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Comparison of Transfer Pricing methods and their application in disputed tax cases in Indonesian courts

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Abstract
Transfer pricing is a trending topic of taxation in various worlds, not least in Indonesia. Directorate General of Taxation is very aggressive to supervise and monitor the practices of transfer pricing conducted by the taxpayer, because it is not just a case of fictitious tax refunds and tax realtor practices that erode the potential for state revenue from taxes, but the practice of tax evasion in the process transfer pricing is also considered a lot of harm to tax revenue. Transfer pricing practice is actually a common practice and commonly practiced by companies group companies. However, this can be a crucial issue when setting transfer prices is not in accordance with the principle of fairness and business prevalence (PKKU / arm's length principle) which regulated in the Indonesian transfer pricing regulations.. The taxpayer is given the freedom to use their own discretion in deciding the most appropriate method of measuring the transfer price. However, this leads to inconsistencies in the methods applied to arm's length transactions similar by entities from similar industries. Loopholes in this area are vulnerable to tax evasion practices since decades ago. This paper aims to compare the available methods for measurement transfer pricing.

Keywords: Arm's Length, Transfer Pricing, tax disputes, affiliation, special relationship, multinational

1. INTRODUCTION

Transfer pricing is a topic that prevails in today's business practice when Global trade has grown, giant companies and market leaders are trying to expand their business globally by engaging in growth strategies through foreign direct investment, joint ventures, strategic alliances, mergers or acquisitions. Can not be avoided, most multinational companies have multiple levels of subsidiaries on foreign soil and occurrences of party transactions related among these companies has accelerated at a record rate. Since 2008, the transaction has been regulated by the DGT under the Act Income Tax Act No.36 of 2008, with great reference to the OECD guidelines and PBB.

Unfortunately, complexity in this area has become a challenging problem because lack of experience in transfer pricing . Practitioners have

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offered a wide range of transfer pricing services from compliance, planning to completion disputes and Prevention. In addition, because Indonesia follows the UN or ASEAN model for agreements his tax, Nofyanti and Arsjah (2019) stated that many subsidiaries were established in tax haven countries including Switzerland, Singapore, Virgin Island, and Hong Kong, in where tax rates are significantly lower in these countries compared to Indonesia. Investing in these countries is not without consideration as Simamora and Hermawan suggest these factors have led to vulnerable conditions against further Tax Abuse such as the transfer of profits and the creation of costs non-existence or intra-group service by many market participants.

Many studies show that intra-group services that is the cost of royalties or licenses, patents have contributed greatly to the low tax revenues among multinational companies. Based on different views on the relationship of transfer pricing with tax evasion and tax law continues to evolve, the use of methods available is becoming more challenging (OECD 2010). This study was conducted to provide contribution of literature on disparity of transfer pricing methods in dispute cases Taxes in Indonesia.

The government through the Minister of Finance on December 30, 2016 has issuing regulations with No. 213 / PMK.03/2016, which is about the obligation to attach a Transfer pricing document (Transfer Pricing Document) which is often abbreviated as TP Doc if the company is doing affiliate transactions and meet certain criteria as the basis for the application of PKKU by taxpayers, but disputes the transfer pricing dispute is still a lot going on.

As mentioned above, the purpose of the study was to bring more understanding on the feasibility of adoption of transfer pricing method by taxpayers in Indonesia. Specifically, the study addresses the following questions: strengths and weaknesses of each transfer pricing method; summary of companies with cases decided by the Supreme Court in Indonesia from 2015 to 2019 and the methods chosen by these companies.

2. RESEARCH METHOD

In this study, the research used is juridical normative. A study that using how to search for study materials with library studies. Juridical normative conducted by means of data collection through materials or data in the library. The main purpose of this study was to analyze the disparity of method adoption transfer pricing between similar transactions in the case of disputes in Indonesia. More specifically again, the research questions aim to test the legal reasoning between the differences. Qualitative research on the basis of explorative studies was chosen as the methodology of this study. There are two steps involved in this study. The first step, the selected research is normative research, which it is essential to the basic principles

governing transfer pricing across transactions affiliates in Indonesia. This is done by determining the sources of law, relevant regulations and principles related to the problem and put into effect by the Indonesian tax law. This process is done by reading, study, cite, and compare Indonesian law in practice and guidelines international. Finally, the analysis procedure is done by describing, interpreting, understand and explain in depth transfer pricing in the tax system Indonesia. The second step is to choose and get the case to be studied. Based on cases decided by the Supreme Court of Indonesia from 2016 to 2019, which can be obtained through search engines using the keyword 'transfer pricing' on the website directory of the Supreme Court of Indonesia. Case properties used in the research is diverse, including Value Added Tax (VAT) and Income Tax Agency (PPh), and / or related to intra-group service disputes. Based on the selected cases, an analysis is then carried out to assess basis of tax disputes, the position of the DGT and taxpayers in the Supreme Court, the transaction disputed affiliations, the application of the principle of fairness and prevalence of business (PKKU) in transactions, the Supreme Court decision and its fundamentals

3. RESULT AND ANALYSIS

The Organization for Economic Cooperation and Development (OECD) and PBB are two major contributors in setting standards used as international tax regimes. Thus these institutions has contributed to setting transfer pricing guidelines since decades ago. Eden proposed that the goal to establish this guideline is to avoid double taxation on corporate income multinational and to avoid tax evasion practices both legally and illegal.

