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# The Arm's Length Principle in Mitigating Tax Avoidance: A Systematic Literature Review

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## ABSTRACT

This study examines the effectiveness of Transfer Pricing Documentation (TP Doc) in supporting the Arm's Length Principle (ALP) to reduce tax avoidance through related-party transactions (RPTs), especially involving tax haven jurisdictions. Using a Systematic Literature Review (SLR) approach, 15 relevant studies published between 2015 and 2024 were analyzed. The literature was selected based on keywords such as "Profit Shifting," "Tax Haven," "Related Party Transaction," "Tax Avoidance," and "Transfer Pricing." The findings indicate that TP Doc contributes significantly to enhancing transparency and providing accurate information that enables tax authorities to evaluate whether intercompany transactions reflect fair market values. However, its implementation faces several challenges, including limited access to reliable data, inconsistencies in international standards, low compliance levels, and exploitable loopholes. Additionally, multinational enterprises (MNEs) frequently use RPTs to shift profits to low-tax jurisdictions, reducing their overall tax obligations. The study highlights the need to strengthen regulations, enhance tax authority enforcement, and promote international cooperation to ensure TP Doc effectively supports Indonesia's tax reform and compliance efforts.

**Keywords:** Arm's Length Principle; Related-Party Transactions; Systematic Literature Review; Tax Avoidance; Tax Haven; Transfer Pricing

## INTRODUCTION

Taxation is a primary focus for every country, as it is one of the main sources of revenue that is crucial for meeting the national budget needs, including in Indonesia (Jeandry & Mokoginta, 2023; Rezeki et al., 2021). The Indonesian government, through the Directorate General of Taxes, continues to strive to optimize revenue from the tax sector. However, tax revenues often fall short of expectations and cannot fully capitalize on potential collections. One of the main reasons for this suboptimal tax revenue is the presence of policy loopholes that provide a pathway for companies, as taxpayers, to engage in tax avoidance practices. The management interests of companies, as taxpayers, often aim to minimize tax obligations since taxes are considered a burden to reduce profits or net income, which is common for corporate management (Rini et al., 2022). The conflict of interest between the state and taxpayers drives taxpayers to seek ways to reduce their tax burdens, whether through legal (compliant) or illegal (non-compliant) methods.

Tax avoidance is the act of reducing tax liabilities by taking advantage of gaps or ambiguities in tax regulations. The factors influencing tax compliance are categorized into five main groups from an interdisciplinary perspective: economic, institutional, social, individual, and other factors (Sepriana, 2021). Tax avoidance practices occur not only in Indonesia but also in most countries, both developed and developing, and have become a global issue, particularly with regard to cross-border matters, as each country has its own policies and different tax rates, especially for income tax. This can trigger taxpayers with related-party affiliations to engage in transactions with the aim of achieving tax efficiency or, more specifically, tax avoidance. Companies that benefit from significant economies of scale, particularly those engaged in extensive international operations as multinational corporations, tend to engage in more aggressive tax avoidance practices (Santoso, 2021). A key driving factor in tax avoidance is the existence of special relationships between entities within a corporate group. Special relationships refer to situations where there is direct or indirect control or significant influence between the involved parties. In the context of taxation, such relationships may create opportunities to structure transactions that allow for profit-shifting through mechanisms that are difficult for tax authorities to identify.

Related-party transactions (RPTs), which are frequently used for tax avoidance, focus on transfer pricing, i.e., the determination of unjustified prices in transactions between affiliated entities to shift profits to jurisdictions with lower taxes. These include excessive royalty payments for the use of trademarks or intellectual property rights to entities in tax havens, disproportionately allocated management fees or consulting services to high-tax jurisdictions, debt shifting (using intercompany debt structures to transfer profits through interest payments), and complex supply chains designed to shift profits through low-tax countries before reaching the main entity. All these types of transactions exploit gaps in tax regulations to significantly reduce tax burdens.

One of the main strategies used by multinational companies (MNCs) affiliated with countries that have lower tax rates or tax havens to avoid taxes is profit shifting, which involves moving profits from high-tax countries to low-tax or tax-free jurisdictions through RPTs. It is widely recognized that multinational enterprises (MNEs) exploit variations in corporate tax rates and preferential tax policies offered by different countries (Choi et al., 2024). This practice takes advantage of differences in tax policies between countries, providing an incentive for companies to shift profits to reduce tax liabilities significantly (Kurniasih et al., 2023).

A tax haven country refers to a jurisdiction that offers very favorable tax policies for companies, such as very low or even zero tax rates, as well as strict privacy protection. Countries like the Cayman Islands, Bermuda, Singapore, and Switzerland are known as hubs for such activities because they provide attractive confidentiality policies and fiscal incentives (Kumar et al., 2021). MNCs often use these countries to shift profits through transactions involving intangible assets, royalty payments, or manipulation of prices for goods and services between entities within their group (Gravelle, 2009).

