SIYASAH DUSTURIYAH LAW REVIEW

Volume 1 No 2
E-ISSN: 3109-9726

Evaluating the Arm's Length Principle in Fiscal Corrections for Intragroup Services: Evidence from the Federal Karyatama-EMAPPL Case

Nafis Dwi Kartiko[1], Alex Oktobertus Pandapotan Gultom[2]
[1,2]Kementerian Keuangan Republik Indonesia, Indonesia
Corresponding Author: nafisdwikartiko@gmail.com

ARTICLE INFO

Keywords:
Arm's Length Principle;
Transfer Pricing;
OECD Guidelines;
Proof Of Management Services;
Fiscal Corrections.

Article History:
Received: Sep, 22 2025
Revised: Sep, 25 2025
Accepted: Sep, 27 2025

ABSTRACT

This study aims to analyze the compatibility between Indonesian domestic norms and the OECD Transfer Pricing Guidelines in the application of the arm's length principle (ALP) on the verification of cross-jurisdictional management service costs. The analysis is based on Tax Court Decision Number PUT-007752.15/2023/PP/M.XIII.B. This study employs a normative-dogmatic legal method to examine the consistency between Indonesian domestic norms and the OECD Transfer Pricing Guidelines in applying the arm's length principle to cross-jurisdictional management service costs. The analysis integrates statutory, case, and conceptual approaches to ensure systematic coherence between positive law, jurisprudence, and international tax doctrine. Primary legal materials such as tax laws and court decisions provide binding authority, while secondary academic sources offer analytical depth to contextualize Indonesia's doctrinal alignment within global transfer pricing standards. This study concludes that applying the arm's length principle (ALP) to cross-jurisdictional management service costs requires balancing legal certainty with economic substance. The PT Federal Karyatama–ExxonMobil Asia Pacific Pte. Ltd. case reveals doctrinal tension between the OECD's soft law flexibility and Indonesia's hard law rigidity under PMK 172/2023. The findings indicate a selective convergence model, where Indonesia adopts OECD principles but enforces stricter evidentiary standards, resulting in a conservative, rule-based approach prone to interpretative disputes. This study contributes theoretically to the strengthening of the ALP and practically to the optimization of Advance Pricing Agreements and Mutual Agreement Procedures.

1. Introduction

Transfer pricing for management services has emerged as one of the primary sources of cross-border tax disputes. This occurs because determining the actual services performed, identifying beneficiaries, allocating costs and mark-ups, and ensuring compliance with the arm's length

principle often involve highly complex factual and legal considerations.[1] In the context of an integrated global economy, multinational companies utilize intra-group service arrangements to optimize operational efficiency and resource allocation, but this practice often raises questions about the fairness of transaction values. Since the Base Erosion and Profit Shifting (BEPS) reform, the OECD Transfer Pricing Guidelines have served as the principal framework for analyzing management costs and intra-group service arrangements. Yet, as the OECD continuously refines its guidance to strengthen compliance, the frequency of disputes and enforcement actions involving management services has also increased.[2]

The complexity increases because each jurisdiction adopts varying interpretations of the principles of fairness and business norms, creating legal uncertainty for international taxpayers. Specific issues such as the operation of service-level agreements, the appropriate treatment of pass-through costs, the selection of relevant comparables, and appropriate profit indicators give rise to high factual sensitivity, which often leads to differences in position between tax authorities and taxpayers.[3] These differences in opinion have the potential to lead to fiscal corrections and require resolution through bilateral mechanisms such as the Mutual Agreement Procedure (MAP). The BEPS project and follow-up OECD studies emphasize the importance of economic substance, robust documentation, and value creation analysis, particularly in relation to intangible elements and Cost Contribution Arrangement (CCA) schemes underlying the pricing of management services.[4]

The increase in standards places a greater burden of proof on taxpayers to demonstrate the existence and economic benefits of the management service costs charged. Consequently, many countries have updated their domestic guidelines and enforcement approaches through revised national regulations, as well as clarified the mechanisms of Advance Pricing Agreements (APAs) and MAPs, which have led to variations in practices at the global level.[5] Such variations have led to unilateral adjustments, end-of-year reconciliations, and a growing dependence on bilateral mechanisms to mitigate double taxation risks. The OECD's evolving guidance on business restructuring and comparability analysis has further complicated management service disputes.

