



DEVELOPMENT OF TRANSFER PRICING REGULATIONS IN INDONESIA

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ABSTRACT

This research driven by the urgency to understanding the massive improvement of transfer pricing regulations in Indonesia. Directorate General of Taxes (DGT) have adjusted along with the advancement of macroeconomic, business field, cross border trade, and domestic needs. This study aims to describe the development of transfer pricing regulations in Indonesia, since it was first enacted in 1983. The analysis covers three main topics, which are the implementation and examination of arm's length principle, transfer pricing documentation, and advance pricing agreement. This research used qualitative methodology, particularly analytical descriptive approach. Analytical descriptive performed by analyze, capture, and summary a set of regulations, then provide them in the text containing important provision from each regulation. The result shows that there has been a significant development in transfer pricing regulation in Indonesia. Since the first time enacted, there are eight regulations concerning arm's length principle, three regulations concerning TP Doc, and five regulations concerning advance pricing agreement which enacted sequentially. Those have provided more detailed rules and fulfilled stakeholders' needs. Novelty of this research can be seen through the comprehensive inventory of transfer pricing regulations in Indonesia, which can provide broad explanation for readers. This research may contribute to enrich the transfer pricing literature for academics. Besides, by describe the whole transfer pricing regulations in Indonesia, this research may also contribute to broaden taxpayer's understanding and improve service quality of tax authority. From this research, it can be concluded that development of the transfer pricing regulations has provided legal certainty and efficiency for taxpayers and DGT in its implementation.

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1. INTRODUCTION

Tax avoidance has increased along with the improvement of multinational companies worldwide (Oats & Tuck, 2019). Existence of overseas related party allows company to shift their profit to party which established in the lower tax rate country (Sitkiewicz & Białek-Jaworska, 2024). Thus, management can save tax burdens globally. The instrument which often used by management to reduce taxes is transfer pricing (Kramarova, 2021).

Transfer pricing is practice of price determination on goods or services' which sold to another party (Hansen & Mowen, 2007). Companies under the same management can determine price of goods or services transacted to related party based on their interests. Commonly, it purposed to reduce cumulative global taxable profit, in order to pay lower taxes (Beebeejaun, 2017). The potential of tax avoidance makes transfer pricing a serious threat to tax authorities. Countries around the world have lost USD 616 billion of potential taxable profit due to transfer pricing within multinational companies (Tørsløv et al., 2023).

Table 1. Shifted Profit on States Around the World in billion USD per 2015

Country Group	Domestic Profits	Of which : foreign firms	Shifted Profits	Corporate tax loss (% tax collected)
OECD	10.092	1.589	537	2
Other Non-Haven	1.423	114	79	7
Total	11.515	1.703	616	9

Source: Torslov (2023)

As illustrated in Table 1, OECD countries experienced the largest profit shifting, reaching USD 537 billion. Indonesia itself faces big challenges to due to the tax revenue which only reached the target on four out of last sixteen tax year. To overcome these challenges, governments in various countries have regulated provisions to enhance fair transfer pricing practice within taxpayers. This spirit stated in the consensus which agreed by OECD and United Nations.

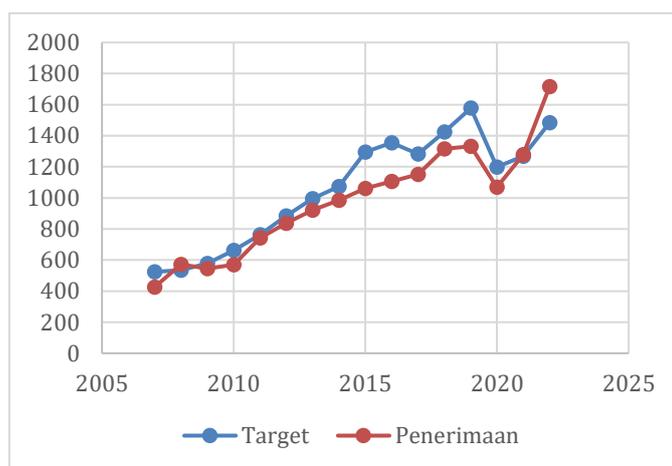


Figure 1. Indonesian Tax Revenue 2007 – 2022
Source: Kementerian Keuangan (2023)

As shown in Figure 1, Indonesian tax revenue from 2007-2022 shows significant fluctuations. From Figure 1, it shows that countries around the world have experienced the development of transfer pricing implementation and regulation. From the very first, many tax authority started to force transfer pricing audit in order to adjust the fairness of related party transaction to an arm's length point which guided by OECD its report (OECD, 1979). After that, enactment of regulations related to Base Erosion and Profit Shifting (BEPS) Action Plan has been a great initiative to faces tax avoidance through transfer pricing since 2013. It involved fifteen actions to overcome profit shifting from high-tax rate jurisdiction to low-tax rate jurisdiction (González-Barreda, 2018). Another development of transfer pricing practices is the implementation of Country-by-Country Report, as a reliable tools for tax authority to track the profit from multinational company in each country where they operating (Unger et al., 2021).

Other development of transfer pricing practices can be observed in the stage of dispute resolution, through Mutual Agreement Procedure (Brauner, 2020). More than 130 countries have implemented Mutual Agreement Procedure in their domestic law, to resolve transfer pricing dispute between other country (Noonan & Plekhanova, 2023).

Several previous research stated the importance of legal regulation to enhance the conduciveness of taxation climate in a country. Singh (2022) stated that decent tax regulations play an important role in building a conducive taxation climate. Besides, it also important to stimulate sustainable development in a country. Septarini (2012) found that Indonesian Transfer Pricing Regulation once was limited to implementation and examination of arm's length principle. Thus, Directorate General of Taxes (DGT) urged to seek the regulation in developed country such as USA and Japan. Mangonting (2018) stated that taxpayer's compliance is very important to countries which implement self-assessment system. Therefore, the regulations must be aligned with the principles of tax collection such as equality, fairness, convenience of payment, and legal certainty (Smith, 1776). Another research conducted by Huda et al., (2017) found that law formulation in transfer pricing realm is very important to prevent risk of tax revenue loss.

Due to author's literature review, research on description of transfer pricing law is still limited. However, it is important to understand the development of tax regulation to reach better governance in tax ecosystem. Significance of this research is the data used, in the form of regulations existed since the 1983 tax reform, where Indonesian tax authorities began to focus on transfer pricing issues. This research conducted by exploring Indonesia's transfer pricing regulations and explaining important components regulated. The regulations mapped into three major themes, i.e. implementation and examination of the arm's length principle, transfer pricing documentation, and advance pricing agreements.

This research aims to describe the development of transfer pricing regulations in Indonesia. Transfer pricing regulation has improved a lot align with domestic needs and global consensus. Methodology used is qualitative, in analytical descriptive approach, and positivist paradigm. The understanding of transfer pricing regulations is very important to tax authority and taxpayers in Indonesia. This study also equipped by comparability analysis on transfer pricing regulation between Indonesia and several regions. This research may broaden taxpayer's understanding which able to decrease tax disputes and improving the service quality of tax authority. Besides, this study may contribute to enrich scientific literature for the academics.

