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Strengthening Institutional Oversight of Transfer Pricing in Indonesia: Towards Legal Certainty Tax Governance

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ABSTRACT

This study examines the institutional oversight of transfer pricing in Indonesia and Malaysia from the perspective of international tax law, focusing on regulatory harmonization, administrative structure, and dispute prevention mechanisms. The issue of transfer pricing has evolved beyond a technical tax matter into one of fiscal justice and national sovereignty amid globalization and the increasing complexity of multinational enterprises (MNEs). While both Indonesia and Malaysia have aligned their regulatory frameworks with the OECD Transfer Pricing Guidelines and the BEPS Action Plan, their institutional capacities differ significantly. Malaysia has consolidated its transfer pricing governance through the establishment of a dedicated Transfer Pricing Division under the Inland Revenue Board of Malaysia (IRBM), supported by comprehensive instruments such as the Income Tax (Transfer Pricing) Rules 2012/2023, Transfer Pricing Guidelines 2017/2024, and APA and MAP Guidelines. In contrast, Indonesia's oversight remains fragmented across multiple directorates within the Directorate General of Taxes (DGT), leading to inconsistent interpretations, weak coordination, and reduced administrative efficiency. This institutional fragmentation undermines legal certainty, facilitates profit shifting, and contributes to both horizontal and vertical tax inequities. The study argues for the establishment of a dedicated transfer pricing division within the DGT to strengthen institutional capacity, enhance coordination with the Directorate General of Customs and Excise, and improve the utilization of risk-based audits and dispute prevention mechanisms. By adopting Malaysia's integrated institutional model, Indonesia can align more effectively with OECD standards, promote fiscal fairness, legal certainty and reinforce national tax sovereignty within a globally interconnected economy.

Keywords: Tax, Transfer Pricing, Tax Governance.

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INTRODUCTION

The era of globalisation has led the world economy towards increasingly intensive interconnectedness. In this situation, there is free flow of investment which implies minimal obstacles or restrictions for investments to enter and exit specific regions and countries, thus making capital movement more intensive. Free flow of investment creates cross-border trade in goods and services as well as high capital mobility, which establishes multinational enterprises (MNEs) with highly complex corporate structures (Minbaeva et al., 2025). Investment creates various special relationship transactions that arise due to the setting of prices between companies related to transactions between related business entities of a multinational nature. Transfer pricing or price determination in transactions is highly relevant as it concerns the principle of fairness and normal business conduct (Arm's Length Principle/ALP) as a pillar in regulating transactions of MNEs that have special relationships, treating them as if conducted by parties with no special relationship (Holtzman & Nagel, 2014). Through this principle, transactions conducted by MNEs use market-based prices so that the range of prices or profits in the transactions can reflect a fair market value.

In practice, MNEs operating in both developing and developed countries often engage in transfer pricing manipulation, profit shifting and the reallocation of intangible assets to tax havens to minimise their tax obligations (Fonseca et al., 2024). This is supported by earnings management practices

through accrual activities, which involve profit engineering through the manipulation of accounting policies and subjective estimates to alter profit reports without affecting actual business operations (Irawan et al., 2020). To mitigate this, the Organisation for Economic Co-operation and Development (OECD) in 2022 issued the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, an international document providing comprehensive guidance for tax authorities and multinational enterprises on the application of the Arm's Length Principle (ALP) in determining transfer prices, including pricing methods, documentation, arrangements for transactions of goods, services, and intangible assets, as well as dispute resolution mechanisms to prevent base erosion and profit shifting (BEPS) and ensure legal certainty and fiscal fairness across jurisdictions (OECD, 2022).