Transfer pricing is the method used to determine prices and terms in transactions between entities with special relationships, both domestically and internationally. This method is often utilized by MNCs to allocate profits among entities within the same group, with the aim of shifting profits to countries with lower tax rates (Septiani et al., 2021). Transfer pricing has several weaknesses that companies frequently exploit for tax avoidance. One weakness is the lack of adequate, comparable data to assess the fairness of prices in affiliated transactions. This condition allows companies to set prices that deviate from the Arm's Length Principle (ALP) to shift profits to low-tax jurisdictions (tax haven countries). Additionally, the complexity of multinational company structures often makes it difficult for tax authorities to detect discrepancies, especially in transactions involving services, intellectual property rights, or risk transfers. Differences in regulations across countries can also create legal gaps that are exploited to design tax avoidance strategies that are difficult to track. One key principle in transfer pricing is the ALP, which states that the price in transactions between companies should be the same as what would be agreed upon by independent parties in a similar situation (Kalra & Afzal, 2023). The application of ALP aims to prevent transfer pricing abuse by ensuring that transactions between related entities are conducted at fair market prices.

The application of ALP ensures that companies conducting transactions with related and non-related parties use fair prices, which can be compared to companies without special relationships, resulting in similar or comparable outcomes (Rahmiati & Sandi, 2016). Previous studies have shown that the effectiveness of ALP in preventing transfer pricing abuse remains in question. A study by Taylor and Richardson (2012) mentioned that resource limitations and data transparency between jurisdictions are major barriers to the implementation of ALP, especially in developing countries like Indonesia. Tax haven countries are often utilized by MNCs to shift profits with lower administrative costs compared to the legal risks that may arise.

Previous studies have shown that the effectiveness of ALP in preventing transfer pricing abuse remains in question. A study by Taylor and Richardson (2012) mentioned that resource limitations and data transparency between jurisdictions are major barriers to the implementation of ALP, especially in developing countries like Indonesia. Tax haven countries are often utilized by MNCs to shift profits with lower administrative costs compared to the legal risks that may arise.

Therefore, tax avoidance through profit shifting to tax havens is an issue that needs special attention. The application of the ALP and effective policies can help countries address this practice while strengthening tax oversight. This study aims to systematically review articles discussing the utilization of transfer pricing by MNCs in Indonesia, particularly in the context of profit shifting to tax haven countries. The primary focus of this research is to evaluate the extent to which the implementation of ALP can influence the relationship between RPTs and tax avoidance through the use of tax haven countries.

This study is expected to provide practical insights for Indonesian tax authorities to strengthen transfer pricing supervision and develop more effective policies. Additionally, this research contributes to the academic literature by filling the gap concerning the effectiveness of ALP in the context of developing countries.

## LITERATURE REVIEW

### Agency Theory

The emergence of agency theory is driven by issues arising in the relationship between the principal and the agent (Nurdiansyah & Masripah, 2023). Agency theory provides a theoretical framework related to a company's capital structure, where taxes are one of the factors considered in financial decision-making (Wuryaningsih & Nuryanah, 2024). From the agency theory perspective, RPTs are seen as opportunistic actions that can create agency conflicts between external parties (such as the government and tax authorities) and internal parties (such as company management) (Barokah & Sari, 2024).

### Tax Avoidance

Tax avoidance refers to a transaction scheme that aims to minimize a company's tax liability by exploiting loopholes in tax laws without violating existing tax regulations (Huda et al., 2017). This practice is particularly common among MNEs operating in multiple jurisdictions, especially when corporate tax rates vary significantly across countries. In such cases, MNEs may shift a large portion of their profits to low-tax or no-tax jurisdictions, thereby narrowing the tax bases of higher-tax countries (Choi et al., 2020).

Tax avoidance can manifest in various forms, including the strategic use of RPTs and dividend policies. Utama and Hermawan (2020) highlight that tax avoidance practices are indicated by a positive relationship between shareholder tax burden and RPTs and a negative relationship between shareholder tax burden and dividend payments. These findings suggest that companies may reduce their tax liabilities by delaying dividend distributions or channeling profits through affiliated entities.

### Transfer Pricing

Transfer pricing has become a central issue in international taxation, particularly due to its potential misuse by MNEs to facilitate tax avoidance. Abusive transfer pricing allows companies to shift profits from high-tax jurisdictions to low-tax ones, eroding tax bases and enabling both tax avoidance and evasion (Sebele-Mpofu et al., 2021). According to Elitzur and Mintz (1996), policymakers often view transfer pricing as a tool manipulated by multinationals to minimize tax obligations.

Historically, the issue of transfer pricing manipulation has long been acknowledged. Samuelson (1982) noted that multinational firms, faced with varying tax and tariff structures, have incentives to adjust their retained earnings through transfer price manipulation. Consequently, governments are likely to impose restrictions to curb such behaviors. Rathke et al. (2021) also emphasized that governments worldwide are aware of the detrimental impact of profit shifting and have implemented various mechanisms to counteract it.

