

# Transfer Pricing Of Multinational Companies As A Business Crime And Their Impact On State Revenue In The Tax Sector

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**Abstract:** Transnational companies are strategic economic actors in economic globalization that play a major role in world economic development. However, the existence of transnational companies also has a negative impact through the practice of transfer pricing, namely the act of allocating profits from corporate entities to other state company entities, within the group of companies which results in reduced state revenue in the tax sector. In this regard, the purpose of this article is to formulate the factors that cause multinational companies to transfer pricing and how legal protection of the country is due to the practice of transfer pricing. The conclusion of this article is that the factors causing transfer pricing are to shift income or profits from high tax jurisdictions to low tax jurisdictions so as to minimize tax payments which have a large impact on reducing state revenue. In order to protect the practice of transfer pricing, the government made regulations against tax avoidance, carried out an Advance Pricing Agreement (APA), and worked with the tax authorities of other countries. In order to make effective the transfer pricing provisions, it is necessary to be supported by Human Resources (HR) who have the ability and understanding in the field of transfer pricing.

**Keywords:** Transfer pricing, multinational companies, losses, taxes.

## 1. INTRODUCTION

Globalization was first introduced to Theodore Levitt in 1985 and then continued to develop in various parts of the world, including to countries with socialist and communist economic systems such as Russia, China and Vietnam. Globalization with special characteristics of interaction and integration, ultimately affects world changes in all areas of life, both regional integration, technological progress, and the investment movement of companies without borders, known as multinational companies (MNC) [1]. Based on data from the Investment Coordinating Board (BKPM), until 2014 there were approximately 22,000 (twenty two thousand) multinational companies operating in Indonesia, and this condition will continue to develop after the entry into force of the Asean Economic Community era since late December 2015. The World Bank provides his study that the ease of investment made by the government with a variety of economic policy packages has increased Indonesia's position from 91th place in 2017 to 72th position in 2018. In terms of investment destination countries of multinational companies, according to the United Nations Conference on Trade and Development (UNCTAD) in the World Investment Report 2017, Indonesia is ranked 4 (four). Meanwhile, a survey conducted by US News & World Report ranks Indonesia as number 2 (two). Foreign Investment (PMA) recorded in the first semester of 2018 was 204.6 trillion rupiah, and the total investment value recorded by the Investment Coordinating Board (BKPM) is 361.6 trillion rupiah [2]. In contrast to the early 1960s to the 1970s, today developing countries as recipients of foreign capital do not consider foreign capital as a threat of new colonialism (economy) termed by Sir Leon Brittan with "Trojan Horses". The amount of influence and power of multinational companies on the development of the world economy on one hand has a positive impact on recipient countries. For Indonesia, foreign capital through the mediation of multinational companies has a large role in

supporting the mandate of Article 33 of the 1945 Constitution in the welfare of the community through national economic development [3], but on the other hand it also has a negative impact, one of which is the application of multinational companies that are restrictive (restrictive business practices), as well as transactions of multinational companies in Indonesia to their overseas affiliates through the practice of transfer pricing [4]. The Directorate General of Taxes noted, in 2012 of 1,161 (one thousand one hundred and sixty-one) Foreign Investment Taxpayers (PMA), a term for multinational companies in Indonesia, which transacted with affiliates abroad as many as 436 (four hundred thirty-six) Mandatory Tax reports Annual Income Tax (Income Tax) loss with total affiliate transactions abroad of Rp. 76.22 trillion [5]. This figure increased rapidly in 2013, where state losses due to transfer pricing practices reached Rp1,300 trillion / year, which amounted to around 114% of the 2013 tax revenue target [6], and based on the results of the transfer pricing inspection conducted by the Directorate General of Taxes for 2014-2015, for 1 (one) oil and gas (oil) company alone provided a state financial loss of Rp 9 trillion [7]. Considering the negative impacts of transfer pricing practices by multinational companies on state revenue in the tax sector, the purpose of this article is to formulate the factors that cause multinational companies to practice transfer principals and how the legal protection of the Indonesian state due to transfer practices pricing.

## 2. RESULT AND DISCUSSIONS

### Factors Causing Multinational Enterprises to Perform Transfer Pricing Practices

The term multinational was first introduced in April 1960 by David E. Lilienthal in a scientific meeting organized by the Carnegie Institute of Technology on Management and Corporation with his paper on management, which was then published with the term The Multinational Corporation (MNCs) [8]. The decision of multinational companies to invest in developing countries is driven by higher expected profits compared to investing in their own country or in other

