).

Firstly stipulated in 1983, the authority to conduct transfer pricing adjustment is conferred by Article 18 (2) Income Tax Law, where, for the calculation of the taxable income of taxpayers with a special relationship, Director General of Taxes is authorized to reallocate the amount of income and/or deduction of expenses and re-classify debt as capital. From this provision, DGT can challenge taxpayer's transfer pricing policy if the taxpayer has a special relationship with other taxpayers. Article 2 (1) of VAT Law was drafted in a similar vein for the purpose of VAT adjustment. The criteria for special relationship was further defined in Article 18(3) of Income Tax Law and Article 2(2) of VAT Law.

Even though the DGT's authority to reassess related party transactions had been enacted in 1983, the domestic law did not mention the basis for such an assessment. Therefore, in 1994, the arm's length principle was included in Income Tax Law as the basis for transfer pricing adjustment. Then, in the year of 2000, Income Tax Law establish the use of transfer pricing method, which comprises Comparable Uncontrolled Price (CUP), Resale Price Method (RPM), Cost Plus Method (CPM), and other methods (i.e., Profit Split Method (PSM) and Transactional Net Margin Method (TNMM).

There have been no further changes to Income Tax Law since the year of 2008. The current version of Income Tax Law still provides the transfer pricing rule in Article 18. It stipulates that DGT has the authority to recalculate the income and deduction, as well as reclassify debt as capital for the calculation of taxable income in accordance with the arm's length principle by using the allowed transfer pricing methods. Likewise, this article defines the criteria for special relationship as:

[11] Law no. 7 Year 1983 as lastly amended by Law no. 36 Year 2008
[12] Law no. 8 Year 1983 as lastly amended by Law no. 42 Year 2009

a. a Taxpayer who owns directly or indirectly at least 25% of equity of other Taxpayers; a relationship between taxpayer through ownership of at least 25% of equity of two or more taxpayer, as well as relationship between two or more taxpayer concerned;
b. a Taxpayer who controls other taxpayer; or two or more Taxpayers are directly or indirectly under the same control;
c. a family relationship either through blood or through marriage within one degree of direct or indirect lineage.

On 3 March 1993, the first Indonesian transfer pricing audit guidelines were released by the Director General of Taxes Decree no. 1/PJ.7/1993 (KEP-01/1993) and its supplementary Director General of Taxes Circular Letter no. 4/PJ.7/1993 (TP-1). Even though the term of arm's length principle had not been regulated in 1983-Income Tax Law, KEP-01/1993 already mentioned arm's length principle to deal with related parties' transaction, particularly in the determination of the price of goods, remuneration for services or the use of assets, allocation of headquarter expenses, and determination of interest expense. However, both KEP-1/1993 and TP-1 did not provide detailed guidance of "other methods" and instead emphasize whether the taxpayer's documentation was adequate.

In March 2010, partly motivated by the difficulties encountered in Indonesian tax offices, Letter of Director of Tax Audit and Collection no. 153/PJ.4/2010 ("S-153/2010") was issued. This internal guideline serves as a reference point for tax auditor to conduct transfer pricing audit, which *inter alia*, also provided the concept of existence test, benefit test, "willingness to pay" test, as well as reference to other TP methods and guidance on special transactions.

Given that S-153/2010 was merely internal guidance for auditor, further in 2010, Director General of Taxes issued a regulation no. 43/PJ/2010 ("PER-43/2010"), so as to uphold fairness and provide Indonesian taxpayers with clearer rights and obligations. It was then amended in 2011 by regulation no. 32/PJ/2011 ("PER-32/2011"), which, *inter alia*, required taxpayers to submit TP Documentation, allowed transfer pricing adjustment for domestic TP only in special cases[13], and replaced the hierarchical concept[14] of transfer pricing methods with the "most appropriate method".

The internal guidance on conducting transfer pricing adjustment itself was further amended in 2013 by the issuance of Directorate General of Taxes Regulation no. 22/PJ/2013 ("PER-22/2013") and Circular Letter Number no. 50/PJ/2013 ("SE-50/2013"). The new regulations among others, provided guidance on how to apply profit split method using the contribution and residual approach.

2.2. Overview on Indonesian Transfer Pricing Regulation in Post-BEPS Era

After 2013, no specific provision was established to regulate transfer pricing in Indonesia until the OECD BEPS Action Plan was announced in 2015. As one member of the Inclusive Framework on BEPS, Indonesia committed to implement all of the minimum standards on BEPS, including the provisions on transfer pricing documentation and improvement of dispute resolution through Mutual Agreement Procedure (MAP).

The first transfer pricing-related regulation, which specifically response to OECD BEPS Action Plan was Minister of Finance Regulation number 213/PMK.03/2016 ("PMK-213/2016") dated and effective on 30 December 2016 regarding the three-tiered transfer pricing documentation

[13] In the case that there are domestic taxation regimes that result in difference of income tax rate, e.g. taxpayer which final income tax applies or oil and gas taxpayer who has Profit Sharing Contract with Indonesian government whose contract include taxation clause.
[14] Hierarchical means that CUP is considered as the most reliable method and PSM/TNMM as last resort only after other traditional methods cannot be applied reliably.

in Indonesia. It responded on BEPS Action Plan 13 that regulates the documents must be provided by taxpayer who meets specific criteria, which are master file, local file, and Country-by-country Reporting (CbCR). For taxpayer who conducts related party transaction, with revenue exceed IDR 50 billion in the previous fiscal year, or total transaction of tangible assets for exceeding 20 billion rupiahs in the previous fiscal year, or total transaction of intangible assets, royalty, interest payment, or others which more than 5 billion rupiahs in the previous fiscal year, or conducting related party transaction with affiliates domiciled in a jurisdiction with lower tax rate, must prepare and submit master and local file[15]. Furthermore, PMK-213/2016 also obliges Indonesian taxpayer who is the ultimate parent entity of a business group with total consolidated revenue exceeding IDR 11 trillion to prepare CbCR and submit it to DGT. The specific regulation which addresses CbCR then established through Director General Regulation number 29/PJ/2017 ("PER-29/2017").

The second transfer pricing-related regulation in the Post-BEPS era was Minister of Finance Regulation number 49/PMK.03/2019 ("PMK-49/2019"), as Indonesia response to BEPS Action 14 on dealing with international tax dispute effectively. PMK-49/2019 replaces the previous MAP regulation ("PMK-240/2014") in stipulating the process of Mutual Agreement Procedure ("MAP") and adopting the BEPS Action 14 minimum standard, inter alia open wider access for taxpayers (Indonesian or foreign taxpayers) to submit MAP request to Indonesia[16].

PMK-49/2019 also set the consultation window between DGT and its tax treaty partner from unlimited to only 24 months. However, this provision could be seemed as a double-edged sword. It provided more certainty to the taxpayer who requests for MAP, but it some cases, it can cause difficulties for DGT as well as Indonesia treaty partner in negotiating their case. It is acknowledged that transfer pricing cases could be complicated, intricate, and lengthy, so it cannot be settled even after 24 months. Therefore, DGT published another regulation, through the enactment of Director General Regulation number PER-16/PJ/2020 ("PER-16/2020") regarding MAP administration, to provide leeway for a case which meets particular criteria to have time extension for another 24 months[17].

The third regulation was Minister of Finance Regulation number 22/PMK.03/2020 ("PMK-22/2020"), which provides the rule of Advance Pricing Agreement (APA) and transfer pricing provisions[18]. This regulation fundamentally changes the transfer pricing policy in Indonesia. It generally adopts BEPS Action 14, the current OECD Transfer Pricing Guidelines 2017 (OECD TPG 2017) and OECD Revised Guidance on Profit Split.

In the context of APA, PMK-22/2020 firstly introduced the implementation of roll-back in APA to accommodate BEPS Action 14 minimum standard since the previous regulation on APA ("PMK-7/2015") did not provide such provision. DGT then releases more detailed regulation on APA in Director General Regulation number PER-17/PJ/2020 ("PER-17/2020"), which provides more elucidation on certain provision in PMK-22/2020 as well as the COVID-19

[15] PMK-213/PMK.03/2016 on Additional Documents and/or Information Compulsarily Retained by Taxpayers Conducting Related Party Transactions and Its Administration Procedures in https://www.pajak.go.id/sites/default/files/2019-08/PMK-213-2016%20-%20TP%20Documentation%20-%20English%20Version.PDF

[16] PMK-49/PMK.03/2019 on Implementation Guidelines on Mutual Agreement Procedure, available in https://www.pajak.go.id/sites/default/files/2020-06/PMK%2049%202019%20English.pdf

[17] PER-16/PJ/2020 on the administration of MAP request and its implementation, available in https://www.pajak.go.id/sites/default/files/2020-08/PER%2016%20PJ%202020.pdf

[18] PMK-22/PMK.03/2020 on Implementation Guidelines on Advance Pricing Agreement, available in https://pajak.go.id/sites/default/files/2020-08/REGULATION%20OF%20THE%20MINISTER%20OF%20FINANCE%20NUMBER%2022PMK.032020.pdf

measure related to APA[19]. As for transfer pricing rules, PMK-22/2020 regulates the elaboration of special relationship, implementation of arm's length principle, comparability analysis, selection of transfer pricing method, transfer pricing for special transaction, and explanation on secondary adjustment[20].

2.3. Evolution Matrix of Indonesian Transfer Pricing Regulation

In describing the evolution of transfer pricing regulation and the dispute provision, this study uses the matrix of evolutionary path developed by Baistrocchi (2012)[21]. The matrix contains seven parts which explain each period from the period as follows:

a. Stage I, represents the periods when ALP rules still not regulated in domestic laws and the absence of any dispute in transfer pricing;
b. Stage II, when the transfer pricing dispute already emerged but without any ALP rules;
c. Stage III, indicates the time when ALP regulation already stipulated in domestic law while transfer pricing disputes was not existed;
d. Stage IV, denotes the period when ALP has been enforced in domestic regulation and transfer pricing dispute has been emerged;
e. Stage V, represents the term when litigation as the basis for settlement in transfer pricing dispute;
f. Stage V', reflects the time when non-litigation procedure, for instance MAP or Advance Pricing Agreement (APA) become the core to resolve the transfer pricing dispute due to the absence of transfer pricing litigation provision;
g. Stage VI, represents the period when most of transfer pricing dispute were settled through MAP, APA, or Alternative Dispute Resolution (ADR) pathways.

The evolution of transfer pricing dispute and its dispute pathways regulation are portrayed in the figure 2.1. The figure shows that Indonesia began stage I in 1925 when the first Corporate Tax Ordinance was enacted. Then, Indonesia leapfrogged to stage III when Income Tax Law released in 1983, which stipulate the authority for DGT to re-determine the amount of income and/or reduction for taxpayer with special relationship. To provide the guidance in performing transfer pricing audit, Indonesia also released its first transfer pricing audit guidelines in 1993. However, in that stage, there was no transfer pricing dispute recorded.

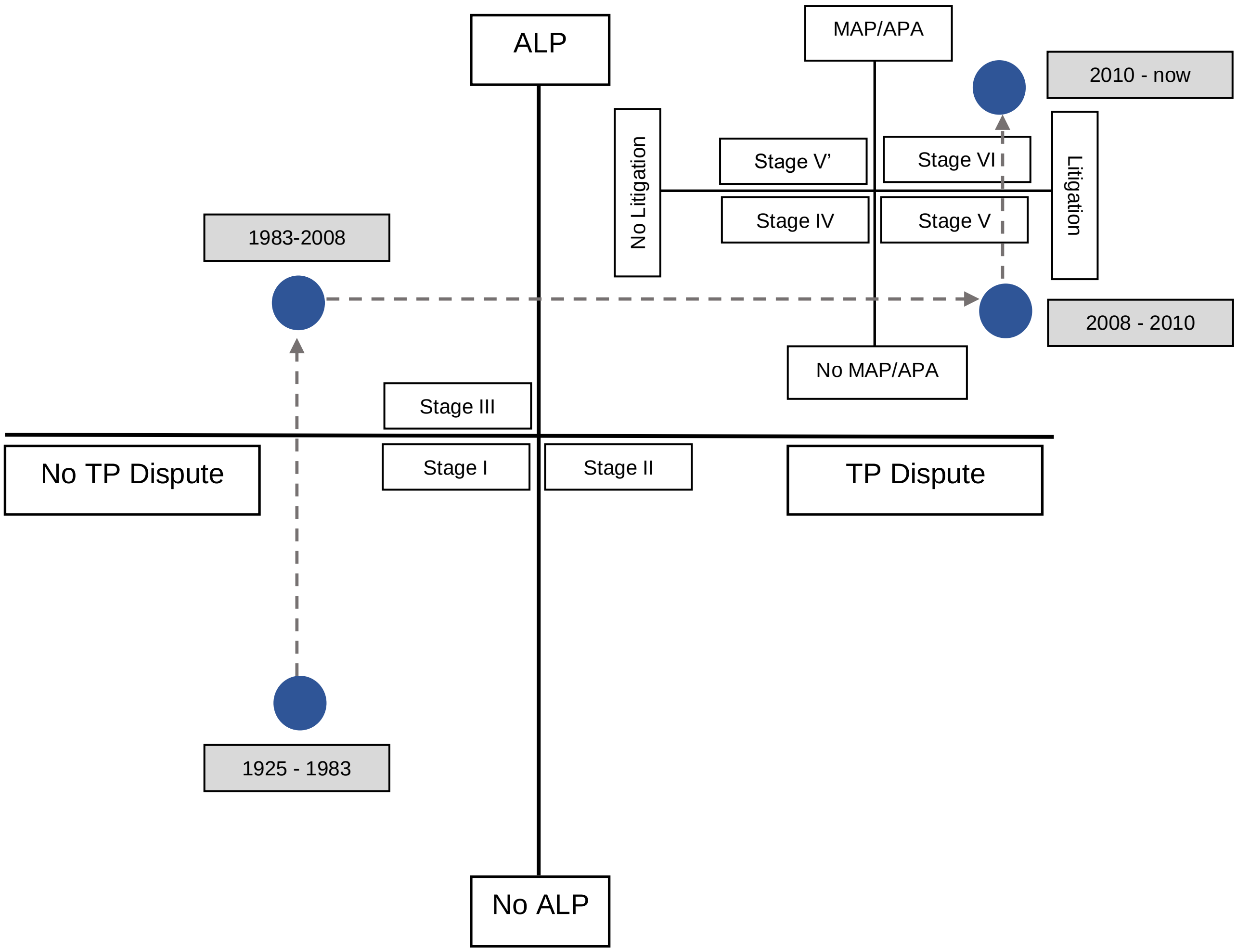
After 25 years in stage III, Indonesia reached stage V when the first recorded transfer pricing dispute was raised in 2008 through litigation. Finally, Indonesia reached stage VI in 2010, when the first MAP regulation was published in Director General of Taxes Regulation. However, the litigation process is still the core and the most popular pathway in resolving transfer pricing dispute albeit the MAP regulation has been enacted for almost ten years. Following the matrix of Baistrocchi (2012), the evolution of Indonesia for all stages is presented as follow:

[19] PER-17/PJ/2020 on The Procedure on Processing, Implementation, and Evaluation of APA, available in https://www.pajak.go.id/sites/default/files/2020-10/PER-17PJ2020.PDF

[20] Further analysis on transfer pricing rules in PMK-22/2020 has been presented in the authors' upcoming works titled Indonesia – New Development and Analyses on Indonesia's Transfer Pricing Regulation (Daholi & Dewantara)

[21] Baistrocchi, E. (2012). *Transfer pricing dispute resolution: the global evolutionary path* (1799–2011). In E. Baistrocchi, & I. Roxan, Resolving Transfer Pricing Disputes: A Global Analysis (pp. 835-882). Cambridge: Cambridge University Press.