### Arm's Length Principle (ALP)

To mitigate the risk of profit shifting through transfer pricing manipulation, tax authorities have widely adopted the ALP. This principle requires that intra-group transactions be priced similarly to those conducted between unrelated parties in an open market (Keuschnigg & Devereux, 2013). By using comparable market prices, tax authorities can assess the fair value (FV) of intercompany transactions, including trade in goods, services, and royalty payments.

The ALP emerged as a global standard following high-profile cases such as E.I. Du Pont de Nemours and Company v. the United States, which exposed aggressive income-shifting tactics. In response, jurisdictions around the world developed transfer pricing documentation (TP Doc) and audit frameworks based on this principle (Cristea & Nguyen, 2016). ALP remains a fundamental concept in international tax policy, aiming to ensure that multinationals are taxed fairly and that profits are not artificially shifted to reduce tax burdens.

## RESEARCH METHOD

This article was developed through a systematic and thorough process following the PRISMA procedure, ultimately resulting in the selection of 15 studies or literature pieces that directly address the research topic. The researcher employed a comprehensive search strategy, utilizing sources that publish Scopus-accredited journals and leveraging Google Scholar as the primary database for identifying relevant materials.

The selection process adhered to clearly defined criteria to ensure the inclusion of high-quality and relevant studies. Relevant research articles were identified using a carefully curated set of keywords such as "Profit Shifting," "Tax Haven," "Related Party Transaction," "Arm's Length Principle," "Transfer Pricing," "Tax Avoidance," and "Indonesia." These keywords were deliberately chosen to encompass diverse yet interconnected themes central to the study's focus. To maintain the relevance and timeliness of the findings, the literature review was limited to studies published between 2015 and 2024. This timeframe was selected to ensure the inclusion of the most current data and insights, reflecting recent developments in the field. Furthermore, only articles that demonstrated a direct connection to the research topic were considered. This criterion was essential to streamline the literature review and exclude studies that were not aligned with the study's primary objectives. Lastly, the final selection comprised only those articles that provided clear, conclusive, and evidence-based answers to the research questions. This approach guaranteed that the literature reviewed would meaningfully contribute to the research objectives and establish a strong foundation for further analysis.

Using the curated set of keywords keywords in the Google Scholar search engine, the researcher identified an initial total of 1,360 articles. To refine the scope, the search results were filtered to include publications from the period 2015 to 2024, narrowing the dataset to 586 articles. A detailed screening process began with an examination of article titles, from which 96 articles were downloaded for further evaluation through abstract and full-text reviews. After assessing the relevance of these articles to the research focus and objectives, 12 articles were selected as core references supporting the study. Additionally, three more articles were obtained from alternative sources, resulting in a final total of 15 literature sources used to substantiate the research objectives comprehensively. This meticulous selection process ensured that the literature reviewed was highly aligned with the study's central themes and analytical framework.

**Figure 1.** Prisma Flow Diagram

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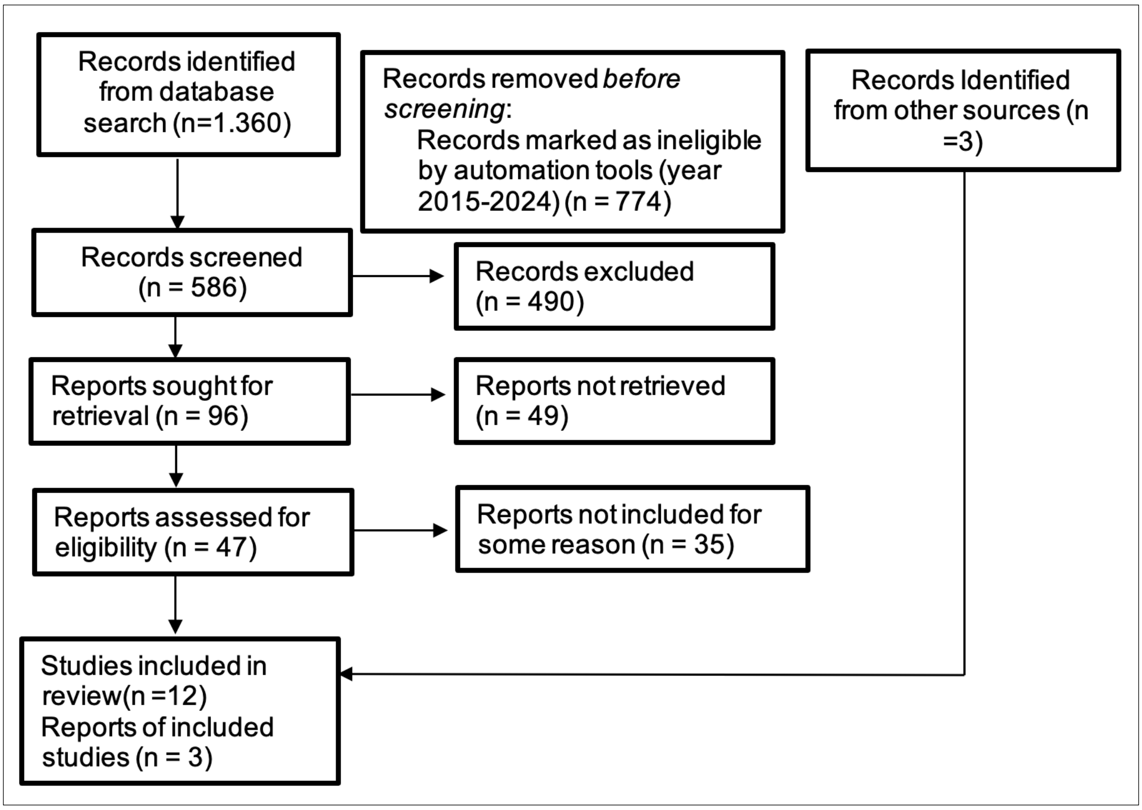