From the perspective of international tax law, transfer pricing activities indicate cross-border issues that require the harmonisation of global standards such as the OECD Transfer Pricing Guidelines, OECD/G20 Inclusive Framework on BEPS, and inter-country regulations such as Double Taxation Avoidance Agreements, as well as the harmonisation of national regulations. This is necessary to ensure legal certainty, fiscal justice, and national tax sovereignty amid MNEs' aggressive practices in exploiting differences in tax systems across jurisdictions. This implies that the international guidelines established by the OECD are positioned as soft law capable of influencing various international tax laws and national tax laws, as well as affecting customary norms and general legal principles in the realm of business and taxation (Zee, 2013). Essentially, Indonesia and Malaysia are not full members of the OECD, but both are committed to being part of the OECD/G20 Inclusive Framework on BEPS. (OECD, 2023). Therefore, the harmonisation of global and national rules on transfer pricing becomes an obligation that cannot be avoided by every OECD/G20 Inclusive Framework on BEPS member country to maintain the credibility of the domestic tax system and to ensure consistency with international standards.

In Indonesia, regulations regarding transfer pricing are governed by a number of laws and regulations. The main instrument is Law Number 36 of 2008 on Income Tax (the Income Tax Law updated by Law Number 6 of 2023 on Job Creation) which contains provisions on related-party relationships and the arm's length principle. On the other hand, the more technical implementation is regulated through Ministry of Finance Regulations (PMK) No. 213/PMK.03/2016 on transfer pricing documentation (Master File, Local File, and Country-by-Country Report/CbCR), PMK No. 22/PMK.03/2020 on Advance Pricing Agreement (APA), as well as PMK No. 49/PMK.03/2019 in conjunction with PER-16/PJ/2020 on Mutual Agreement Procedure (MAP). Although regulations governing transfer pricing are already in place, the main challenge in Indonesia is the absence of a dedicated transfer pricing unit within the structure of the Directorate General of Taxes (DGT), resulting in the oversight of transfer pricing remaining sectoral and fragmented across various directorates.

Malaysia, on the other hand, has developed a more comprehensive institutional framework for transfer pricing. Through the Income Tax (Transfer Pricing) Rules 2012, updated in 2023, as well as the Transfer Pricing Guidelines 2017 (updated 2024), Malaysia affirms the systematic application of the ALP principle. Furthermore, the Inland Revenue Board of Malaysia (LHDN) has a dedicated directorate handling transfer pricing under the International Tax Division, including the preparation of Advance Pricing Agreement (APA) Guidelines (2024) and Mutual Agreement Procedure (MAP) Guidelines (2023). This reflects Malaysia's seriousness in adopting OECD best practices while providing legal certainty for taxpayers. With a dedicated institution, transfer pricing governance in Malaysia is more structured, transparent, and can serve as a tool for both prevention and resolution of cross-border tax disputes.

The main issue transfer pricing oversight in Indonesia is institutional fragmentation, which makes the implementation of transfer pricing regulations potentially less effective. The absence of a dedicated unit results in weak internal coordination, inconsistent interpretation of rules, and limited utilisation of dispute prevention instruments such as APAs and MAPs. Consequently, transfer pricing manipulation by MNEs is difficult to detect early and often only emerges during audits, which frequently result in disputes. This situation creates legal uncertainty, potentially harms state revenue,

and generates a perception of fiscal unfairness. Therefore, the urgency of establishing a dedicated transfer pricing institution in Indonesia lies in the need for legal certainty, administrative efficiency, and the protection of the rights of both taxpayers and the state.

This study aims to describe and analyse the comparison of transfer pricing institutions in Indonesia and Malaysia from the perspective of tax law, emphasising the regulatory, institutional aspects, and dispute resolution mechanisms. Furthermore, this study intends to formulate an ideal institutional design for transfer pricing in Indonesia, referring to practices in Malaysia and the OECD/G20 Inclusive Framework on BEPS international standards, in order to enhance legal certainty, prevent base erosion and profit shifting (BEPS), and uphold fiscal justice and sustainable state revenue. Furthermore, this paper discusses two issues, namely:

1. How do transfer pricing oversight policies in Indonesia and Malaysia?

2. How is the institutional strengthening of transfer pricing in Indonesia to achieve equitable tax governance?

METHOD RESEARCH

This study is a legal research with a normative nature, using a comparative approach and a statute approach. The statute approach is conducted by analysing national regulations related to transfer pricing in Indonesia, including Law No. 36 of 2008 on Income Tax, PMK No. 213/PMK.03/2016, PMK No. 22/PMK.03/2020, and PMK No. 49/PMK.03/2019 in conjunction with PER-16/PJ/2020, as well as national regulations in Malaysia such as the Income Tax (Transfer Pricing) Rules 2012/2023, Transfer Pricing Guidelines 2017/2024, APA Guidelines 2024, and MAP Guidelines 2023. The comparative approach is employed by comparing the institutional governance of transfer pricing between Indonesia and Malaysia to assess strengths, weaknesses, and its relevance to international standards. The analysis also refers to international documents, particularly the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022 and the OECD/G20 BEPS Action Plans, as soft law that serves as a global standard in transfer pricing regulation.