The parties referred to have a special relationship set forth in Article 18 paragraph (4) of the Income Tax Law, stipulates that the parties special relationship occurs when :

1. Taxpayers have the most direct or indirect capital participation low 25% (twenty-five percent) on other taxpayers; the relationship between taxpayers with the participation of at least 25% (twenty-five percent) on two taxpayers or more; or the relationship between two or more taxpayers referred to last;
2. Taxpayers control other taxpayers or two or more taxpayers are under the same control either directly or indirectly; or
3. There are family relationships both blood and semenda in the lineage straight and / or sideways one degree

Article 1 point 5 PER 32/PJ / 2011 mentions the principle of fairness and prevalence Work (arm's Length Principle/ALP) is a principle that governs that in terms of condition in transactions made between the parties who have a special relationship equal or comparable to the conditions in a transaction made between the parties does not have a special relationship that serves as a comparison, price or profit in transactions made between

the parties who have a special relationship referred to must be equal to or within the price range or profit range in transactions made between parties who do not have a special relationship served as a comparison. Although there are many transactions that are prone to privileged relationship transactions, the most common transactions are categorized into four groups: sales or purchase of goods/ services, intra-group services, intangible assets and interest on loans.

There are the following methods used in determining a reasonable price as stipulated in Article 11 of the regulation of the Director General of taxes no PER-32/PJ/2011 :

1. Method of price comparison between parties who do not have a special relationship (Comparable Uncontrolled Price / CUP / CUPM)
2. Resale Price Method (RPM)
3. Cost Plus Method (CPM)
4. Profit Spilt Method (PSM)
5. Transactional Net Margin Method (TNMM)

Method of price comparison between parties who do not have a relationship (Comparable Uncontrolled Price / CUP) is a method of determining the Transfer price which is done by comparing prices in transactions made between parties-parties who have a special relationship with the price of goods or services in the transactionconducted between parties who do not have a special relationship in conditionsor comparable circumstances (PER-32/PJ / 2011 article 11.

Cup / CUPM compares the transaction price of goods or services charged to a controlled party with that charged to an uncontrolled party. The difference between these two prices indicates that the transaction is not on arm's length price. CUP allows taxpayers to use the price transactional with an independent company ("internalcomparable") or price transactional between other independent companies ("external comparable").

According to Darussalam, CUP is the most appropriate to establish fair prices for the sale of commodities where market prices or interest rates are available to the public and products or services sold without further process or differentiation, namely crude palm oil, cocoa beans, pulp, coal. determined that some Indonesian market data that can serve as external comparison data this method is as follows:

1. Commodity: crude palm oil; externally comparable: Coftra (Supervisory Board Commodity Futures Trading), MPOB (Malaysia Palm Oil Board).
2. Commodity: cocoa beans; externally comparable: Coftra, ASKINDO Indonesia).
3. Commodity: paper pulp; external composition: RISI Asian Pulp and Paper Monitor

4. Commodity: coal; external composition: Indonesian Coal Index/Argus Coalindo
5. Interest rates: London Interbank Offered Rate (LIBOR), Jakarta Interbank Offered Rate (JIBOR).

Resale Price Method (RPM) is a method Determination of Transfer prices made by comparing prices in the transaction a product made between the parties who have a special relationship with the resale price of the product after deducting reasonable gross profit, which reflect the functions, assets and risks, on the resale of the product to the party others who do not have a special relationship or resale of products conducted under reasonable conditions (PER-32/PJ / 2011 article 11). The corresponding margins and other costs associated with the purchase of goods or services are then subtracted from the resale price to calculate the arm's length price. OECD proposed that this method is the most appropriate for determine reasonable prices for sales and marketing operations as usual made by the distributor.

Cost-Plus Method (Cost Plus Method) is a method of determining the Transfer price which is done by adding the level of fair gross profit earned by the company the same from transactions with parties who do not have a special relationship or the level of fair gross profit obtained by other companies from transactions is proportional to parties who have no special relationship to the cost of goods sold that have been in accordance with the principle of fairness and the prevalence of Business (PER-32/PJ / 2011 article 11. Eden states that this method is the most appropriate if adopted by manufacturers at direct cost whose activities do not include complex transactions those intangible assets or unusual risks.