## RESULTS

Table 1 below summarizes the author's observations of the literature regarding the scope and objectives of the research.

**Table 1.** Literature Data Extraction

| Author | Method | Variables | Results |
|---|---|---|---|
| Saputra (2023) | Regression Discontinuity Design (RD)/Difference-in-Difference (DID) | Tax/Sales, COGS/Sales, OPEX/Sales, Lagged Sales, Dummy TPD, ETR, Log of PBT, Industry Fixed Effects | TP documentation policy implementation can encourage taxpayers to reduce tax avoidance practices through transfer pricing. |
| Wuryaningsih & Nuryanah (2024) | Case study with ADKAR framework (awareness, desire, knowledge, ability, reinforcement) | ADKAR framework | AR realized the importance of conducting transfer pricing analysis, where knowledge and ability were identified as main barriers to implementing the ALP. |
| Pramesthi et al. (2019) | Panel data regression analysis using Eviews 7, Hausman Test, F Test, T Test | Tax Haven Utilization, Multinationality, Transfer Pricing, Intangible Assets | Income shifting strategy, in terms of multinationality and transfer pricing, positively impacts tax haven utilization, while thin capitalization and |

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|---|---|---|---|
| | | | intangible assets do not affect tax haven utilization. |
| Tambunan (2022) | Qualitative approach with inductive technique for data analysis | Transfer Pricing | Automotive manufacturing industry in Indonesia experiences significant transfer pricing disputes, especially related to royalty payments and sales prices to affiliates not aligned with appropriate price ranges. ALP implementation is often not applied as intended, resulting in differences in tax obligations. |
| Huda et al. (2017) | Normative research with legal framework approach | Transfer Pricing System in Indonesia | Transfer pricing practices by MNCs in Indonesia significantly reduce potential tax revenue for the government, as these companies often shift tax obligations to countries with lower tax rates. |
| Rathke et al. (2021) | Hierarchical clustering method for analyzing 57 observable quantitative and qualitative characteristics of transfer pricing rules across countries | Intrafirm Transaction Volume, Tax Differential, Transfer Pricing Systems, Labor Expenses, PPE | Companies tend to increase intragroup transactions with related parties in low-tax countries, supporting profit shifting hypotheses. Differences in transfer pricing rules across countries affect transaction volumes, where domestic rules differing from the Organization for Economic Co-operation and Development (OECD) guidelines may hinder profit shifting, while OECD compliance facilitates it. |

| | | | |
|---|---|---|---|
| Yoo (2022) | Fixed Effects Panel Regression | Domestic Reported Pre-tax Income, Domestic TP Regulation (DomReg), Foreign TP Regulation (ForReg) | Domestic transfer pricing regulations effectively reduce income-shifting motivations by affiliates, especially in small MNCs. |
| Naibaho & Romdoni (2021) | Qualitative research with exploratory approach | Transfer Pricing, ALP | This study highlights the complexities of transfer pricing disputes among MNCs in Indonesia, emphasizing challenges in achieving proper comparability in pricing transactions. It underscores the need for external comparables and the Transactional Net Profit Method (TNMM) model for comparison activities to align with the ALP. |
| Lazuardi (2022) | Qualitative analysis for evaluating the implementation of Advance Pricing Agreement (APA) regulations in Indonesia (PMK-22/2020) | APA, Transfer Pricing | Findings show that the implementation of APA regulations in Indonesia, as stipulated in PMK-22/2020, has not fully met policy indicators, especially target group indicators. However, it meets all policy-related indicators, including power, interest, strategy, and compliance. APA regulations can effectively prevent transfer pricing disputes in Indonesia. |
| Rahmiati & Sandi (2016) | Qualitative research with ethnographic approach | Transfer Pricing Methods: CUP, RPM, Cost Plus Method, TNMM, PSM | Tax expenses can be reduced using the Cost Plus Method. The TNMM was found to be the best choice for companies to optimize tax expenditures. |