2. RESEARCH METHODS

This research is qualitative research with analytical descriptive approach. According to (Saunders et al., 2019), analytical descriptive research aims to provide an overview of the object under study without making a general conclusion. Besides, according to Wirartha (2006), analytical descriptive approach performed by analyze, capture, and summarize every condition and situation of the researched object. Analytical descriptive approach performed by analyze a set of regulations, then provide them in the text containing important provision on each regulation. In general, analytical descriptive approach is able to generates data that describe the object from a subjective (Doyle et al., 2020). Through qualitative analytical descriptive, it is necessary to concentrate closely on rigor and trustworthiness throughout the study, and to provide reflexive explanations (Doyle et al., 2020). Analytical descriptive is the most suitable approach for this study as it is able to achieve a low level of interpretation by staying closer to the data (Sandelowski, 2000).

Table 2. Source of Research Data

No	Regulations
1	Law Number 7 Year 1983 regarding Income Taxes
2	Circular Letter of Director General of Taxes Number SE-04/PJ.7/1993 regarding Guidelines for the Implementation of Transfer Pricing
3	Decree of Director General of Taxes Number KEP-01/PJ.7/1993 regarding Guidelines for Audit of Taxpayers in Special Relationship

- 4 Director General of Taxes Regulation Number PER-43/PJ/2010 regarding the Application of Arm's Length Principles in Transactions Between Taxpayers and Related Parties
- 5 Director General of Taxes Regulation Number PER-69/PJ/2010 regarding Advance Pricing Agreement
- 6 Director General of Taxes Regulation Number PER-32/PJ/2011 regarding the Application of Arm's Length Principles in Transactions Between Taxpayers and Related Parties
- 7 Circular Letter of Director General of Taxes Number SE-50/PJ/2013 regarding Audit Guidelines for Taxpayers with Special Relationship
- 8 Director General of Taxes Regulation No. PER-22/PJ/2013 regarding Audit Guidelines for Taxpayers with Special Relationships
- 9 Minister of Finance Regulation Number 07/PMK.03/2015 regarding Procedures of Formulation and Implementation of Advance Pricing Agreement
- 10 Minister of Finance Regulation Number PMK 213/2016 regarding Types of Documents and/or Additional Information Required to be Kept by Taxpayers with Related Party Transactions
- 11 Director General of Taxes Regulation Number PER-17/PJ/2020 regarding Procedures for the Accomplishment of Applications, Implementation, and Evaluation of Advance Pricing Agreements
- 12 Minister of Finance Regulation Number 22/PMK.03/2020 regarding Implementation Procedures of Advance Pricing Agreement
- 13 Minister of Finance Regulation No. PMK 172/2023 regarding the Application of Arm's Length Principles in Related Party Transactions

Source: Author (2024)

Data used in this research are tax laws and regulations related to transfer pricing. Regulations included in this research involve tax laws since the 1983 tax reform, where Indonesian tax authorities began to focus on transfer pricing issues. Research data divided into three main themes i.e. implementation and examination of arm's length principle, transfer pricing documentation, and advance pricing agreement. This research aims to find out the development of transfer pricing regulations in Indonesia. Thus, it is necessary to conduct an in-depth analysis of each transfer pricing regulations. Besides, this research also added comparative analysis of transfer pricing regulations between Indonesia and regions in the world which able to enrich the knowledge horizon in this study.

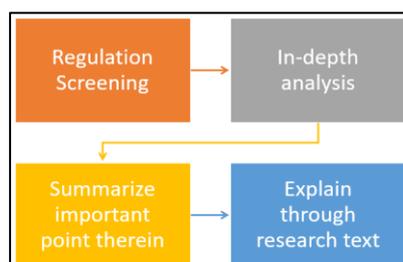


Figure 2. Data Processing Steps

Source: Author (2024)

The data processing steps in this research are illustrated in Figure 2, showing the systematic flow of transfer pricing regulation analysis.

3. RESULTS AND DISCUSSION

DEVELOPMENT OF REGULATIONS FOR ARM'S LENGTH PRINCIPLE IMPLEMENTATION AND EXAMINATION

First basis for transfer pricing regulations in Indonesia is Article 18 paragraphs (2) and (3) of Law Number 7 year 1983. This section contains first specific anti-avoidance rules (SAAR) in Indonesia which used as the base for tax authority to examine the fairness of related party transactions. SAAR also used by Directorate General of Taxes (DGT) to determine the existence of special relationships within taxpayers.

Special relationship existence between corporate taxpayers in this regulation is determined if there are direct or indirect business ownership and control. Meanwhile, special relationships for individual taxpayers exist between blood and blood relatives in a straight line of one degree or one degree to the side. But this clause considered ineffective because have not defined the tax avoidance clearly, which implied to difference in the interpretation between taxpayer and tax authority.

Details of that clause explained in the Decree of the Director General of Taxes Number KEP-01/PJ.7/1993 (Direktorat Jenderal Pajak, 1993a), regarding Guidelines for Audit to Taxpayer in Special Relationships. This decree prevailed as a guidance for DGT in examine the fairness of taxpayer's related party transactions. These regulation agglomerate risky transactions into four types, i.e.: 1) Determination of goods prices; 2) Determination of compensation for services, use of assets, and use of rights; 3) Charging of indirect costs allocated from the home office, such as monitoring, administration and planning costs; and 4) Determination of loan interest. The audit stages for related party transactions based on KEP-01/PJ.7/1993 are depicted in Figure 3, showing the systematic examination process.



Figure 3. Stages of Audit on Related Party Transaction based on KEP-01/PJ.7/1993
Source: KEP-01/PJ.7/1993 (1993)

In the same year, the DGT issued a Circular Letter from the Director General of Taxes Number SE-04/PJ.7/1993 regarding Guidelines for Implementation of Transfer Pricing. This provision referred to the Report of the OECD Committee on Fiscal Affairs which issued on 1979. That report highlighted the phenomena of the price charging on the transaction between group members, which doesn't represent the result of free play of market forces. This report concerned on the intra-group transactions which forced to shift profit to tax haven country (OECD, 1979). In this internal provision, a special relationship with corporate taxpayers can occur due to the control of 25% or more share capital by another entity, or between several entities whose 25% or more of shares owned by one entity. Meanwhile, for individual taxpayers, special relationships can occur due to blood or joint family relationships in a straight line or one degree sideways. This provision regulates seven causes of price unfairness in related party transactions. SE-04/PJ.07/1993 (Direktorat Jenderal Pajak, 1993b), also regulated transfer pricing methods to adjust unfairness in each segment. Based on this regulation, there are seven type of transaction which prone to cause the unfairness of related party transaction. Those are selling price; buying price; overhead cost; intragroup interest loan; commission, license, franchise, rent, royalties, service fees; purchase of assets below market price by related party; and sales abroad through third parties without business substance. But the use of SE-04/PJ.07/1993 is prone to cause arguments between taxpayers and tax auditors regarding the selection of the most appropriate pricing method, because the regulation has not rigid (Irfan et al., 2021).

