UNTAG Law Review (ULREV)
Volume 5, Issue 2, November 2021, PP 49 - 53
ISSN 2549-4910 (online) & ISSN 2579-5279 (print)
http://jurnal.untagsmg.ac.id/indeks.php/ulrev/indeks
www.fakhukum.untagsmg.ac.id

JURIDICIAL ANALYSIS OF TRANSFER PRICING DOCUMENTS IN RESPECT OF TAX AVOIDANCE FOR MULTINATIONAL COMPANIES

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ABSTRACT: Essential principle within business world definitely would be maximizing profit and minimizing capital. Hence many companies would struggle and develop their own ways to avoid taxes as much as they could. Tax avoidance which is taken illegally would disrupt government's revenue indeed. This paper discusses normative juridical approach to examine problems as 1. How does transfer pricing documents could help to diagnose tax avoidance practice within companies? 2. How to prevent the occurrence of transfer pricing's shortcomings? This would highlight the transfer pricing's existence to eliminate illegal practice of tax avoidance within multinational companies and some methods to prevent the shortcomings of transfer pricing. The results shows that 1. transfer Pricing documents are useful for diagnosing tax avoidance practices in multinational companies through an analysis of fairness and business practice and 2. in order to prevent deficiencies in Transfer Pricing documents, the Government must establish a cooperative relationship between companies and reliable tax administrations. such as through AEoI (Automatic Exchange of Information) between countries to encourage transfer pricing inspection processes in multinational companies. The government should conduct cooperative relationship between the companies and tax administration to encourage the process of transfer pricing examination within multinational companies in precise scheduled time frame. Fair and favorable assessment of business report is significant due to undermine unnecessary cost and improper result. The competence and professional judgement from the Directorate General of Taxes are substantial.

Keywords: Transfer Pricing; Tax Avoidance; Business Investment

INTRODUCTION

Companies especially multinational companies within world wide reach might want to seek alternatives way to depress their tax contribution to the respective government. Some of those companies chose illegal manuvers to avoid taxes which is not right. Basically transfer pricing is used to control the trade between two companies (the seller and the buyer) by other party, it is either the seller or the buyer, or both are controlled by the same person.[1]

The ideal analysis to represent the situation within multinational companies or companies' trade would be arm's length principle. The arm's length principle analysis is actually an early examination to indicate whether such company (ies) is trying to avoid tax since it will obviously start within the business group wherever it resided in. Hence the arm's length principle would treat the independent companies equally to the same or similar transaction with the companies that have special relationship. Organization for Economic Co-operation and Development (hereinafter OECD) has provided the basic structure and contents for worldwide regulation such as transfer pricing's option methods through each transaction with special relationship's parties. The OECD extends its regulation through the obligatory of transfer pricing documents.

PROBLEMS

1. How does transfer pricing documents could help to diagnose tax avoidance practice within companies?
2. How to prevent the occurrence of transfer pricing's shortcomings?

RESEARCH METHOD

This research method is normative juridical, descriptive analytical research specifications, data sources are secondary data and primary data, data analysis method is qualitative method. The regulation mainly supports the extend explanation of Transfer Pricing Document such as Finance Minister Regulation No.213/PMK.03/2016 about Types of Documents and/or Additional Information.

Should be Kept by Taxpayers Who Conduct Transactions with Parties that Have Special Relationship and Management Procedures, also Directorate General of Taxes Regulation No. 43/PJ/2010 about Arm's Length Principle Analysis with Afilliated Parties. The others resource came from journals from ancestor researcher.

DISCUSSION

1. Transfer Pricing Documents in Diagnosing Tax Avoidance Practice

Transfer pricing is substantial tool in respect to achieve goals within companies while its objective could be internal and external. The internal objective might in form to facilitate business evaluation among directors and managers throughout countries. External objective is mostly dedicated to reduce global income taxes,depress expenditures, minimise foreign exchange risk and maintain cash flows and competitiveness in global markets.

The legal fashion to minimize tax contribution to the government is through tax planning and tax control. Most companies choose not to do the legal fashion as long as their tax contribution target is still in line.

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[1] Saunders. G and Antczak.G, Tolley's Corporation Tax (Tolley Publisher 2001).

Moreover transfer pricing also a tool to accommodate better management control. Transfer pricing faciliates the evaluation of standard performance of business unit especially in case of enormous number of export transactions. Transfer pricing contributes in cash and fund management, investment and capital budgeting as well, as in global scope.[2]

In prevention the financial reports manipulation, the government make obligatory regulation of analysis financial report not only by internal accountants but also external accountants to recheck them. Not all public accountants are eligible to arrange such transfer pricing documents since there is need for internal and external data which will be analysed in depth by process.