RESULT AND DISCUSSION

1. Transfer Pricing`s Oversight Policies in Indonesia And Malaysia

Transfer pricing issues nowadays are no longer merely a matter of tax technicalities, but have developed into problems of fiscal justice and national sovereignty. Amid the rapid flow of globalization and cross-border business expansion, multinational companies have considerable leeway in determining transaction prices between entities within their group. This situation creates opportunities for profit shifting to jurisdictions with low tax rates, which ultimately erodes the tax base of the country where the actual economic value is created. For developing countries such as Indonesia and Malaysia, which rely on tax revenue as a primary source of development, this challenge concerns not only legal certainty but also the legitimacy of the tax system in ensuring a fair distribution of the tax burden. Therefore, analysis of transfer pricing should not stop merely at the normative aspect, but must be placed within a broader fiscal policy framework. Regulatory oversight and institutional aspects become important elements in assessing the extent to which a country can close tax avoidance loopholes while maintaining its investment competitiveness.

Firstly, in terms of transfer pricing regulations, Malaysia has consolidated the technical framework of transfer pricing into rules and guidelines in line with the OECD, including:

a. Income Tax (Transfer Pricing) Rules 2012/2023;

b. Transfer Pricing Guidelines 2017/2024;

c. APA Guidelines 2024; and

d. MAP Guidelines 2023.

The existence of these rules and documents indicates that Malaysia has transformed ALP (OECD) norms into operational supervisory procedures: audit guidelines, risk indicators, and dispute prevention mechanisms (APA/MAP) are managed in an integrated manner.

Meanwhile, Indonesia has legal foundations related to transfer pricing, including:

a. The Income Tax Law (as updated through the Job Creation Law) which regulates the general principle of the Arm's Length Principle; and

b. Ministry of Finance Regulation 172 of 2023 concerning the Application of the Fairness and Business Usual Principles in Transactions Affected by Related Parties.

In general terms, this regulation governs related party relationships, the application of fairness and business usual principles, documentation of the application of fairness and business usual principles, compliance testing for the application of fairness and business usual principles, adjustment of related transactions, mutual agreement procedures, and transfer pricing agreements.

Malaysia has reaffirmed its commitment to the Arm's Length Principle (ALP) through the consolidation of technical transfer pricing regulations, including the Transfer Pricing Rules (2023) and the Transfer Pricing Guidelines (2024), and translated them into operational elements through the APA Guidelines 2024 and MAP Guidelines 2023. This approach reflects the transformation of OECD standards into structured and integrated fiscal administration procedures. On the other hand, Indonesia has also strengthened TP regulations through the institutional basis in the Income Tax Law and technical enhancements in PMK No. 172/2023, which include provisions regarding documentation, ALP testing, and dispute resolution mechanisms such as APA and MAP. The integration of tiered documentation and MAP/APA in PMK 172/2023 reflects progress in fulfilling Action 13 of the Action Plan on Base Erosion and Profit Shifting, namely Country-by-Country Reporting (CbCR) which focuses on revising and developing transfer pricing documentation rules to enhance tax transparency. The main outcome is the Country-by-Country Reporting (CbCR) requirement for large multinational enterprises (MNEs).