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developed countries. The Government of Indonesia in 1967 seized this investment opportunity by passing the Foreign Investment Law No. 1 of January 1967 as amended by Law No. 25 of 2007. From an economic point of view, multinational companies are companies that invest in and operate in many countries to obtain raw materials, expand foreign markets, and benefit from lower production costs or taxes [9]. Clive Schmitthoff [10] provides the definition of multinational companies as a combination or combination of several companies with different nationalities which is an integrated economic unit that is bound by managerial supervision or control by shareholders, namely: "... a combination of companies of different nationalities connected by means of shareholdings, managerial control or contract and constituting an economic unit". The core of multinational companies based on the above understanding is the ability of multinational companies to coordinate activities between companies in more than one country. This understanding has a broad enough scope to cover or include both equity and non-equity originating from direct foreign investment without regard to the legal form or ownership of the investment [11]. From the several definitions of multinational companies above, obtained the distinctive characteristics of multinational companies, namely: (1) Companies operating in several countries, (2) Having a holding company in the country of origin as the center of its organization, (3) Forming a combination of national companies in a country or interstate, and (4) Management system is centralized and operates in a holding company [12]. The strength of multinational companies over the past two or three decades has had a major influence in controlling more than 20 percent of world output and the value of trade transactions that account for more than 25 percent of all manufacturing company transactions in the world, seen from the world of products such as: Microsoft, Honda, Toshiba, Exxon, Toyota, Sony, even the gross profit can exceed a country's GDP. The presence of multinational companies in addition to having a positive impact, is expected to fill the gap between "domestically available supplies of saving, foreign exchange, government revenue and skills" with "the planned level of these resources necessary to achieve development targets", increase tax revenues for the country, get management experience, entrepreneurial enthusiasm, technological ability to be transferred to local counterparts by learning by doing [13], but it turns out that in the next stage there have been many problems. Problems that arise include the decline in domestic investment, due to losing competition with foreign capital. Besides that, MNC does not "reinvest" the profits it gets, but transfers it to the parent company in the country of origin of multinational companies, not using intermediate products from domestic, but importing from overseas affiliates. Multinational companies (MNCs) pay taxes, but multinational companies get tariff protection, can also avoid local tax from purchasing intermediate products from overseas affiliates by lowering the price listed, which is often called transfer pricing [9]. Transfer pricing, also known as intracompany pricing, corporate pricing, interdivisional or internal pricing, is a policy carried out by companies through the act of transferring income from a company from a country that has a higher tax rate to other companies in one group in the country with a tax rate that is higher. lower

so as to reduce the total group tax burden of the company or manipulate prices that make it look like the company is losing so that it reduces the tax that should be imposed in a country [14]. Another transfer pricing mode undertaken by multinational companies is to utilize tax incentive facilities, such as tax holidays and tax allowances when submitting licenses to the Investment Coordinating Board (BKPM), but at the time of filing a complaint, the company raised the cost of purchasing its capital goods, so that when incentives the tax exhausted has already accumulated very high capital goods purchases, which has led to high depreciation costs. Eventually depreciation increased and what happened was that the company suffered losses which were continually increasing. In addition, there are fixed royalty payments made by subsidiaries in Indonesia to their parent companies abroad. Even other modes to change the name of the company, with the aim of regaining tax incentives and eventually the company can be lost again [7]. Multinational company transfer pricing is one part of "white collar crime", which is translated into Indonesian as "White Collar Crimes" or "Criminal Deeds", is a violation of criminal law committed by people with high socio economic class status. in the implementation of their work activities (in course on his occupational activities), or crimes committed by white collared persons / honorable people [15]. Factors causing transfer pricing: (1) Application of tax efficiency in all multinational corporate group entities; (2) Avoiding depreciation of company profits due to tax costs; (3) Diverting income from a company in a country with a higher tax rate to another company in a group in a country with a lower tax rate thereby reducing the total tax burden of that group of companies; and (4) Minimizing tax payments through transferring profits abroad at a much lower tax rate [16].

### **Legal Protection of the Indonesian State Due to Transfer Pricing Practices**

Transfer pricing seen from the theory of tax law is an obstacle or avoidance of tax payments known as tax evasion and tax avoidance. Tax evasion is tax evasion carried out by taxpayers by violating the provisions of the Taxation Law which consequently can cause a loss of state revenue. Meanwhile, taxpayers are said to do tax avoidance, if tax avoidance, but it is legal and justified according to the provisions of the Taxation Act [17]. Reviewing the two concepts of tax law above, transfer pricing is categorized as Tax evasion, which in Rohatgi's opinion is an unacceptable tax avoidance, because it has a significant negative impact on the reduced potential of state revenue from the tax sector [16]. Other impacts hamper economic growth, and indirectly have an impact on the reduction of funds for public services, as well as the reduction of government subsidized aid funds [18]. The Director General of Taxes, Ken Dwiugustead revealed that there are 2000 multinational companies operating in Indonesia that have not paid corporate income tax in the last 10 years because of loss reasons so the country has the potential to lose 1,300 Trillion Rupiah due to transfer pricing practices. Losses due to transfer of pricing will continue to grow, bearing in mind that to prove the occurrence of the transfer of pricing, it is necessary to prove the stages that are not short and not simple from taxpayers [19]. To prevent the misuse of transfer pricing by