Next stage of arm's length principle regulation in Indonesia marked by the issuance of Regulation of the Director General of Taxes Number PER-43/PJ/2010 (Direktorat Jenderal Pajak, 2010a), regarding the Application of the Arm's Length Principle in Transactions Between Taxpayers and Related Parties. Related party transactions are considered fair if no significant difference found compared to independent ones, or if there is difference but still can be adjusted. In this regulation, documentation is very important for DGT to assess transaction's fairness. Apart from that, taxpayers also required to attach the steps of comparative data determination. This regulation explains the stages of implementing ALP which include comparability analysis, selection of the most appropriate transfer pricing method, implementation of arm's length principle, and the documentation. Types of transactions causing price unfairness based on PER-43/PJ/2010 are summarized in Figure 4.



Figure 4. Types of Transactions Causing Price Unfairness based on PER-43/PJ/2010
Source: PER-43/PJ/2010 (2010)

PER-43/PJ/2013 (Direktorat Jenderal Pajak, 2013b), started to apply five benchmarking factors in determining the fairness of related party transaction. Those are function of each party, characteristics of goods and services, provisions of the contract, economic conditions, and business strategy. Meanwhile, the use of transfer pricing methods is narrowed down to five types, and applied hierarchically. This regulation state the ideal conditions for each method implementation. This clause implied to the effectivity of implementation of this regulation, as it able to states the certainty of transfer pricing method for particular transaction. Besides, this regulation also emphasizes DGT's authority in adjust unfair related party transaction. PER-43 put highlight on the intragroup service transaction by require DGT to ensure the legality of intragroup service transactions. This regulation implied to certainty of transfer pricing between overseas related party as stated in Article 2, which included the related party transaction either with domestic party or with overseas party into the scope of related party transaction. The hierarchy of transfer pricing methods based on PER-43/PJ/2013 is presented in Figure 5.

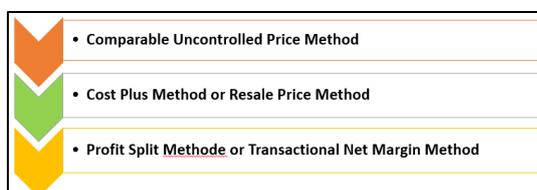


Figure 5. Hierarchy of Transfer Pricing Method based on PER-43/PJ/2013
Source: PER-43/PJ/2013 (2013)

Next stage of arm's length principle regulation is the issuance of Regulation of the Director General of Taxes Number PER-32/PJ/2011 (Direktorat Jenderal Pajak, 2011), regarding the Application of the Arm's Length Principle in Business Transactions Between Taxpayers and Parties with Special Relationships. This provision amends PER-43 to provide legal certainty and deeper regulation. In testing the fairness of related party transactions, DGT is urged to analyze taxpayer's profit beside price of transaction. Fairness of related party transactions is demonstrated when prices and profits are not affected by significant differences in current conditions. In this provision, the use of internal comparative data is prioritized in examine the fairness of transactions. This regulation also changes the stages of functional analysis which must be performed by tax auditor in examine related party transaction. The functional analysis that must be performed in audits is outlined in Figure 6.



Figure 6. Functional Analysis must be Performed in Audit
Source: PER-32/PJ/2011 (2011)

In this regulation, transfer pricing method has no longer chosen hierarchically. DGT prioritizes implementation that best suits to actual conditions or known as the most appropriate method. Economic condition is one of the most important benchmarking factors. DGT explains nine factors can be used to determine economic conditions of taxpayer. PER-32 completes transfer pricing arrangements by regulating the implementation of Cost Contribution Arrangements (CCA). CCA is an agreement made by related party to share the risks in developing, producing or acquiring assets, services or rights. CCA is also useful in determine the functions and roles of the parties in an agreement regarding the assets, services or rights in question. DGT provides room for taxpayers to receive benefits from agreements with related party, as long comparable to independent party. In addition, DGT's authority not only limited to transaction counterparties, but also to permanent establishments. Factors to be considered in analyzing economic conditions are detailed in Table 3.

Table 3. Factors to Consider in Analyzing Economic Conditions

No.	Determinants of Economic Conditions
1	Geographic Location
2	Market Size
3	Level of Competition in the Market
4	Availability of Substitute Goods
5	Demand and Supply in the Market Regionally and Globally
6	Consumer Purchasing Power
7	The Nature And Scope of Government Regulations
8	Production Cost
9	Time of Transaction

Source: PER-32/PJ/2011 (2011)

Further developments arm's length principle regulations contained in the Regulation of the Director General of Taxes Number PER-22/PJ/2013 (Direktorat Jenderal Pajak, 2013a), regarding Audit Guidelines for Taxpayers in Special Relationships. This provision divides the stages of audit on related party transaction into three parts, i.e. preparation, implementation and reporting. Preparation stage includes the process of data research and collection from taxpayer and its counterparties. Implementation stage includes the process of business characteristics of taxpayer (as an additional to previous regulation), selection of transfer pricing method, and implementation of arm's length principle. Reporting stage includes the preparation and submission of mandated document for taxpayer to fulfill the obligation based on prevailed regulation. Implementation stages of transfer pricing audit based on PER-22/PJ/2013 are explained in Figure 7.



Figure 7. Implementation Stage on Transfer Pricing Audit based on PER-22/PJ/2013
Source: PER-22/PJ/2013 (2013)

This regulation accommodates five transfer pricing methods can be used by taxpayers in Indonesia which are comparable uncontrolled price method, cost-plus method, resale price method, transactional net margin method, and profit split method. PER-22/PJ/2013 also places special emphasis on related party transactions in the form of intragroup services, use of intangible assets, and payment of interest on intragroup loans. It is important because these are the most often used transaction by taxpayers in tax avoidance. This regulation has referred to OECD Manual on Transfer Pricing, particularly in Attachment I which require taxpayer to explain their comparability characteristics in their actual conduct (Permatasari & Husnasari, 2022). But this regulation was prone to raise distinction in interpretation of facts and circumstances which used as basis to determine the most appropriated transfer pricing method which can be used (Zaki & Irawan, 2022).

PER-22/PJ/2013 also implied on taxpayer’s behavior to register their intangible asset owned to Directorate General of Intellectual Property Ministry of Law and Human Rights, to ensure its legal force. Thus, it will have stronger legal force while needed in the tax dispute (Ningtias, 2022).

Also in 2013, for internal purposes, DGT issued audit guidelines in the form of Circular Letter of the Director General of Taxes Number SE-50/PJ/2013 (Direktorat Jenderal Pajak, 2013c), regarding Technical Instructions for Audits of Taxpayers with Special Relationships. This provision divides transfer pricing audit stages into three parts which are preparation, implementation, and reporting. The preparation stage includes the process of information review on related party transactions based on tax return reported. However, if the taxpayer does not fill in this information, review can be performed based on PSAK 7. And if DGT still have not found the relevant information, the review can be performed based on the website, commercial database, or other sources. Second part of audit preparation stage is the tax avoidance risk analysis. This section is performed by analyze the proportion of related party transactions to company sales, related party transactions with other parties in tax haven countries, special transactions (services, interest, royalties, etc.), the fairness of the net margin, non-routine transactions such as business restructuring, and losses incurred in the past few years. Methods and mechanisms for examining transaction fairness are elaborated in detail in Table 4.