From a supervisory perspective, the OECD distinguishes two core authorities in the institutional aspect of oversight, namely: (1) Core functions, which are essential for overseeing the substantive quality and evidence-based nature of the regulatory governance cycle, or key parts of it (for example, ex ante impact assessment oversight and ex post evaluation); and (2) Additional functions, which are complementary functions aimed at enhancing supervisory capacity, for example, training and capacity development in administration (Renda et al., 2022). On the other hand, Max Weber emphasised that the legitimacy and effectiveness of bureaucracy rely on formal rules, task specialization, and accountable procedures (Almhairat, 2025). Based on these two conceptions, Malaysia has institutionally demonstrated a more specialised form of oversight by establishing the Multinational Tax Department under the Inland Revenue Board of Malaysia (IRBM), which oversees the Transfer Pricing Policy Section, Compliance Audit Division, Multinational Audit Division, and Advance Pricing Arrangement Division. This structure represents the separation of core functions as outlined by the OECD, namely oversight of the substantive quality of the implementation of the Arm's Length Principle (ALP).

Indonesia, through the International Taxation Directorate under the Directorate General of Taxes, does have a mandate to formulate transfer pricing policies and procedures. However, transfer pricing oversight in Indonesia remains fragmented, being spread across other functional units such as the Audit and Collection Directorate and the Potential, Compliance, and Revenue Directorate. This

institutional model shows a limitation in specialisation, resulting in oversight often being caught in inconsistent interpretations. This affects audit consistency and frequently creates legal uncertainty for taxpayers.

From the perspective of international tax law, Malaysia is more coherent with international best practices as it has institutionalised the dispute prevention mechanism (APA/MAP) within the same structure as oversight. This institutional integration makes it easier for taxpayers to choose a centralised and consistent route for resolving cross-border disputes, in accordance with OECD BEPS Action 14 on Making Dispute Resolution Mechanisms More Effective. In contrast, in Indonesia, the APA and MAP mechanisms are still carried out with cross-directorate coordination, making the administrative process longer, inefficient, and potentially reducing the investment climate competitiveness.

Malaysia has successfully positioned itself as a country that formulates transfer pricing institutional policies effectively. It is because the transfer pricing division under the international tax department of IRBM not only functions as a domestic regulator but also as a partner in bilateral MAP negotiations with other jurisdictions. This position strengthens Malaysia's legitimacy in the eyes of multinational investors and foreign tax authorities. In Indonesia, although transfer pricing regulations are substantively aligned with the OECD, institutional fragmentation makes the role of the Directorate General of Taxes less effective in demonstrating international oversight credibility, often being perceived as weak in resolving disputes at the global level. As a result, more than 40% of cases in the Tax Court are caused by administrative and technical issues in transfer pricing audits (Tambunan, 2020).

2. Institutional Strengthening of Transfer Pricing`s Oversight In Indonesia to Achieve Equitable Tax Governance

Transfer pricing is essentially a tax law issue because it involves the application of the principle of fairness and normal business practice (Arm's Length Principle/ALP) as stipulated in Article 18 paragraph (3) of the Income Tax Law. This norm grants the tax authorities the power to make adjustments if transactions between related parties do not reflect fair market prices. From this, it is clear that the ALP is not merely an economic principle, but serves as a basis for fairness in business which correlates with tax aspects. In practice, the Directorate General of Taxes of Indonesia through the Directorate of International Taxation has functions related to transfer pricing. However, the DJP does not yet have a dedicated transfer pricing unit like the LHDN/IRBM. From an administrative law perspective, this situation creates coordination and interpretation problems because authority is dispersed across various technical directorates. As a result, tax law enforcement on transfer pricing is often partial and inconsistent across cases.

The main weakness of the institutional framework related to transfer pricing is its fragmented nature, which contradicts the principles of legal certainty and simplicity in the tax system. This situation not only disadvantages taxpayers but also weakens the position of the Directorate General of Taxes as the tax law enforcer. In terms of authority, Indonesia still faces a dilemma: the authority to correct transfer pricing has already been granted by the Income Tax Law, but the implementation of this authority is dispersed and not organised within a specialised unit. This creates ambiguity in the locus of authority, which in administrative law can lead to accountability issues. The absence of a dedicated transfer pricing unit at the DJP also has the potential to create overlapping authority between directorates. For example, the Directorate of Tax Audit, Collection, and Investigation (PPIP) conducts TP audits, but technical coordination lies with the Directorate of International Taxation (DPI). This situation creates dual interpretations and opens the door to legal uncertainty. Malaysia, through LHDN, has appointed a Transfer Pricing Division that is directly coordinated within the framework of audits and APA/MAP, making the locus of authority clearer and strengthening the legal legitimacy of actions related to transfer pricing activities.