multinational companies, Law No. 7 of 1983 concerning income tax in conjunction with Law No. 36 of 2008, as provided for in Article 18 paragraph (3) authorizes the Directorate General of Taxation to re-determine the fair price of transactions between related parties and obliges taxpayers who have transactions with parties that have a special relationship to make an agreement with the Director General of Tax in the form of an Advance Pricing Agreement (APA) regarding the fair price of the product in the transactions of the parties [18]. In accordance with Article 18 paragraph (4) of Law No. 36 of 2008 concerning Income Tax states that a special relationship is deemed to exist if: (1) Taxpayers have a direct or indirect equity participation of at least 25% (twenty-five percent) in other taxpayers; the relationship between the taxpayer and the participation of at least 25% (twenty-five percent) in two or more taxpayers; or the relationship between the last two or more taxpayers; (2) Taxpayers control other taxpayers or two or more taxpayers are under the same control either directly or indirectly; or (3) There is a family relationship both blood and semenda in a straight line or to one side [18]. Furthermore, the Directorate General of Tax through the Director General of Tax Circular No. SE-04/PJ.7/1993 dated March 9, 1993 Concerning Guidelines for Handling Transfer Pricing Cases as amended by Circular of the Director General of Tax Number SE-50/PJ/2013 Concerning Technical Guidelines for Examining Taxpayers with Special Relationship, states that irregularities from the existence of transfer pricing practices can occur on: a) Sales prices; b) Purchase price; c) Risk allocation that is not always related to the activities carried out; d) The rate of return on financing that is not always related to the level of lending activities; e) Payment of commissions, licenses, franchises, rent, royalties, fees for management services, fees for technical services, and compensation for other services; f) Purchase of company assets by shareholders (owners) or parties that have a special relationship that is lower than the market price; g) Sales to foreign parties through third parties that lack or have no business substance (for example a dummy company, letter box company or re invoicing center). If there are indications of non-arm's length prices for transactions that are not fair with parties that have special relations, then the taxation apparatus can conduct an inspection with the following stages:

1. Studying the Taxpayer data file through a notarial deed and its amendments in order to obtain a general description relating to: (a) Business and company characteristics; (b) Share ownership structure to determine the possibility of a special relationship between the shareholders and the audited Taxpayer; (c) Company organizational structure; (d) Nature and type of business activity; and (e) Examining previous reports;
2. Analyzing tax returns and financial statements of taxpayers to detect the irregularity of the sale or purchase price between the parties that have a special relationship.

The inspection methods used in determining the market price (market price or arm's length price) in a special relationship are: a) Comparable uncontrolled price method which is done through price comparison of transactions

carried out by parties that have Special Relationship with those who have no Relationship Special in comparable conditions or circumstances; b) Resale Price Method or RPM, is done by comparing the price in a product transaction conducted between parties that have a Special Relationship with the resale price of the product after deducting the gross gross profit, to other parties who do not have a Special Relationship or product resale conducted in reasonable conditions; c) Cost Plus Method or CPM) is used for taxpayers of manufacturing business owners who sell products to affiliates for further processing. In this method, arm's length price is calculated by adding a reasonable gross margin to production costs, the data of which is obtained from sales to independent third parties from sellers who also sell to affiliates [20]. Another mechanism that can be used by DGT to resolve transfer pricing issues is to enter into an agreement commonly referred to as the Advance Pricing Agreement (APA), which is an agreement between the Taxpayer and the DGT regarding the fair selling price of the product it produces to parties that have a special relationship. APA can be carried out either unilaterally between Taxpayers and DGT, or bilaterally, namely agreements between DGT and other countries' tax authorities to determine the price of transactions between parties that have a special relationship that applies for a certain period and oversee their implementation and conduct renegotiations after the specified period expires against taxpayers who are in their jurisdiction. The benefits of implementing APA can reduce the practice of transfer pricing abuse by multinational companies, provide legal certainty and ease of tax calculation, and the tax authorities do not need to make corrections on the selling prices and profits of products sold by taxpayers to companies in the same group [18].

### 3. CONCLUSION

Transfer pricing is an issue in the field of taxation, especially concerning international transactions carried out by multinational companies which can result in lost and reduced potential for state revenue because multinational companies shift their tax obligations from countries that have high tax rates (high tax countries) to countries which applies low tax rates (low tax countries). Factors causing transfer pricing to make tax efficiency across all multinational corporate group entities, avoiding depreciation of corporate profits due to tax costs, and reducing the total group tax burden of companies through transferring profits abroad at a much lower tax rate. In addition, for multinational companies, transfer pricing is believed to be one of the effective strategies to win the competition for limited resources. Transfer pricing has a significant negative impact on the reduced potential of state revenue from the tax sector. In order to prevent the practice of transfer pricing abuse, the Directorate General of Taxes Income Tax Act is given the authority to redefine the fair price of transactions between related parties and related parties, and requires taxpayers who have transactions with parties parties that have a special relationship to make an agreement with the Director General of Tax in the form of an Advance Pricing Agreement (APA) regarding the fair price of the product in the transactions of the parties. APA can be carried out either unilaterally between Taxpayers and DGT, or bilaterally, namely agreements between DGT

and other countries' tax authorities to determine the price of transactions between parties that have a special relationship that applies for a certain period and oversee their implementation and conduct renegotiations after the specified period expires against taxpayers who are in their jurisdiction.

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