| | | | |
|---|---|---|---|
| Barokah & Sari (2024) | Multiple Regression Analysis | Tax Avoidance, Related Party Cross-border Sales (CB-RPT), Related Party Other Receivables (RPOR) | Positive and significant relationship between tax avoidance and CB-RPT and RPOR during the pre-TP Doc regulation period (2012-2016). No significant impact of tax avoidance on CB-RPT and RPOR during the post-regulation period (2017-2019). |
| Sari & Hunar (2015) | Normative research with legal, comparative, and conceptual approaches | Transfer Pricing, ALP | ALP application is complex in Indonesia, and there is a need for better comparability analysis and a legal framework to enhance compliance and prevent tax avoidance. |
| Saptono & Khozen (2022) | Descriptive Qualitative through document analysis and in-depth interviews | FV, ALP | The need for harmonization between FV and ALP to ease administrative burdens for taxpayers. |
| Nurdiansyah & Masripah (2023) | Multiple Regression with Stata 12 | Transfer Pricing, Tax Haven, Thin Capitalization, Tax Avoidance | Transfer pricing and tax haven utilization have a positive effect on tax avoidance, while thin capitalization has no effect on tax avoidance. |
| Saragi (2024) | Descriptive Qualitative | TP Regulation | Significant developments in transfer pricing regulations in Indonesia since 1983, with eight regulations on ALP, three on TP documentation, and five on Advance Pricing Agreements (APA). |

Source: Author Processed Data

Based on the synthesis of 15 research studies on transfer pricing and tax avoidance, as displayed in Table 1, a comprehensive interpretation reveals several key themes and insights into the practices, regulations, and challenges faced in Indonesia and globally. Most studies affirm that transfer pricing remains a crucial channel for income shifting by MNCs, often leading to reduced tax obligations through strategies involving RPTs, tax havens, and misaligned pricing mechanisms. For instance, empirical studies by Barokah & Sari (2024) and Saputra (2023) confirm that the implementation of TP Doc policies and regulatory shifts can effectively reduce tax avoidance when enforced properly. However, in the earlier periods, the lack of stringent documentation allowed tax avoidance to persist through cross-border RPTs.

The complexity of applying the ALP is consistently highlighted as a barrier in several studies (e.g., Naibaho & Romdoni, 2021; Sari & Hunar, 2015; Wuryaningsih & Nuryanah, 2024), where issues of comparability and limited external benchmarks hamper the effective enforcement of ALP. This aligns with findings from Huda et al. (2017) and Tambunan (2022), which show that mispricing in royalty and sales transactions often escapes appropriate scrutiny, especially in industries like automotive manufacturing. In addition, Rathke et al. (2021) and Yoo (2022) provide international perspectives that further validate the role of domestic and OECD-compliant transfer pricing rules in either mitigating or enabling profit shifting, with stronger regulations tending to curb abusive practices.

On the policy front, Lazuardi (2022) and Saragi (2024) outline the evolution and partial success of Advance Pricing Agreements (APA) in Indonesia, showing promise for dispute prevention, even though they are yet to fully address all stakeholder concerns. Several studies, including Saptono and Khozen (2022), propose harmonizing the concept of FV with ALP to ease administrative burdens and reduce interpretational ambiguity. Meanwhile, Nurdiansyah & Masripah (2023) and Rahmiati & Sandi (2016) explore practical transfer pricing methods, indicating that TNMM is widely favored due to its effectiveness, while Cost Plus is useful in specific scenarios.

Finally, underlying all these discussions is a shared concern about the legal and institutional capability to enforce these policies effectively. Studies such as those by Huda et al. (2017) and Pramesthi et al. (2019) warn that as long as multinational corporations can leverage regulatory gaps or exploit complexity, aggressive tax planning through transfer pricing will persist. Hence, comprehensive reforms that include capacity building for tax authorities, standardized regulations aligned with international norms, and proactive corporate compliance measures are essential to curb tax avoidance and ensure fair taxation in the globalized economy.

## DISCUSSION

### Utilization of Tax Haven Countries in Transfer Pricing Practices

The OECD defines transfer pricing as a practice in MNEs where transactions are typically conducted between members of the same group (Huda et al., 2017). In the implementation of transfer pricing, MNCs tend to shift their tax burden from high-tax jurisdictions to low-tax jurisdictions by lowering intercompany prices within the same group. Companies established in tax haven countries can play a significant role as facilitators of efficient transfer pricing to reduce the tax burden between group members. Thus, efficient tax planning involves entities within the group related to companies in tax haven countries (Nurdiansyah & Masripah, 2023).

The use of tax haven countries is influenced by several factors, such as efforts to obtain lower labor costs, maintain investor confidentiality, and avoid tax liabilities. Investors utilizing tax haven countries can reduce their tax burdens. Tax havens provide opportunities to gain tax benefits through differences in tax treatment between countries, leading to the belief that the use of tax havens impacts a company's ability to avoid taxes (Nurdiansyah & Masripah, 2023). On the other hand, the existence of tax haven countries can damage a company's reputation if used for profit-shifting purposes (Pramesthi et al., 2019). In their research, Rathke et al. (2021) found that companies tend to conduct more intrafirm transactions with related parties in low-tax jurisdictions, underscoring the central role of tax havens in global tax strategies.