Table 4. Methods and Mechanisms to Examine Transactions Fairness

No	Transaction Relevant Method	Examination Mechanism
1	Intragroup Service CUP, CPM, & TNMM	Ensure that services have conducted and provided benefits Calculating the fairness of services charges
2	Intangible Aset All methods	Identify the existence of intangible assets (IP) Measure IP and determine the parties involved in IP creation Ensure that the transaction has occurred Determine the fair value of compensation
3	Intragroup Loan CUP	Conduct debt requirements analysis Ensure that the loan has actually occurred Testing the fairness of the debt-to-equity ratio Testing the fairness of interest rates

Source: PER-32/PJ/2011 (2011)

The second stage of transfer pricing audit is examination, which divided into four parts. First part is administrative aspect which performed by issue an inspection order; document request on taxpayers; in-depth analysis on the taxpayer’s documents; arrangement of audit working papers; direct request for taxpayer’s explanation; request for exchange of information; and risk mapping. After the administrative aspects fulfilled, DGT determine the characteristics of taxpayer’s business by identifying related party transactions through industry analysis, arrange the related party transaction scheme, analyze the supply chain, and perform a functional analysis. The third part in this stage is selection of the most appropriate method. The final part is done by perform arm’s length principle on each type of transaction. Then, tax auditor can submit the Tax Audit Report as an output of this process.

This regulation has existed for a long time, while related party transactions and cross-border trading increased rapidly. Anti tax avoidance rules regulations in Indonesia are very important to prevent tax avoidance through interest charges, postponement of dividend payments, transfer mispricing, and regulations on the use of special purpose companies in tax-free countries. Current government preferred to more harmonious policy arrangements. Therefore, DGT sees the urgency of provide the comprehensive arm's length principle regulations in one script. Authorized party issued Minister of Finance Regulation Number PMK 172/2023 (Menteri Keuangan Republik Indonesia, 2023) regarding the Application of Arm’s Length Principle in Related Party Transaction.

Table 5. Stages of Arm’s Length Principle Implementation

No	Steps
1	Identification of related party transaction
2	Analyze the industry and the factors that influence performance in that industry
3	Consider all the five benchmarking factors (contract; function, assets and risks; product characteristics; economic conditions; and business strategy)
4	Conduct a comparability analysis
5	Determine the most appropriate transfer pricing method
6	Implementation of the transfer pricing method

Source: PMK Number 172/2023 (2023)

In this regulation, ALP must be implemented based on actual circumstances and adopt the ex-ante principle. There are six stages of ALP implementation. The most important stage is comparability analysis. The fairness of a related party transaction assessed on this stage. Related party transactions considered comparable to independent transactions if there are similar conditions, or there are differences but don’t affect price determination, or there are differences in conditions affecting price determination but can be adjusted accurately. Comparability analysis must be performed in six stages, i.e. understand the transaction characteristics, identification of transaction’s existence, determination of tested party, identification of differences on each transaction, adjustments, and selection of comparable independent transaction.

This regulation also accommodates three newest transfer pricing methods which recognized globally. Those are tangible and intangible asset valuation method, comparable uncontrolled transactions (CUT) method, and business valuation method, as stated in the OECD Transfer Pricing Guidelines 2017. The CUT method is performed by comparing prices or profits on a certain basis between related party transactions and independent transactions. The business valuation method can be carried out using three approaches, i.e. market approach, income approach and asset approach. Transfer pricing methods for each related party transaction based on PMK 172/2023 are visualized in Figure 8.

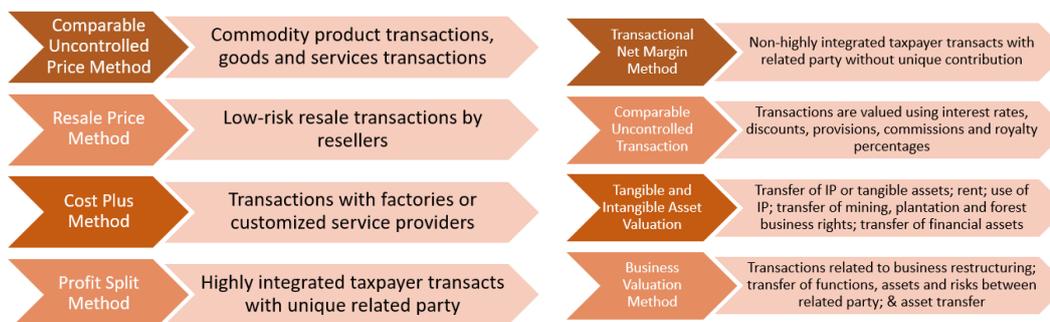


Figure 8. Transfer Pricing Methods for each Related Party Transaction based on PMK 172/2023

Source: PMK Number 172/2023 (2023)

Another legal certainty provided by this regulation is specific usage of each transfer pricing method for each type of transaction. The specific regulation can drive into the reduction of tax dispute between taxpayer and DGT. This regulation specifically states the eligible method for each transaction. Specific arrangements can reduce the risk of disputes caused by different interpretation. This provision also expands the scope of risky transactions in transfer pricing. There are seven types of transactions (previously five), i.e. services, use of intangible property (IP), loan transactions, other financial transactions, transfer of assets, business restructuring, and other contribution agreements.

Article 13 is an important part of this regulation because it explains the preliminary stages to prove the feasibility of charging these seven transactions on taxpayer's financial statement. This provision clearly states the types of services cannot be charged on fiscal financial statement. Previously, transfer pricing often give rise to disputes due to the choice of methods based on different reasons between DGT and taxpayer. Through this regulation, there is a superb development in legal certainty for transfer pricing application within taxpayers. Yet, the effectivity and implication for taxpayer still can't be known as the regulation just started to prevail for one year. The overview of regulatory development on arm's length principle implementation and examination is illustrated in Figure 9.

UU No. 7/1983

- DGT authorized to test the fairness of related party transactions and determine the existence of special relationship between taxpayers.
- Regulates the concept of special relationship between individual or corporate taxpayers, but limited to business ownership and family relationships.

KEP-01/PJ.7/1993

- Categorize transactions with unfairness risk into four types which are :
 - determination of goods price
 - determination of compensation for services and asset usage
 - allocation of indirect costs from head office
 - determination of interest on loans.