Transfer pricing documents accommodate three types of documents which are Master File, Local File and Country-by-Country Report. The OECD covers full overview of each document and it is quite similar throughout countries. Indonesia adapts with the OECD by the existence of Finance Minister Regulation No.213/PMK.03/2016 about Types of Documents and/or Additional Information Should be Kept by Taxpayers Who Conduct Transactions with Parties that Have Special Relationship and Management Procedures and its attachment.

Firstly for Master File contains complete information about the whole group, not only specifically one entity member of the group. It discloses the organization structures along with the main business for the whole group and activities of each member of entity.

Secondly, the Local File contains many information in respect of the member of entity which act as taxpayer. In this local file, each of the transaction with special relationship entity (ies) will be analysed to diagnose early stage of tax avoidance practice's existence. The analysis will also provide with suggested approach or methods such as Comparable Uncontrolled Price Method, Resale Price Method, Cost Plus Method, Transactional Net Margin Method and Transactional Profit Split Method.[3] All those methods will be utilised along with the proper special relationship's transactions.Those methods ensure that the pricelist or rate induced In transaction with special relationship party is equal to the independent party hence fulfilling the arm's length principle.

Thirdly, the country-by-country report is usuall in such a form which must be fulfilled by the taxpayer. Supposed the parent company which resides aboard has already fulfilled its country-by-country report, the taxpayer would not need to generate another country-by-country report.

The modern transfer pricing regulation does not depend on whether small or medium business which in the United Kindom both of them are determined as the small enterprise is a company with maximum fifty staffs and turnover 10 million euros, the medium enterprise is a company with maximum of 250 staffs and annual turnover fifty million euros.[4]

[2] Curtis, S. L. (2008). Transfer Pricing for Corporate Treasury in the Multinational Enterprise. Journal of Applied Corporate Finance, 20, 97 - 112.

[3] Organisation for Economic, Co-Operation and Development, 'OECD Transfer Pricing Legislation-A Suggested Approach. 2011.

[4] HM Revenue and Custom. 'The Definition of Small and Medium Enterprises'. (2013).

2. Prevention the Occurrence of Transfer Pricing's Shortcomings

In many cases, tax consideration is not superiority while making transfer pricing decision. OECD regulates certain entities to provide transfer pricing documents in respect to diagnose early trace of tax avoidance.

Special note must be put on tax haven country which is a country that has low rate of taxes or not taxable at all.[5] This situation surely attract various companies to establish their business activity.

Government should build co-operation relationship between entities and tax office to administrate the transfer pricing audit are processed in proper assessment and reasonable time. The co-operation shortage may affect the occurrence of uncertainty result. The co-operation relationship could be composed by the cross-border transaction information such us with AEoI (Automatic Exchange of Information) where Indonesia's government could coordinate with global tax department aboard who already signed on AEoI. For instance when a country is adjusting the profit of an entity for tax purpose yet that profit had already taxed in other country must do correlative adjustment. Another note to highlight is for the special parties, the transaction must also use fair market value as with independent parties.[6]

The government also should provide a database for entities to update with latest price of goods or commodities related to companies' financial report assessment. The examination to the fairness in annual turnover of a company in respect to arm's length principle. Its analysis is explained widely in Directorate General of Taxes Regulation No. 43/PJ/2010 about Arm's Length Principle Analysis with Afilliated Parties where it comes with the most appropriate transfer pricing methods.

The recent regulation only explains penalty and sanction if the companies do not fulfill its transfer pricing obligation. This circumstance is not fair and ideal for the companies supposed they do not understand what stages need to be taken. Therefore the lack of acknowledgement also causing more distressed in financial reports' assessment.

CLOSING

Conclusion

1. Transfer pricing documents which are contained of Master File, Local File and Country-by-Country Report is useful to diagnose early stage of tax avoidance within entities, especially for cross-border countries' companies.
2. Government should build co-operation relationship with companies to understand better the business activities and their financial reports. AEoI assists government of a country to get further information from another countries related to aboard's transactions. Easy and affordable access to the database would be helpful the financial reports' examination.

[5] Dharmapala D. and James r. Hiner Jr., 'Which Countries Become Tax Havens?' (2009) 93 Journal of Public Economics.

[6] Cravens, K. S. (1997). Examining the role of transfer pricing as a strategy for multinational firms. International Business Review, 6 (2), 127-145.

Recommendation

The transfer pricing documents' regulation has been prevailed since 2016 where a full disclosure and documents are required in detail. However, a lot of tax consultants and entities itself still do not fully make a proper assessment. The government should educate its taxpayers and help with further executive instruction for better understanding.

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