

## TRANSFER PRICING IN THE PERSPECTIVE OF INTERNATIONAL BUSINESS LAW AND ETHICS

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### Abstract

Transfer Pricing is currently widely carried out by multinational companies with the aim of avoiding taxes because the company wants a large amount of profit, Tax avoidance activities result in bad risks for the company related to the company's reputation in the wider community but in fact taxes are very important income in the country, because the tax revenue is used to finance all forms of national development for the welfare of the people. This research is motivated by government complaints about transfer pricing actions carried out by multinational manufacturing companies or other large companies which are considered very contrary to the state system of the Republic of Indonesia, The formulation of the problem in this study is how the process of transfer pricing occurs and its relationship to state revenues to the tax sector in Indonesia and how according to the views of international business law and ethics related to the application of transfer pricing in a company. This research is an empirical juridical research with a descriptive analytical approach.

**Keywords:** *Transfer Pricing, Law, Business Ethics, International, Tax*

### INTRODUCTION

Transfer pricing in the tax world can be defined as the pricing of transactions between different parties within a group of companies that have a relationship or affiliation with one another. In Indonesian law, particularly regarding taxation, transfer pricing is the pricing of transactions influenced by special relationships. A transaction can be considered a transaction influenced by special relationships if it is an affiliated transaction, that is, a transaction conducted between parties that have a special relationship with each other and a transaction between parties that are not influenced by a special relationship. Transfer pricing is basically a reasonable and normal thing in business, but currently, transfer pricing has taken on a connotative meaning because it is usually related to tax avoidance practices. There is abuse of transfer pricing or transfer pricing manipulation. Transfer pricing becomes one when it is used for tax avoidance purposes. In transactions between independent parties, it is usually reasonable and common because the seller will maintain the price/profit at the highest level and the buyer will maintain the price/profit at the lowest level to achieve a market mechanism or what is known as a balanced market. Meanwhile, in affiliate transactions there is no demand or supply force that is the same as in independent transactions.

Therefore, transfer pricing should be neutral. It is a tool used by companies to coordinate production and determine sales across different business segments. With the flow of globalization, business models have evolved from single companies to complex groups (multinational enterprises) that cross national borders. This has led to the need to establish standard transaction prices (transfer pricing) between companies within a group. In this regard, the principle of arm's length and business practice has been internationally agreed upon. This principle states that, under identical conditions, the price or profit in the exchange of goods and services between related parties should be the same as the price in the exchange with unrelated parties. However, today, multinational companies engage in transfer pricing solely to avoid taxes because they seek substantial profits. Tax avoidance poses significant risks to companies' reputations within the wider community, yet taxes are crucial revenue sources for the country, as they are used to finance all forms of national development for the well-being of the people.

## **FORMULATION OF THE PROBLEM**

Based on the background description above, a problem formulation emerges which will be discussed, namely:

1. How does the transfer pricing process occur and how is it related to state revenue in the tax sector in Indonesia?
2. What is the legal and ethical view of international business regarding the application of transfer pricing in a company?

## **METHOD**

This research is a juridical study, namely research guided by positive law and using library research methods. From a legal perspective, its objectives are normative legal research or doctrinal legal research. Doctrinal legal research seeks to inventory positive law, discover the principles and philosophical foundations of positive law, and discover the law in concrete as it applies to specific legal cases. The problem-solving approaches used in this legal research are the statutory approach, the conceptual approach, and the historical approach. The sources of legal materials used in this research are divided into 2 (two), namely primary legal materials consisting of statutory regulations and their derivatives, while secondary legal materials consist of a collection of written works and literature related to transfer pricing regulations, international business law and ethics, and international taxation. The legal material collection technique is conducted through a literature review, consisting of laws and regulations and other documents related to transfer pricing. Meanwhile, legal material analysis is the final step in research, before drawing conclusions. This step is crucial in any research because analysis allows us to determine the validity of any conclusions drawn.

## **RESULTS AND DISCUSSION**

### **Scope of Transfer Pricing**

Transfer pricing in the tax world can be defined as the pricing of transactions between different entities within a corporate group that are related or affiliated with one another. In Indonesian tax laws and regulations, transfer pricing refers to the pricing of transactions influenced by a special relationship. A transaction can be considered a related transaction if it is an affiliated transaction, that is, a transaction conducted between parties that have a special relationship with each other, or a transaction between parties that are not influenced by a special relationship. However, in practice, it has been proven that there is influence from one of the parties that has a special relationship with the other party in the transaction. Furthermore, a special relationship is a state of dependence or attachment of one party to another party caused by ownership or capital participation, control, or family ties by blood or marriage.

Special relationships can be assessed based on the following:

- a. Taxpayers have direct or indirect capital participation of at least 25% in other taxpayers, a relationship between taxpayers with participation of at least 25% in two or more taxpayers, or a relationship between two or more of the last mentioned taxpayers,
- b. A taxpayer controls another taxpayer or two or more taxpayers are under the same control either directly or indirectly or
- c. There are family relationships, both by blood and by blood, in a straight line of descent and/or to the side of one degree.

