An Analysis of Indonesia's Tax Cases to Determine Transfer Pricing Dispute

Andy Wardhana
Ph.D Candidate
QUT Business School
Queensland University of Technology, Brisbane, Australia
Email: andywhisnu.wardhana@hdr.qut.edu.au

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Supervised by: Prof. Kerrie Sadiq - Dr. Andrew West - Dr. Sue Taylor

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Abstract

Transfer pricing, the price charged in a transaction between associated entities (such as a trade between parent company and its foreign subsidiaries) (Eden & Smith, 2001, p. 3), is a prominent corporate tax issue in Indonesia given that it contributes the determination of overall tax liability of multinational enterprises' (MNEs) operating in Indonesia. The key, global tax issue arising from transfer pricing is that MNEs, in order to achieve a lower taxable income, can value the transaction between affiliated enterprises, integrated under the same management at artificially high or low levels (OECD, 2001). In turn, issue then arise as to whether the lodged tax returns of these MNEs fairly represent their actual economic activity. For example, recent research has indicated that approximately USD $ 15.6 billion of tax revenue losses occur in Indonesia annually (Suroyo & Danubrata, 2015) while more than 4,000 MNEs reported continual losses for many years in their financial statements that made them not paying corporate income tax (Kristiaji, 2015). While there are a range of contributing factors to these corporate tax losses, such as the impact of extraordinary market conditions and global financial crises, this research seeks to focus on the extent to which the tax minimisation strategies of MNEs operating in Indonesia, such as aggressive transfer pricing, have contributed to these consistent, corporate losses.

The overall objective of the doctoral research is to contribute to the debate on the reform of the presently prevailing Indonesia's law and its implementing legislation on transfer pricing by using an international tax regime framework. In spite of adopting the OECD arm's-length principle (OECD, 2010), Indonesia's judicial implementation process faces challenges which include: tax administration complexity (Picciotto, 2013); unavailability of comparable data (Mitchell, 2011; Spencer, 2013); and the unique characteristics of MNEs (Durst, 2010).

Within this project, the objective of this paper is to examine how Indonesia's transfer pricing legislation is interpreted by the Indonesian Tax Court and uses Baistrocchi's (2013) structural analysis as a theoretical lens. This study, firstly, seeks to assess how the Indonesian transfer pricing rules are applied by the tax courts compared to the original legislation. Second, the gap between the 'law in action' and 'law in the book' on Indonesia's transfer pricing regime will be examined. The relevant case law methodology is including these steps:

organising 80 court decisions into coherent categories, factual situations in each case, identifying specific disputes, the soundness of legal reasoning, the extensive source of law, and what law interpretation is being used (Canadian Legal Research, 2015). The practical implication of this research is to identify whether parts of the Indonesia's transfer pricing rules require further reform by identifying judicial decisions. The theoretical implication of this research is to apply the Baistrocchi's network market to understand to what extent Indonesia adopt international tax regime principles such as the OECD transfer pricing regime to resolve transfer pricing disputes.

1.1 INTRODUCTION

In Indonesia, tax revenue is an important state's source to finance development because 86% of government revenue is collected from taxes (Ministry of Finance, 2016a). Tax revenue is very crucial to Indonesian society as the failure to collect tax revenue disrupts public services which, in turn, slows economic growth and increases state debt. Tax ratio or total tax revenue to gross domestic products in Indonesia estimated 12-13% is below the OECD standard that Government of Indonesia seek efforts to increase tax revenue. It is estimated that the corporate income tax contributes to tax revenue approximately 42% (OECD, 2015). Corporate income tax is the major tax revenue in Indonesia because most of firms operate in a formal business system. A heavy reliance to tax of MNEs increasing challenges as they have a more sophisticated tax planning strategies (Cottarelli, 2011). However, a few decades ago, Lecraw (1985) conducted an interview with executives of 153 subsidiaries of MNEs in six manufacturing industries in South Asian countries including Indonesia. The result shows that MNEs use a systematic transfer pricing to increase global profits, to allocate funds between subsidiaries, and to reduce risk (Lecraw, 1985) that leads to the hurdles of corporate tax collection by tax authority. For example, many large corporations such as Toyota Motor Manufacturing Indonesia, Unilever Indonesia, Asian Agri, and Adaro seeking any possible loopholes to aggressively apply transfer pricing rules in their favor (Utari, Ludigdo, Achsin, & Subekti, 2013).

Even though there are a number of contributing factors of corporate tax losses, such as the impact of extraordinary market conditions and global financial crises, this research seeks to focus on the extent to which the tax minimisation strategies of MNEs such as aggressive transfer pricing has contributed to these consistent corporate losses. To achieve this goal, this study focuses on cases filed in the tax court that cover transfer pricing disputes in Indonesia from the fiscal year 2002 to 2013. It also examines to what extent the prevailing Indonesian transfer pricing law is interpreted and is applied in the tax courts. This study intends to identify to what extent tax courts can make appropriate decisions based on particular legal reasoning that could be used for policymakers so as to potentially enact law revisions on transfer pricing legislation.

Therefore, the proposed research question for this study is: "What legal reasoning is undertaken by the Indonesian Tax Court in deciding cases involving transfer pricing dispute?" Following the Introduction, section 1.2 discusses the legal system and transfer pricing regime in Indonesia. Section 1.3. identifies the gaps in the current research. Section 1.4. explores the research methodology used to analyse the transfer pricing cases. Section 1.5 elaborates the theoretical framework. Section 1.6 discusses the results. Section 1.7 discussion. Last, section 1.8 is the conclusions, implications, limitations, and future research.

1.2 INDONESIA'S LEGAL SYSTEM AND TRANSFER PRICING REGIME

Indonesia's legal system was developed based on a civil law system (Juriglobe, 2016; Lev, 1965). It has characteristics as follows: court decisions are made by a panel of judges, has a shorter court decisions compared to the common-law system, courts are not bound to precedent or the previous judicial decisions, an inquisitorial system that during the trial panel of judges actively involved in investigating the facts (Lindsey, 2003). The main source of law is statutes or legislation, and judges do not make law (Neubauer & Meinhold, 2016). In addition, Indonesia's legal system does not automatically adopt the international law into its domestic legal system. However, it needs ratification by the President and Parliament to apply treaties into domestic legislation (Butt, 2014). In Indonesia, the OECD transfer pricing guidelines does not automatically adopted into domestic rules. Instead, it needs implementing regulation in order to be enforced into domestic laws.