Figure 2.1. Evolutionary Path of Indonesian Transfer Pricing Dispute Resolution



III. Mechanism of Indonesian dispute resolution

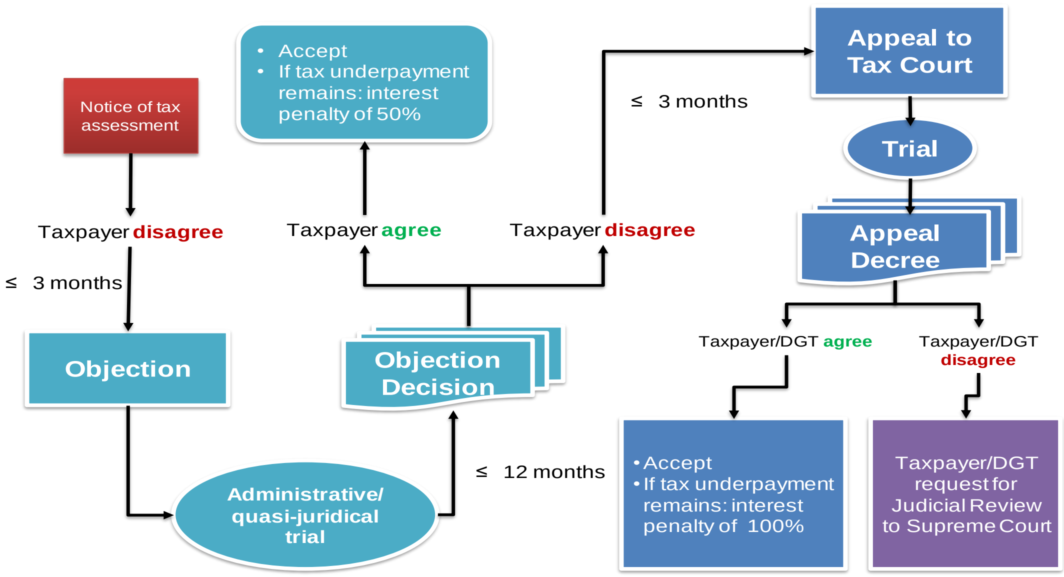
3.1. Litigation pathway

Based on Article 25 of General Provisions Law, a taxpayer who disagrees with the audit result could submit an Objection request. An objection is a form of administrative trial in the Directorate General of Taxes. The taxpayer can submit one Objection for each Notice of Tax Assessment[22] no later than three months after the Notice date of receipt. The case is then handled by objection reviewer at Regional Tax Office. The reviewer must subsequently issue an Objection Decision no later than twelve months after the Objection request is received.

If taxpayer still disagrees on the Objection Decision, Article 27 of General Provisions Law allows for Appeal to the Tax Court, which is independent from Directorate General of Taxes. The taxpayer must submit the request no later than three months after the Decision date of receipt. If either taxpayer or Directorate General of Taxes disagree with the Appeal Decree, Indonesian Tax Court Law no. 14 Year 2002 provides a chance for either of them to file Judicial Review to Indonesian Supreme Court, which would then issue a final and binding ruling. In each of the three stages, the process requires 12 months for the judges to reach the verdict.

[22] Notice of Tax Assessment is a letter issued after tax audit indicating whether the tax obligation is underpaid, overpaid, or nil. A tax audit may or may not include a transfer pricing adjustment.

Figure 2.2. Domestic Dispute Flow



3.2. Negotiation pathway

3.2.1. Mutual Agreement Procedure (MAP) in Indonesia

Ordinary legal remedies available under domestic law, such as objection or appeal, may not resolve the case satisfactorily. For instance, a country may not be able to exercise its taxation right, or double taxation on parts of taxpayer's income may remain. The procedure to resolve such dispute through which the competent authorities of the Contracting States may resolve differences or difficulties regarding the interpretation or application of tax treaty on a mutually-agreed basis is called MAP[23]. The advantage that MAP offers is that they include the agreement of tax authorities on both sides of a transaction, thus ensuring that – when the agreement applies – double taxation is eliminated.[24] MAP is enshrined in all Indonesian tax treaty except with Saudi Arabia[25] under Article 25 or its equivalent. Domestically, it is stipulated by Article 32A of Income Tax Law.

Procedure to administer MAP was firstly regulated by Director General of Taxes Regulation no. 48/PJ/2010 ("PER-48/2010"). Here, MAP was not intended as alternative dispute resolution mechanism that can run in parallel with domestic dispute resolution mechanism. Article 8 and 17 of PER-48/2010 stated that MAP must be terminated if taxpayer (or a foreign permanent establishment in Indonesia) files for Objection or Appeal. It also limited the entry to MAP request related to a corresponding adjustment if either 1) the treaty with Indonesia does not contain Article 9 (2), or 2) the related Indonesian taxpayer does not file an MAP request in conjunction with corresponding adjustment request from the other competent authority.

After the stipulation of Article 59 of Government of Indonesia Regulation no. 74 Year 2011 and following BEPS Project, Indonesia issued PMK-240/2014 concerning MAP. Effective on 22 December 2014, this regulation, among others established MAP as an alternative dispute resolution that can run in parallel with Objection or Appeal. It, however, only softened the wording from "shall reject" to "may reject" a corresponding adjustment MAP request on the

[23] Organisation for Economic Co-operation and Development (OECD) (2015), Action 14 - 2015 Final Report: Making Dispute Resolution Mechanisms More Effective (Paris: OECD).
[24] Roxan, I. (2012), *Resolving the Resolution of Transfer Pricing Disputes: Global Trends and Divergences*. in E. Baistrocchi and I. Roxan (eds.) *Resolving Transfer Pricing Disputes: A Global Analysis*, Cambridge University Press (2012)
[25] Mulyani, Y. (2016) *Menyelesaikan Sengketa dengan Mutual Agreement Procedure* (in Indonesian), Inside Tax Magazine DDTC Indonesia, Jakarta

ground that the treaty does not contain Article 9 (2). Even though Indonesia never rejected a request from treaty partner in practice, it warranted enough concern that there is a barrier to access MAP. PMK-240/2014 is then updated by PMK-49/2019 for better adherence to BEPS Action Plan 14 minimum standard.

In PMK-49/2019, cases that can be requested for MAP by Treaty Partner Country/Jurisdiction are no longer regulated. The implication is that the new regulation widely opens the access for MAP, and that the access of MAP request by Treaty Partner Country/Jurisdiction is not bound to Indonesian domestic regulation, but solely to the article of the tax treaty. PMK-49/2019 retains the provision in PMK-240/2014, allowing taxpayers to apply for MAP and simultaneously pursue domestic dispute resolution avenues (i.e., applying for a tax objection, appealing to the Tax Court, and requesting reduction or cancellation of administrative penalty)[26].

A new provision according to PMK-49/2019, however, requires matters to be resolved by MAP to be included in matters submitted to the aforementioned domestic dispute resolution avenues[27]. The new provision should be understood in the context of Indonesian legal system. Like other countries such as Australia[28] and Japan[29], the tax court position (judicative function) is higher than DGT (executive function)[30]. The tax authority is legally bound to abide by the court decision. Hence MAP cannot override the Decision on Appeal issued by the tax court. Complication may arise, where, for the same Notice of Tax Assessment (tax audit result), taxpayer submitted transfer pricing matter to MAP and only the non-transfer pricing matter to tax court. If MAP results in agreement fully eliminate double taxation, Indonesian tax court cannot take into account the Mutual Agreement into the ruling, as – by the principle of *non ultra petita* – the court may not decide on matter that is not requested by taxpayer.

In mitigating the issue above, the old regulation prevents MAP cases to be submitted in the event that the hearing has been finalized by the tax court (meaning decision has been made, but not yet rendered). In the new regulation, the provision preventing access to MAP due to the finalization of the court hearing is revoked.

Widening access to MAP notwithstanding, the new regulation realizes that Indonesian tax court decisions may fully or partially eliminate taxation not in accordance with tax treaty. Thus, the subsequent endeavour of Indonesian competent authority will be to establish that MAP can still proceed, with a mutual agreement affirming Indonesian tax court decision. Nevertheless, this requires matters to be resolved by MAP to be included on the issues submitted to tax court as explained above

PMK-49/2019 was aimed to provide better availability and access to MAP, as well as timely and effective resolution of MAP cases and implementation of MAP agreements. A selected comparison between old and new regulation is as follows:

BEPS Action Plan 14 Minimum Standard	PMK-240/2014	PMK-49/2019
Roll-back for bilateral APA	Not explicitly stated	Accommodated by Article 2 (5) letter b
Taxpayer can present the request within a period of no less than three years from the first notification of the action resulting in taxation not in	In case where tax treaty does not specify, there is no definite timeline of submission	In case where tax treaty does not specify, three years period is stipulated (Article 3 (1) letter c)

[26] PMK 240/2014 Article 5 (1)
[27] See PMK-49/PMK.03/2019 in https://www.pajak.go.id/sites/default/files/2020-06/PMK%2049%202019%20English.pdf
[28] Australian Tax Ruling TR 2000/16, 2000 (amended 2018), para. 4.45; Australian Tax Office Guidance to Mutual Agreement Procedure
[29] Japan National Tax Agency Guidance for Taxpayers on the Mutual Agreement Procedure (Q&A), 2019, Q2-11
[30] See Article 77 of Indonesian Law Number 14 Year 2002 regarding Tax Court, available at http://www.flevin.com/id/lgso/translations/JICA%20Mirror/english/14.14.2002.eng.qc.html

BEPS Action Plan 14 Minimum Standard	PMK-240/2014	PMK-49/2019
accordance with the provisions of the tax treaty		
Jurisdictions should provide access to MAP in transfer pricing cases	Article 18 (3) states that there may be ground to reject the submission if the tax treaty does not contain Corresponding adjustment clause as contained in Article 9 (2) of Model Tax Convention. (Even though in practice Indonesia never rejects any cases by this reason)	No such limitation.
Jurisdictions should seek to resolve MAP cases within an average time frame of 24 months	Consultation process could last for 3 (three) years, with further extension insofar as agreed by both CAs	Article 5(1) stipulates that consultation process lasts 24 months starting from the acceptance of MAP case from treaty partner, or from the submission of MAP case to treaty partner. If the consultation process goes further than 24 months, DGT is authorized to end the discussion with disagreement.
Agreements reached by competent authorities through the MAP process should be implemented on a timely basis	Mutual Agreement is implemented by the issuance of Director General of Taxes Decree, but there is no specific timeline for the issuance	Director General of Taxes Decree to implement the Mutual Agreement shall be issued no later than 1 (one) month after closing letter (Article 5 (6)). This provides greater certainty to the taxpayer.

3.2.2. Advance Pricing Agreement (APA) in Indonesia

The heightened amount of affiliated transactions and the complexity in the determination of arm's length price had made transfer pricing inherently uncertain. Such uncertainty is faced both by taxpayer and tax administration, whereby the taxpayer would face double taxation risk on same transaction, while the tax administration should allocate their resources in handling transfer pricing dispute if such case being brought to litigation[31]. To reduce or even remove the uncertainty, both parties can take APA as a way to prevent transfer pricing dispute.

APA is an agreement between taxpayer and tax authority regarding the approach in determining transfer price to be aligned with arm's length principle. It can be unilateral (involving a taxpayer and one tax jurisdiction), bilateral (between a taxpayer and two jurisdictions), or multilateral (involving a taxpayer and more than two jurisdictions)[32]. In contrast with MAP or litigation which offer *ex-post* settlement[33], APA constitutes the manifestation of *ex-ante* principle, in which the taxpayer already determined transfer price before the affiliated transaction was conducted.

To provide and ensure an effective dispute resolution mechanisms in global level , OECD developed minimum standard in BEPS Action 14[34]. Currently, most countries with tax treaties network already implement APA in their domestic rule. Even more, some tax administration

[31] Markham, M. (2020). Are Advance Pricing Agreements Experiencing a Renaissance as a Dispute Resolution Mechanism in the Era Following the OECD/G20's Base Erosion and Profit Shifting Initiative?, 74 *Bull. Intl. Taxn*. 1 (2020), Journal Articles & Papers

[32] Cooper, J., R. Fox, J. Loeprick, and K. Mohindra. (2016). T*ransfer Pricing and Developing Economies: A Handbook for Policy Makers and Practitioners*. Directions in Development. Washington, DC: World Bank. doi:10.1596/978-1-4648- 0969-9. License: Creative Commons Attribution CC BY 3.0 IGO

[33] Markham, *Supra* n. 31

[34] See the list of minimum standard in 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

allows APA negotiation in the absence of APA regulation[35]. Such a phenomenon shows that increasing taxpayer and tax administration's willingness to employ APA as a tool to alleviate the risk of transfer pricing dispute in the future[36].