The Director General of Taxes is authorized to calculate the amount of taxable income in accordance with the fairness and customary business practices that are not influenced by special relationships, with the aim of preventing tax avoidance. Therefore, the principle of fairness and customary business practices is a principle that must be considered in transfer pricing. Based on Article 1 number 10 of PMK 172/2023, the principle of fairness and customary business practices is known as the Arm's Length Principle, which is the main principle in assessing the fairness and customary business practices based on independent transactions, as stated below:

The principle of fairness and customary business practices that are not influenced by special relationships, hereinafter referred to as the principle of fairness and customary business practices, is a principle that applies in normal business practices that are carried out as independent transactions. In transfer pricing, the Arm's Length Principle is applied to determine an arm's length price by comparing the conditions of transaction price indicators influenced by special relationships and the same or comparable independent transactions.

The implementation is based on the following:

- a. The actual situation
- b. Implementation of transfer pricing and/or TDHI and

c. Stages of implementing the arm's length principle

If there is a taxpayer who carries out transactions with affiliated parties, the taxpayer is obliged to organize and store documents to create data and/or information to support that the transactions carried out with affiliated parties are in accordance with the Arm's Length Principle, which is stated in the transfer pricing document .

Transfer Pricing Document consists of the following:

- a. Local Documents are documents that contain information regarding taxpayers, including identity and business activities, details of affiliated and independent transactions, application of Arm's Length, financial data, and non-financial information that affects pricing or profit determination.
- b. Master Document is a document containing information about a business group, including the structure and chart of ownership and countries including their jurisdictions, business activities, ownership of intangible assets (prices), financial and financing activities, as well as consolidated financial reports and tax data related to affiliated transactions.
- c. Country Reports covering income allocation, taxes paid, and business activities per country or jurisdiction of all members of the business group and main business activities per country.

The obligation to organize, create and store transfer pricing documents is intended for taxpayers who fulfill the following provisions:

- a. Conducting affiliated transactions with a gross turnover value of more than IDR 50 billion in the previous tax year in one tax year, is required to organize and store master documents and local documents.
- b. Conducting affiliated transactions with a value in the previous tax year in one tax year of more than IDR 20 billion for tangible goods transactions, is required to organize and store master documents and local documents.
- c. Conducting affiliated transactions with a value in the previous tax year of more than IDR 5 billion for each provision of services, payment of interest, utilization of intangible goods, or other affiliated transactions, is required to organize and store master documents and local documents.
- d. Conducting transactions with affiliates located in countries or jurisdictions with lower income tax rates, are required to organize and store master documents and local documents.
- e. Domestic taxpayers who are the parent entity of a business group with a consolidated gross turnover of at least IDR 11 trillion in the tax year preceding the reported tax year are required to organize and retain master documents, local documents, and country-by-country reports.
- f. In the case where a domestic taxpayer is domiciled as a constituent entity and the parent entity of the business group is a foreign tax subject, the domestic taxpayer is required to submit a country-by-country report, as long as the country or jurisdiction where the parent entity is domiciled:
  1. Does not require submission of reports per country
  2. Does not have an agreement with the Indonesian Government regarding the exchange of tax information or
  3. Has an agreement with the Indonesian government regarding the exchange of tax information, but the Indonesian government cannot obtain country-by-country reports from that country or jurisdiction.

### **The Role of Transfer Pricing in State Revenue in the Tax Sector in Indonesia**

In the Indonesian government system, the tax sector is one of the most important sources of state revenue. The state imposes a tax burden on its citizens and on individuals or entities that are not citizens. Regarding taxes, we can see Article 23A of the 1945 Constitution of the Republic of Indonesia. Tax planning, which is a small part of the many plans carried out by companies, requires a very long time in its own assessment or evaluation, seeing the extent to which the results of the implementation of tax planning on the tax burden. Tax planning also includes mechanisms established by business entities or companies that are structured and related to potential tax consequences, where the emphasis is on such control can streamline the amount of tax burden that must be paid to the government through tax avoidance and not tax evasion. However, transfer pricing results in the loss of potential revenue for a country, especially from taxes, because multinational companies tend to shift their tax obligations. Transfer pricing is a tax planning strategy used by multinational companies to shift the tax burden from countries with high tax rates to countries with low tax rates, thereby generating profits for subsidiaries with low tax rates. Transfer pricing is not only practiced by mid-sized companies but also by top-tier companies such as Google and Amazon. In Indonesia, the practice of transfer pricing is also common. It is estimated that around 4,000 multinational companies have not paid their taxes in the past seven years, one of the largest cases being transfer pricing by PT. Toyota Motor

Manufacturing Indonesia. Currently examining Toyota's tax return, the Director General of Taxes found several irregularities. The company's gross profit decreased by 30% from Rp. 1.5 trillion to Rp. 950 billion. Furthermore, the gross margin ratio, or the ratio between gross profit and sales, decreased from 14.59% in 2003 to 6.58% in 2004. Another example of this practice by a multinational company is a parent company located in Malaysia producing a product with a cost price of Rp. 100. The applicable tax rate in the country is 42%. To avoid the imposition of high tax rates, the parent company decides to sell the product to a subsidiary in China with a transfer price equal to the cost price of Rp. 100, so that the tax payable on the sales transaction between the parent company and the subsidiary is Rp. 0. This is because the transfer price used is the same as the cost price of the product, thus generating a profit that will be subject to tax.