Figure 1 Indonesia's Hierarchy of Laws and Regulations

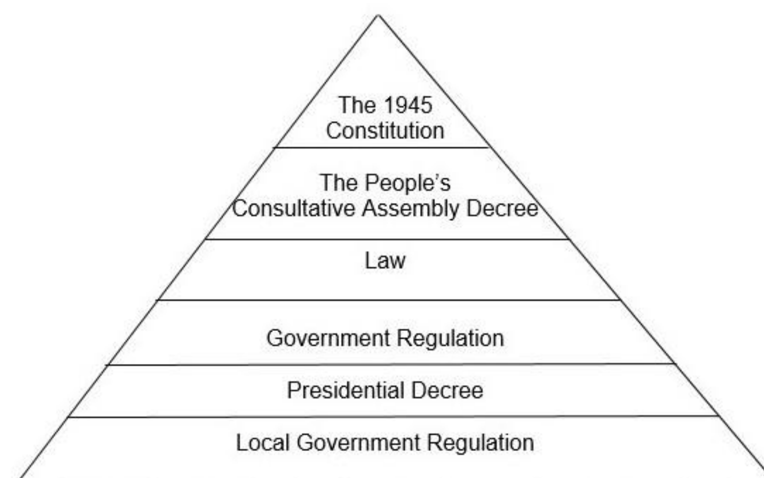

Figure 1 above shows the official hierarchy of legal system in Indonesia. The following section discusses the position of tax legislation in Indonesia's legal system. It is prescribed in Article 7 (1) of Indonesia's Law on Formation of Regulation and Legislation No. 12 enacted in 2011 that the 1945 Constitution of the Republic of Indonesia is fundamental for laws and regulations. The 1945 Constitution is the highest regulation while local government regulation is the lowest regulation. In hierarchical order, the lower legislation cannot exceed and contradict the higher legislation. The legal basis of the Indonesian taxes is the 1945 Constitution article 23A that "All taxes and other levies for the needs of the state of a compulsory nature shall be regulated by law" (Government of Indonesia, 1945). The Indonesian tax law is quite substantial because it is mandated by the constitution. The 1945 Constitution underlined that tax rules controlled by the people through House of Representatives. Subsequently, based on the 1945 Constitution, central government taxes are enacted such as Income Tax Law of 1983, Value Added Tax Law of 1983, General Provisions and Tax Procedures Law of 1983, and Stamp Duty Law of 1985. And a local tax that is imposed based on Local Tax and Retribution Law of 2009 consists of province tax and county tax such as vehicle registration tax, taxes for the hotel, restaurant, and advertising.

This study mainly focuses on the three essential tax laws, i.e. the Indonesian Income Tax Law of 1983, VAT Law of 1983 and the General Provisions and Tax Procedures Law of 1983. Indonesian tax rules segregate between substantive law and procedural law. In this regard, the Indonesian Income Tax Law of 1983 and VAT Law of 1983 are the substantive law, while the General Provisions and Tax Procedures Law of 1983 are the procedural law. The substantive law consists of written statutory rules in legislation that govern what types of taxes imposed, who pay the tax, and tax tariffs. While procedural law consists of criteria for taxpayers, tax return, tax assessment, tax collection, objection, appeal, bookkeeping, and tax audit.

The Indonesian tax system is managed by Ministry of Finance of Republic Indonesia that are delegated to Directorate General of Taxes (DGT), Fiscal Policy Agency, Taxation Supervisory Committee, and Tax Court Secretariat. (Ministry of Finance, 2016b). The role of DGT is to organize policy formulation and implementation of taxes by the provisions of the legislation, to prepare norms, standards, and tax procedures. Fiscal Policy Agency is to formulate, determine, and recommend fiscal policy and tax regulation along with DGT. Taxation Supervisory Committee is assigned to prepare a recommendation, and provision of

advice and feedback to improve DGT. Tax Court Secretariat is assigned to administer tax appeal, lawsuit, trial preparation, tax court administration, decisions, data processing and tax appeal information services.

Indonesia has adopted the OECD traditional arm's-length principle into domestic legislation (OECD, 2012). Table 1 below reveals the adoption in details.

Table 1. Indonesia's Transfer Pricing Regime

No.	Transfer Pricing Regulations (A)	1983 (B)	1993 (C)	2001 (D)	2002 (E)	2003-2007 (F)	2008 (G)	2009 (H)	2010 (I)	2011 (J)	2012-2014 (K)	2015 (L)
1	Existence & applicability	Indonesian Income Tax Law Art 18 (3)	DGT Circular Letter KEP-01/1993 and SE-04/1993	TP regulations since 1984, applicable to domestic & foreign related party					DGT Regulation PER-43/2010	DGT Regulation PER-32/2011		
2	Methods		CUP, RPM, Cost Plus	CUP, RPM, Cost Plus, Profit Split, TNMM, Other					Hierarchy	The most appropiate method		
3	Documentation requirements			No statutoty requirement	Affiliated companies disclosures: short		Affiliated companies disclosures: long		Transfer pricing docs			
4	Submission deadlines				3 months after fiscal year end		4 months after fiscal year end					
5	Penalties			No TP penalty, tax adjustment 2% per month								
6	Statute of limitations			10 years from tax year end			5 years from tax year end					
7	APA			IITL Art 18 (3a)					DGT Regulation PER-69/2010			MoF Regulation 7/2015
8	TP Dispute	No TP dispute	ALP, TP Dispute						Litigation, APA, MAP			
9	Comply with ALP								DGT Regulation PER-43/2010			

Table 1 shows Indonesia's transfer pricing regime in chronological order using the category suggested by Lohse et al (2012), the OECD (2012) and Baistrocchi (2013). Lohse et al (2012) categorise the adoption of international transfer pricing into domestic legislation from 2001 to 2009 into seven sections, i.e. through its existence & applicability, methods, documentation requirements, submission deadlines, penalties, statute of limitations, and advance price agreement (Lohse, Riedel, & Spengel, 2012). In Table 1 this category could be seen in column A row 1 to 7. In Indonesia context, Table 1 expands the period of adoption from 1983 to 1993, and from 2010 to 2015. Moreover, the OECD conducted a questionnaire

to all members, Observer countries and several non-OECD countries on their general obligation to comply with the arm's-length principle and transfer pricing simplification measures. Forty-one countries respond to this questionnaire including Indonesia (OECD, 2012). In Table 1 this category could be seen in row 9 column A to L.

Baistrocchi (2013) introduces transfer pricing evolutionary path using dispute resolution as a proxy, i.e. (1) the emergence of MNEs without transfer pricing regulation that led to no transfer pricing disputes, (2) the inception of transfer pricing disputes without transfer pricing regulation, no arm's-length principle (ALP), (3) the introduction of transfer pricing ALP, no conflict exists at this stage, (4) the emergence of intangibles in cross-border transaction, transfer pricing disputes appear solved with administrative procedure. (5) transfer pricing litigations to solve transfer pricing disputes, (6) transfer pricing disputes solved with non-litigation, (7) the ALP to become a standard-based concept, transfer pricing dispute solved by an advance pricing agreement (APA), a mutual agreement procedure (MAP), and an alternative dispute resolution (ADR) method (Baistrocchi, 2013). In Table 1 this category could be seen in row 8 column A to L.