SE-04/PJ.7/1993

- Regulates special relationship in more detail
- For corporate taxpayer : control of 25% or more of the share capital of an entity by another entity, or between several entities in which 25% or more of the shares are owned by an entity.
- For Individual Taxpayers : detailed to parties such as father, mother, children, siblings, in-laws, stepchildren and in-laws.
- Mapping seven vulnerable transactions, i.e. sales price, purchase price, overhead cost allocation, intragroup loan interest, fee payment, and overseas sales through third parties without business substance
- Set up a suitable method to adjust the unfairness of those seven vulnerable transactions

PER-43/PJ/2010

- Transaction is considered fair if no significant difference between related party and independent transactions, or if there is a difference but can be adjusted
- Taxpayer required to attach a research and decision flow for the selection of comparable data
- Transfer pricing methods is narrowed down to five types, and applied hierarchically started with CUP, then CPM or RPM, and PSM or TNMM in the last order
- DGT started to recognize five comparability factors in determining the fairness of transactions, i.e. characteristics of goods and services, functions of each party, provisions in the contract, economic conditions, and business strategy
- Stated the ideal conditions for application of each method

PER-32/PJ/2011

- Fairness of related party transactions is detailed by the existence of price or profit which not affected by different
- Transfer pricing method is no longer applied hierarchically
- Started to regulate the implementation of Cost Contribution Arrangement

PER-22/PJ/2013

- Simplify the stages of related party transaction examination into three parts, i.e. preparation, execution, and reporting
- Putting special emphasis on related party transactions such as intragroup services, use of intangible assets, and intragroup loan interest payments
- Regulating the method and mechanism of fairness examination for each of transactions

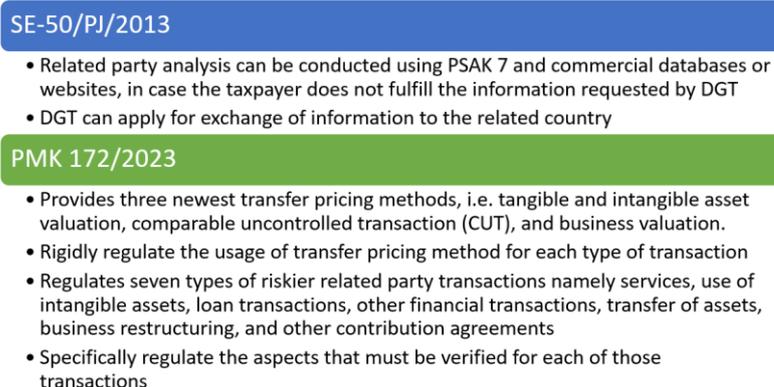


Figure 9. Overview of Regulation Development on the Arm's Length Principle Implementation and Examination

Source: Author (2024)

DEVELOPMENT OF TRANSFER PRICING DOCUMENTATION REGULATION

Taxpayer's obligation to record transfer pricing practice has existed since the enactment of PER-43/PJ/2010. This clause was prevailed to align with the BEPS Action Plan 13 regarding Transfer Pricing Documentation and Country-by-Country Reporting. Existence of this regulation implied to taxpayers which generated revenue more than Rp50 billion in a year, to provide documentation for its transfer pricing practice (Sari & Salamun, 2019). Documentation must contain the steps of transfer pricing documentation, internal research, and price determinant factor. Then Government Regulation Number 74 of 2011 regarding Procedures for the Implementation of Tax Rights and Fulfillment of Tax Obligations mandates to regulate this issue in a Minister of Finance Regulation. Furthermore, these arrangements accommodated in the Minister of Finance Regulation Number PMK 213/2016 (Kementerian Keuangan Republik Indonesia, 2016), regarding Types of Documents and/or Additional Information must be kept by Taxpayers Conducted Related Party Transaction. Transfer Pricing Documentation is also known as TP Doc. Components must be available in TP Doc are master files, local files, and country-by-country reports (CbCR).

The master file must be prepared based on the information available at the occurrence of related party transaction. This concept is known as *ex ante*. Master file must contain structure and ownership of each company group member, business activity explanation, IP possession, financial and financing activities, and parent entity's consolidated financial statement. All of this information must be attached to the Annual Tax Return. Components of transfer pricing documentation are explained in Table 6.

Table 6. Components of Transfer Pricing Documentation

Component	Definition
Master File	Main component which contains general information of companies
Local File	Contains specific information of the business group member entities
CbCr	Contains high-level information related to company's global activities

Source: Fun & Rahayu (2018)

Local file is a segmented component of TP Doc. It must contain taxpayer's identity, business activities, information of related party and independent transactions, ALP implementation, and financial information. If taxpayer has several businesses in different industries, local files must be reported according to business type segmentation. Last component must be included in the TP Doc is CbCR. CbCR encourages taxpayer's transparency regarding the composition of businesses in various branch countries. Taxpayers are required to provide information concerning income allocation, taxes paid, and each country's business activity.

All information in the TP Doc must be presented in Indonesian language. However, for taxpayer with permission of foreign language bookkeeping, TP Doc can be presented in foreign language according to the permission granted, including an Indonesian translation. Taxpayer which is not in compliance with the provisions considered having a tax law violation. In taxpayer audits, the TP Doc is stated as a document which must be submitted if requested by the DGT and must be attached in the Annual Tax Return. For taxpayers which unable to provide their own TP Doc, it is important to hire tax consultant to assist the preparation of TP Doc. This implied to the increase of compliance cost on taxpayer (Sukarno, 2022).

Development of TP Doc regulations in Indonesia continues in PMK Number 172 Year 2023 which also arrange the TP Doc submission. The basic principles are still the same as prevailed in previous regulation. However, this provision regulates several new clauses to increase legal certainty and the effectiveness of TP Doc implementation in Indonesia. In this regulation, domestic taxpayer acted as parent entity defined as entities that have other members, not owned by other entities, or owned but whose financial reports are not consolidated. It required to prepare consolidated financial statement. Meanwhile, foreign parent entities have the same definition as domestic taxpayers, with additional regulatory in the form of minimum turnover of €750,000,000.00 in a year. This clause also aligned to the BEPS Action Plan 13 which concerned about fairness transfer pricing practice of high-turnover foreign entity (OECD, 2015).

This provision also introduces the terminology of constituent entities, which are members of multinational business groups included in consolidated financial statements. Constituent entities are obliged to report CbCR, regardless of any clauses regulated by the parent country. Domestic taxpayers who are members of business groups required to submit notification to the DGT. It contains information regarding the list of domestic taxpayers acted either as parent or as non-parent entities, as well as a statement of CbCR reporting obligations.

PMK 172 does not regulate any different substance regarding the completeness of reported contains in the master file, local file, and CbCr compared to PMK 213. However, this provision expands the DGT's authority to perform an in-depth analysis on taxpayer's TP Doc. This regulation states a requirement for transaction to be considered arm's length. Article 3 paragraph (3) stated that:

“Prinsip Kewajaran dan Kelaziman Usaha sebagaimana dimaksud pada ayat (2) diterapkan dengan membandingkan kondisi dan indikator harga Transaksi yang Dipengaruhi Hubungan Istimewa dengan kondisi dan indikator harga Transaksi Independen yang sama atau sebanding”. Besides, article 4 paragraph (1) stated: *Penerapan Prinsip Kewajaran dan Kelaziman U saha sebagaimana dimaksud dalam Pasal 3 ayat (3) wajib dilakukan: a. berdasarkan keadaan yang se benarnya; b. pada saat Penentuan Harga Transfer dan/ atau saat terjadinya Transaksi yang Dipengaruhi Hubungan Istimewa; dan c. sesuai dengan tahapan penerapan Prinsip Kewajaran dan Kelaziman Usaha.”*

If there is an unaccordance with those clauses, DGT is authorized to determine the tax payable ex-officio. The same treatment also prevailed if there are related party transactions which cannot be proven. Regarding this regulation, effectivity and implication for taxpayer still can't be known as the regulation just started to prevail for one year. The overview of TP Doc regulation development in Indonesia is presented in Figure 10.