The regulation which administers APA was enacted in Income Tax Law, Government of Indonesia Regulation no. 74 Year 2011, and PMK-7/2015. Furthermore, as a response to BEPS Action 14 minimum standard, specifically the inclusion of roll-back provision in Indonesia APA regulation, PMK-7/2015 was updated by Finance Minister Regulation Number PMK-22/2020. The differences between the last APA regulation and the most updated can be seen as follows:

Items	PMK-7/2015	PMK-22/2020
Document and Form	Not provided (up to the taxpayer)	Providing form for APA submission to ensure consistency
Timeline in processing APA	No particular timeline	The timeline for each of step is clearly stated to provide certainty for taxpayer and tax administration, for instance: negotiation can only be performed for maximum 24 months
APA Covered Period	3 years maximum for Unilateral APA, and 4 years maximum for Bilateral APA	5 years maximum for both Unilateral and Bilateral
Roll-Back provision	No roll-back provision	Roll-back can be implemented as long as the taxpayer can fulfill the criteria
Documentation	A standalone annual compliance report is necessary	No need for additional document since the taxpayer's transfer pricing documentation should state and reflect the agreement in APA.
Renewal APA	The taxpayer should submit new APA request	The taxpayer only submit a request to renew the previous APA.

From the amendment of APA regulation, it can be discerned that Indonesia provides more convenience and certainty for their taxpayers in submitting APA request. For example, the roll-back provision allows the taxpayer to implement APA for fiscal years prior the APA period as long as the taxpayer request for roll-back and the following criteria was met[37]:

a. No material difference in facts and condition between the APA period and roll-back period
b. The statute of limitation has not been surpassed (five years based on Indonesian Taxation Law)
c. No corporate income tax assessment notice being issued
d. No tax-crime investigation or tax-crime punishment

[35] Markham, *Supra* n. 31
[36] *Ibid*
[37] *Supra* n.18

Based on these grounds, practically the taxpayers could cover ten fiscal years if their APA request is agreed, consisting of five years for APA period, and five years for roll-back period if the taxpayer meets roll-back requirement.

However, the APA facility only provided for the eligible taxpayer who able to satisfy the following criteria[38]:

a. Already fulfilled obligation to submit corporate income tax return for the last three years
b. It has been obliged and fulfill the obligation to prepare transfer pricing documentation for the last 3 years.
c. Not currently under tax-crime investigation or tax-crime punishment.
d. The related party transaction as well as the related party to be proposed on APA had been reported in the last 3 years corporate income tax return
e. The proposed transfer price in APA proposal does not result in a lower operating profit than the operating profit already reported in the last three years.

Such strict requirements for Indonesian taxpayers in submitting APA requests made only "the chosen-taxpayer" can be eligible to submit such request. On the other hand, such criteria could also be viewed as an effort to prevent the utilization of APA as a legalized tax planning strategy.

It can be understood that PMK-22/2020 was developed under the assumption of a normal, non-pandemic economic condition. However, when the COVID-19 outbreak spread globally, the prerequisite that APA should not result in lower operating profits has an unforeseen barrier for Indonesian taxpayers, since most business suffer losses. Most enterprises projected a decline in revenue and financial performance for the coming years, at least until the year 2021. Consequently, based on PMK-22/2020 provisions, it would be very difficult for Indonesian taxpayers to meet the criteria for submitting APA.

Fortunately, the Indonesian government is responsive to the pandemic condition. To accommodate the COVID-19 impact, DGT released PER-17/2020 to provide a leeway for Indonesian taxpayers when submitting APA requests. It stipulates that the taxpayer who is negatively impacted by COVID-19, could submit APA proposal using adjusted operating profit based on the assumption that the proposed APA periods are in normal condition (without Covid-19 effect). In other words, the taxpayers could submit a lower operating margin proposal as long as they can explain that such a lower margin is caused by COVID-19, and if the condition is normal, the APA proposal will not result in lower operating profit. PER-17/2020 provides a standard form for the taxpayer to show the projected financial performance in APA period (which includes) how APA proposal affected by COVID-19 and a "counterfactual" projection assuming APA proposal is implemented in normal economic condition[39].

IV. Core Issues of Indonesia's Transfer Pricing Disputes

Transfer pricing is a consequence of globalization and multi-nationality. As a capital importing country and the largest economy in Southeast Asia with strong purchasing power and demographic bonus, Indonesia constitutes a huge potential market for MNEs. Even though Indonesia impose 25% corporate income tax rate until 2019 (which is set lower to 22% in 2020 and 20% in 2021 forward), the foreign direct investment still grew for 14%. It achieved an FDI of USD 23 billion, with the manufacture, mining, and financial investment as the main

[38] *Ibid*
[39] See Appendix of PER-17/PJ/2020

industries[40].

It is unsurprising if Indonesia sets quite a high target for tax revenue collection, and DGT consequently establishes a tax policy to protect Indonesia's tax base. As a result, the tax auditor could be more aggressive in conducting their assessment, particularly in transfer pricing audit. Such a situation will trigger an increasing number of transfer pricing litigation in Indonesian tax court.

To the author's knowledge, the study that analyse the main root of transfer pricing dispute in Indonesia is still scarce. Wardhana's (2019) study on Indonesia's transfer pricing dispute had provided an overarching analysis on the cause of transfer pricing dispute in the Indonesian tax court[41]. In his research, Wardhana sampled 80 of Appeal Cases, of which 56 transfer pricing cases were eligible for his analysis. The study found that the statement of ALP, intangible property (include royalty payment), and intercompany sales were the majority case brought to Indonesian tax court[42]. Other than those mentioned, management fees and related interest payments also be the disputed cases in the tax court[43].

To provide more knowledge and perspective in studying the root cause of transfer pricing dispute in Indonesia, this works following the method in Silberztein (2010)[44] and Wardhana (2019), by reviewing 131 Indonesian tax court decisions to identify the main issues in Indonesian transfer pricing dispute.

4.1. Formality Issue (Formal VS Substance)

One of the main issues in the Indonesian tax court related to transfer pricing is the dispute related to the fulfillment of formal requirements before entering the material assessment. The tax auditor will generally evaluate the formality aspect of taxpayer's document, such as the reporting of affiliated transaction in taxpayers' tax return, the availability of transfer pricing documentation ("TP Doc"), or the content of such TP Doc vis-à-vis the TP Doc regulation (i.e., PER-32/2011 for the fiscal year before 2016, and PMK-213/2016 for the fiscal year 2016 and forward). If the taxpayers did not fulfill the requirement in transfer pricing regulation, the tax auditor would disregard the affiliated transactions, recharacterize, or recalculate the price of affiliated transactions according to the tax auditor's own application of ALP.

A different perspective is often provided by the judges in Indonesian tax court. They more likely to decide the transfer pricing case based on the substance over form. Therefore, in the event that the taxpayers could prove that the transaction already exists in substance, the judge could accept such argument.

Put.46958/PP/M.II/15/2013 could be a perfect example in this case[45]. The tax auditor conducted an audit towards the taxpayer's related party transaction for the fiscal year 2008. As a result, the auditor disregarded the royalty payment to taxpayer headquarter in another jurisdiction due to the unavailability of sufficient transfer pricing documentation. However, the taxpayer provided evidence regarding the royalty to the tax court, including the contract of royalty payment, transfer slip, and the headquarter's proof of intangible ownership. Furthermore, the taxpayer also provided its TP Doc for the fiscal year 2009 as a detailed

[40] United Nations. (2020). World Investment Report 2020, International Production Beyond The Pandemic. New York: United Nations Publications
[41] Wardhana, A. W. (2019). A policy proposal to address tax base erosion caused by transfer pricing in Indonesia. PhD thesis, Queensland University of Technology
[42] *Ibid*
[43] *Ibid*
[44] Silberztein, C. (2010). Transfer Pricing Disputes and Their Causes. *Asia-Pacific Tax Bulletin*, 439-446, Journals IBFD
[45] See Risalah Put.46958/PP/M.II/15/2013 in http://www.setpp.kemenkeu.go.id/risalah

description of what occurred in 2008. Based on the evidence, the judges consider that the royalty had been paid in substance, and the TP Doc in the subsequent fiscal year should be considered when performing the audit. As a result, panel of judges approved the taxpayer's argument, accepted the taxpayer's appeal, and revoked tax auditor's adjustment.

4.2. Comparability Issue

Comparability analysis is the heart of the application of ALP[46]. It consists of reviewing the related party transaction and finding the potential comparable[47]. At the end, it aims to find the most reliable comparable[48]. Hence, comparability is always one of the core questions in transfer pricing dispute, particularly in deciding whether the comparable should be selected or rejected.

Indonesia's transfer pricing regulation had been implemented the OECD's approach since 2010, included comparability analysis. Accordingly, PMK-22/2020 as Indonesia's most updated transfer pricing regulation, also adopts the comparability analysis as elaborated in OECD Transfer Pricing Guidelines, such as the comparability factor and the steps of performing comparability analysis.

The scope of this topic is broad, however, the authors identify at least three main categories related to this issue:

4.2.1. Selection of loss-making comparable

The inclusion of loss-making comparable often triggers dispute between tax auditors and taxpayers. The OECD Transfer Pricing Guidelines and Indonesian tax regulation do not provide a detailed prescription on the appropriate circumstances to use loss-making comparable, and how to include or exclude such comparables. OECD suggests that the fact and circumstances surrounding the comparable, instead of its financial result, should be the main consideration when it comes to select comparable[49]. However, OECD acknowledges that the inclusion of consistently loss-making comparables should trigger further investigation since no independent company would continue to generate loss except having reasonable expected profit[50].

It is expected if the tax auditor would reject the loss making comparable, and the taxpayer would do the contrary. Such a case ever occurred in the Indonesian tax court in PUT.80432/PP/M.XIIA/16/2017[51], in which the tax auditor rejected one comparable due to its financial performance. The use of the rejected comparable by Indonesian taxpayer was unacceptable due to its suffering loss for three consecutive years.

The taxpayer brought the case to the tax court and arguing the inconsistency of the tax auditor's approach when conducting the audit. However, the panel of judges contended their decision based on OECD Transfer Pricing Guideline, and concluded that the use of three-consecutive-years-loss-making comparable was not appropriate. The decision was then in favour of DGT.

4.2.2. Rejection of comparable due to material differences

To select or reject potential comparable in finding the most reliable comparable requires several steps. One of them is to identify the differences between the potential comparable and

[46] Para 1.6. of OECD TPG 2017
[47] Para 3.1. of OECD TPG 2017
[48] Para 3.2. of OECD TPG 2017
[49] Para 3.65. of OECD TPG 2017
[50] Para 3.64. of OECD TPG 2017
[51] See Risalah Put. 80432/PP/M.XIIA/16/2017 in http://www.setpp.kemenkeu.go.id/risalah

the tested party under review, and if the differences are material, adjustments should be made to eliminate the effect so the comparability could be enhanced [52].

The same principle applies to Indonesia's transfer pricing regulations. Both in the pre-BEPS regulation PER-32/2011, as well as PMK-22/2020 require comparability adjustment to be performed before determining the most reliable comparable. When there exists material differences and comparability adjustment cannot be made reliably, then said comparable should be rejected.

The dispute in comparable selection can be discerned in PUT-80433/PP/M.XIIA/16/2017[53]. DGT's auditor rejected one comparable from the taxpayer due to different characteristics of the comparable. The taxpayer was characterized as a fully-fledged manufacturer that engages in the production of fluorescent lamps and ballast. The auditor's viewpoint was that the taxpayer should also be characterized as fully-fledged distributor. Furthermore, based on comparability analysis towards the potential comparable, one comparable should be rejected because it carried out information technology business, which was materially different with the taxpayer. Based on this argument, the panel of judges agree with the DGT's auditor, and the transfer pricing adjustment was upheld.

4.2.3. The use of multiple vs single-year data

The dispute of whether to use single or multiple-year data frequently occurs in tax court. OECD TPG 2017 acknowledges that multiple-year data can add value in transfer pricing analysis, for instance, to understand the long-term arrangement[54]. Nevertheless, the guidelines do not set prescriptive guidance on when to use or not to use multiple-year analysis[55]. OECD emphasizes that the use of multiple year data does not mean using multiple-year average instead[56].

A similar approach is used in PMK-22/2020, whereby the use of multiple-year data is useful to enhance comparability. The prevailed Indonesia transfer pricing audit guideline (PER-22/2013 and SE-50/2013) also set out the principle in using single or multiple-year data, which was beneficial in selecting or eliminating potential comparable. Using similar wording with OECD 2010 Transfer Pricing Guidelines, the TP audit guidance also emphasized that the use of multiple year data did not imply that the determination of arm's length price should also use multiple-year average data[57]. Based on this wording, it would seem that the DGT's auditor prefers to use a single-year of data than a multiple-year average.

Both PUT-103250.15/2011/PP/M.VA and PUT-116100.15/2013/PP/M.IVB are examples of how the different approaches by taxpayer and tax auditor lead to dispute in tax court. Generally, tax auditor used single-year data, while there was no specific tendency of the approach used by taxpayers. In both court cases, the taxpayers used multiple-year average data of their comparables, then compared the results to their financial performance as their reasons that the transfer price had been in arm's length range. In contrast, the auditor used single-year approach based on OECD TPG and Indonesian domestic regulation, and adjust the taxpayers' transfer price since the result of single-year analysis made the taxpayers' performance being out of arm's length range.

[52] See Para 3.64 to 3.54 regarding Comparability Adjustments of OECD TPG 2017
[53] See Risalah Put. 80433/PP/M.XIIA/16/2017 in http://www.setpp.kemenkeu.go.id/risalah
[54] Para 3.75 to 3.79. of OECD TPG 2017
[55] Ibid
[56] Ibid
[57] See the attachment of SE-50/PJ/2013

For both cases, the panel of judges view that the multiple-year analysis, as well as multiple-year average data could be used in transfer pricing analysis. In PUT-103250.15/2011/PP/M.VA the judges used both single and multiple year analysis and proved that the taxpayer's profit level indicator was in fact still in the arm's length range for both approaches.

There was a different condition in PUT-116100.15/2013/PP/M.IVB. In the latter case, the taxpayer argued that the use of multiple-year data could eliminate the effect of abnormal inflation that occurred in a particular year. Based on the taxpayer's analysis, there was a spike of inflation in 2013 (the fiscal year under review). To eliminate such effect, the taxpayer argued that the use of multiple-year data was required. The argument was then received by the judges. For both cases, the tax court decisions were in favour of the taxpayers.