As seen in Table 1, the first implementing transfer pricing legislation of Indonesia's Income Tax Law Article 18 (3) are Circular Letter number SE-04/1993 about the Instruction to Oversee Transfer Pricing Cases and KEP-01/1993 about Guidelines for Examination of Controlled Company. For the first time, the term "transfer pricing" was introduced in Indonesian tax legislation. These circulars aim to prevent aggressive tax planning through the utilisation of intra-group transaction between associated enterprises. The non-arm's-length transactions could be found in transactions such as sale price, cost of goods sold, overhead cost allocation, interest expense of shareholder loan, commission, licence, franchise, rent, royalty, management fees, and technical fees, purchase of firm's assets to shareholder, sale to offshore company, third party dummy company, letter box company and re-invoicing centre.

Subsequently, there have been implementing legal basis of transfer pricing, i.e. DGT Regulation PER-43/2010 and PER-32/2011 to adopt the traditional arm's-length principle (KPMG, 2012). The DGT regulation PER-43/2010 clearly states the definition of the arm's-length principle as a principle which provides that if the conditions of the transactions made between the related parties are equal to or comparable data with the conditions in transactions made between unrelated parties, then the price or profit of the transactions made between the relevant parties must be equal to or be in a range of prices or profit in transactions made

between unrelated parties. The implementing legislation cover the scope of the Indonesian transfer pricing regime for transaction conducted by domestic taxpayer, permanent establishment with foreign taxpayer, the arm's-length principle reflects the fair market value, to introduce internal and external comparable data from commercial databases, to introduce the most appropriate method of comparable uncontrolled price (CUP), resale price method (RPM), cost plus method (CPM), and transactional approach such as profit split method (PSM) and transactional net margin method or TNMM (Directorate General of Taxes, 2011). Indonesian transfer pricing rules only apply to transaction above IDR 10 billion (AUD $ 1 million). The DGT regulations also introduce transfer pricing documentation requirement for the first time.

Subsequently, DGT regulation PER-22/PJ/2013 about the guidelines to audit affiliated transaction is aware of the aggressive tax planning practice and profit shifting through the cross-border trade and transfer pricing (Directorate General of Taxes, 2013). The objective of transfer pricing audit legislation is to ensure the application of the arm's-length principle in affiliated transactions – such as sale, purchase, transfer of tangible assets, intra-group services, transfer and the use of intangibles, interest expense from intra-group loans, and sale or purchase of shares – complies with the transfer pricing rules. In addition, the Indonesia tax system adopts a self-assessment system that the burden of proof is on the taxpayer. In this regard, the taxpayer needs to prove that the argument to determine the price and its method should be consistent with the at arm's-length principle. If the taxpayer cannot provide the required documentation, a substantial adjustment will be imposed based on market price (Directorate General of Taxes, 2011).

In summary, Table 1 reveals that the OECD transfer pricing regime based on the traditional arm's-length principle is adopted in Indonesia via DGT Regulation PER-43 enacted in 2010 (Lohse et al., 2012; OECD, 2012). The transfer pricing methods adopted are CUP, RPM, Cost Plus, Profit Split, TNMM, and other method using the most appropriate method. However, there is no specific regulation what other transfer pricing methods are accepted. Although official transfer pricing documentation requirements was introduced in 2010, MNEs need to disclose transactions with their affiliated companies since 2002 that were submitted along with the annual tax return. In Indonesia, there are no transfer pricing penalties, and statutes of limitations are five years from fiscal year ended. APA was enacted through DGT Regulation PER-69/2010 and Ministry of Finance Regulation 7/2015 that

comply with the OECD's Base Erosion and Profit Shifting Action Plan (KPMG, 2015). The adoption of the OECD transfer pricing regime could be seen from its dispute resolution through MAP, APA, and ADR (Baistrocchi, 2013) in Indonesia. The OECD questionnaire reveals that currently, Indonesia does not have transfer pricing simplification measures in place (OECD, 2012, p. 81).

1.3 RESEARCH GAP

First, Although the international tax regime was formulated solely by developed countries, there is a continuing global convergence in international tax regime adoption (Baistrocchi, 2013). BRIC countries (Brazil, Russia, India, and China) adopted the OECD Model in the 1980s although they played no relevant role in developing the international tax regime. This study fills the gap by extending the convergence of international tax regime in Indonesia.

Second, literature on transfer pricing in Indonesia generally falls into one of three categories: a descriptive study of transfer pricing regime such as transfer pricing report publishes by the big four accounting firms (KPMG, 2012; PWC, 2013), a study of transfer pricing compliance, i.e., the perception of transfer pricing by tax auditors (Mulyani, 2010), and an analysis of selected case law e.g. court decisions on royalty payments (Adoe, 2015; Navarro, Mukanov, & Priatna, 2012). To date, the existing literature does not cover the legal reasoning of court decisions involving transfer pricing dispute to identify which parts of the Indonesian transfer pricing legislations require necessary changes. This study aims to fill these gaps.

1.4 RESEARCH METHODOLOGY

This study proposes a legal research as a chosen methodology due to several reasons. First, this study uses sources of law, i.e. legislation, case law and legal doctrine as source of analysis. Second, this study aims to solve a tax problem through a systematic exposition of the rules, or what is known as doctrinal legal research (Hutchinson & Duncan, 2012). Third, this study intends to reveal the law interpretation being used to solve transfer pricing disputes by analysing the legal reasoning of court decisions. Fourth, a case law approach is used to unveil the prescriptive function of the court to solve a tax dispute.

In doing so, 80 transfer pricing dispute cases for the fiscal year 2002 – 2013 and decided between 2008 – 2015 are taken from the website of the Indonesian Supreme Court (Indonesian Supreme Court, 2016). Manual analysis is then undertaken by organising cases law into coherent elements, categories, and concepts: type of taxes, the level of the jurisdiction of courts, industry, country of origin, and legal facts. The next step is to identify a specific transfer pricing dispute including transfer pricing documentation, royalty payments, intercompany sales, and the factual situation in each case. Further, the analysis is to identify the soundness of legal reasoning, to notice what the court had said, applied or not applied the prevailing rule, and the legal facts emphasised. The last step is to identify what source of law such as statutes, precedents (if any), and legal doctrine and to identify which law interpretation had been applied.

1.5 THEORETICAL FRAMEWORK

Baistrocchi's theory offers a number of opportunities to contribute to the debate of resolving transfer pricing dispute between MNEs and tax authority (Baistrocchi, 2013). First, Baistrocchi proposes a theoretical framework to investigate how the transfer pricing regime which is a component of international tax regime works. The international tax regime is a network market that could be seen from its main features: network, expectations, and lock-in effects. Network effects stand for the larger the number of member of the international transfer pricing regime, the better for each of them. Expectations denote that the international transfer pricing regime is sponsored by an influential player, i.e. the OECD. Lock-in effects means that a later regime is unable to replace the earlier regime.