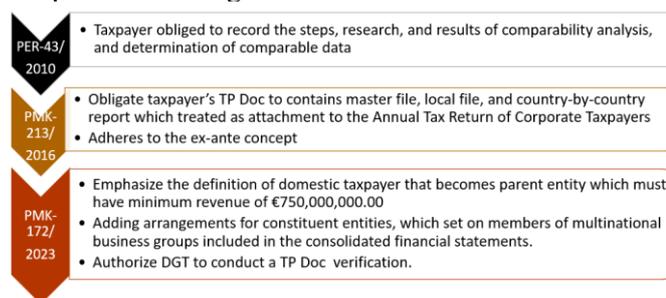


Figure 10. Overview of TP Doc Regulation Development in Indonesia

Source: Author (2024)

DEVELOPMENT OF ADVANCE PRICING AGREEMENT REGULATION

First Advance Pricing Agreement (APA) in Indonesia was regulated on Director General of Taxes Regulation Number PER-69/PJ/2010 (Direktorat Jenderal Pajak, 2010b), regarding Advance Pricing Agreements. This regulation referred to BEPS Action Plan 14 regarding the urgency to making dispute resolution mechanism more effective. APA is defined as an agreement between DGT and taxpayer and/or other country's tax authority to determine fair price of related party transaction in advance. The agreed criteria include the transfer pricing method determination and critical assumptions analysis. The most important stage is the agreement discussion which determines the boundaries of APA implementation such as transaction scope, comparability analysis, comparative data determination, TP method determination, discussion of conditions and determinant factors of TP method, and the urgency of APA implementation. The agreed APA can be valid for three years with a year before the agreement where tax audit has never performed, taxpayer has never submitted an objection or appeal, and no indication of a taxation crime.

APA Script is the main output in this regulation. It contains components that regulate the implementation of APA after agreed. Important components in the APA Script are the agreed transfer pricing method, critical assumptions, fair prices for each transaction should be performed, legal consequences, confidentiality of information, and dispute resolution mechanisms. APA implementation must be based on the agreement script. The stages of APA formulation based on PER-69/PJ/2010 are illustrated in Figure 11.

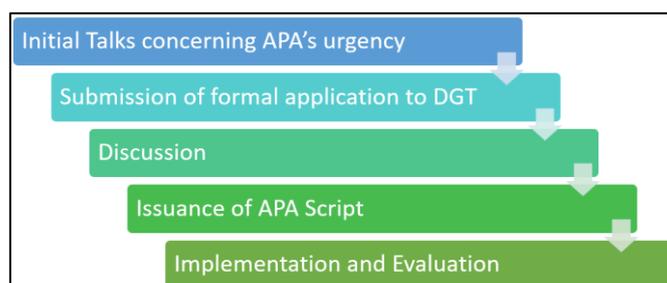


Figure 11. Stages of APA Formulation based on PER-69/PJ/2010
Source: PER-69/PJ/2010 (2010)

DGT also authorized to evaluate APA implementation. In addition, DGT has the right to cancel the APA if taxpayer didn't comply to the clauses listed, submitted incorrect information, didn't submit annual report, experienced changes that affect the critical assumptions, found errors on the APA submission, taxpayer committed to a tax crime, and taxpayer submitted annual report without fulfill the provisions in Article 16 paragraph (2).

Next development of APA regulations in Indonesia marked by the issuance of PMK Number 7 of 2015, (Kementerian Keuangan Republik Indonesia, 2015), regarding Procedures for the Formulation and Implementation of Advance Pricing Agreements. This regulation stated that taxpayers can only implement APA if they have been operating in Indonesia for at least three years. Meanwhile, the APA validity period is three years for unilateral APA and four years for bilateral APA. This regulation emphasized that APA must not reduce taxpayers' tax burden. So that, the potential for tax avoidance can be minimized.

This regulation provided more rigid requirements for APA submission. Article 6 paragraph (2) states fifteen types of documents must be completed by taxpayer discussing the agreement with DGT. These include the reasons of APA submission, explanation of the taxpayer's activities, business plan, business structure, transfer pricing method, and other information contained in these provisions. Furthermore, the initial discussion must be performed no later than six months before implementation. This stage discusses the urgency of APA implementation, scope, methods used, time period, and other relevant matters. If it can be completed, then DGT sends an invitation letter to the taxpayer to submit an APA application.

Furthermore, taxpayers can submit an APA request in Indonesian language. Administration of APA is under the Directorate of Tax Regulations II. The stages of APA formulation based on PMK 7/2015 are explained in Figure 12.

After the application submitted, DGT formed an APA Discussion Team consisting of DGT's employees and appointed experts. The discussion includes the scope of transactions, tax years covered, benchmarking analysis, transfer pricing method determination, critical assumptions in determining the transfer pricing method, and the existence of double taxation. Based on the results of the discussion, the Discussion Team submitted a letter of recommendation to the board of DGT. This letter is followed up with a joint discussion with the Quality Assurance Team, and then it can be decided whether the APA request can be approved. The output is same as in the previous provisions, which called as APA Script.

If the application has been approved, taxpayer can perform related party transactions based on the APA Script issued by DGT and is deemed to arm's length. However, in order to maintain compliance, DGT has the authority to evaluate APA implementation periodically. Besides, APA Annual Report used as the basis for evaluation by DGT. Taxpayers must submit it to the DGT by April 30, containing a detailed explanation regarding compliance and consistency in implementing the APA. If the taxpayer does not submit an Annual Report, DGT is authorized to cancel or review the APA. Then, if the implementation goes well, taxpayer is given the opportunity to update the APA, by conduct all nine stages as in the APA formulation. In this regulation, DGT is required to archive the stages of APA formulation including the results of analysis, discussion results, and correspondence and the media used. This regulation was considered beneficial for taxpayers, which reflected from the increase of APA submission from 13 applications in 2015 to 24 applications in 2016 (Oktaviani & Tambunan, 2021).

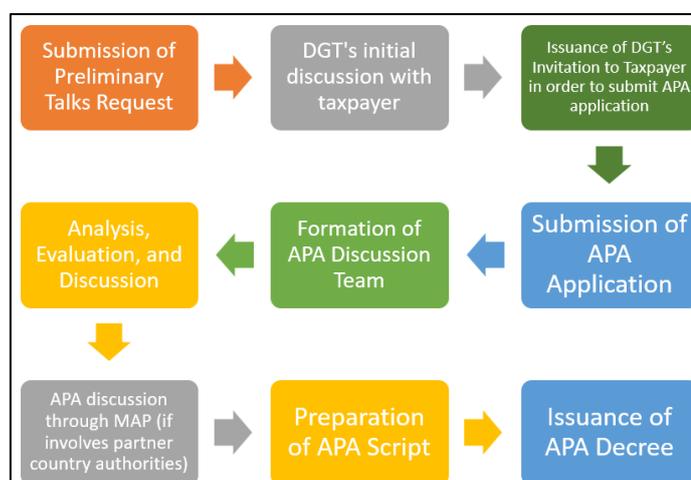


Figure 12. Stages of APA Formulation based on PMK Number 7 Year 2015
Source: PMK 07/PMK.03/2015 (2015)

Further development in APA regulations marked by the publication of PER-17/PJ/2020 regarding Procedures for Settlement of Applications, Implementation and Evaluation of Transfer Price Agreements. In general, technical matters related to APA formulation are still the same as previous regulation. However, the important which differ this regulation is the duties and authority of APA administration which moved to the Directorate of International Taxation. In addition, there is a roll-back facility which allows taxpayers to apply the APA agreement for transactions which occurred before the APA agreement period. This provision also details the scope of APA evaluation which is limited to compliance with the implementation and conformity of criteria in determining transfer prices. If DGT find incorrect or incomplete information from taxpayer, DGT can give an opportunity for the taxpayer make a clarification. If it does not meet the provisions, DGT can revoke the enforcement of the APA.