---

1 Yuri Matsubara and Clémence Garcia, "OECD Transfer Pricing Guidelines and International Tax Law," 2023, 535–54, https://doi.org/10.1093/oxfordhb/9780192897688.013.32; Magdalena Szymczak, "Good Practice for Transfer Pricing in Selected OECD Countries," Prace Naukowe Uniwersytetu Ekonomicznego We Wrocławiu 64, no. 9 (2020): 119–30, https://doi.org/10.15611/pn.2020.9.09; B Brzeziński, Krzysztof Lasiński-Sulecki, and Wojciech Morawski, "OECD Transfer Pricing Guidelines as a Quasi Source of Law in a Post-Beps World – Legislative and Judicial Developments From a Polish Perspective," Intl. Transfer Pricing J. 27, no. 3 (2020), https://doi.org/10.59403/8p0kjq.

2 Matsubara and Garcia, "OECD Transfer Pricing Guidelines and International Tax Law."

3 Tomáš Brabenec, "Transfer Pricing of Intangible Assets and R&D Services in Service Level Agreement," Český Finanční a Účetní Časopis 2011, no. 2 (2011): 58–71, https://doi.org/10.18267/j.cfuc.105; S K Bilaney, "Concept of Pass-Through Costs and Their Treatment," Intl. Transfer Pricing J. 25, no. 1 (2018), https://doi.org/10.59403/35k6h7k.

4 E Sporken and Pieter J Visser, "BEPS Guidance on Transfer Pricing Aspects of Intangibles and the Need for Substance and Transfer Pricing Documentation," Intl. Transfer Pricing J. 22, no. 1 (2015), https://doi.org/10.59403/43kxhh; Melani D Astuti, "Country Note: Implementation of BEPS Recommendations in Indonesia's New APA and Transfer Pricing Rules," Intertax 48, no. Issue 12 (2020): 1145–54, https://doi.org/10.54648/taxi2020114; Michael Kobetsky, "The Status of the OECD Transfer Pricing Guidelines in the Post-Beps Dynamic," Intl. Tax Stud. 3, no. 2 (2020), https://doi.org/10.59403/2rpcabz.

5 Paul D Sutton, "HM Revenue &Amp; Customs Takes a Tougher Stance With New TP Guidelines," Intl. Transfer Pricing J. 32, no. 1 (2024), https://doi.org/10.59403/ty28zk; Mihai Lupu, "International Cooperation and Solving Transfer Pricing Disputes: A Discussion about Mutual Agreement Procedures," in Proceedings of the International Conference on Business Excellence, vol. 17, 2023, 236–45; Andrew R Jupp, K Heggs, and John Rigby, "Transfer Pricing End-of-Year Adjustments in the United Kingdom," Intl. Transfer Pricing J. 31, no. 7 (2024), https://doi.org/10.59403/20xjafx.

Reorganization, functional centralization, or shifts in internal service models often alter the distribution of functions, risks, and assets among group members.[6]

The dispute between PT Federal Karyatama and the Directorate General of Taxes (DGT) in Tax Court Decision Number PUT-007752.15/2023/PP/M.XIII.B (2025) originated from a fiscal correction on management service fees paid to ExxonMobil Asia Pacific Pte. Ltd. (EMAPPL). The DGT argued that the services lacked proof of actual performance and direct economic benefit, deeming them duplicative and related to shareholder activities, while the taxpayer maintained that all services were contractually valid, supported by reports, correspondence, and objective cost allocation reflecting efficiency gains and alignment with ExxonMobil's global standards. The Tax Authority questioned the absence of deliverables, benchmarking, and mark-up reasonableness, whereas the Tax Court applied the arm's length principle under OECD guidance, requiring proof of both service existence and benefit realization. After evaluating digital evidence and cost data, the Court ruled that part of the services were substantiated and economically beneficial, finding the Rp29.99 billion correction unjustified. This case illustrates Indonesia's evidentiary rigor in applying the benefit test, the importance of documentation consistency with economic substance, and the ongoing tension between formal proof and substantive value in cross-border management service transactions.