Second, Baistrocchi argues that the transfer pricing regime is a two-sided platform that performs three functions, i.e. matchmaker to facilitate exchange, build an audience, and provide shared resources & reduce costs. The international transfer pricing regime is a dual trader in independent markets, provides a soft law template of transfer pricing regime through transfer pricing guidelines, and aims to minimise transaction cost between the taxpayer and tax authority. Indeed, Baistrocchi offers a theoretical avenue to understand to what extent Indonesia adopts international tax regime principles to resolve transfer pricing disputes, i.e. the aim of this study. It does so by adopting the arm's-length principle.

1.6 RESULTS

1.6.1 Descriptive Results

Table 2. Number of Cases Law Involving Transfer Pricing

No	Taxes	Tax Court Decisions	Supreme Court Decisions	Domestic Transfer Pricing	Total	% taxpayer successful	% ITA successful
A	Corporate Income Tax						
1	Intangible property	15	2		17		
2	Intercompany sales	6	3	7	16		
3	Interest	1			1		
4	Management	2			2		
	Subtotal	24	5	7	36	73 %	27 %
B	Value Added Tax						
1	Intangible property	9	7		16		
2	Intercompany sales	8	2	14	24		
3	Interest				0		
4	Management		1		1		
	Subtotal	17	10	14	41	78 %	22 %
C	Import duty & other			3	3		
D	Total	41	15	24	80	76 %	24 %

Table 2 shows case laws that were categorised into type of taxes and level of courts. There is corporate income tax 36 cases, value added tax 41 cases, import duty and other 3 cases. And there are 41 cases decided by the tax court, 15 cases decided by the Supreme Court, and 24 cases involving domestic transfer pricing. This study focuses on corporate income tax and VAT decided by the Indonesia's Tax Court and Indonesia's Supreme Court. Domestic transfer pricing, import duty and other cases law are excluded from the analysis. Therefore, there are corporate income tax cases law decided by Tax Court and Supreme Court 24 and 5 consecutively. And there are 17 and 10 VAT cases law decided by Tax Court and Supreme Court consecutively. In total 56 cases law are included in the analysis.

1.6.2 Case Law Analysis

Out of 56 cases law for analysis, selected transfer pricing decisions are discussed below. The Tax Court and Supreme Court decisions are publicly available from the official website of the Indonesian Supreme Court, as well as MNEs' identify. Indonesia has enacted Freedom of Access to Public Information Law in 2008. The specific disputes filed to tax courts are including cases involving the application of the arm's-length principle, intangible property, intercompany sales, interest expense, management fee, and value added taxes. A number of cases are discussed below.

1.6.2.1. Arm's-length Principle

In *Teckwah Paper Products Indonesia vs Indonesian Tax Authority (ITA)* case number 217/PK/2013, tax auditor uses two legal bases, i.e. Article 18 (3) and Article 18 (4) Indonesian Income Tax Law of 1983. First, tax auditor argues if transactions are undertaken between associated enterprises, tax assessment is released. Second, appellant do not submit related parties' disclosures in tax return. Similar legal bases are used by Indonesian Tax Authority in majority cases law. Further analysis will be discussed in section 1.7.1.1.

1.6.2.2. Intangible Property

Cases involving intangible properties are the most frequent dispute filed to court by the taxpayers. This section will consider a thorough analysis of the judicial decisions of intangible properties:

1.6.2.2.1. Royalty

In *Cussons Indonesia vs Indonesian Tax Authority (ITA)* case number Put.53966/2014, the tax auditor disallows royalty payments 3% of net sales from Cussons Indonesia to its parent company because appellant was unable to prove that the transaction is at arm's-length, as well as unable to provide transfer pricing documentation. Appellant claims that the royalty payments have been supported with documents such as royalty agreement, VAT payment, and withheld tax on royalty. Appellant argues that sales in Indonesia were positively influenced by Cusson's trademark. Court decision states that Cussons Indonesia was under the ownership of PZ Cussons International Ltd so that provisions regarding associated enterprise refers to tax treaty Indonesia and Great Britain. Moreover, comparability analysis

of royalty using RoyaltyStat shows the quartile range between 1.75% to 6% are similar transaction in PZ Cussons Australia, Ghana, East Africa, and Thailand. Judges conclude that royalty fees 3% from sales is at arm's-length. The court decided in the favour of appellant.

In *Frisian Flag Indonesia vs ITA* case number Put.42729/2013, the dispute is a fiscal correction for technical assistance fee and royalty to Friesland Brands BV in the Netherlands. Tax auditor contends that taxpayer is not entitled to claim royalty expenses from its gross income because the taxpayer does not declare unrelated party transaction to the annual tax return. The Judges applies several criteria to ensure that the royalty fees are at arm's-length, i.e. existence and benefit, duplication, and valuation. Appellant argues that the existence and benefit of royalty could be seen from Friesland Brands' effort to develop know-how, IT, experience, data, method, process and technical expertise to support its production and marketing in Indonesia. Appellant ensures that there is no duplication on royalty expenses. For valuation, Friesland Brands BV has endorsed E&Y and PWC Netherlands to prepare documentation and research to calculate the arm's-length price for royalty, i.e. 2% of net sales for all products. Know-how license agreement was signed in 2003 between Friesland Brands BV and appellant. Appellant won the case.

In *Mead Johnson Indonesia* vs *ITA* case number Put.44244/2013, tax authority presumes that royalty and know-how expenses to Mead Johnson Company is a dividend to the parent company, and there is no existence of utilisation of intangible property. The trial reveals the facts the existence of trademarks and design, intellectual property agreement, and marketing intangible between Mead Johnson Company and appellant. Tax authority incorrectly disallows royalty fees and does not provide arm's-length royalty fees. In their decision, the judges argue that unpaid royalty violates Indonesian Royalty Law of 2002 and violates agreement on Trade-related Aspects of Intellectual Property Rights.

In *Sharp Semiconductor Indonesia* vs *ITA* case number Put.49339/2013, in contrast to the previous case laws, tax court reject appellant's suit. Tax court argues that appellant was not able to prove the existence of know-how, the existence of training provided, the value of intangible property owned by Sharp Corporation. Moreover, although appellant able to provide a certificate of trademark "Sharp", appellant sells its product to its associated enterprise. Royalty fees are deductible once the product sold to independent parties, not to associated parties. Last, appellant was not able to prove the economic benefit received from the trademark "Sharp". In *Roche Indonesia* vs *ITA* case number Put.50616/2014 judges reject

appellant's suit. The reasons are, appellant was unable to show the value and the existence of intangible properties owned by F. Hoffmann-La Roche & Co. Appellant was also unable to show the ultimate owner of intangible properties.