Profit Split Method (PSM) is a method of determining the price Transactional Profit Method based transfers by identifying the combined profit on affiliate transactions to be shared by the parties- parties who have a special relationship with the use of policies economically acceptable which gives an estimate of profit sharing should occur and will be reflected in the agreement between the parties who do not have a special relationship, using the method of contribution (Contribution Profit Split Method or Residual Profit Split Method. This method is commonly used in complex transfer pricing transactions which is challenging to determine based on traditional transaction methods, including assets intangible, integrated commercial transactions, complex intra-group services.

Transactional Net Margin method (TNMM) is a method of determining the Transfer price is done by comparing the percentage of net operating income to costs, to sales, to assets, or on other grounds for transactions between parties that have a relationship Privileged with the percentage of net operating income obtained from comparable transactions with other parties who do not have a special relationship or a percentage of net income

operations obtained on comparable transactions made by parties that are not have another special relationship. Unlike CPM and RPM which check gross margin as an indicator, TNMM using indicators of net income in comparing profits derived from controlled transactions with those obtained from uncontrolled transactions comparable.

There are three methods in the selection of transfer pricing, namely the hierarchy of methods, method rules best and most appropriate method. The hierarchy of methods is the oldest method and is considered outdated in many countries for current practice. However, in Indonesia this method is also popular especially before the introduction of PER-32. In this method, CUP is considered a method best, followed by RPM and CPM (KPMG 2012). In which case the analysis can not be carried out with the gross profit method, TNMM and PSM can be adopted for analysis at the profit level clean because there is no specific method that fits in any related transactions and rules the best method is not cost-effective, under the OECD (2010), the application of different methods various transactions are allowed. This Proposal was also adopted in Indonesia where the criteria hierarchical, which was required by the PER-43 has been replaced by the PER-32. Method approach the most appropriate was proposed by PER-32. for transactions related to the consideration as follows:

1. Strengths and weaknesses of each method;
2. Level of suitability of the method based on related party transactions, determined by functional analysis;
3. Availability of valid information to be applied by the chosen method;
4. Comparison of transactions between related and non-related parties (including adjustments necessary to eliminate differences in materiality)

Furthermore, when performing a comparability analysis, the elements include characteristics of the transferred property or services provided, functional analysis, terms of the transaction contract, the state of the economy and business strategy must also considered. However, Indonesian regulations for transfer pricing transactions not as broad and detailed as those regulated by the OECD or PBB.

The first consideration in choosing a transfer pricing method with an approach it is most correct to determine the strengths and weaknesses of each method. Table the following presents the strengths and weaknesses of the available methods:

Methods	Strength	Disadvantages
CUPM	The most direct method and reliable if any independent party transactions comparable.	There are material differences in transactions between related parties

		and independent parties.
RPM	There is a need for adjustments that less than with CUPM	This applies only to the retail sector or marketing.
CPM	There is a need for adjustments that less than with CUPM.	It is difficult to determine the cost for each transaction due to fees this may not be a determinant of profit appropriate.
PSM	It offers solutions for highly integrated operation where the one-sided method is not would be appropriate.	Difficult to access information from foreign affiliates and difficult to measure income and the combined costs for all participating related parties in affiliate transactions
TNMM	Indicators of net income (eg return on assets, revenue operations against sales) ess affected b transactional differences than it is with the price, as used in CUPM; It avoids the problems that due to the uncertainty in the classification of costs in calculation of gross profit; Examination of financial indicators it is easier to do for complex transactions with many mutual activities related.	It is difficult to choosethe determining factor accurate and reliable used as an indicator of net income; Information about the transaction uncontrolled as a factor comparability is not available; Difficult to determine suitable adjustments for working back to the transfer price (related companies on both sides purchase and sale of controlled transactions)

4. CONCLUSION

Determination of Transfer Pricing method is very necessary to prevent the occurrence of transfer pricing or transfer of income abroad, which may result in state revenues may decrease. The method used in transfer pricing transactions in Indonesia can not mapped or classified by industry or transaction type. Temporary multiple taxpayers in the same industry and

similar dispute cases, using a similar approach, there are many companies that show a view differ in pricing and acknowledge transactions between them and affiliates them. In addition, some entities in this study did not provide documentation for the methods they use or prefer to adopt other alternative methods.Popular methods adopted by the company in this study (at the level of Supreme Court) is CUP, CPM, TNMM approach and net sales approach. These methods are chosen by the taxpayer in determining related party transactions because it is considered the most appropriate method. DGT and MA also decide each cas transfer pricing based on method suitability and compliance with the principle of fairness and the prevalence strives. Most of the cases covered in the study, tax audit conducted using a hierarchical method in which the DGT calculate transfer price by CUP method. Nevertheless, the reasons for which the method proposed by the DGT is often not aligned with the taxpayer and variable transactions certain, such comparators are not available in the market. As a result, there is a difference in the method chosen is not only among taxpayers, but also between taxpayers and DGT during the tax audit.It may be useful if Indonesian tax laws can enforce more detailed transfer pricing regulations and guidelines as proposed by the OECD, thus creating regulations and adoption of transfer pricing more harmonious between domestic affiliates and international affiliates.

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