4.3. Selection of Transfer Pricing Method

The dispute in the transfer pricing method essentially stemmed from different results or approaches in functional and comparability analysis[58]. It can be in the form of which one is more appropriate between traditional or transactional method (e.g., CUP vs TNMM), the use of a non-recognized-internationally methods, or profit attribution when profit split method is selected[59]. In Indonesian context, the authors found the first-two mentioned dispute ever been brought to the Indonesian tax court.

The case which decided in PUT-100870.15/2012/PP/M.XVIA was related to the determination of the most appropriate method between CUP or TNMM[60]. Generally, DGT's auditors had a preference to use CUP than other methods since CUP is the most direct and reliable method, no need for working capital adjustments, and relatively free from differences in accounting treatment. On the other side, the use of CUP requires high comparability of products being compared, so it is suitable for transaction related to selling or buying commodity products with active and liquid market.

However, different conditions occurred in the case as mentioned earlier. The taxpayer, who engaged in commodity business, already selected CUP as the most appropriate method, while DGT's auditor determined that TNMM was the most reliable method for the taxpayer's case.

The auditor argued that the use of CUP by the taxpayer was invalid because the auditor believed that the use of CUP method necessitated a more rigid requirement regarding the characteristics of products. Furthermore, the auditor believed that the taxpayer could not provide the evidence to prove the existence of the taxpayer's purchase from its foreign affiliates. Therefore, DGT auditor chose to select TNMM by using Net Profit Margin (NPM) as the profit level indicator.

The decisions by the panel of judges concurred with DGT's argument. The judges decided that the use of CUP method required high comparability, such as identical or similar products being compared, and similar condition between the transaction under review and the comparables. Such requirement was unable to be fulfilled by the taxpayer. Taxpayer also could not furnish the evidence required by DGT auditor, such as the complete flow of document, flow of inventory, and cash flow related to taxpayer's purchase to its affiliate. Therefore, the decision was in favour of DGT.

[58] Silberztein, *Supra* n.44
[59] *Ibid*
[60] See Risalah PUT-100870.15/2012/PP/M.XVIA in http://www.setpp.kemenkeu.go.id/risalah

The authors also identify the case where DGT used a non-recognized internationally method when performing an audit for affiliated-royalty payment in Put-63364/PP/M.VIIIA/15/2015[61]. In assessing the arm's length price for royalty, the auditors use 25% rule of thumb approach, which principally similar to Comparable Uncontrolled Transaction (CUT) method in PMK-22/ 2020. The auditors argue that affiliated royalty expenses should not exceed 25% from Profit Before Interest and Taxes. However, the taxpayer was of the view that such approach was not eligible in determining arm's length price for royalty since the 25% rule of thumb was considered a starting point in negotiation related to intangible properties, not for transfer pricing analysis purposes. Therefore, the rule of thumb could not be used as a basis for transfer pricing adjustment[62]. The panel of judges fully granted the taxpayer request, and the decision was in favour of the taxpayer.

4.4. Segregated or Aggregated Analysis

The OECD TPG para 3.9 – 3.10 explain that arm's length principle should be applied on the transaction-by-transaction basis (i.e. segregated approach), except for specific condition when related party transactions are closely linked or continuous, so segregated approach could generate an unreliable result. For such condition, the aggregation approach would be more appropriate.

Previous TP regulation, such as PER-32/2011, only requires the taxpayer to provide DGT with segmented financial statement. A later regulation PER-22/2013 only mirror OECD in prescribing that aggregation approach could be used when the affiliated transactions is closely linked and continuous. Nevertheless, the latest TP regulation PMK-22/2020 strongly require transaction-by-transaction basis as the primary approach in applying arm's length principle.

The landmark case regarding the segregation (or segmentation) and aggregation could be seen in Canadian GlaxoSmithKline case[63]. Such dispute also occurred in Indonesian tax court, for example in PUT-107454.15/2013/PP/M.XVA[64]. The case involved a dispute between taxpayer, who used CUP method and transaction-by-transaction basis, and DGT's auditor who determine that aggregated and TNMM approach was more appropriate. The taxpayer performed two affiliated transactions, purchase and royalty payment to its related party. After conducting Function, Assets, and Risk (FAR) analysis, the taxpayer treated its affiliate as the less-complex entity, hence, the tested party should be its affiliate which is resident in Japan.

However, the auditors found that the taxpayer has a less-complex function so it should be the tested party. The auditor was not convinced by the evidence provided by the taxpayer because it could not provide any confirmation from the third parties (the customer of the Japan's affiliates) to prove the document's authenticity. Moreover, after analysing the comparables from the taxpayer, the auditors concluded that the comparables used in CUP method were not reliable and had a low degree of comparability. Therefore, the auditor determined that TNMM and aggregated approach was more appropriate in testing the arm's length price of the affiliated transactions. The tax court then decided to reject the taxpayer request.

Even though the panel of judges upheld the auditors' adjustment, the authors found that the taxpayer has a stronger argument, if compared with international standard and theory regarding the appropriateness of CUP method and segregation approach. Putting aside its inability to provide convincing evidence, the taxpayer's approach was more in line to the idea

[61] See Risalah Put-63364/PP/M.VIIIA/15/2015 in http://www.setpp.kemenkeu.go.id/risalah
[62] *Ibid*.
[63] Silberztein, *Supra* n.44
[64] See Risalah Put-107454.15/2013/PP/M.XVA in http://www.setpp.kemenkeu.go.id/risalah

that CUP method and transaction-by-transaction basis have a higher level of reliability when an entity has more than one affiliated transactions.

4.5. Issue of Intra-Group Services

The charging of intra-group services is commonly questioned by tax auditor and the inquiries will typically relate to the issue of existence, benefits (i.e. willingness to pay), and the arm's length price for the service rendered. To address the issue in intra-group service, PMK-22/2020 provide preliminary steps to be performed in applying ALP, which is aimed to require taxpayer to prove that such service has actual substance, and the transaction is commercially rational.

Regarding intra-group services, the authors identify two examples of dispute brought to the Indonesian tax-court. In PUT-098444.15/2012/PP/M.VIIIB, DGT auditors could not ensure the existence and benefit of services provided by foreign subsidiaries to Indonesian taxpayer. According to the auditor, the taxpayer could not provide the evidence on what type of service being rendered, who carried out the service, when and where such service performed, the capability of the service provider, and whether such payment already follow arm's length principle[65]. Moreover, the transfer pricing method was considered inappropriate, since the taxpayer use percentage of sales instead of cost-based method typically used by service provider[66]. The taxpayer argued by presenting the document and the company profile of the service provider to the tax court. However, the judges were not convinced and upheld the adjustment by the tax auditor.

Different decision could be seen in PUT-104900.15/2010/PP/M.XIIIA. The dispute was related to trading service paid to majority shareowner, which was re-characterized as dividends payment by tax auditors[67]. Based on the trading agreement between the taxpayer and its parent, consultation service on selecting raw material, referencing services in selecting supplier and customer should be provided by the headquarter. The taxpayer should pay the commission for such services which calculated based on a certain rate (i.e., 2,1%-2.5% from purchase or 5% from sales). DGT's auditor was of the view that purchasing and selling activities were conducted by the taxpayer itself, and majority of suppliers and customers were affiliated parties of its MNE group. The auditors concluded that such service was not rendered and had no benefit for the taxpayer. However, the panel of judges viewed that, based on the evidence provided in the tax court, the service gave benefit to the taxpayer and the characteristic of such commission payment was different from dividends even though the remuneration was paid to the parent entity. As a result, the panel of judges fully accepted the taxpayer's request.

4.6. Issue of Intangible, including Royalty Payment

The role of intangible is increasing in current economics, particularly due to the development of information and technology[68]. Once a business group could develop a unique and valuable intangible, it could generate "above-normal" profit compared with its competitors. Therefore, the investment amount in intangible had been heightened as the intangible be the key value drivers for today's businesses[69]. In transfer pricing context, any analysis involving intangible

[65] See Risalah PUT-098444.15/2012/PP/M.VIIIB in http://www.setpp.kemenkeu.go.id/risalah
[66] OECD Transfer Pricing Guidelines 2017 para. 7.31
[67] See Risalah PUT-104900.15/2010/PP/M.XIIIA in http://www.setpp.kemenkeu.go.id/risalah
[68] See Haskel, J. and S. Westlake (2017) *Capitalism without Capital: The Rise of the Intangible Economy*. Princeton University Press
[69] Koch, G., K. H. Leitner & M. Bornemann, (2000). "Measuring and Reporting Intangible Assets and Results in a European Contract Research Organization" in C. (X.) Peng & M. Lagarden, (2019) DEMPE Functions and the RACI Concept – More Clarity or Confusion Ahead?, 26 *Intl. Transfer Pricing J*. 1 (2019), Journals IBFD

has its own difficulties, particularly in comparability issue because of its unique characteristics and data availability[70].

Generally, the transfer pricing issue of intangible would involve the allocation of remuneration for the group members based on their contribution in development, enhancement, maintenance, protection, and exploitation (DEMPE) activities related to the intangible, determination of the entities who ultimately share the residual profit from the use of intangible, and the arm's length payment for the use or right to use of an intangible (royalty)[71]. For Indonesian cases, Wardhana (2019) found that royalty-related dispute was the majority case being brought to the Indonesian tax court[72]. For royalty dispute, the authors found that there are two main issues.

4.6.1. The existence and benefit issue

Similar with intra-group service, the dispute in intangible and royalty also revolves around the issues of existence and benefit, in which the auditors did not contend that the taxpayer has convinced satisfactorily that the intangible and royalty payment exists, and such payment is proven to be beneficial for the taxpayer, e.g. in the form of increasing sales or profits.

PUT-089897.15/2011/PP/M.IIA could describe how the dispute on existence and benefit of intangible brought to the tax court[73]. The taxpayer paid royalty fee to its Japanese parent entity for know-how and trademark with a rate of 5% from its annual sales. The auditors argued that taxpayer could not provide the evidence that the intangible was owned by the Japan entities, and could not be convinced that the intangible had been beneficial in the production process. Moreover, the taxpayer did not have sufficient TP documentation which accurately delineated the taxpayer application of the arm's length principle for each of its affiliated transactions. The auditors disallowed the royalty deduction, and the case was brought to Indonesian tax court.

After hearing the argument from both sides, and the fact that 99.85% of sales were actually related party transaction. The judges reasoned that royalty payments, in particular for the use of trademarks, would have provided economic benefits if the taxpayer soldl its product to an independent party. As the sales conducted between affiliated parties, the use of trademarks for such transaction would be of no benefit. The counterpart would still buy from its affiliate notwithstanding any trademark, since both of the parties were in the common control of their parent. As the result, the DGT's adjustment was upheld.

A similar dispute can also be seen in PUT-70461/PP/M.XB/15/2016[74]. In this case, the taxpayer paid royalty for the license of know-how and technical services to its parent. Nevertheless, DGT's auditor disregarded such payment due to taxpayer's inability to prove that there were companies with a same or similar condition, that were willing to pay such amount of royalty for the use of such know-how. The auditor also found that the know-how was available on the internet and could be accessed publicly and freely. Therefore, no need for the taxpayer to pay royalty to its parent.

The taxpayer then argued that the royalty paid as the remuneration for the distribution of parent's knowledge and experience in conducting a particular technique in their business.

[70] Para 6.17 of OECD TPG, in OECD (2017), OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2017, OECD Publishing, Paris. http://dx.doi.org/10.1787/tpg-2017-en

[71] Para 6.32 of OECD TPG, in OECD (2017), OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2017, OECD Publishing, Paris. http://dx.doi.org/10.1787/tpg-2017-en

[72] Wardhana, *Supra*.n.41

[73] See Risalah PUT-089897.15/2011/PP/M.IIA in http://www.setpp.kemenkeu.go.id/risalah

[74] See Risalah PUT- 70461/PP/M.XB/15/2016 in http://www.setpp.kemenkeu.go.id/risalah

Such a technique was a trade secret and beneficial in the manufacturing process. As the basis for the payment, the taxpayer submitted to the court the agreement with the parent as well as other supporting documents. The taxpayer disagreed with the auditor regarding the availability of public information regarding the particular technique because the publicly available information only explained general information about the technique, not the particular intricacies of manufacturing process. The judges conclude that the intangible indeed existed and beneficial for the taxpayers. Therefore, the royalty payment could be accepted, and the auditor's adjustment should be rejected.

4.6.2. The arm's length range issue

If there is no dispute between taxpayer and tax authority regarding the existence and benefit of an intangible, the next issue would be how much the arm's length price or range for the royalty payment should be. Such dispute can be seen in PUT-108378.15/2013/PP/M.IA[75]. The dispute began with the disagreement between taxpayer and DGT's auditor regarding the selection of comparables, in which the taxpayer use license-type agreement while the auditor use agency-type agreement as the comparables. The auditors also found that one of the comparable provided was an exclusive agreement, which was different from the taxpayer's non-exclusive agreement. Due to such differences, the auditors concluded that the royalty's rate should be 5.75% from sales instead of 8.75% as documented by the taxpayer.

The taxpayer then argued that license-type agreement was more appropriate than the agency-type since the agreement facilitated the taxpayer to use the intangible property of its parent. Furthermore, it was known from the auditor's document that the auditors used the word "Remuneration: License based on Net Sales" as searching criteria, implying that the auditors themselves already seeked license-type agreement as comparables. As for the exclusivity issue, the taxpayer could prove that exclusivity bore no significant effect on the determination of arm's length price. The degree of comparability of intangible under review was more material than exclusivity. Based on this argument, the panel of judges decided that royalty payment already in line with arm's length principle and fully granted the taxpayer's request.

4.7. Financing Transaction

Intra-group financing had been empirically proven to be one of the most effective vehicle to minimize multinational tax burden[76]. Due to the deductibility of interest, the business group could easily move their debt or equity to get interest deduction, which often time become so excessive that erode the tax base in jurisdictions where they operate. In addressing such issue, OECD released BEPS Action 4, a specific measure to limit the excessive interest deduction and other financial payment[77].

Indonesia has its own interest limitation provision or thin-capitalisation rule, starting in the level of Indonesian Income Tax Law (Income Tax Law), Finance Minister Regulation, up to the lower Director General Regulation level. The Indonesian taxation regulation uses Fixed Debt-Equity Ratio (4:1) approach instead of a percentage of EBITDA. The rule is enshrined in PMK-169/PMK.010/2015 and PER-25/2017. Nevertheless, the dispute concerning arm's length interest deduction had already been brought to tax court since the authority to recharacterize debt to equity had been stipulated in Income Tax Law since 1984.