1.6.2.2.2. Technical assistance, brand fees & know how

In *Panasonic Indonesia* vs *ITA* case number Put.45162/2013*,* the taxpayer was unable to show actual 'services' undertaken for 3% of net sales of all product manufactured and 1% of net sales for technical assistance and brand fees. During the trial, tax authority argues that appellant was unable to show intellectual property ownership by Panasonic Corporation Japan, Panasonic Indonesia is owned by Panasonic Holding Netherlands BV but pay royalty to Panasonic Corporation Japan, taxpayer does not receive benefit upon royalty due to its contracting manufacturing status, and 3% technical assistance and 1% brand fees are unfair. Appellant argues that technical assistance and brand fees are at arm's-length and based on the contract agreement and approval from the Indonesia Investment Coordinating Board since 1970, supported by PWC independent accounting firm's report. The judges are to entirely accept the appellant case, regardless the fact that its net income was reported consistent loss.

In *Colas Indonesia* vs *ITA* case number Put.44519/2013*,* apart from disallowing technical assistance expenses to Colas SA, tax auditor unable to determine its arm's-length price. Moreover, the tax auditor was unable to provide the source of law of technical assistance definition. In their decisions, judges provide the definitions of assistance cited from the UNESCO, the OECD, and the UN. Judges accept the taxpayer's appeal.

1.6.2.3. Intercompany Sales

There are five cases law involving intercompany sales between associated enterprises for the financial year 2006 – 2008. In this period, Indonesia has not adopted the OECD transfer pricing guidelines into domestic legislation. Because tax court decisions are decided in 2013 and 2014, the transfer pricing legislation in Indonesia that was enacted in 2010 cannot be used to resolve the case. In *SKGroup Indonesia* vs *ITA* case number Put.56237/2014*,* under-price lube base oil sold to SK Energy International (Singapore) was adjusted by tax auditor with comparable transaction Pertamina local company to SK Energy (Korea). Tax auditor uses transfer pricing method Comparable Uncontrolled Price (CUP),

while appellant uses Transactional Net Margin Method (TNMM). Tax auditor was unable to prove the comparable data and a valid reason why CUP is the appropriate method. To solve the dispute, the judges use the OECD five comparability factors, i.e. characteristics of goods and services, functional analysis, contractual terms, economic circumstances, and business strategies. The dispute concluded that intercompany transaction to SK Energy International is at arm's-length.

Similar to the previous case, In *PT XXX* vs *ITA* case number Put.43022/2013*,* court decision reveals that the OECD's comparability analysis of functions, assets, and risks the main requirements of the traditional arm's-length principle. Although CUP is used by tax authority and appellant, the tax authority was unable to provide an analysis of functions, assets, and risks. Appellant, on the other hand, has a transfer pricing documentation prepared by independent tax consulting. Appellant uses internal comparable, while tax authority uses external comparable, i.e. the Newcastle Coal (NEWC) Index. The decision is in the favor of appellant because the comparability data used by tax authority does not represent comparability analysis.

1.6.2.4. Interest Expense

In *Schlumberger Indonesia* vs *ITA,* case number Put.50285/2014*,* a substantial amount of interest expenses incurred in non-operating expenses. Fiscal correction of the intercompany loan with an excessive ratio of debt to equity from Schlumberger Finance BV in unreasonable because the taxpayer's balance sheet is unhealthy, i.e. high capital deficiency, and loss from operation from 2003 until 2008. Appellant argues that debt to equity ratio was not regulated by the Government, loan originally not from a shareholder, and the interest rate is at arm's-length. The tax court accepted appellant's case because at that time there was no regulation in Indonesia to govern the ratio of debt compared equity.

1.6.2.5. Management fee

There are two cases law involving management fees for the fiscal year 2008 that were decided in 2013. Although these case laws are identical, the decisions are contradictive. In *Longyear Global Holding Indonesia* vs *ITA* case number Put.49616/2013*,* appellant pays services such as management, production, IT, finance, human resource, sales, procurement,

and drilling to its sister company Boart Longyear Company. There are no actual services that have taken place, and only correspondence via email is provided. The court decision is to reject the appeal that management fees to sister company is not acceptable, the using of the percentage of sales rather than a real cost, and lack of evidence of actual services.

However, in *XXX Corporation* vs *ITA* case number Put.46469/2013, appellant pays management fees 3% of sales to the parent company in Japan. Management services are including accounting, human resource, and general services by assigning director, commissioner, and employees to Indonesia twice of three times annually. Although judges state that management fees are not relevant, the tax authority does not recalculate the arm's-length price. A judicial decision is to accept the taxpayer's appeal.

1.6.2.6. Indirect Tax (Value Added Tax)

There are 41 case laws covering VAT on transfer pricing, ranging from the fiscal year 2002 to 2009. Currently, Indonesia does not have a specific regulation on transfer pricing audit. Tax audit on transfer pricing conducted concurrently with all taxes audit including VAT. Indonesian Income Tax Law of 2009 Article 26 (1) states that royalty payment to the foreign company subject to VAT 20%. Fiscal correction for VAT on royalties due to insufficient transfer pricing documentation such as in *Honda Motor Indonesia* vs *ITA* case number Put.43696/2013. Appellant was unable to provide transfer pricing documentation in 2009 because it is formally introduced with a decree of Director of General of Taxes PER-43/PJ/2010 on 6 September 2010. Judges contend that in principle transfer pricing documentation are all documents that can be used to describe any transaction with parties related without being bound to specific forms and formats. It can be either contract, agreement, proof of payment and other related documents.

In most cases in relation to VAT, fiscal correction is aborted because Article 6 (1) point (a) of Income Tax Law of 2000 states that royalty and technical assistance fee is the cost incurred for obtaining, collecting, and maintaining the income that can be deducted from gross income, therefore Input VAT on these costs can be calculated. Moreover, Article 9 (2)

VAT Law of 2000 Input VAT in a tax period is credited with Output VAT for that similar period tax. The dispute concludes to accept the appellant suit. Similar case law is in *Onamba Indonesia* vs *ITA* case number Put.49631/2013*, in Nagai Plastic Industry Indonesia* vs *ITA* case number Put.44009/2013*, in Sumitomo Forestry Indonesia* vs *ITA* case number Put.56242/2014*, and in Panasonic Consumer Electronics Indonesia* vs *ITA* case number Put.44735/2013.

Moreover, the discrepancy of under-pricing sales subjects to VAT assessment. For instance, in *SKGroup Indonesia* vs *ITA* covering intercompany sales, despite subject to fiscal correction, the taxpayer also charged Output VAT. The court decision is to accept the appeal because concurringly corporate income tax dispute is also accepted. Similar case law is in XXX *Indonesia* vs *ITA*.

1.7 DISCUSSION

1.7.1 Legal Reasoning

Article 78 of the Tax Court Law of 2002 states that tax court decisions are taken based on three criteria, i.e. assessment of evidence, taxation legislation, and judge's conviction. Judge conviction is something that is known by judges and believed to be true. Despite statutory interpretation, a judge's conviction plays an important role in legal reasoning. The legal analysis approach undertaken by the Indonesian Tax Court is the issue, rule, fact, application, and conclusion (IRAC). The following section discusses legal reasoning using IRAC approach.