Tax haven countries typically offer favorable tax facilities, such as minimal or zero tax rates, as well as robust protections for taxpayer confidentiality, creating an environment conducive to tax avoidance. These features make tax havens particularly attractive for taxpayers seeking to shift income and minimize their tax liabilities. The appeal of tax havens gained global attention following the leak of the Panama Papers, a collection of documents from the Mossack Fonseca law firm in Panama. These documents exposed millions of offshore investments, including those involving prominent figures, multinational corporations, and even heads of state. The revelations highlighted the exploitation of tax havens' loose tax regulations and confidential protections by individuals and entities seeking to evade higher tax liabilities.

Further research conducted by Nurdiansyah and Masripah (2023) analyzed the relationship between transfer pricing, the use of tax havens, and tax avoidance. Their study, which examined 37 MNCs listed on the Indonesia Stock Exchange (IDX) from 2018 to 2020 (yielding a total of 111 observations), revealed that both transfer pricing and tax havens significantly influence tax avoidance practices. Weak regulatory frameworks surrounding transfer pricing in Indonesia were identified as a contributing factor to this issue, enabling companies to reduce their tax payments. Moreover, the discriminatory tax policies in tax haven jurisdictions—such as low tax rates, special tax facilities for selected taxpayers, and limited information exchange—further encourage MNCs to engage in international tax avoidance practices.

Some of the most common mechanisms employed in international tax avoidance through tax havens include transfer pricing and thin capitalization. These schemes exploit regulatory gaps and inconsistencies to shift income to jurisdictions with favorable tax conditions. The level of multinationality of a company also plays a crucial role in its use of tax havens. Companies with a high degree of multinational operations are more likely to utilize tax havens like Hong Kong and Singapore, which offer lower tax rates than Indonesia, to facilitate income shifting and optimize their global tax strategies.

Overall, the use of tax havens represents a complex interplay of financial incentives, regulatory gaps, and strategic decision-making by MNCs. While these jurisdictions offer short-term financial gains, they also pose significant challenges to global tax policy and equity, underscoring the need for stronger international cooperation and regulatory reforms to address tax avoidance effectively.

**Transfer Pricing Regulations and Their Impact on Tax Avoidance Practices**

The affiliation between domestic and international companies often leads to issues concerning tax rights and obligations within each jurisdiction. These issues stem from various business policies adopted by companies, which are aimed at maximizing profits. As a result, financial reports may become inaccurate due to income or expense shifting in interparty transactions, complicating the tax compliance process and potentially misleading tax authorities regarding the actual financial standing of a company (Sari & Hunar, 2015). Such practices, designed to reduce tax liabilities, increase the potential for tax avoidance, making transfer pricing a significant concern for tax authorities globally (Saragi, 2024).

In light of the growing concerns around tax avoidance, the government has made several efforts to address these issues by implementing regulations and guidelines to control the practice of tax avoidance. One of the most notable steps in this direction is the incorporation of Anti-Avoidance Rules (AAR) into tax regulations. These rules are intended to prevent companies from engaging in artificial tax avoidance strategies that exploit loopholes within the tax system, ensuring that taxpayers fulfill their obligations in a fair and transparent manner (Nurdiansyah & Masripah, 2023). Such measures are critical in strengthening the country's tax framework, ensuring that tax liabilities are

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allocated in a way that reflects the actual business operations taking place across jurisdictions.

The evolution of transfer pricing regulations in Indonesia is a testament to the government's commitment to addressing the challenges posed by tax avoidance practices. Transfer pricing regulations were first introduced in 1983, and since then, they have undergone significant revisions. These developments have led to the introduction of more specific rules, which aim to enhance both the legal certainty for taxpayers and the efficiency of the tax administration process. By refining these regulations, Indonesia has worked to improve the alignment of its tax laws with international standards, which is essential for promoting fairness and consistency within its tax system (Saragi, 2024). The evolution of these rules over the years has enabled the Indonesian government to better address the complexities of cross-border transactions and ensure that companies operating in the country pay their fair share of taxes.

Transfer pricing regulations generally provide guidelines on how to determine appropriate transfer prices or arm's length prices for transactions between related parties. These regulations are important because they ensure that businesses report their financials in a way that accurately reflects their economic activities rather than artificially inflating or deflating prices to avoid taxes. In addition, taxpayers are required to provide relevant and accurate information to tax authorities regarding these transactions. By requiring transparency in this regard, tax authorities can better assess whether the reported transfer prices are in line with market conditions or whether adjustments are needed to align with the ALP (Yoo, 2022). Such provisions are essential for ensuring fairness and reducing the potential for tax avoidance through the manipulation of intercompany transactions.

Indonesia implemented TP Doc on December 30, 2016, through the issuance of Minister of Finance Regulation No. 213/PMK.03/2016 (PMK-213/2016) (Saputra, 2023). The primary objective of TP docs is to provide transparency for taxpayers engaged in RPTs by ensuring that the prices set for intercompany transactions are determined in a way that reflects the economic reality of the transactions. This regulation aims to prevent potential tax avoidance behaviors by enabling tax authorities to review and verify the transfer prices reported by taxpayers. Through the provision of clear documentation, tax authorities can ensure that these prices align with market conditions and comply with applicable tax laws, thus contributing to the overall integrity of the tax system.