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[75] See Risalah PUT-108378.15/2013/PP/M.IA in http://www.setpp.kemenkeu.go.id/risalah

[76] See OECD (2015), *Limiting Base Erosion Involving Interest Deductions and Other Financial Payments, Action 4 -2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris. http://dx.doi.org/10.1787/9789264241176-en

[77] *Ibid*

The dispute on financing and interest deduction usually relate to the amount of the debt, the arm's length rate of interest, and the implicit guarantee between affiliates[78]. PUT-110844.15/2012/PP/M.XIIIB showed how the case involving affiliated interest being brought to the Indonesian tax court[79]. The DGT's auditors argue that the intra-group debt lacked substance after analysing that the debt was not supported with sufficient evidence, such as working-capital requirement analysis. There was no cash-inflow recorded to the recipient of the debt, and there were no maturity date and no periodic payments. Even though at the time the fixed debt to equity ratio (4:1) rule has not been implemented, the auditor founds that the taxpayer's debt-equity ratio was 7.16, which should be considered high-risk by the creditor. In the comparable condition, tax auditors argued, there was no independent party that would lend another entity with such a high-level of debt-equity ratio. Therefore, the interest deduction was disallowed.

The taxpayer argued that the debt under review was a result of debt reclassification, from unpaid trade payable (without interest) into short term notes payable (with 9% of interest). Therefore, there was no cash-inflow recorded by the taxpayer. The sufficient document which prove the debt existence also presented in the tax court, such as loan-agreement with affiliates, accounting records, and audited financial statement. The judges then were convinced by the taxpayer's evidence and fully granted the taxpayer's request to allow the interest deduction.

V. Unlocking the Conundrum – Which one is the most efficient way?

A cursory analysis through various court decisions involving transfer pricing dispute shows that the main issue actually does not revolve around complex related party arrangement, but sufficiency of documentation, i.e. whether the documentation provided by taxpayer suffice to establish the existence and benefits of related party transaction. The other most common dispute revolves around the issue of determination arm's length price, which is tightly connected to the selection of comparables (including whether multiple-year or single-year data is used).

Inasmuch as the Indonesian legal system does not acknowledge precedence as used in common law system, the authors opined that the above-mentioned issues do not necessarily have to proceed to court which would 1) either take longer time due to the very design of Indonesian tax court law as well as the backlog in Indonesian tax court, 2) do not necessarily result in a "win-win" situation since other jurisdiction where the affiliated party is resident may not recognize the Indonesian court decision. A more detailed explanation will be elaborated below.

Indonesia domestic regulation allows two pathways to resolve transfer pricing dispute: litigation through objection, appeal and judicial review; and negotiation through MAP or APA. Both can be taken in a parallel way, which means the taxpayer can submit litigation, as well as negotiation for one object of transfer pricing dispute. This measure is aligned with Article 25 of Model Tax Convention which provides access to MAP for taxpayers irrespective of the domestic remedies by domestic law. Nonetheless, it should be noted that if the taxpayer intends to apply MAP/APA in parallel with objection/appeal, the dispute matters being

[78] Silberztein, *Supra* n.44
[79] See Risalah PUT-110844.15/2012/PP/M.XIIIB in http://www.setpp.kemenkeu.go.id/risalah

submitted for MAP/APA must also be covered in the dispute matters as submitted in the application of objection/appeal[80].

Even though both pathways can be taken in a parallel way, the analysis on which way is considered the most efficient way is still required, particularly for the taxpayer as the party who will suffer the burden because of the transfer pricing dispute, and tax authority as the party who resolve the transfer pricing dispute and designing policy in handling such dispute. In answering the question, the authors use two methods. Firstly, by using the tax dispute statistic and data collected from 131 randomly selected transfer pricing-related tax court decision, the authors compare the timeliness of negotiation and litigation pathway. Secondly, by adopting the approach used by Baistrocchi (2006) in explaining transfer pricing litigation and APA using Game Theory (Prisoner's Dillema)[81], and Game Theory model developed by Rastegar et al. (2019) in determining the optimum strategy of claim resolution in construction (through negotiation, mediation, arbitration and litigation)[82], the authors developed the decision making analytical model which assess the cost and time aspect of both litigation and negotiation pathway to investigate which one could be considered as the most efficient approach for taxpayer in resolving their transfer pricing dispute.

5.1. Statistic Facts about Litigation and Negotiation Request

The data collected from Secretariat of Indonesian Tax Court[83], MAP statistic in DGT official website[84], and DGT National Forum of Transfer Pricing (NFTP)[85], show that heightened numbers of transfer pricing dispute occurred in Indonesia. Based on the statistic presented in NFTP regarding the statistic in transfer pricing litigation, there were 9.580 and 11.436 new appeal submitted in 2017 and 2018 respectively. In average approximately 2% of the case brought to Indonesian tax court was related to transfer pricing cases, i.e. around 191 and 228 new transfer pricing case being brought to Indonesian tax court in 2017 and 2018 respectively. All tax disputes, including transfer pricing dispute, increased by 19.37% in 2018.

Until July 2019, there were 7.876 new cases submitted to Indonesian tax court, whereby for the same period there were 6.185 new dispute brought to Indonesian tax court in 2018 (period of January – July). The data also show that in 2019, the number of new transfer pricing cases in Indonesian tax court increased approximately by 27,34% around the same period.

A different condition was observed in the Indonesian MAP profile. Based on statistic published in APA-MAP page, only 18 new MAP request submitted in 2017, and then increased by 50% into 27 new submission in 2018 [86]. Even though the increasing percentage was significantly high, the absolute number of new APA/MAP request was much lower than new litigation request.

The large gap between the amount of request in Indonesian tax court and MAP request can also be comprehended from the statistic of outstanding cases (backlog). The comparison of backlog between litigation and negotiation can be seen in this following table:

[80] Article 2(7) PMK-49/2019 in https://www.pajak.go.id/sites/default/files/2020-06/PMK%2049%202019%20English.pdf

[81] See Baistrocchi, E. (2006*). The Transfer Pricing Problem: A Global Proposal for Simplification. The Tax Lawyer*, 59(4), 941-979. from http://www.jstor.org/stable/20772637

[82] See Rastegar, H., Arbab Shirani, B., Mirmohammadi, S., Akhondi Bajegani, E. (2019). A game theory approach for determining optimum strategy of claim resolution in construction projects. *Journal of Industrial and Systems Engineering*, 12(3), 1-21.

[83] See http://www.setpp.kemenkeu.go.id/statistik

[84] See https://pajak.go.id/apa-map

[85] The DGT National Forum of Transfer Pricing was held internally for DGT officials from 19 – 20 September 2019. Most of the data presented in the forum was not publicly available.

[86] See the statistics in https://pajak.go.id/apa-map

Comparison	2017			2018		
	Outstanding Appeal in Tax Court (Total)[87]	Outstanding Transfer Pricing Cases in Tax Court (2% of Total)[88]	Outstanding MAP Cases[89]	Outstanding Appeal in Tax Court (Total)	Outstanding Transfer Pricing Cases in Tax Court (2% of Total)	Outstanding MAP Cases
Outstanding Case	5.553	111	53	7.813	156	58

From the statistic above, outstanding transfer pricing case in Indonesian tax court were approximately twice larger than MAP. Therefore, based on the aforementioned phenomenon, it can be concluded that most of Indonesian taxpayer prefer litigation to negotiation in resolving their transfer pricing dispute.

5.2. Comparison of Timeliness

The first approach used in this research in evaluating the most efficient way in resolving transfer pricing dispute is by measuring the average time of completion for both pathways. For this research purpose, the authors selected the statistics in Tax Court Decision as the representative for litigation pathway, since Tax Court Decision already legally binding for both the taxpayer and DGT[90]. In doing so, the authors collected data from 131 transfer pricing-related tax court decision and calculating the average time of completion if the taxpayer take the litigation. The decisions were published from the year of 2011 to 2019. The authors use the date of Notice of Tax Assessment as the starting date, and the date stated in Minutes of Tax Court Decision as provided in the webpage of Indonesian Tax Court Secretariat, since the Tax Court Decision Letter is not publicly accessible. If the date was not clearly stated in Minutes of Decision, the authors used the year as stated in the minutes as the year period when the tax court decision being released. The list of Tax Court Decisions used in this research, the starting date, and the date (if available) or the year (if the date was unavailable) when the tax court decision released had been presented in Appendix I.

After the data of tax court decision had been collected, the average time of completion in resolving transfer pricing dispute through litigation can be measured. The average time was thereupon compared with the average time needed to complete MAP cases, both pre-2016 cases and post-2015 cases, as published in Indonesia MAP Peer Review Report[91]. The result of timeliness comparison is presented in the following table:

Comparison	Theoretical Maximum Time	Average Time
Domestic (Objection and Appeal)	24 months	38.76 months
MAP	24 months	27.25 months

[87] *Supra* n.83
[88] Based on NFTP presentation which describe that approximately 2% of case in Indonesian tax court are related to transfer pricing dispute
[89] *Supra* n.84
[90] See Article 77 para 1 Law Number 14 Year 2002 which stipulated: “Tax court verdict is final and binding”.
[91] See OECD (2019), Making Dispute Resolution More Effective – MAP Peer Review Report, Indonesia (Stage 1): Inclusive Framework on BEPS: Action 14, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, https://doi.org/10.1787/deb42398-en

The table shows that the average time needed to settle case through negotiation (MAP) is shorter than litigation (objection and appeal). It can be deduced that the negotiation approach could provide certainty in a more timely manner than the litigation pathway.

A longer period of settlement in litigation might be occurred because there is no specific timeframe in place for Indonesian Tax Court to announce or issue their verdict after the panel of judges already made decision. Indonesian Tax Court Law only require that the verdict is made in a period of twelve months from the date of receipt of the appeal letter[92], but no specific provision regulates the timeframe on when to announce such verdicts. In contrast, Indonesian MAP regulation (PMK-49 and PER-16) provide clearer rules on the period for DGT to issue decision letter regarding MAP result, which is no longer than one month after both competent authorities exchanging their closing letter[93].

5.3. Decision making analysis

In order to assess both pathways in resolving transfer pricing dispute, the authors develop decision making analytical model based on game theory to investigate which pathways are considered as the most time-efficient and cost-efficient way in handling transfer pricing dispute.

5.3.1. Examining Cost Element

Assume that, without the loss of generality, the taxpayer's group income is 1.

We assume honest taxpayer that does not play reporting game a la De Waegenare, Sansing, and Wielhouwer (2006)[94]. The taxpayer reports internally consistent income r to tax authority H, and (1-r) to tax authority L, where the value of r is affected by transfer pricing. We assume that due to the existence of transfer pricing risk, H and L will always conduct an audit in its respective country. We also assume that H and L try to maximize its own revenue without due regard to taxation in other country. This results in the taxable income of y_H and y_L respectively. Best scenario for taxpayer is if there is no double tax: $y_H = \tau_H (r)$ and $y_L = \tau_L (1-r)$. With no double tax, taxpayer must only pay $-(\tau_H + \tau_L)$

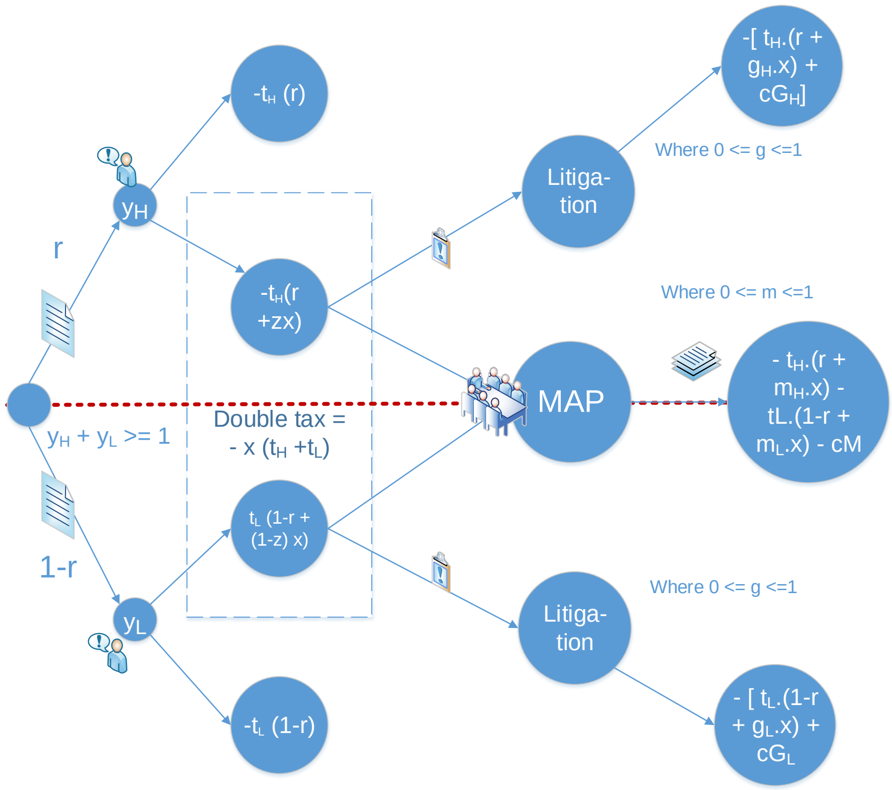
If double tax exists and there is no corresponding adjustment by both competent authorities, there exist x such that $x = y_H + y_L - 1$, hence $y_H = \tau_H (r + zx)$ and $y_L = \tau_L (1-r + (1-z) x)$.

Due to Article 25 para. (1) of tax treaty, H and L will not consider revenue impact to enter dispute resolution. As such, the tax authority would provide access to MAP notwithstanding domestic remedy, provided that taxpayer's objection is justified and presented within the appropriate timeline. We assume further that similarly for litigation, both H & L will be obliged by law to process taxpayer's litigation request.

[92] See Article 81 of Law Number 14 Year 2002

[93] See Article 5 (6) of PMK-49 in https://www.pajak.go.id/sites/default/files/2020-06/PMK%2049%202019%20English.pdf

[94] De Waegenaere, A., Sansing, R.C. and Wielhouwer, J.L. (2006), Who Benefits from Inconsistent Multinational Tax Transfer-Pricing Rules?. *Contemporary Accounting Research*, 23: 103-131. https://doi.org/10.1506/C5NJ-3D6X-WKBJ-V2H8



We denote m_H and m_L income allocation agreed in MAP by H and L respectively, where $0 \leq m_H \leq z$ and $0 \leq m_L \leq (1\text{-}z)$. If both competent authorities agree to fully eliminate double taxation, then $m_H + m_L = 0$. Otherwise, if they disagree (or agree to disagree), $m_H + m_L = 1$, in which double taxation remains. $0 < m_H + m_L < 1$ means a partial elimination of double taxation. g_H and g_L are defined similarly to denote the income allocation as independently decided by the respective tax court of H and L.