1.7.1.1. To What Extent the Arm's-length Principle Effectively Adopted in Indonesia

There are two articles that mainly used by tax authority during tax audit. First, article 18 (3) Indonesian Income Tax Law states that "Director General of Taxes is authorized to reallocate income and deductions between related parties and to characterize debt as equity for the purposes of the computation of taxable income to assure that the transaction is those which would have been made between independent parties using price comparison method between independent parties, resale price method, cost-plus method, or other methods". Second, article 18 (4) Indonesian Income Tax Law states that the term "related taxpayer" means: (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 taxpayers, 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. Using these two articles, once the transactions could be proved between related parties, tax authority disregard the expenses or revenues.

1.7.1.2. To What Extent Intangible Property Fees to Parent Company are at Arm's-length

Income Tax Law of 2008 Article 4 (1) point h has a clear definition of royalty, i.e., rights over intangible property, and article 6 (1) a number 3 states that royalty is a deductible expense. The amount in excess of the fair limit to related companies may not be deducted. In support their conviction, judges use a broad definition of royalty and know-how from extensive sources of law, such as article 12 of the OECD Model Tax Convention, para 6.5 the OECD Transfer Pricing Guidelines, and Trade Secret Law of 2000, and Royalty Law of 2002. Court identifies criteria of an MNE is entitled to pay royalties to parent company: competitive technological advantage, economic benefit, access to technology. And a panel of judges applies several criteria to ensure that the royalty fees are at arm's-length, i.e. existence and benefit, duplication, and valuation.

1.7.1.3. What are the Criteria of a Fair Intercompany Sales?

Tax Court faces cases law involving intercompany sales prior fiscal year 2010 when Indonesia's transfer pricing regime was at its early stage. In considering the dispute, the panel of judges use para 1.33 the OECD Transfer Pricing Guidelines' five comparability factors e.g. characteristics of goods and services, functional analysis, contractual terms, economic circumstances, and business strategies. And para 1.42 the OECD functional analysis that consists of functions performed, assets used and risk assumed. Rather than using a hierarchy of transfer pricing methods, Tax Court use the most appropriate method for transfer pricing dispute prior 2010.

1.7.1.4. What is the ratio of Excessive Interest Expense?

There is no debt to equity legislation until 9 September 2015. The court decision is in favour of the taxpayer. Tax Court is unable to find a law to settle excessive interest expense Debt to Equity Ratio regulation is enacted with Ministry of Finance Regulation PMK169/2015.

1.7.1.5. Requirement of Management Fee

Although there are two contrary decisions, panel of judges have a similar perception about case law involving management fees. First, there should be actual services take place. Second, the management fees should be relevant to their activities. Third, management fees should be paid to the parent company.

1.7.1.6. Indirect Tax (Value Added Tax) of Transfer Pricing

The arm's-length principle also applies for VAT purposes including intra-group sales and purchase. Judges use Article 6 (1) point (a) of Income Tax Law of 2000 and Article 9 (2) VAT Law of 2000. For VAT on royalty, the Tax Court requires a complete supporting documentation not limited to formal form of Transfer Pricing Documentation. For VAT on inter-company sales, once appeal on corporate income tax is in favour of the taxpayer, the decision for VAT would be similar to CIT.

1.7.2 Law Interpretation

1.7.2.1. Statutory Interpretation

Statute interpretation could be seen in *Mead Johnson Indonesia* vs *ITA,* the judges' opinion in relation to the arm's-length transaction preconditions are based on DGT Regulation 43/2010: that the actual transactions had taken place, there are the economic or commercial benefit of the services, and the transaction is comparable to an unrelated party. In *Frisian Flag Indonesia vs ITA,* while deciding dispute the judges applied Article 6 (1) point a 3 Income Tax Law which states that taxpayers are entitled to claim expenses to secure income among others cost which are directly or indirectly related to business including interest, rents, and royalties. Moreover, court decision employs Article 9 (1) point f Income Tax Law of 2008 which states that in determining the taxable income of a resident taxpayer,

excessive compensation paid to other associated parties as a consideration of work performed is not deductible. Therefore, as long as payment to associated parties is not excessive, is considered deductible.

1.7.2.2. Extensive Interpretation

In *Colas Indonesia* vs *ITA,* the dispute is covering technical assistance payment to the parent company in France. The judges use an extensive definition of technical assistance. For instance, gathered from UNESCO, "Technical assistance is non-financial assistance provided by local or international specialists. It can take the form of sharing information and expertise, instruction, skills training, transmission of working knowledge, and consulting services and may also involve the transfer of technical data". In *Frisian Flag Indonesia vs ITA,* the Judges applies several criteria to ensure that the royalty fees are at arm's-length, e.g. existence and benefit, duplication, and valuation.

1.7.3 Summary of Results

Table 3. Summary of Results

Issue	Rule	Application	Conclusion
To What Extent the Arm's-length Principle Effectively Adopted in Indonesia	IITH Art 18 (3) and Art 18 (4)	- ITA: transaction with related parties are non-deductible - Appellant argues that transaction to associated enterprise is at arm's-length	To adopt the traditional arm's-length principle
To What Extent Intangible Property Fees to Parent Company are Arm's-length	IITL Art 4 (1) h IITL Art 6 (1) a 3 Art 12 OECD MTC Para 6.5 OECD TPG Trade Secret Law 2000 Royalty Law of 2001 Trademark Law of 2001 Legal doctrine US IRC, UK's HMRC Vienna Convention	- ITA: royalty to parent company is a non-deductible expense - Appellant provides supporting document, contract, comparable transaction	-Royalty: competitive technological advantage, economic benefit, access to technology - ALP: existence and benefit, duplication, and valuation

What are the Criteria of a Fair Intercompany Sales?	IITL Art 18 (3) DGTax Regulation KEP-01/1993 Para 1.33 OECD TPG five comparability factor Para 1.42 OECD TPG functional analysis	- ITA: fiscal correction for transaction to related party - Appellant: TP docs, FAR analysis, TP method justification	- Comparability analysis: characteristics, functional, contractual, economic, business - Functions, assets, and risks analysis
What are the ratio of Excessive Interest Expense?	There is no DER regulation prior 2015	- ITA: excessive debt, unhealthy balance sheet, loss 5 years in row - Appellant: no regulation, market interest rate	Tax Court unable to decide dispute due to inexistence legislation
Requirement of Management Fee	IGPL Art 28 (3) IGPL Art 29 (1) IITL Art 6 (1) IITL Art 9 (1)	ITA: management fee to sister company, no actual service, lack of evidence Appellant: 3% sales via email & certificate	- Actual services - Real cost
Indirect Tax (Value Added Tax) of Transfer Pricing	IITLL Art 6 (1) a IITL Art 26 (1) VATL Art 9 (2)	ITA: insufficient TP Docs Appellant provides supporting documents: contract, invoice, VAT payment	TP docs are not specific forms and formats but can be any forms of documents

The result shows what approach is taken by the tax authority during tax audit that leads to transfer pricing dispute, and to what extent legal reasoning of judicial decisions resolve the dispute. At the outset, tax auditor's approach to expenses incurred especially intangible property and sales to associated enterprises are not at arm's-length. In addition, tax authority does not hold a strong legal basis of fiscal correction, and neither can recalculate the arm's-length price. Therefore, tax court using IRAC approach identifies the relationship between MNEs and their related parties. Next is to provide a legal basis that intercompany expenses and sales are acceptable. The court then identifies the criteria of arm's-length transaction. The last step is to determine whether the dispute filed to court is at arm's-length. The judicial decision is conformed to Article 84 (1) point h of Tax Court Law of 2002 that court decisions must include legal reasoning.