This transfer price engineering was made to avoid the high tax rate applicable to the parent company. Then the goods that have been purchased are sold by the subsidiary in China to another subsidiary in Australia with a transfer price of Rp. 200. The applicable tax rate in China is 0%. This sales transaction generates a profit of Rp. 200. On the resulting profit, tax should be owed, but because the tax rate in the country is 0%, the tax payable on the resulting profit is Rp. 0. Then the goods that have been purchased by the subsidiary in Australia are resold to a company that does not have a special relationship in the same country, with a selling price of Rp. 200. The policy of setting this selling price is intended to avoid high tax rates applicable in the country concerned. Assuming the applicable tax rate in Australia is 35%, it can then be calculated that the tax payable on this sales transaction is Rp. 0. This is because the selling price of the product is the same as the cost of purchasing the goods so that the profit arising from this transaction is Rp. 0. The conclusion that can be drawn from the transactions above is how important it is to know the applicable tax rates in a country, before making a decision to carry out sales and purchase transactions of goods.

Transfer pricing abuse between related companies can occur within a single group of companies or within a parent company in a country with a higher tax rate, provided the company in that country is experiencing losses or has numerous problems that can be exploited in that country. However, abuse can only occur in multinational companies with branches in various countries, a practice known as international transfer pricing. Domestic transfer pricing, on the other hand, does not impact potential state revenue from the tax sector in a country. Consequently, a reduction in profit or income in one company will result in an increase in profit or income in another company, resulting in the same state revenue from the tax sector. However, in the case of companies entitled to compensation for losses, domestic transfer pricing can still be used. Therefore, the influence of transfer pricing has the potential to reduce state revenue from the tax sector in Indonesia.

### **Implementation of Transfer Pricing in Companies According to International Business Law and Ethics**

According to international business law and ethics, transfer pricing is a legal method, as long as companies comply with applicable tax regulations and policies in each jurisdiction where they operate. However, if companies use transfer pricing to evade tax payments or engage in other tax fraud, this can be considered illegal and can result in strict legal sanctions. The legal basis for transfer pricing is the provisions of Article 18 of Law Number 36 of 2008. In practice, transfer pricing implementation must consider the principle of arm's length pricing as well as aspects of fairness and business custom. Unfortunately, transfer pricing techniques are often used by companies to avoid taxes by shifting profits to low-tax countries or shifting losses to high-tax countries through the transfer of deductible expenses. Therefore, companies must pay close attention to and comply with applicable tax regulations and policies in their jurisdictions. This is done to avoid abuse of transfers.

The risks of transfer pricing are as follows:

a. Reputational Risk

Questionable transfer pricing practices or unfair assessments by tax authorities can damage a company's reputation with the public and other stakeholders. This results in a decline in trust from customers, investors, and business partners, which can negatively impact the company's overall performance.

b. Unfair assessment by tax authorities

One of the main risks of transfer pricing is unfair or inadequate assessments by tax authorities in various jurisdictions. If the price set is deemed unreasonable by the tax authorities, companies may face tax disputes, resulting in additional costs and legal uncertainty.

c. Cross-border tax disputes

Transfer pricing can also lead to cross-border tax disputes between companies and tax authorities in the countries where they operate. Such disputes can disrupt company operations, result in high legal costs, and pose reputational risks.

d. Violation of legal provisions

transfer pricing laws, both nationally and internationally. Such violations can result in severe legal sanctions, including fines and other penalties, and increase the risk of tax audits by the relevant authorities.

By understanding the risks, companies can take appropriate steps to mitigate risks and ensure their compliance with applicable tax regulations, this includes conducting careful transfer pricing analysis, complying with applicable tax guidelines and maintaining transparency in financial reporting.

## CONCLUSION

Based on the research results, the following conclusions can be drawn:

1. Transfer Pricing is the determination of transaction prices influenced by special relationships, namely transactions carried out between parties who have no relationship or who have a relationship but it is later proven that there is influence from one of the parties who has a special relationship with the parties in the transaction. Special relationships arise from ownership, control, and or family relationships and these things are important elements in determining whether or not there is an influence on transfer pricing. To ensure that transactions influenced by special relationships are in accordance with the principles of arm's length and business customs, taxpayers who meet certain criteria are required to prepare and store TP Documents consisting of local documents, master documents, and reports per country.
2. Transfer pricing is used by multinational corporations as a means of tax avoidance. Multinational corporations with high tax rates temporarily transfer their income to companies in low-tax countries. This transfer of income is achieved by manipulating product sales prices, and this transfer can only be done by companies with special relationships.
3. According to international business law and ethics, transfer pricing is a legal method, as long as companies comply with applicable tax regulations and policies in each jurisdiction where they operate. However, if a company uses transfer pricing to evade tax payments or engage in other tax fraud, it can be considered illegal and can result in strict legal sanctions. The legal basis for transfer pricing is Article 18 of Law Number 36 of 2008.

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