The first benefit of MAP is that in practice m is not as "random" as g, as 1) both CAs would consult each other in the allocation of m, unlike g which is decided independently by H and L with no regard to each other, and 2) the other CA would provide corresponding adjustment and/or tax refund in the case MAP results in an agreement to fully eliminate double taxation[95]. In contrast, a litigation process in H do not necessarily take into account the allocation as determined in the litigation process in L. As a result, if the litigation in H reject taxpayer's case and hence $y_H = \tau_H (r + zx)$, L do not necessarily provide a corresponding adjustment in the form of -zx, hence the double taxation x remains.

If we purely consider administrative cost standpoint (i.e. assuming that the probability of full elimination, partial elimination, and no elimination of double taxation are equal across MAP and litigation pathway), then the total taxes payable plus costs to administer MAP are:

$$-\tau_H(r + m_H.x) - \tau_L[(1-r) + m_L.x) - cM,$$

where cM is the cost to administer MAP. On the other hand, doing litigation in both countries would results in

$$-[\tau_H(r + g_H.x) + cG_H] - [\tau_L[(1-r) + g_L.x) + cG_L],$$

[95] Article 25 para. (2) of tax treaty stated that any agreement reached shall be implemented notwithstanding any time limits in the domestic law of the Contracting States. This is also in line with *pacta sund servanda* principle in Article 26 of Vienna Convention on Law of Treaties that the agreement must be performed by the parties in good faith.

where cG_H is the cost of litigation in H, and cG_L is the cost of litigation in L. The expected value $E(\tau_m)$ and $E(\tau_g)$ are similarly $\frac{1}{2}x$, with taxes $-\frac{(t_H.zx)+(t_L-t_L.zx)}{2}$.

MAP is better than litigation if the share of cM born by taxpayer is less that the share of (cG_H + CG_L) born by taxpayer. If the cost is shared equally between taxpayer and tax authority, then taxpayer would bear $cM_T = \frac{cM}{3}$ for MAP, and $cG_T = \frac{(cG_H+cG_L)}{2}$ if the taxpayer uses litigation in both jurisdiction.

Assuming $cM = cG_H = cG_L$, then entering MAP would be better off to taxpayer, since MAP only costing taxpayer 1/3 the costs of litigations. Indeed, one of the main benefit of MAP is that by the Article 25 of Tax Convention, taxpayer could present the case to either competent authorities ("CA")[96]. Taxpayer would typically either presented the same set of documents for both CAs, or submit them to one CA which would then exchange such information to the other CA. In contrast to litigation, taxpayer does not have to be heavily involved in the case in both fronts, as the competent authorities would then proceed by conducting negotiation or consultation at their own costs. Further, countries typically do not charge taxpayer for a MAP request. [97]

5.3.2. Examining Time Element

MAP allows dispute to be settled in the same time, resulting in $tM = tM_H = tM_L$. On the other hand, litigations run independently in H and L. Therefore, the best time achieved in dispute resolution is when the litigations in H and L run and finish concurrently, resulting in $tG = tG_H = tG_L$. The worst possible time would be if the litigations in two countries run consecutively, hence $tG = tG_H + tG_L$. The expected time for litigation, assuming tM, tG_H, and tG_L are similar, is therefore E(tG) = 3/2 E(tM).

If $E(\tau_m) = E(\tau_g)$ (i.e. no dispute resolution avenue that is inherently results in decision favoring taxpayer), then MAP will be better if:

$$\frac{cG.(1+i)^{tG-tM}}{cM} > 1$$

Proof:

An ex-ante decision of taxpayer could be calculated by considering the future value of cG and cM, which is calculated by:

$$c\ (1+i)^t$$

where i denotes appropriate discounting rate and t is time. MAP is strongly preferred than litigation if

$$cG(1+i)^{tG} - cM(1+i)^{tM} > 0$$

This expression is analytically hard to evaluate. Nevertheless, since c, t, and i are all positive value ≠ 0, the expression above would be true if $\frac{cG(1+i)^{tG}}{cM(1+i)^{tM}} > 1$, hence the result.

If E(tG) = 3/2 E(tM) and E(cG) = 3 E(cM), as outlined above, then MAP indeed will strictly preferred as it costs the taxpayer less than litigation.

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[96] Indonesia fully adopts this standard in the Article 2 of PMK 49/2019 and Article 2 of PER-16/2020
[97] OECD Country MAP Profiles. https://www.oecd.org/tax/dispute/country-map-profiles.htm

5.3.3. Examining Advance Pricing Agreement for Dispute Prevention

Article 25 Para. (3) of Tax Convention authorizes the competent authorities to resolve difficulties of interpretation or application by means of mutual agreement. Under this provision, competent authorities can conclude Advance Pricing Agreement, which is a mode of transfer pricing dispute prevention by setting up a transfer pricing policy for the taxpayer that is sanctioned by both states. In this case, APA enables x = 0, hence $y_H = \tau_H r$ and $y_L = \tau_L (1 - r)$ for the periods covered by the APA.

Assume that APA is consulted bilaterally similar to MAP (the cost is cM and it is resolved in tM time), and the result (double tax agreed by both CAs to be fully eliminated) applies for n years. If taxpayer's transfer pricing dispute is recurrent, then APA will strongly be preferred to litigation in every year if: $\frac{cG[\frac{(1+i)^n-1}{i}]}{cM(1+i)^{tM}} > 1$

Proof:

In a counterfactual, taxpayer face a recurring transfer pricing disputes for n periods in the absence of APA. If taxpayer always enters into litigation in both countries, this would cost the taxpayer n.cG for the periods. An *ex-ante* decision of taxpayer to enter APA could be calculated by taking the future value of cG for APA periods and cM for the consultation period. This results in $cG[\frac{(1+i)^n-1}{i}]$ and $cM(1+i)^{tM}$, where i denotes appropriate discounting rate, n denotes APA covered periods, and tM as the bilateral consultation period needed to conclude the APA. APA is therefore preferred if $cG[\frac{(1+i)^n-1}{i}] - cM(1+i)^{tM} > 0$, which if we assume c, t, and i are all positive value ≠ 0, the expression would evaluate to the above formula.

VI. Another Road: Transfer Pricing Safe Harbour Provision

As already elaborated in previous chapters, applying the arm's length principle can be a resource-intensive process. Its compliance regime may impose a high administrative cost for taxpayer and tax administration[98]. Generally, a transfer pricing audit also requires taxpayer to cooperate with lengthier and more thorough examination.

The administration of complex transfer pricing rule can lead to a wide range of possible results, depending on facts and circumstances of the transaction. It is expected to result in disagreement among taxpayers and tax authorities, leading to potential double taxation. Tax authorities spend extensive resources not only in drafting and enforcing transfer pricing rules, but also in resolving double taxation cases stemming from transfer pricing.

The term "safe harbour" refers to a variety of possible legislative or regulatory approaches for simplifying taxpayer compliance and tax administration with regards to transfer pricing. However, since transfer pricing regime (including that enshrined in Article 9 of Tax Treaty) is based on arm's-length principle instead of formulary apportionment, safe harbour must therefore emulate arm's-length results. Safe harbour is suitable for relatively routine or low-risk situations, allowing tax authorities to focus their resources on more complex and potentially abusive situations.

6.1. Safe Harbour in International Practice

The concept of transfer pricing safe harbours is not new. The US transfer pricing rules under Section 482 of the Internal Revenue Code contains provision for safe harbour interest rates

[98] Avi-Yonah, R. S. and I. Benshalom (2011). Formulary Apportionment: Myths and Prospects – Promoting Better International Policy and Utilizing the Misunderstood and Under-Theorized Formulary Alternative.. *World Tax J*. 3, No. 3: 371-98.

for inter-company loans and a 'cost only' (no-mark up) routine inter-company services safe harbour.

Previously, the 1988 Section 482 white paper Chapter 9 ("The Need for Certainty: Are Safe Harbours the Solution?") resoundingly rejected safe harbour. Safe harbours tend to deviate from arm's length principle, and "all have one common element that makes them both attractive to the taxpayer and potentially troublesome to the government: they generally would serve only to reduce tax liability". It was proposed as an elective measure for small-scale affiliated transaction (less than USD 10 million). However, it was finally dropped in the 1994 regulation, as there are concern that safe harbour might cause taxpayers to overreport their U.S. taxable income and underreport their foreign taxable income, as well as the possibility of inappropriate use by large taxpayers.

Despite international concerns there was growing impetus to adopt safe harbour. OECD conducted a survey and found similar safe harbours in 10 countries, along with a few transfer pricing exemptions for small taxpayers and/or less-complex transaction. A newer survey on existing transfer pricing simplification measures by Solilova (2013) [99] found that 33 out of 41 respondent countries have transfer pricing simplification measures, and 16 countries have safe harbours measure. Of these 16 countries, there countries which adopt more than one type of safe harbours. 8 countries implement exemption from transfer pricing rules/adjustments; simplified transfer pricing method and safe harbour arm's length range/rate are implemented by 6 countries each; and 3 countries have provisions for safe harbour interest rate, totalling at 23 safe harbour measures by 16 countries.[100]

Nevertheless, the OECD TPG 2017 paras. 4.96-4.97[101] still assert that safe harbour rules "could potentially have perverse effects" (especially for unilateral safe harbour) and that it "may not be compatible with the arm's length principle". While OECD concludes that safe harbours are "generally not advisable", it acknowledges that tax administrations and taxpayers generally favour safe harbours. OECD cautions that safe harbour should be carefully targeted and advises tax administration to avoid the problems that could arise from poorly designed safe harbour regimes.

To address potential downside arising from unilateral safe harbour regime, OECD goes so far as to provide sample memoranda of understanding (MOUs) that treaty partners can use to implement specific bilateral safe harbours. The sample memoranda is designed so that the the countries on both sides of the transaction agree on the same result and thus automatically avoid double taxation.

Further, although the OECD TP Guidelines does not explicitly designate low value-adding intragroup services (LVAS) as "safe harbour"[102] it cannot be denied that LVAS regime is an elective, simplified approach which contains qualifying criteria, such as: the service are of a supportive nature, are not the core business of the business group (not profit-earning or economically significant activities), do not involve or create intangible goods that are unique and valuable, and do not involve the assumption of significant risks for service providers. OECD ascribes an applied profit mark-up is 5% from relevant costs (except pass-through costs), irrespective of the categories of service. As a form of simplification, it does not need to be justified by a benchmarking study.

[99] Solilova (2013) "Transfer Pricing and Safe Harbours". *Acta Universitatis Agriculturae et Silviculturae Mendelianae Brunensis*, Vol. LXI No. 7. pp. 2757–2768

[100] OECD, Multi-country analysis of existing transfer pricing simplification measures, 2012.

[101] First included in June 6 2012 draft of OECD Transfer Pricing Guidelines, as revisions to the safe harbour section in Chapter IV of the guidelines.

[102] Referred to as "simplified determination of arm's length charges" instead

6.2. Cost and Benefits

Summarizing from OECD TPG 2017, Solilova (2013), and Picciotto (2018), the benefits, issues, and potential feature of a safe harbour provision that may be applicable are as follows:

Benefits	Issues	Feature of safe harbour to address
Simplifying transfer pricing regime, reducing compliance cost for taxpayer, more efficient resource allocation and and monitoring cost for tax administration	Divergence from ALP, the method applied may not be most appropriate considering facts and circumstances of the transaction or characterization of taxpayer	Eligibility criteria, target low-risk taxpayers or transactions to ensure that administrative costs savings outweigh potential tax revenue losses Elective provision
Certainty that transfer prices will be accepted by tax authority May increase the level of compliance among small taxpayers that may otherwise believe their transfer pricing practices will escape scrutiny. Given relief from burden of proof and documentation, taxpayers may take advantage of safe harbour certainty, even if they perceive they have an arm's-length argument for reporting less income. .	Risk of double taxation or double non-taxation, including safe-harbour shopping Potential for inappropriate tax planning (taxpayer choosing safe harbour when it results in lower tax but not if otherwise, fragmentation of transaction, bunching, profit shifting to low-tax jurisdiction) and other transfer pricing manipulation with results of lower tax revenues	Bilateral/multilateral safe harbour MoU, MAP[103] Mandatory parameters to avoid under- and over-taxation, for example setting a target profit range Advance notice of election or a commitment to use the safe harbour for a certain number of years a la APA Carve-out or opt-out/revocation clause
Suitable for low-risk taxpayer/low-risk transaction, or small and medium enterprise. Small business may have to incur TP compliance costs that are not proportional to their operating profit, when compared to large companies (para. 3.8.4 OECD TPG 2017). Safe harbors allow small business to be competitive. Consequently, this is beneficial for for developing countries whose economies are significantly supported by small and medium-sized companies.	Potential discrimination, competitive, investment or trade distortions	Criteria for eligible taxpayer/transaction, elective provision Updating of information regarding prices and pricing developments of uncontrolled transactions (monitored going-forward approach)

6.3. History of Safe Harbour in Indonesia

6.3.1. Safe Harbour in Toys Industry

At present, there is an applicable rule of simplification measures in determining a taxable income of international toll manufacturing services (*maklon*) in the production of children's

[103] In contrast with 1995 OECD guidelines' stance that access to competent authority relief should be prohibited for elective safe harbours, current guidelines endorses the position that country to make MAP available to mitigate the risk of double taxation – or, at least, to state clearly its double taxation posture in advance so that taxpayers can make informed decisions about whether to elect the safe harbour

toys. The regulation is stipulated in the Decree of the Minister of Finance No. 543/KMK.03/2002 concerning Specific Norms of Calculating Net Income and the Payment of Income Taxes for Taxpayers Conducting International *Maklon* Service Business in the Children's Toys Production. In the Decree, taxpayers who carry out international toll-manufacturing service business activities are stipulated by a special taxable income calculation norm of 7% of the total cost of manufacturing or assembling goods, excluding the cost of using raw materials. (Looking at the formula that ignores the value of raw materials, it can be safely inferred that the service referred here is a toll-manufacturer). This rule applies as long as the Taxpayer does not enter into an APA with the Director General of Taxes, as the APA would have taken precedence over the safe harbour.