The result confirms the previous study by Adoe (2015) and Navarro et al (2012). Adoe (2015) discusses an approach to tax audit and clarify transfer pricing disputes using court decisions. Adoe (2015) identifies transfer pricing disputes such as intangibles, transfer pricing methods, and profitability. Moreover, Adoe (2015) argues how Indonesian Tax Authority has a different interpretation of how the arm's-length principle should be applied. However, this study reveals legal reasoning of majority cases such as intangibles, intercompany sales, interest expense, management fee, and VAT. This study discusses further a focus area for a reform. Navarro et al (2012) suggest a stronger transfer pricing documentation as a basis for a tax audit and a clearer transfer pricing rules for a more reasonable tax assessment.

Preliminary case analysis indicated that judicial decisions as a 'law in action' is able to identify how prevailing legislation or 'law in the book' is effectively applied by the courts to resolve transfer pricing dispute. This paper argues that because Indonesia adopts the civil law system, clearer transfer pricing rules that are identified by analysing judicial decisions, laws in such that revisions may enacted by reformation of the prevailing law. For this reason, this paper proposes suggestion to reform Indonesia's transfer pricing legislation.

Table 4. Proposed reform

No.	Problem	Proposed reform
1	Transfer pricing based on Article 18 (3) Indonesian Income Tax Law: "Director General of Taxes is authorized to reallocate income and deductions between related parties and to characterize debt as equity for the purposes of the computation of taxable income to assure that the transaction is those which would have been made between independent parties using price comparison method between independent parties, resale price method, cost-plus method, or other methods"	To enact transfer pricing rules based on the OECD Model by adding "arm's-length principle" "Director General of Taxes is authorized to reallocate income and deductions between related parties and to characterize debt as equity for the purposes of the computation of taxable income **using the arm's-length principle** to assure that the transaction is those which would have been made between independent parties using price comparison method between independent parties, resale price method, cost-plus method, or other methods"

2	Elucidation article 4 (1) IITL point h especially point 1 to 3 states that royalty is an amount paid or payable both periodic or not for a compensation of using: 1. rights over intangible property, such as copyrights in the field of literature, art, or scientific masterpiece, patents, design or model, plans, formulas or secret process, company trade secrets, or intellectual/ industrial rights or other similar rights 2. rights over tangible property, such as rights over industrial, commercial, and scientific equipment 3. Transfer of knowledge or information in the field of scientific, technical, industrial, or commercial	Adding criteria of the arm's-length principle for royalty through its **existence and benefit, duplication, and valuation.**
3	The criteria of a fair intercompany sales are elucidation IITL Article 18 (3) "The Director General of taxes is authorized to reallocate income or expense to assure that the transactions are those which would have been made between independent parties. In reallocating those income and/or expenses, the following methods are used, namely comparable uncontrolled price method, resale price method, cost-plus method, or other methods such as profit split method and transactional net margin method"	Prior 2010, the judges use Para 1.33 OECD TPG five comparability factor Para 1.42 OECD TPG functional analysis. Indonesia has enacted DGT Regulation PER-43/2010 especially in Chapter 3 about the arm's-length principle and comparability analysis.
4	There is legislation for ratio of excessive interest expense?	Debt to Equity Ratio legislation based on Ministry of Finance Regulation PMK169/2015 enacted on 9 September 2015.

5	Requirement of Management Fee Art 6 (1) IITL “Resident taxpayers and permanent establishments are entitled to claim the deductions in the form of expenses to earn, to collect and secure income from their gross income” Art 9 (1) f “In determining the taxable income of a resident taxpayer, the following are not deductible including excessive compensation paid to shareholders or other associated parties as a consideration for work performed”	Adding criteria of the arm’s-length principle for management fees, i.e. **actual services and real cost**
6	Lack of documentation for Indirect Tax (Value Added Tax) of Transfer Pricing for royalty fees and intercompany sales.	Indonesia has enacted DGT Regulation PER-43/2010 Art 5 (2) about transfer pricing documentation

1.8 CONCLUSIONS, IMPLICATIONS, LIMITATIONS, & FUTURE RESEARCH

1.8.1 Conclusions

1) This study examines court decisions on transfer pricing disputes from the fiscal year 2002 to 2013, with the majority of cases filed to courts are the prior fiscal year 2010. Before 2010, Indonesia has not adopted the OECD traditional transfer pricing regime (See Table 1 for detail). It was in 2010 when DGT Regulation PER-43/2010 was enacted. This paper argues that the disputes motivate the Indonesian Tax Authority to improve its transfer pricing regime, such as (See Table 4 point 3, 4 and 6):

   - In deciding dispute of intercompany sales, judges use Para 1.33 OECD TPG on five-comparability factor (characteristics of goods and services, functional analysis, contractual terms, economic circumstances, and business strategies) and para 1.42 OECD TPG on functional analysis (functions performed, assets used and risk assumed). Indonesian Tax Authority subsequently respond by enacting DGT Regulation PER-43/2010 to adopt the arm's-length principles based on the OECD transfer pricing guidelines.

   - To respond excessive interest expenses, Ministry of Finance Regulation PMK169/2015 was enacted on 9 September 2015 with the ratio of debt compared to equity (DER) is maximum 4:1. Under thin cap rules, any interest expenses associated with excess liability over 4:1 will be denied as a taxable deduction.

   - Disputes involving value-added tax (VAT) are caused by in absence of formal transfer pricing documentation. Detail transfer pricing documentation requirement governed by DGT Regulation PER-43/2010 especially Article 5 (2) states that taxpayers are required to document the steps, and to store bookkeeping, records, and documents in accordance with applicable regulations.