This situation creates the potential for horizontal inequity, as MNEs with access to international consultants can more easily exploit various regulatory loopholes. The principle of horizontal equity requires that the state imposes taxes fairly on all taxpayers (Repetti & Ring, 2012). In this context, the taxpayers referred to are corporate taxpayers who must be taxed fairly, so MNEs operating in the multinational sphere are obliged to comply with the tax regulations in the countries where they operate. However, due to institutional weaknesses in transfer pricing, this becomes a trigger for unfair tax collection from a horizontal perspective.

In addition to horizontal inequity, the weaknesses of transfer pricing institutions in Indonesia also have implications for vertical inequity. Vertical equity is understood as taxpayers with different economic capacities being taxed in amounts proportional to their ability to pay (Rosenzweig, 2021). This means that the greater a person's or entity's economic capacity, the greater their tax contribution. The vertical inequality in this case is that MNEs with large capacity and ability to pay can actually reduce their tax burden through transfer pricing practices, whereas local companies (SMEs) do not have the same opportunities. This situation contradicts the ability to pay principle in tax law. Malaysia, through an integrated transfer pricing system and a more comprehensive regulatory institution, minimises this gap so that the distribution of the tax burden is fairer. Therefore, a reform of the oversight institutions for transfer pricing activities in Indonesia is necessary. There is an urgency to establish a transfer pricing division within the structure of the Directorate General of Taxes and the Directorate of International Taxation. From an administrative law perspective, the establishment of this unit can be legitimised through a Minister of Finance Decree or a Director General of Taxes Regulation.

This new institution must be based on the principle of legal accountability, namely the existence of standard operating procedures (SOPs), uniform legal interpretation standards for transfer pricing, and an internal appeal mechanism before disputes go to tax court. In this way, legal certainty can be better ensured and the caseload in tax courts can be reduced. This special unit can function as a centre for risk analysis, technical policy formulation, and international dispute coordination. With an institutional model like Malaysia, Indonesia can enhance supervisory capacity, strengthen documentation, and optimally utilise bilateral mechanisms (APA/MAP). Furthermore, institutional integration will align with the demands of the OECD BEPS Action Plans, which emphasise risk-based audits and the prevention of tax disputes.

In addition, the human resources aspect is one of the gaps in the institutional oversight of transfer pricing. The readiness mechanism and technical competence of transfer pricing auditors significantly affect the implementation of transfer pricing audits (Togatorop et al., 2024). Limited technical competence is the main factor causing the high rate of tax disputes related to secondary transfer pricing adjustments, resulting in legal uncertainty and additional procedural burdens (Auliya & Rosid, 2024). Therefore, strengthening the institutional framework for transfer pricing is not enough with just rules or systems; there must be human resources who understand the intricacies of transfer pricing aspects divided into public law and private law, and a gradual training programme is needed to ensure that the Directorate General of Taxes has strong technical and legal authority in enforcing the Arm's Length Principle and overseeing transfer pricing itself.

In the context of modern taxation, the issue of transfer pricing cannot be separated from the principle of integrated regulation across authorities, such as the interaction between the Directorate General of Taxes (DJP) and the Directorate General of Customs and Excise (DJBC). Transfer pricing is commonly understood in the realm of income tax, primarily to ensure that transactions between related parties comply with the Arm's Length Principle (ALP). However, in customs, import transactions also require the determination of customs value as the basis for calculating import duties, import VAT, and other levies. Customs value generally uses the transaction value method as stipulated in the Agreement on Customs Valuation (WTO), which has been adopted by Indonesia in Customs Law No. 17 of 2006. This is where the convergence occurs, namely the transaction price between

affiliated companies is used both for customs value purposes, which falls under the authority of DJBC, and for ALP purposes, which falls under the authority of DJP.