The Indonesian *Maklon* provision could be compared to Mexican *Maquiladora*. However, the former is narrower as it only applies for a very specific manufacturer (children toys). Absent from the Indonesian provision is also the exclusion from the permanent establishment and asset-based profit calculation.

There are several criticisms related to the *Maklon* rules. The first is its legal *raison d'etre*. Article 15 of Income Tax Law states that the authority of Minister of Finance to establish special calculation norms for certain taxpayers only applies for taxable income that cannot be calculated based on the provisions of Article 16 (1) or paragraph (3) (i.e. for small taxpayer which is not obliged to conduct bookkeeping). Considering the toll-manufacturer conducts bookkeeping, the argument that the costs and taxable income for *maklon* cannot be calculated is certainly moot.

Secondly, the narrowness of the rules that only applies to children's toys *maklon*. There is no explanation for the exclusive selection for toy manufacturer. Considering the business model, all toll manufacturers should have been able to apply the similar compliance regime, regardless of its domestic or international transaction. This difference may distort business competition between toll manufacturers.

Thirdly, it clearly deviates from arm's length principle as the provision covers all transactions which may include transactions with independent party already priced at arm's length. Based on these considerations, KMK No.543/KMK.03/2002 needs to be revised to be more targeted.

6.3.2. Exemption from general TP rule

Article 3 (1) of PER-43/2010 as amended by PER- 32/2011 stipulates that taxpayer engaging in the transaction with related party shall apply arm's length principle. Article 3 (2) of the Regulation further specifies steps to apply arm's length principle, which are:

a. conduct comparability analysis and determine the comparables;
b. determine the appropriate Transfer Pricing method;
c. apply the arm's length principle based on the results of the comparability analysis and the appropriate transfer pricing method into the related party transactions; and
d. document each step in determining the arm's length price or profit in accordance with tax legislation.

However, a simplification may be applicable for taxpayer who conduct related party transaction with the total values not exceeding 10 billion rupiah in 1 taxable year, for each affiliated party to the transactions. They are exempt from the obligations referred to in Article 3 paragraph (2) (particularly relevant is the obligation to document each step in applying arm's length principle).

By the PMK-213/2016, which was enacted as an implementation of BEPS Action Plan 13, the obligations to apply arm's length principle for related party transactions remains.[104] Nevertheless, it sets a transfer pricing documentation obligation threshold only for taxpayer which conducts a Related Party Transaction with:

a. annual gross turnover in the preceeding Fiscal Year more than 50 billion rupiah;

b. annual value of Related Party Transaction in the preceeding Fiscal Year:

1. more than 20 billion rupiah for tangible goods transaction; or
2. more than 5 billion rupiah for each of service provision, interest payment, utilization of intangible goods, or any other Related Party Transactions; or

c. Related Party in a country or jurisdiction with income tax rate lower than Indonesian corporate income tax rate as stipulated by the Law.

Taxpayer who does not qualify for the obligation is consequently not obligated to prepare and retain Local File and Master File as a part of their obligations to retain taxation documents.

6.4. Proposal for Unilateral Safe Harbour

To formulate regulations on the safe harbour in transfer pricing, we need to refer to the legal basis regarding the authority of the DGT as stated in Article 18 Paragraph (3) of the Income Tax Law. However, with the current wordings of the law, it is not possible to apply safe harbour insofar as safe harbour deviates from what independent parties to the transaction would behave. Arguably, the "other methods" mentioned in the Elucidation of Article 18 (3) of Income Tax Law – which currently encompasses TNMM and profit split, may be expanded to include safe harbour. Alternatively, a qualifying clause could be added, for example: "... in accordance with arm's length principle that is not affected by a special relationship, or ***in accordance with other values*** determined by the Director General of Taxes..."

If the legal aspects have been fulfilled, it is also necessary to make appropriate regulatory designs. The first aspect is determining the taxpayer or transaction criteria covered by the safe harbour. One concrete form of safe harbour recommended by the OECD is the determination of remuneration for low value-adding services (LVAS). Should there a possible profit stripping concern, Indonesia could adopt differential rates similar to Australia, where the mark-up for service fee charges is set at 5% maximum, while the mark-up for remuneration of service income is set at 5% minimum.

In addition, as applied in India and Singapore, it is necessary to consider the threshold option for both the taxpayer's turnover and transaction value. For example, in order to be in line with the limitations related to the implementation of Transfer Price Documentation as stipulated in PMK-213/2016, a proposed set limit on the turnover of not more than 50 billion rupiah and intra-group service transactions value of not more than 5 billion rupiah could be applied.

Another type of safe harbour that can be applied is a safe harbour for contract and toll-manufacturers. Some provisions that can be adopted from the Mexican *Maquiladora* regime including:

1. the goods supplied by foreign affiliates must be imported temporarily to be processed and exported back;
2. the goods will ultimately be owned by unrelated parties who make orders to foreign affiliates which have agreements or are related party to the companies in Indonesia;

[104] In addition, Article 3 (1) of the Minister of Finance Regulation obliges taxpayer to implement ex-ante pricing policy, and deems ex-post pricing policy to be not in accordance with arm's length principle.

3. the Indonesian companies have a very minimal risk related to raw material production;
4. the revenues of Indonesian companies come exclusively from contracts with foreign affiliate; and
5. the goods are only sold outside the territory of Indonesia.

In addition, with a few modifications, for the above rules to also be applicable to contract manufacturers there could be criteria of functions performed, assets used, and risks assumed by the Indonesian manufacturers. For example, risks related to inventories/raw materials, whose purchases and storage are performed and controlled by the Indonesian companies.

Finally, the arm's length profit could be set to a range that is appropriate for each sectors. Indonesia, for example, issued benchmarking studies for various industries[105]. With further refinement to exclude those with transfer pricing risks (whose profits are thus tainted), as well as establishing a set of turnover and asset threshold, the benchmarking could serve as a safe harbour arm's length range for qualifying manufacturers. It may also be periodically updated to take into account business cycles and economic circumstances.

6.5. Possibility for Bilateral Safe Harbour

The OECD Annex I to Chapter IV proposes sample MOUs for bilateral/multilateral purpose. The authority for MOU is based on Article 25(3) of the OECD Model Tax Convention, which, among other things, provides that the competent authorities "shall endeavour to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the Convention".[106]

Arguably, bilateral MOU provides an arm's-length bargaining between the tax authorities to design a fair and balanced safe harbour[107]. Para. 4.120 of OECD TPG 2017 states that "the rigor of having two or more countries with potentially divergent interests agree... should serve to limit some of the arbitrariness that otherwise might characterize a unilateral safe harbour. Bilateral safe harbours could also mitigate the concerns of potential tax abuse by limiting safe harbours to transactions involving countries with "similar transfer-pricing concerns" (and, preferably, similar tax rates). It could be further mitigated by having bilateral safe harbour with countries not engaging in harmful tax practice, as well as requiring consistent reporting in both countries. Steps to avoid safe harbour shopping through treaty networks would also need to be considered[108].

The sample MOUs are intended to provide a starting framework without being either mandatory or prescriptive. They deal with three kinds of transactions, described as "important classes of transfer pricing cases that now take up a great deal of time and effort when processed on a case by case basis":

- low-risk distribution functions;
- low-risk manufacturing functions; and
- low-risk research and development (R&D) functions.

The eligibility criteria for qualifying enterprise are designed to consider functions (that must be performed or must be excluded), risks to be assumed, permitted mix of assets, as well as exclusion by size or industry type. There is also emphasize to low-risk, limited-function

[105] Director General of Taxes Circular Letter No. 96/PJ/2009, 11/PJ/2010, 68/PJ/2010, and 105/PJ/2010
[106] As evidenced by 1999 mutual agreement between the United States and Mexico regarding safe harbour profit levels for *maquiladora* operations.
[107] Patricia Lewis, (2012) "Safe at last? Transfer pricing safe harbours on the horizon" *Tax Management Transfer Pricing Report*, Vol 21, No 9, 9/6/2012. The Bureau of National Affairs, Inc
[108] Ibid.

business activities, which could be designed as a “bright-line test” (for example, low-risk distribution MOU limits marketing and advertising expense to a specified percentage of sales).

In addition, bilateral safe harbours can be tailored to the economics of a particular market and circumstances compatibly with the arm's-length principle, modified and updated to reflect developments, and be designed to limit exposures to tax revenues. It suggests that bilateral MOUs can provide a means for developing countries to protect the local tax base in common

Such sample MOU nevertheless contains several limitations, *inter alia*:

1. It has not considered situations where comparables are reasonably known to be reliable for the industries.
2. Possible exclusion of low-risk taxpayers, such as small-size full-fledged distributors or manufacturers, or taxpayer having intangibles licensing transaction whose value is small.
3. Exclusion of routine support services or interest charges, which account for most existing unilateral safe harbours measures.
4. Narrowness of exclusion, e.g. barring contract R&D from using its own know-how, and limiting the contract distributor to selling products to customers in its home country, may require taxpayer to restructure should it wants to qualify for safe-harbour. Lewis (2012) suggest an intra-firm ring-fencing as an alternative.
5. The MOU does not permit taxpayer to deviate from the range in any given year. However, this is not sensitive to business cycle. Referring to Section 482 of US regulation, MOU could be designed to permit deviation from range, insofar as the multi-year average still falls within range.
6. Consideration for business line. It is not clear whether the limitations with respect to size or financial ratios, as well as operational tests, also applies for other business activities within the same legal entity, or whether it is supposed to be on a segmental basis.
7. It does not specify a mechanism of post-year-end adjustments for taxpayer to bring its taxable profit within range, along the lines of self-initiated adjustments.
8. It does not contain anti-abuse mechanism that authorizes tax authority to deny benefit of safe harbour if taxpayer engaged in a pattern of transactions designed to abuse the provision.
9. Potential undermining of APA or regular arm’s length standard TP adjustment for non-qualifying taxpayers. Non-qualifying taxpayers may argue that what is good enough (and implicitly roughly arm's length) for eligible taxpayers should also be appropriate enough for them, if facts and circumstances of the transaction are comparable.
10. No provisions to update the target ranges/qualifying criteria or other features. Although, this could be done by requesting MAP for a formal modification of the memoranda. Alternatively, countries may want to consider is embedding some adjustment provisions that automatically apply sans administrative procedure, for example by referring to kind of dynamic external index or adjustment mechanism for this purpose.

In addition, Indonesian government needs to monitor the cost savings and revenue effects of safe harbour, with consideration to before and after evaluations of:

1. Whether safe harbour reduce numbers of dispute
2. Whether it undermines the revenue from transfer pricing audit or administrative appeals.
3. The impact on investments and tax base

VII. Conclusions

As the most controversial issue in international taxation arena, the dispute in transfer pricing may require a lot of resources and take such a lengthy process. It potentially lasts for years, which would increase uncertainty for business and heighten cost for the taxpayer. On the other hand, the tax administration actually faces the same issue because the longer the dispute, the less opportunity to collect tax revenue. Therefore, both the tax administration and business should manage their strategy in handling transfer pricing dispute more efficiently.

This research focusses on three main issues: what are the main causes of transfer pricing dispute in Indonesia, what is the most efficient pathway for taxpayer in handling such dispute, and what could be taken by Indonesian tax authority to provide more certainty in this area. This work also elaborates the current regulation regarding transfer pricing dispute in Indonesia which portray how responsive the Indonesian government in implementing OECD BEPS Action Plan, setting the regulation to be align with international standard, and accommodating the rapid changes in business.

After reviewing 131 transfer pricing-related tax court decision this research found that the common causes of transfer pricing dispute in Indonesia are formality issue, comparability problems, selection of transfer pricing method, determination of segregation or aggregation approach, intra-group services, intangible issues, and intra-group financing. Our analysis shows that the main issue actually involve not only complex related party arrangement, but also document sufficiency or the existence and benefits of related party transaction. Among other things, the authors were of the view that those issues do not have to proceed to court since it could take longer time due to the very design of Indonesian tax court law as well as the backlog in Indonesian tax court, and no guarantee that such dispute result in a "win-win" solution because other jurisdiction affected by DGT auditor's adjustment may not recognize the Indonesian court decision.

Indonesian taxpayers can take two alternatives in parallel way in resolving their transfer pricing dispute: litigation through objection, appeal and judicial review; and negotiation through MAP or APA. However, the author found that there was large gap between the case in Indonesian tax court and MAP request which based on the statistic of new request and outstanding cases. Based on this finding, Indonesian taxpayer seems prefer to choose litigation pathway to negotiation in resolving their transfer pricing dispute. On the other side, analysis on the data collected from 131 transfer pricing related-tax court decisions shows that the average time of completion in resolving transfer pricing dispute through litigation was 38.76 months. Compared with 27.25 months as the average time needed to complete MAP cases, it took longer period to resolve dispute through litigation. Based on the finding, it could be deduced that negotiation pathway could provide certainty in timelier manner than litigation.

Furthermore, the authors examine the cost element, time factor, and APA in preventing transfer pricing dispute based on decision making analytical model. Such method also demonstrates that negotiation alternatives (MAP and APA) promotes the most time-efficient and cost-efficient way in resolving transfer pricing dispute. Still, this road had not been taken by Indonesian taxpayers.

Finally, this research elaborates on the opportunity to implement safe harbour provision in Indonesia transfer pricing regulation. The authors propose to use unilateral or bilateral safe harbour, and then provide some considerations to be evaluated by Indonesian tax authority before the safe harbour implementation.