The goal of TP docs is to ensure that taxpayers use the correct methodology when determining the prices of RPTs. This is crucial to limit the ability of companies to shift profits to jurisdictions with favorable tax treatment, thereby minimizing their tax liabilities. In order to achieve this, taxpayers are required to disclose the application of the ALP, which is a standard used to ensure that transactions between related parties are priced as if the parties were independent, thus preventing tax avoidance through transfer pricing manipulation (Saputra, 2023). The ALP serves as a reference for determining the appropriate transfer pricing for RPTs, and its application is essential in ensuring that prices are set based on the same principles as those applied in transactions between unrelated entities (Saptono & Khozen, 2022).

Indonesia aims to strengthen its tax system and align its regulations with international standards by mandating the use of TP docs and enforcing transparency in RPTs. This helps prevent the manipulation of transfer prices and tax base erosion, ensuring that tax revenues are fairly collected and that companies contribute to the public finances in a manner that reflects their economic activities. The implementation of such documentation requirements also demonstrates Indonesia’s commitment to adhering to global best practices in tax governance, contributing to the prevention of tax avoidance and reinforcing trust in the country's tax system.

The success of transfer pricing in taxation relies heavily on the existence of transactions based on affiliated relationships (Sari & Hunar, 2015). These special relationships are explicitly defined in Article 18, paragraph (4) of Law No. 36 of 2008 concerning Income Tax (House of Representatives of the Republic of Indonesia [DPR RI), 2008). A special relationship is considered to exist under several conditions. First, there is direct or indirect ownership, where one party owns at least 25% of the capital in another party or where two parties collectively own at least 25% of the capital in a third party. Second, a special relationship may arise through management control, whereby one party has control over another, either directly or indirectly. Lastly, a special relationship can also be established through familial ties, whether by blood or marriage, within direct or collateral lines up to a certain degree. These criteria form the legal foundation for identifying RPTs, which are essential in the application and enforcement of transfer pricing regulations.

Taxpayers are obligated to adhere to the ALP when fulfilling their tax obligations concerning transactions involving special relationships. These transactions generally occur between related parties, such as affiliates or subsidiaries within multinational corporations. The ALP serves as a standard that ensures that the prices set in these transactions reflect the prices that would be agreed upon by independent parties in a similar transaction under similar circumstances. By applying the ALP, taxpayers are expected to ensure that their transfer pricing practices align with market conditions, thus reducing the potential for tax avoidance through manipulated pricing. Lazuardi (2022) emphasizes the importance of this principle in maintaining fairness and transparency in cross-border transactions.

Research by Barokah and Sari (2024) compares tax avoidance practices before and after the introduction of TP Doc regulations, focusing on CB-RPTs and RPOR. Their study reveals a significant shift in corporate behavior with the implementation of the TP docs regulations. Before the regulations were introduced, companies frequently used CB-RPTs and RPOR to avoid taxes, which was evident from the negative relationship between effective tax rates (ETR) and CB-RPTs and RPOR. This indicates that companies were engaging in practices designed to minimize their tax burden through intercompany transactions that were not aligned with arm's length standards.

However, after the TP docs regulations were enacted, the study found no significant relationship between tax avoidance and CB-RPTs or RPOR, suggesting that the introduction of these regulations had a positive effect on curbing tax avoidance strategies. This shift indicates that the Indonesian transfer pricing regulations, through the mandatory documentation requirements, successfully prompted companies to adjust their strategies and comply with proper transfer pricing guidelines, thus reducing opportunities for tax avoidance.

Saputra (2023) conducted an additional study examining the specific effects of the TP docs regulations compared to other transfer pricing regulations at the company level using tax report data. Analyzing 3,619 taxpayers from 2013 to 2018, the study involved a total of 19,463 observations. The findings revealed that, on average, there was an increase of 0.9 percentage points in the tax-to-sales ratio for taxpayers who were required to prepare TP Doc. This increase indicates that the TP docs regulations were effective in ensuring that companies paid a higher proportion of taxes relative to their sales. The study's results suggest that the introduction of TP docs regulations led to a decrease in the tendency for companies to engage in tax avoidance through transfer pricing, as the regulations provided greater transparency and accountability in the reporting of intercompany transactions.

Overall, these studies underline the importance of TP Doc as a tool for enhancing tax compliance and reducing the opportunities for tax avoidance. By ensuring that companies adhere to the ALP and provide adequate documentation for their RPTs, tax authorities can better monitor and regulate transfer pricing practices, ultimately improving tax revenue and fairness in the tax system. The results of these studies also demonstrate that the implementation of TP Doc regulations has had a positive impact on reducing tax avoidance in Indonesia, making it an important policy tool for strengthening the country's tax administration.