In Indonesia, this aspect is not yet comprehensive due to the absence of a cross-agency Standard Operating Procedure that is normatively binding to unify the approach to customs valuation and transfer pricing. The lack of a joint protocol between DJP, DJBC, and BI/OJK results in two regimes operating in parallel rather than integratively. DJBC emphasises customs valuation for the purpose of protecting domestic industry and state customs revenue, while DJP emphasises the principles of fairness and business normality (ALP). According to H.L.A. Hart's theory of the rule of recognition, a good legal system requires a point of convergence between legal sub-systems (Kingsbury, 2009). The absence of inter-agency protocols creates legal loopholes that could potentially be exploited by multinational taxpayers to engage in transfer pricing practices.

To address the lack of protocol between transfer pricing aspects and customs aspects, several steps can be taken. First, a MoU between the DJP and DJBC is needed that goes beyond merely a formal framework. This MoU must function as a legal umbrella confirming: (i) the scope of data exchanged (invoices, contracts, TP documentation, customs database), (ii) the mechanism for electronic data exchange, (iii) confidentiality protocols to ensure information is not misused, and (iv) the legal basis for using cross-agency data as audit evidence. Without clear clauses, data exchange is prone to stop at mere formalities, so a MoU is needed as a mechanism of legal certainty so taxpayers do not face two different interpretations of the same transaction.

Secondly, there needs to be cooperation between the DJP and DJBC based on data synchronization. For instance, if the DJBC finds a payment that increases customs value, this information must be integrated with the DJP's analysis to determine whether the payment is reasonable on an arm's length basis. Conversely, if the DJP finds indications of overpricing in purchases of goods from foreign affiliates, the analysis results can be used by the DJBC to examine potential undervaluation. In this way, a finding by one authority automatically enhances the assessment base of the other authority.

Thirdly, the next recommendation is to build an integrated electronic data exchange platform by utilizing artificial intelligence. This system enables profiling of import taxpayers with global affiliations so that the risks of undervaluation and profit shifting can be mapped simultaneously. Big data analytics technology can be used to compare import invoices, TP documents, monitor payment data through banking systems, and CbCR reports.

Fourth, in terms of human resources, strengthening is needed through capacity building, MoUs, or Joint Circulars accompanied by cross-directorate training. DJBC inspectors need to understand ALP principles, while DJP inspectors need to understand customs valuation methods. This creates shared competence so that officials no longer work with diverse perspectives.

The institutional design of transfer pricing in Indonesia needs to be strengthened, not only to close tax avoidance loopholes, but also to uphold the principles of fairness and fiscal sovereignty. By adopting practices from Malaysia, Indonesia can establish a dedicated transfer pricing unit within the Directorate General of Taxes and enhance human resource capacity in conducting audits. This institutional reform not only improves the effectiveness of tax administration, but also affirms that Indonesian tax law aligns with international standards, while placing ethics and fiscal fairness as the foundation in addressing the aggressive tax strategies of MNEs.

CONCLUSION

There are institutional weaknesses in Indonesia's transfer pricing system that could lead to base erosion and vertical as well as horizontal inequities in the tax system. The absence of a dedicated transfer pricing unit within the Directorate General of Taxes (DGT) structure is a major obstacle. This results in fragmented supervision, inconsistent interpretation of regulations, and legal uncertainty for taxpayers. In comparison, Malaysia has developed a more comprehensive transfer pricing

governance framework by establishing a dedicated unit under the Inland Revenue Board of Malaysia (LHDN) responsible for transfer pricing policy and audits. This specialised institutional structure allows Malaysia to integrate OECD guidelines into operational monitoring procedures, as well as provide greater legal certainty for taxpayers.

To strengthen transfer pricing governance, Indonesia needs to adopt institutional reform measures. This includes establishing a dedicated transfer pricing division within the Directorate General of Taxes (DGT) to improve coordination, setting comprehensive technical guidelines, and institutionalising risk-based audits. Additionally, reforms should cover enhancing human resource competencies and fostering stronger, integrated cooperation between the DGT and the Directorate General of Customs and Excise (DGCE), supported by electronic data exchanges and normatively binding protocols. Implementing these reforms will improve the effectiveness of tax administration, enforce fiscal justice, and align Indonesian tax law with international standards.

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