APPENDIX I

List of Transfer Pricing Related Tax Court Decisions

Num	Number of Tax Court Decision*	Date of Notice of Tax Assessment as Stated in the Decision	Date or Year of Tax Court Decision	Average Months to Complete (Date Basis)	Average Months to Complete (Year Basis - when Date not Available)
1	PUT-0xxx10.15/2011/PP/M.XIA	22 April 2013	19 March 2018	59.73	
2	PUT.3xxx6/PP/M.XVII/16/2011	15 October 2009	2011		24.00
3	Put-3xxx5/PP/M.IV/15/2012	23 April 2009	2012		36.00
4	Put.4xxx0/PP/M.III/15/2012	24 July 2009	2012		36.00
5	Put-xxx00/PP/M.I/16/2012	19 November 2009	2012		36.00
6	Put-xxx01/PP/M.I/16/2012	19 November 2009	2012		36.00
7	Put-3xxx8/PP/M.VIII/15/2012	09 April 2010	2012		24.00
8	Put.4xxx8/PP/M.I/16/2012	12 February 2010	2012		24.00
9	Put.4xxx9/PP/M.I/16/2012	12 February 2010	2012		24.00
10	PUT.8xxx7/PP/M.XIIA/15/2017	15 August 2012	30 January 2017	54.30	
11	PUT.8xxx6/PP/M.XIIA/13/2017	30 August 2012	30 January 2017	53.80	
12	PUT-8xxx3/PP/M.XIIA/16/2017	31 January 2013	30 January 2017	48.67	
13	PUT.8xxx2/PP/M.XIIA/16/2017	31 January 2013	30 January 2017	48.67	
14	Put.5xxx4/PP/M.XA/15/2014	11 October 2007	18 August 2014	83.43	
15	PUT.4xxx5/PP/M.XVI/16/2013	21 April 2010	2013		36.00
16	PUT.4xxx4/PP/M.XVI/16/2013	21 April 2010	2013		36.00
17	PUT.4xxx3/PP/M.XVI/15/2013	21 April 2010	2013		36.00
18	Put-4xxx0/PP/M.VIII/16/2013	05 March 2010	2013		36.00
19	Put.4xxx9/PP/M.XIII/15/2013	29 April 2010	2013		36.00
20	Put-4xxx2/PP/M.XI/16/2013	21 June 2010	2013		36.00
21	Put-4xxx1/PP/M.XI/16/2013	21 June 2010	2013		36.00
22	Put-4xxx7/PP/M.I/16/2013	23 August 2010	2013		36.00
23	PUT-1xxx27.15/2011/PP/M.IIIA	24 November 2015	30 August 2018	33.67	
24	PUT-1xxx87.15/2013/PP/M.XIIB	14 September 2015	30 May 2018	32.97	
25	PUT-1xxx83.15/2012/PP/M.XIA	08 December 2014	18 February 2019	51.10	
26	PUT-1xxx50.15/2011/PP/M.VA	24 October 2014	29 January 2018	39.77	
27	PUT-1xxx27.15/2012/PP/M.XIIIA	05 November 2014	20 February 2019	52.27	
28	PUT-0xxx24.15/2012/PP/M.XVI.A	14 April 2014	12 February 2019	58.83	
29	PUT-0xxx03.15/2012/PP/M.VIIIA	30 April 2014	12 February 2018	46.13	
30	PUT-1xxx82.15/2013/PP/M.IVA	24 November 2015	12 February 2019	39.20	
31	PUT-1xxx70.15/2012/PP/M.XVIA	08 September 2014	29 January 2019	53.47	
32	PUT-0xxx44.15/2012/PP/M.VIIIB	03 July 2014	07 March 2018	44.77	
33	PUT-1xxx00.15/2013/PP/M.IVB	18 May 2016	06 September 2018	28.03	
34	PUT-1xxx55.99/2015/PP/M.XIVA	13 April 2016	28 May 2018	25.83	
35	PUT-1xxx54.99/2015/PP/M.XIVA	13 April 2016	28 May 2018	25.83	
36	PUT-1xxx53.99/2014/PP/M.XIVA	13 April 2016	28 May 2018	25.83	
37	PUT-1xxx52.99/2014/PP/M.XIVA	13 April 2016	28 May 2018	25.83	

Num	Number of Tax Court Decision*	Date of Notice of Tax Assessment as Stated in the Decision	Date or Year of Tax Court Decision	Average Months to Complete (Date Basis)	Average Months to Complete (Year Basis - when Date not Available)
38	PUT-1xxx51.99/2014/PP/M.XIVA	13 April 2016	28 May 2018	25.83	
39	PUT-1xxx50.99/2014/PP/M.XIVA	13 April 2016	28 May 2018	25.83	
40	PUT-1xxx49.99/2014/PP/M.XIVA	13 April 2016	28 May 2018	25.83	
41	PUT-1xxx48.99/2014/PP/M.XIVA	13 April 2016	28 May 2018	25.83	
42	PUT-1xxx23.16/2013/PP/M.IVB	18 May 2016	06 September 2018	28.03	
43	PUT-1xxx10.35/2010/PP/M.XIIIA	30 December 2014	22 March 2018	39.27	
44	PUT-1xxx08.35/2010/PP/M.XIIIA	30 December 2014	22 March 2018	39.27	
45	PUT-1xxx05.35/2010/PP/M.XIIIA	30 December 2014	22 March 2018	39.27	
46	PUT-1xxx04.35/2010/PP/M.XIIIA	30 December 2014	22 March 2018	39.27	
47	PUT-1xxx00.15/2010/PP/M.XIIIA	30 December 2014	22 March 2018	39.27	
48	PUT-1xxx60.15/2013/PP/M.XIIIA	24 April 2015	28 February 2018	34.70	
49	PUT-0xxx80.15/2011/PP/M.XVIA	26 July 2013	06 February 2018	55.20	
50	PUT-8xxx4/PP/M.VIB/15/2017	27 August 2014	14 September 2017	37.13	
51	PUT-0xxx96.15/2011/PP/M.XVIIIB	27 June 2013	13 February 2018	56.40	
52	PUT-1xxx11.35/2010/PP/M.XIIIA	30 December 2014	22 March 2018	39.27	
53	PUT-1xxx50.13/2012/PP/M.VIIIA	29 March 2016	01 April 2019	36.60	
54	PUT-1xxx61.15/2014/PP/M.IIB	14 June 2016	09 August 2018	26.20	
55	PUT-1xxx43.15/2011/PP/M.IA	24 February 2016	11 February 2019	36.10	
56	PUT-1xxx42.15/2010/PP/M.IA	11 December 2015	11 February 2019	38.60	
57	PUT-1xxx44.15/2012/PP /M.XIIIB	15 September 2015	12 February 2019	41.53	
58	PUT-1xxx68.15/2013/PP/M.XVIIIB	18 June 2015	24 January 2019	43.87	
59	PUT-1xxx90.15/2012/PP/M.XVIIIA	23 July 2015	22 January 2019	42.63	
60	PUT-1xxx55.15/2013/PP/M.XVIIIA	11 June 2015	22 January 2019	44.03	
61	PUT-1xxx53.13/2012/PP/M.VIIIA	29 March 2016	01 April 2019	36.60	
62	PUT-1xxx56.16/2013/PP/M.XIIB	08 May 2015	28 February 2018	34.23	
63	PUT-1xxx55.16/2013/PP/M.XIIB	29 May 2015	28 February 2018	33.53	
64	PUT-1xxx54.16/2013/PP/M.XIIB	08 May 2015	28 February 2018	34.23	
65	PUT-1xxx53.16/2013/PP/M.XIIB	08 May 2015	28 February 2018	34.23	
66	PUT-1xxx49.15/2013/PP/M.XIIB	08 May 2015	28 February 2018	34.23	
67	PUT-1xxx45.15/2013/PP/M.IIIA	27 April 2015	27 February 2018	34.57	
68	PUT-1xxx65.15/2013/PP/M.XIIB	27 April 2015	14 February 2018	34.13	
69	PUT-1xxx59.15/2013/PP/M.IIIA	22 April 2015	15 February 2018	34.33	
70	PUT-1xxx54.15/2013/PP/M.XVA	08 April 2015	22 January 2018	34.00	
71	PUT-0xxx15.15/2008/PP/M.XA	28 April 2010	07 May 2018	97.70	
72	PUT-1xxx35.15/2013/PP/M.IIB	23 June 2015	01 February 2018	31.80	
73	PUT-1xxx16.16/2014/PP/M.XXA	13 June 2016	13 November 2018	29.43	
74	PUT-1xxx15.16/2014/PP/M.XXA	02 June 2016	13 November 2018	29.80	

Num	Number of Tax Court Decision*	Date of Notice of Tax Assessment as Stated in the Decision	Date or Year of Tax Court Decision	Average Months to Complete (Date Basis)	Average Months to Complete (Year Basis - when Date not Available)
75	PUT-1xxx87.15/2013/PP/M.XIIIA	02 February 2016	07 February 2019	36.70	
76	PUT-1xxx65.25/2014/PP/M.VB	11 April 2016	30 January 2019	34.13	
77	PUT-1xxx64.16/2014/PP/M.VB	11 April 2016	30 January 2019	34.13	
78	PUT-1xxx63.15/2014/PP/M.VB	11 April 2016	30 January 2019	34.13	
79	PUT-1xxx44.15/2013/PP/M.IA	18 December 2015	11 February 2019	38.37	
80	Put-2xxx6/PP/M.XI/15/2011	25 September 2008	2011		36.00
81	Put.2xxx3/PP/M.III/15/2011	17 January 2008	2011		36.00
82	Put-4xxx5/PP/M.I/16/2013	23 August 2010	2013		36.00
83	PUT.4xxx4/PP/M.XII/13/2013	24 July 2008	2013		60.00
84	PUT.4xxx3/PP/M.XI/16/2013	21 June 2010	2013		36.00
85	Put.4xxx9/PP/M.IV/15/2013	18 October 2010	2013		36.00
86	PUT-xxx09/PP/M.VIII/13/2013	22 January 2010	2013		36.00
87	Put-4xxx9/PP/M.I/15/2013	11 June 2010	2013		36.00
88	09290xxx5/2008/PP/M.XA	31 December 2013	29 February 2016	26.33	
89	PUT.4xxx9/PP/M.XI/16/2013	21 June 2010	2013		36.00
90	Put-4xxx2/PP/M.XIII/16/2012	01 June 2010	2012		24.00
91	Put.4xxx5/PP/M.VIII/15/2013	27 August 2010	2013		36.00
92	Put-4xxx5/PP/M.VI/15/2013	18 March 2010	2013		36.00
93	Put-4xxx8/PP/M.III/15/2013	21 June 2010	2013		36.00
94	PUT.4xxx6/PP/M.I/16/2013	23 August 2010	2013		36.00
95	Put-4xxx1/PP/M.XIII/16/2012	01 June 2010	2012		24.00
96	Put.6xxx1 /PP/M.VIA/15/2015	19 April 2012	26 May 2015	37.73	
97	Put.6xxx7/PP/M.IA/15/2016	04 July 2013	15 February 2016	31.87	
98	Put-6xxx4/PP/M.VIIIA/15/2015	19 July 2011	24 August 2015	49.90	
99	PUT-xxx61/PP/M.XB/15/2016	30 January 2013	27 April 2016	39.43	
100	Put.7xxx3/PP/M.XVIIIA/13/2016	11 April 2013	02 August 2016	40.30	
101	Put-7xxx6/PP/M.XIA/13/2016	12 August 2013	13 June 2016	34.53	
102	Put-7xxx7/PP/M.XIA/13/2016	12 August 2013	13 June 2016	34.53	
103	Put-7xxx8/PP/M.XIA/13/2016	12 August 2013	13 June 2016	34.53	
104	Put-5xxx6/PP/M.XIA/15/2015	19 April 2012	09 February 2015	34.20	
105	Put-6xxx3/PP/M.IVA/15/2015	25 January 2011	21 April 2015	51.57	
106	PUT.4xxx2/PP/M.IV/15/2014	24 March 2010	21 January 2014	46.63	
107	Put-4xxx0/PP/M.V/15/2014	25 April 2011	13 January 2014	33.13	
108	Put-5xxx7/PP/M.XVB/15/2014	15 April 2010	04 July 2014	51.37	
109	PUT.5xxx7/PP/M.XVIB/15/2014	28 June 2010	03 April 2014	45.83	
110	PUT.5xxx7/PP/M.VB/15/2014	17 September 2009	20 October 2014	61.97	
111	Put.5xxx8/PP/M.IIA/12/2014	23 April 2010	18 October 2014	54.63	
112	PUT.xxx73/PP/M.XIV.A/13/2014	25 July 2008	04 December 2014	77.43	
113	Put.4xxx8/PP/M.II/15/2013	01 April 2010	2013		36.00
114	Put.8xxx4/PP/M.IA/15/2017	07 October 2014	25 September 2017	36.13	

Num	Number of Tax Court Decision*	Date of Notice of Tax Assessment as Stated in the Decision	Date or Year of Tax Court Decision	Average Months to Complete (Date Basis)	Average Months to Complete (Year Basis - when Date not Available)
115	PUT-8xxx4/PP/M.XIA/15/2017	25 July 2012	17 October 2014	27.13	
116	PUT-8xxx3/PP/M.XIA/15/2017	19 July 2012	17 October 2014	27.33	
117	PUT.7xxx6/PP/M.XIIA/15/2017	27 January 2012	16 January 2017	60.53	
118	PUT-7xxx6/PP/M.XIA/13/2016	12 August 2013	13 June 2016	34.53	
119	PUT-7xxx7/PP/M.XIA/13/2016	12 August 2013	13 June 2016	34.53	
120	PUT-7xxx5/PP/M.XIA/13/2016	12 August 2013	13 June 2016	34.53	
121	PUT-7xxx4/PP/M.XIA/13/2016	12 August 2013	13 June 2016	34.53	
122	Put-7xxx3/PP/M.XIA/13/2016	12 August 2013	13 June 2016	34.53	
123	Put-7xxx2/PP/M.XIA/13/2016	12 August 2013	13 June 2016	34.53	
124	Put-7xxx1/PP/M.XIA/13/2016	12 August 2013	13 June 2016	34.53	
125	Put-7xxx0/PP/M.XIA/13/2016	12 August 2013	13 June 2016	34.53	
126	Put-8xxx5/PP/M.XVIIIB/15/2017	24 July 2013	20 April 2017	45.53	
127	Put-4xxx5/PP/M.VIII/15/2013	16 April 2010	2013		36.00
128	PUT-0xxx38.15/2012/PP/M.XB	19 June 2014	21 February 2018	44.77	
129	PUT-0xxx97.15/2011/PP/M.IIA	25 September 2013	2018		60.00
130	PUT-1xxx99.15/2014/PP/M.XIIIB	14 April 2016	19 February 2019	34.70	
131	PUT-1xxx78.15/2013/PP/M.IA	18 May 2015	28 May 2018	36.87	
Average Months to Resolve Transfer Pricing Dispute through Litigation				**38.76**	

*All data was collected through the official website of Indonesian Tax Court Secretariat http://www.setpp.kemenkeu.go.id/risalah. Since this work is still a working paper, the tax court decision number was deliberately disguised.