2) There is an inconsistent legal basis originally from the existing legislation concerning to the treatment between deductible expenses and transfer pricing as follows:

   a) Indonesian Income Tax Law (IITL) Article 6 (1) states that "resident taxpayers and permanent establishments are entitled to claim the **deductions in the form of expenses** to earn, to collect and secure income from their gross income, including costs which are directly or indirectly related to business, among others: (1) costs of

materials; (2) costs in relation to employment or services including wages, salaries, honoraria, bonuses, gratuities and remuneration in the form of money; (3) **interest, rents and royalties".**

Moreover, IITL Article 9 (1) point f states that "in determining the taxable income of a resident Taxpayer and a permanent establishment, the following are not deductible: **excessive compensation paid to shareholders or other associated parties** as a consideration for work performed".

b) IITL Article 18 (3) states that "Director General of Taxes is **authorized to reallocate income and deductions** between **related parties** and to characterize debt as equity for the purposes of the computation of taxable income to assure that the transactions are those which would have been made between independent parties using price comparison method between independent parties, resale price method, cost-plus method, or other methods".

Moreover, IITL Article 18 (5) states that the term "**related taxpayer**" as referred to in paragraphs (3) to paragraphs (3d), paragraph (1) subparagraph (f) of Article 9, and paragraph (1) of Article 10 means: "(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 another taxpayer; or two or more taxpayers, are directly or indirectly under the same control".

Subsequently, there are several issues concerning to this matter:

(1) IITL Art 18 (3) and Art (5) are the legal basis for tax auditor to presume that if the transaction with controlled company exists, this allows them to reallocate (or not to admit) income and deductions. However, the judges have a different interpretation. Article 9 (1) of the OECD Model Tax Convention on Income and on Capital (OECD, 2014) regarding associated enterprises constitute the arm's-length principle norms that if a transfer pricing transaction is not consistent with the arm's-length principle, then tax authority has the discretion to adjust the

transaction to make it consistent with the arm's-length principle (Baistrocchi & Roxan, 2012). In this regard, the issue of transfer pricing dispute is the arm's-length principle, not the fiscal correction. On the contrary, IITL Art 6 (1) and 9 (1) allows intangible properties such as royalty fees are taxable deductions.

(2) This paper argues that there is unclear classification between IITL Art 18 (3) & (4) with IITL Art 6 (1) & 9 (1). Therefore, it is suggested that:

- IITL Art 18 (3) deals with the arm's-length principle. The suggestion for reform is provided in Table 4 point 1 as follow: "Director General of Taxes is authorized to reallocate income and deductions between related parties and to characterize debt as equity for the purposes of the computation of taxable income **using the arm's-length principle** to assure that the transaction is those which would have been made between independent parties using price comparison method between independent parties, resale price method, cost-plus method, or other methods"
- IITL Art 6 (1) deals with royalty expenses incurred in the domestic transaction, and not applicable to a transaction between MNEs and its associated enterprises.

3) An examination of the legal reasoning of court decisions of transfer pricing dispute reveals that Indonesia inevitably has adopted the international transfer pricing regime as well as the arm's-length principle to resolve transfer pricing dispute (Baistrocchi & Roxan, 2012). This study is to apply Baistrocchi's (2013) theory that the OECD provides a template of a soft law for a tax authority to develop model tax convention and transfer pricing regime. It is well-accepted internationally and reduces transaction cost.

4) The way forward, this paper argues that an analysis of court's legal reasoning is able to identify elements of transfer pricing legislation that needs further reform:

- To include the definition and scope of the traditional arm's-length principle during transfer pricing audit. Currently, Indonesia has no transfer pricing audit legislation. The existing legislation covers tax audit in general. It is required to underline that the

objective of transfer pricing audit is to examine the arm's-length principle of revenue and expenses, not about deductible or non-deductible expenses.

- Detailed definition and criteria of intangible properties, through its existence and benefit, duplication, and valuation. Rather than contend whether royalty fees are deductible or non-deductible expenses, this approach allows appellant and defendant to argue what are the arm's-length price of intangible properties expenses.
- Detail criterion for management fees, i.e. actual service is undertaken and a real cost is incurred

5) As a civil law country, the primary source of law in Indonesia is the legislation. And because the judges do not make law (Neubauer & Meinhold, 2016), not like a common law country, judicial decisions are not the source of law. In Indonesia context, judicial decisions play important role in Indonesian legal system because it performs a function through the legal establishment and legal discovery (Fauzi, 2015). This paper argues that an analysis of legal reasoning of transfer pricing disputes that lead to the identification of further reform as discusses in point 5 above, need to accommodate into law reform of the existing legislation. This study also argues that a policy proposal should be enacted into domestic legislation because although legal reasoning of judicial decisions takes the principle of the international tax regime, it can be automatically adopted for a future dispute because the adoption of international law into domestic legislation requires ratification from the President and Parliament (Butt, 2014).

6) Point 1 to 5 above allows the author to explain why 76% transfer pricing disputes involving transfer pricing in Indonesia are in the favor of the taxpayer (refer to Table 2 for detail). A number of reasons explain this phenomenon as follows:
   - Inconsistent and conflicting legal basis of the existing legislation, such as IITL Art 18 (3) versus IITL Art 6 (1). See point 2 for detail explanation
   - Indonesia has no transfer pricing audit regime. See point 5 for detail
   - Transfer pricing is a complex system. Indonesia lack of expertise in this area
   - Indonesia has a week transfer pricing regime. Although mentions in IITL since 1983, the implementing legislation was enacted in 2010-2011.

1.8.2 Implications

The adoption of international transfer pricing in Indonesia confirms the Baistrocchi's theory about the adoption of international tax regime as a network market. In Indonesia, MNEs are originally from developed nations that adopt the OECD transfer pricing regime. Indonesia intends to receive benefit from an internationally accepted transfer pricing regime developed by the OECD. Indonesia adopts the traditional transfer pricing regime originally from the separate entity doctrine. In Indonesia, a two-sided platform of transfer pricing regime is the need of transfer pricing regime both for tax authority and MNEs to ensure certainty. Transfer pricing regime is required to avoid double taxation and double non-taxation. As a developing nation, to transplant the existing regime is easier than developing a brand-new system. The OECD provides a template of transfer pricing guideline that could be used for both tax authority and MNEs. Therefore, Indonesia transplants the OECD transfer pricing guidelines because it minimises transaction cost to develop a new system. Practically. This study reveals what are the elements of Indonesia's transfer pricing legislation that require further reform.

1.8.3 Limitations

The limitations of this paper are:

- A limited sample size of court decisions. Eighty transfer pricing dispute cases for the fiscal year 2002 – 2013 and decided between 2008 – 2015. After eliminating irrelevant cases law, this paper analyses 56 judicial decisions.
- This research focuses on civil law jurisdiction only that may not be implemented in common law jurisdiction
- Case laws decisions are in the Indonesian language, and it is subjective to the author understanding to interpret the texts

1.8.4 Future Research

And the possible future research is:

- To conduct research analysing transfer pricing reform from the perspective of experts, tax auditor, taxpayer, academia, policymakers, and legislators
- To carry out study using other methodology such as interview and survey to identify what elements of Indonesia's transfer pricing regime that require reforms
- To expand the cases law in terms of fiscal year and the coverage of decisions

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