# CHAPTER I

# INTRODUCTION

## 1.1 Background of the Study

Tax has always been considered as an expense in the eyes of companies. Most companies would put a great deal of effort in minimizing tax, whether it is through legal or illegal means. Some methods of tax minimization are through (a) tax planning; (b) tax avoidance; (c) tax evasion; (d) tax sheltering, and many more. At present, transfer pricing is one of the most common practices when it comes to minimizing tax. Transfer pricing is not an illegal conduct. However, when it is done with intentions to evade tax, then transfer pricing becomes an illicit affair. To separate the legal and illegal transactions, the terms "transfer mispricing" and "abusive transfer pricing" will be used for the unlawful matters. Multinational enterprises allocate their income from countries with high tax rate to subsidiaries located in countries with lower tax rate to reduce the total amount of tax they must pay. This results in loss to the government as tax is one of their main sources of revenue. Transfer mispricing is an international issue visible in both first and third world countries. Some of the most well-known cases regarding transfer mispricing are Amazon's $1.5 billion dispute with Internal Revenue Service (IRS), Google's £130m settlement with Her Majesty's Revenue and Customs (HMRC), and Coca Cola's $3.3 billion transfer mispricing. From the year 2016 to 2018, the recorded amount of transfer mispricing disputes in Indonesia is shown as follows:

**Table. 1.1 Mutual Agreement Procedure Statistics of Transfer Pricing Cases in Indonesia year 2016 to 2018**

| Year | Transfer pricing cases | | | |
|---|---|---|---|---|
| | Year Start Inventory | Cases Started | Cases Closed | Year End Inventory |
| 2016 | 62 | 19 | 32 | 49 |
| 2017 | 55 | 16 | 20 | 51 |
| 2018 | 52 | 26 | 19 | 59 |

Source: OECD Dispute Resolution Statistics (2018)
Prepared by the Writer (2020)

The table above shows that the amount of cases closed year by year continues to decrease. In addition to the table, the amount of cases started before 2016 that was solved in 2017 is only 7 cases while in 2018, only 4 cases were solved. By the end of 2018, the total of unsolved cases that started before 2016 is 25 cases. Additionally, according to OECD, out of the 71 cases closed within 2016 to 2018, 25.3% is solved through fully eliminating double taxation or fully resolving not in accordance with the tax treaty. This indicates the lack of proper regulations to solve transfer pricing issues or there is an overlap between several regulations regarding said issues.

Indonesia has seen its' own fair share of transfer mispricing cases, some examples being Asian Agri's tax avoidance which amounts to Rp 2.6 trillion and Toyota's Rp. 1.2 trillion transfer pricing abuse. To minimize the abuse of transfer pricing, Indonesia has continuously released new regulations year after year in accordance with Organization for Economic Co-operation and Development (OECD) Transfer Pricing Guidelines. The regulations define not only the special relationships, but also dictate the steps in applying the arm's length principle, proper documentation, and what activities incite an inspection from the Directorate General of Taxes. However, even after many measures have been taken, transfer mispricing cases are still visible with Yustinus Prastowo, Executive Director of

Center For Indonesian Taxation, stating that Indonesia will still experience loss around 100 trillion rupiah due to transfer pricing and tax planning every year (Neraca, 2015).

Hardiyanto (2019) stated in his journal titled "*Permasalahan Transfer Pricing Dalam Undang-Undang Pajak Di Indonesia*" that there is no certainty of law for taxpayers as well as the government regarding the issue of transfer mispricing. The researcher labelled transfer pricing as an immoral act done simply for the self-benefit of tax evasion. Additionally, in a previous research conducted by Wardhana (2019), a conclusion was made that the arm's length standard is unreliable in regulating transfer pricing. Arm's length standard failed to accurately manage the allocation of income of Multinational Enterprise (MNE) departments to the location of economic activity. However, Huda, Nugraheni, & Kamarudin (2017) concluded in their journal that transfer pricing and its implementation has been comprehensively regulated. The researcher claimed that the conduct of transfer mispricing stems from the lack of understanding regarding the said subject by the human resources at Directorate General of Taxes. The increasing number of MNE every year is also partly the cause in the increase of transfer mispricing.

Due to the varying results of the previous researches, the writer intends to conduct another research regarding transfer mispricing to analyze whether the application of the regulations is consistent with the law as it is written, and to analyze the effectiveness of the regulation when applied to transfer mispricing cases in Indonesia. A comparison will also be made between Indonesia's and China's transfer pricing law as both are developing countries that follow the OECD transfer pricing guidelines, and China has been proven to successfully collect ¥10.272

billion through the establishment and implementation of transfer pricing regimes during 2010 (Cooper et al., 2016). As such, this research will be titled "**Analysis of The Taxation Law Regarding Transfer Pricing at Indonesi**a"

## 1.2 Problem Formulation

"How does the certainty of transfer pricing regulations for entrepreneurs as taxpayers and for the government in Indonesia?"

## 1.3 Research Focus

1. This research will analyze whether the application of regulations is in accordance with how it is written in the law
2. An analysis of potential adoption of China's transfer pricing law will be conducted.

## 1.4 Research Objective

The purpose of this research is to know the certainty of law regarding transfer pricing in accordance with Law No. 36 Year 2008 article 18, Law No. 42 Year 2009 article 2, Directorate General of Taxes Regulation No. PER-32/PJ/2011, PER-48/PJ/2010, PER-69/PJ/2010, and PER-22/PJ/2013, Directorate General of Taxes Circular Letter No. SE-50/PJ/2013 and SE-04/PJ.07/1993, Minister of Finance Regulation No. 7/PMK.03/2015 and No. 213/PMK.03/2016, and Director of Investigation and Billing Letter No. S-153/PJ.04/2010.

## 1.5 Benefit of the Research

Based on the research objectives, the research is expected to generate theoretical benefits and practical benefits as follows:

### 1.5.1 Theoretical Benefit

1. This research can provide understanding regarding transfer pricing and its' current issues.
2. This research can give further insight into any existing loopholes in Indonesia's transfer pricing law.
3. This research can contribute to the discussion regarding potential adoption of transfer pricing approaches found in other countries.
4. This research can be used as a reference for other researchers in conducting research with the same topic.

### 1.5.2 Practical Benefit

1. This research is expected to give information to taxpayers as well as government of Indonesia regarding possible grey areas in the transfer pricing regulations.