Next development which is considered very significant regarding APA regulations is the issuance of PMK Number 22 Year 2020 (Kementerian Keuangan Republik Indonesia, 2020), regarding Procedures for Implementing Transfer Price Agreements. This regulation regulates several new things such as the validity period of the agreement, more rigid submission requirements, conditions that allow roll-back, and so on. The roll-back facility can still be used by taxpayers if the facts and conditions of the transaction doesn't change, no tax assessment has been issued, and the taxpayer is not currently undergoing an investigation or taxation crime. This regulation tightens the requirements for submitting an APA in the form of an obligation to submit Annual Tax Returns for three consecutive years before the year of submission. Related party transactions which will be submitted by taxpayer in the APA should be reported in the tax return for previous three years. This clause implied to taxpayers which unable to outsmart the fair transfer pricing practice in their group, thus it will defend DGT from tax avoidance (Nindita et al., 2023). The stages of APA formulation based on PMK 22/2020 are shown in Figure 13.

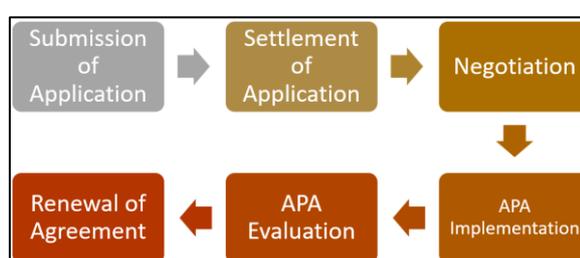


Figure 13. APA Formulation Stages based on PMK Number 22 Year 2020
Source: PMK 22/PMK.03/2020 (2020)

Apart from tax return, taxpayers must also submit TP Doc; audited financial reports for the last three years; and specific information in the form of a business description, explanation of related party transactions, and description of ALP implementation. Thus, taxpayer can submit the APA application. Once the application is received, DGT is obliged to process and determine the validity of submission. After that, DGT should verify the substance listed in the taxpayer's application. Verification is performed by conduct a discussion, interviews, request of taxpayer's data, and even visit the taxpayer's business locations. Meanwhile, the application of the arm's length principle performed in six stages as explained in the previous subchapter. In more detail, this provision regulated the most appropriate transfer pricing methods for each type of transaction, as described in the section on the development of arm's length principle regulations, thus it can maximize the legal certainty within taxpayer.

In the formulation of unilateral APA, negotiations occurred between DGT and taxpayer. Meanwhile, for bilateral APA, negotiation held between DGT and tax authorities from other countries. The application submitted may not be approved if the related party transaction is not based on an economic motive, the substance is different to the form, the transaction settled to minimize tax burden, there is incorrect or incomplete information, and there is a tax assessment issued from DGT within the APA year or roll-back period. If the negotiation meets an agreement, it should be stated in the APA script (for unilateral APA) or tax treaty (for bilateral APA).

APA can be implemented one month after the publication of the APA Script or from the issuance of assessment from partner country's tax authority. DGT is able to evaluate the APA implementation to prevent tax avoidance. As performed in the material testing stage. Based on the evaluation results, DGT has the authority to review or even cancel the APA if taxpayer doesn't comply the regulation. However, if the implementation goes well and no significant changes in conditions occurred, APA can be renewed and implemented for next year. This regulation considered effective because it arranged the particular transfer pricing method for each kind of transaction which prone to be used as tax avoidance medium as stated in Article 13. The hierarchy of determinant factors for transfer pricing method in APA formulation is presented in Figure 14.

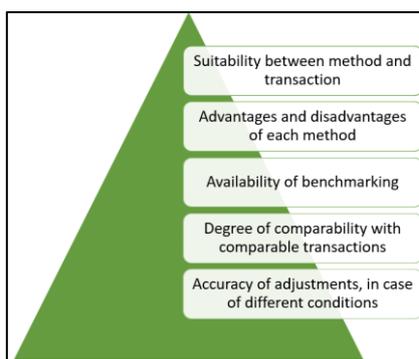


Figure 14. Hierarchy of Determinant Factor for Transfer Pricing Method in the APA Formulation
Source: PMK Number 172 Year 2023 (2023)

The latest development of APA regulation marked by the issuance of PMK 172 Year 2023. There are the same requirements of APA formulation stages, critical assumptions used, and submission requirement as stated in the previous regulation. There is additional provision which prohibit taxpayer in the process of inspection of initial evidence, investigation, prosecution, trial, and still in the tax crime punishment to implement roll-back. The hierarchy of determinant factors for transfer pricing method in APA formulation is presented in Figure 14.

Table 7. Changes on APA Regulation based on PMK Number 172 Year 2023

No.	Regulation Changes Stated in PMK 172
1	Roll-back requirements
2	APA arrangements in force majeure
3	Stages of material testing
4	Submission of reapplication after any disagreement
5	Mutatis mutandis application of APA formulation in judicial review process
6	Electronic update on APA

Source: PMK Number 172 Year 2023 (2023)

Furthermore, there also clause which regulated APA submissions during force majeure. The profit level during force majeure must be adjusted to the projected profit under normal conditions. DGT has additional authority to ask for required information from financial services institutions, other financial institutions, and to exchange information with parties in other countries. This authority can be used in the material testing process for the APA application which expected to increase accuration of the audit.

PER-69/PI/2010

- Agreement points expanded to the determination of transfer pricing methods and critical assumptions.
- Agreement must discuss the determination of transaction scope, comparability analysis, determination of TP method, determination of economic conditions, and urgency of bilateral APA with partner country
- APA valid for 3 years, can be valid for the year before agreement if meets certain conditions
- DGT was authorized to evaluate, review, and cancel the APA implementation
- Established five stages in APA formulation

PMK 07/PMK.03/2015

- Taxpayers can only implement APA if have operated in Indonesia for at least three years before the application
- Established three stages in the APA formulation
- APA script valid for three years for unilateral APA and four years for bilateral APA.
- Initial discussion must held at least six months before the year of APA implementation.
- APA administration assigned to the Directorate of Tax Regulation II.
- Taxpayer obliged to submit APA Annual Report each year on April 30th.