Several studies reveal that Indonesia's anti-tax avoidance regulations still require review in their implementation to be more effective. According to research by Nurdiansyah and Masripah (2023), Indonesia's AAR is currently unable to resolve the challenges related to transfer pricing issues. This issue stems from the lack of clear provisions regarding the application of transfer pricing regulations and penalties for violations, leaving gaps in the enforcement of transfer pricing rules. These gaps undermine the effectiveness of the regulations, as they do not provide sufficient guidance for tax authorities to consistently apply and enforce transfer pricing principles across all sectors.

Furthermore, research by Wuryaningsih and Nuryanah (2024) identifies the perspectives of Account Representatives (AR) on the obstacles they face in applying the ALP, especially in intercompany loan transactions in Indonesia. This research used the ADKAR model (awareness, desire, knowledge, ability, and reinforcement) to analyze the barriers ARs encounter. The study found that the primary obstacles to effectively applying the ALP to intercompany loans are "knowledge" and "ability." The "knowledge" barrier pertains to the lack of understanding in assessing credit ratings, which are essential for determining the appropriate arm's length pricing for loans between related parties. Without the necessary knowledge and expertise, ARs may struggle to evaluate whether the terms of intercompany loans align with market conditions.

On the other hand, the "ability" barrier highlights the insufficiency of resources available to ARs to apply the ALP effectively. There is a notable gap in the availability of the necessary tools, training, and support structures to enable ARs to perform accurate transfer pricing analyses. This lack of resources may hinder their ability to fully apply the ALP to intercompany transactions, potentially leading to tax avoidance opportunities.

Based on these findings, the research recommends that the Directorate General of Taxes enhance the knowledge and skills of ARs through case-based training and other educational programs. This would enable ARs to better understand transfer pricing principles and apply them more effectively, particularly in complex cases such as intercompany loans. By improving the expertise of tax officers, Indonesia's tax administration can better address the challenges posed by transfer pricing and minimize the risk of tax avoidance.

In addition, Tambunan (2022) suggests that tax authorities consider establishing a special unit dedicated to addressing transfer pricing issues. A specialized unit could focus on monitoring and auditing RPTs more effectively, ensuring compliance with transfer pricing regulations and minimizing the risk of tax avoidance through pricing manipulation. This recommendation emphasizes the importance of institutional support and expertise in tackling the complexities of transfer pricing and enhancing the overall effectiveness of Indonesia's tax administration.

Taken together, these studies underline the need for stronger regulations, enhanced training, and dedicated resources to tackle the ongoing challenges in transfer pricing enforcement in Indonesia. Strengthening these aspects would contribute significantly to improving the country's ability to address tax avoidance and ensure a fairer and more transparent taxation system.

## CONCLUSION

This study investigates the role of TP Documentation in enhancing the application of the ALP to curb tax avoidance through related-party dealings in tax havens. Tax avoidance practices, particularly through transfer pricing and the utilization of tax havens, pose significant challenges in optimizing tax revenue in various countries, including Indonesia. MNCs often exploit regulatory gaps, both domestic and international, to shift profits to low-tax jurisdictions. Although the ALP is globally recognized as the standard for managing transfer pricing, its effectiveness in Indonesia still faces various obstacles, such as limited data transparency, regulatory differences between countries, and a lack of competent human resources.

This research highlights the need for more comprehensive policies and the consistent implementation of regulations to strengthen transfer pricing oversight and prevent abuse of tax havens. Harmonizing domestic policies with international guidelines, such as those from the OECD, and enhancing the capacity of tax authorities is crucial in addressing complex tax avoidance practices. This study not only contributes to the academic literature but also provides practical recommendations for tax authorities to enhance fairness and efficiency in Indonesia's taxation system.

Given the evolving nature of global tax policies and the increasing sophistication of corporate tax planning strategies, future research is strongly encouraged to further investigate this issue. A deeper exploration of TP Doc, compliance behavior, and the impact of digitalization on tax transparency can offer valuable insights and support evidence-based policy development in Indonesia and beyond.

## LIMITATION

This study has several limitations that should be acknowledged. First, there is a limited number of studies specifically discussing how the application of the ALP helps reduce tax avoidance practices, particularly within the Indonesian context. This scarcity of literature affects the depth and scope of analysis. Second, the study is limited by the scope of databases used in the literature search, which may have resulted in the exclusion of relevant studies published in non-English languages or those categorized as grey literature, such as theses, working papers, or unpublished reports.

Moreover, many of the reviewed studies are qualitative or conceptual in nature, which constrains the ability to perform cross-case comparisons or draw broader generalizations. The lack of empirical, data-driven research further reduces the opportunity to assess the measurable impact of ALP implementation on tax avoidance.
These limitations highlight the need for future research to expand the scope of data sources and include more empirical studies across different jurisdictions. Such efforts will provide a stronger foundation for understanding the effectiveness of TP Doc and ALP-based regulations in addressing aggressive tax planning practices.

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## DECLARATION OF CONFLICTING INTERESTS

The Author declared no potential conflict of Interest.

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