PER-17/PI/2020

- APA administration duties and authority moved to the Directorate of International Taxation.
- DGT provided roll-back facility that allows taxpayer to apply APA retrospectively
- DGT provided opportunity for taxpayer to clarify submitted information which is considered incorrect

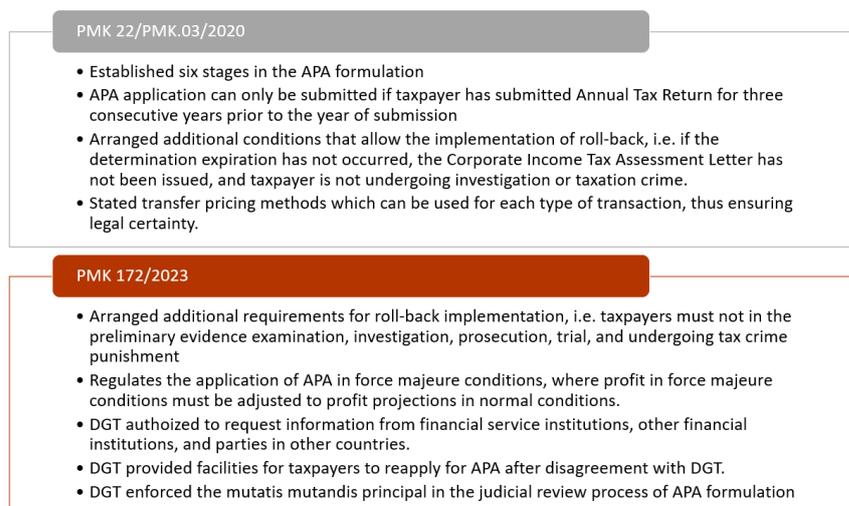


Figure 15. Overview of Regulation Development on the Advance Pricing Agreement in Indonesia
Source: Author (2024)

In this regulation, DGT also provides facilities for taxpayers to re-submit APA application after disagreement occurs during previous negotiations. Besides, in the APA review process, the principle of mutatis mutandis applies to research procedures, material testing, and negotiations. This allows the discussion team to ensure that APA implementation runs in align with the regulation. Another facility provided is the electronic APA procedure. However, DGT still has not provided the technical systems and provisions. PMK 172/2023 introduced six significant changes to APA regulations, as detailed in Table 7, including new provisions for roll-back requirements, force majeure situations, and electronic updates. So, this article is provided to accommodate the electronic APA when the system is available. The overview of APA regulation development in Indonesia is summarized in Figure 15.

COMPARABILITY ANALYSIS ON TRANSFER PRICING REGULATION BETWEEN INDONESIA AND ALL REGION

This section compares Indonesia's transfer pricing regulations to other regions around the world. While the aspects of Indonesian regulations that are compared referred to the latest transfer pricing regulation in Indonesia, which is PMK 172 Year 2023. The aspects compared in this section consist of the existence of transfer pricing regulations, transfer pricing methods that can be used in each region, the obligation to provide TP Doc, the average time limit to provide TP Doc in each region, the existence of advance pricing agreement facility, and the average time limit for APA settlement in each region.

In general, there are no unequal differences in regulations between regions in the world. However, it can be noted that not every country has implemented the provisions referring to the OECD Transfer Pricing Guidelines and the Base Erosion and Profit Shifting Action Plan. This is not a problem since each country has the sovereignty to regulate its own laws and regulations. By mapping the differences and similarities in taxation policies, this comparability analysis aims to provide insight into transfer pricing arrangements in each region of the world. A comprehensive comparison of transfer pricing regulations between Indonesia and other regions worldwide is presented in Table 8, examining six key aspects: existence of TP regulations, approved methods, TP documentation requirements, documentation deadlines, APA availability, and APA conclusion timeframes.

Table 8. Comparability Analysis of Transfer Pricing Regulations between Indonesia and other Region

State	TP Regulation	Methods	TP Doc	Requirement to Prepare TP Doc Annually	APA	Time Limit to Concluding APA
Indonesia	Yes	Yes (all methods listed in the OECD Guidelines)	Yes	4 months after tax year ended	Yes	2 – 4 years
North America	Yes, mostly using the OECD Guidelines	Yes, mostly regarding to method listed in the OECD Guidelines	Yes	Simultaneously with annual tax return submission, 6 months, etc	Mostly yes, except Puerto Rico	3 – 5 years
South America	Yes, mostly using the OECD Guidelines even for the non-member state	Yes, mostly regarding to method listed in the OECD Guidelines	Yes, except Paraguay	6 months before – 8 months after tax year ended	Mostly No. (e.g. Brazil, Argentina, Paraguay)	3 – 5 years
Europe EU Members States	Yes, almost all state using the OECD Guidelines	Yes (all methods listed in the OECD Guidelines)	Yes (mostly in line with the OECD Guidelines)	6 months before – at the time of annual tax return submission	Mostly yes, except Malta	5 – 8 years
Europe Non EU States	Yes (OECD Guidelines are used)	Yes, mostly regarding to method listed in the OECD Guidelines	Yes	April before tax year ended – at the time of annual tax return submission	Mostly No. (except Russia and Albania)	2 – 5 years
Asia	Yes, mostly using the OECD Guidelines	Yes (all methods listed in the OECD Guidelines)	Yes	At the time of annual tax return submission	Yes (except Qatar)	3 – 5 years
Africa	Yes, mostly using the OECD Guidelines even for the non-member state	Yes (all methods listed in the OECD Guidelines)	Yes	Some state obliged simultaneously with the tax return submission	Mostly No. (e.g. Zambia, South Africa, Kenya)	Not defined
Oceania	Yes, mostly using the OECD Guidelines even for the non-member state	Yes (all methods listed in the OECD Guidelines)	Yes	At the time of annual tax return submission	Yes (except Fiji)	3 – 5 years

Source: Processed Data (2024)

4. CONCLUSION

Based on this research, it can be concluded that transfer pricing regulation in Indonesia has experienced excellent improvement since it was first regulated in 1983. The development can be seen from the existence of more specific regulations, which can increase legal certainty and efficiency for taxpayers. In the regulation on arm's length principle, there are details in terms of the transfer pricing method selection, comparability analysis update, definition assertion on important aspects in arm's length principle, special treatment on high-risk related party transactions, and application of the latest transfer pricing methods. In the Transfer Pricing Documentation (TP Doc) regulation, the existing regulations have been well developed so as to provide legal certainty and clearer details of obligations for taxpayers. These include the components of TP Doc, the information must be included in it, the application of ex-ante concept, and the DGT's authority to ensure the information accuracy. For regulations related to the implementation of APA, regulatory developments include changes in the stage of APA formulation, the implementation of roll-back facilities, the application of APA in force majeure conditions, and increasingly rigid submission requirements. Regulations in Indonesia also aligned to most of countries around the world. Thus, it makes tax administration in Indonesia more inclusive and able to follow the improvement in global stage.

Limitation of this research is its inability to produce generalization from the result and the subjectivity on the interpretation in the analytical steps. There are several implications from enactment of current transfer pricing regulations such as encourage cooperative compliance from taxpayers and simplify the conduct of price setting within affiliation group, thus it can prevent and reduce tax dispute caused by transfer pricing. This research recommends Directorate General of Taxes to regulate safe harbors for several transaction which can be simplified through arm's length range/rate such as intra-group services and toll manufacturing. It can reduce the potential of tax dispute in the future. Besides, this research can be followed up with further study such as overview of specific regulations practice by involving primary data collection through interview with taxpayers, tax authority, tax consultants, and academics.

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