However, beyond these empirical findings, the dispute reveals a deeper epistemological tension between differing interpretations of the arm's length principle, reflecting a shift from factual assessment to conceptual evaluation. This tension not only reveals technical issues of proof, but also reflects a difference in paradigms in viewing the relationship between legal certainty and fiscal justice-the core of evaluating the principle of fairness in affiliated transactions. From an academic perspective, this case is important because it illustrates the limitations of applying the OECD guidelines in the context of tax administration in developing countries, which face limitations in audit capacity and access to cross-border information. Accordingly, this study evaluates the consistency of the arm's length principle in intra-group service tax adjustments through the Federal Karyatama–EMAPPL case. The analysis focuses on the alignment between the court's considerations and OECD standards across five key dimensions: existence of services, economic benefit, comparability, cost allocation method, and mark-up reasonableness.

The difference in perspective between taxpayers and tax authorities in the case of PT Federal Karyatama Exxon Mobil Asia Pacific Pte. Ltd (EMAPPL) indicates a fundamental research gap in the practical application of the arm's length principle to intra-group management services. Taxpayers rely on an economic-substance approach emphasizing potential and realized benefits, whereas the Tax Authority adopts a formalistic perspective that prioritizes tangible deliverables as the basis for recognizing deductible costs. This difference highlights an interpretative gap between the arm's length principle in the OECD Guidelines, which emphasizes potential economic benefits, and domestic norms in PER-43/PJ/2010 jo. PER-32/PJ/2011 and PER-22/PJ/2013, which require evidence of actual services rendered and benefits received. This gap creates legal uncertainty and the potential for differences in audit results between jurisdictions. In the context of national law, Indonesia requires proof of the existence of services, economic benefits, and price reasonableness based on an analysis of functions, risks, and assets (functional analysis) as stated in Article 18 paragraph (3) of the Income Tax Law. However, in practice, differences in the interpretation of the concepts of "economic benefits" and "substance of services" have led to ambiguities in interpretation between the tax authorities and taxpayers.

Taxpayers consider that administrative evidence, such as activity reports and correspondence, is sufficient to prove the existence of services received in accordance with the OECD principle that

6 Lupu, "International Cooperation and Solving Transfer Pricing Disputes: A Discussion about Mutual Agreement Procedures"; E Sporken, D Brouwers, and R d. Looze, "OECD Report on Business Restructuring: Dutch Transfer Pricing Perspective," Intl. Transfer Pricing J. 17, no. 6 (2010), https://doi.org/10.59403/1stpmva.

recognizes potential benefits as the basis for imposing reasonableness (Matsubara & Garcia, 2023). Conversely, the Tax Authority adheres to the substance over form doctrine by emphasizing that new cost allocations can only be recognized if the services provide results that can be objectively measured and verified. This conflict highlights an interpretative gap between international soft law and national tax regulations, particularly in the context of proving economic benefits that are not always quantitative in nature. The OECD (2022) emphasizes that management services classified as low value-adding intra-group services should be assessed based on proportionality and substance of contribution, not merely physical results. However, the absence of explicit implementation guidelines in Indonesia's tax administration system has led to inconsistencies in assessments between tax auditors. This gap shows that although the arm's length principle is recognized globally, its application mechanism still depends heavily on the capacity and legal approach of each country.

In terms of novelty, this research has high academic value because it discusses the Federal Karyatama–EMAPPL case, which is one of the most recent tax disputes in Indonesia with complex empirical characteristics. This case was decided in 2025, making it highly relevant in the context of post-BEPS implementation and the adaptation of remote management services practices due to the pandemic. The novelty of this research lies in its legal-empirical analysis of the standard of proof for remote services and the application of the benefit test to low value-added services in developing country jurisdictions. This study develops a conceptual framework that combines value creation theory with the economic substance approach, thereby systematically explaining the relationship between the fairness of service prices and the proof of economic benefits. In addition, this study also offers a contextual arm's length evaluation model for developing country jurisdictions, where limited comparative data and audit capacity are major factors in the resolution of transfer pricing disputes.[7]

Theoretically, this research enriches international taxation literature by reinterpreting the arm's length principle within the framework of low value-adding services. It underscores the need to integrate comparability analysis and benefit-test concepts into domestic tax law to achieve closer alignment with OECD standards. Beyond its theoretical contribution, this study also broadens understanding of how international norms (soft law) interact with national norms (hard law) in the practical enforcement of tax law.[8] Practically, the results of this study have strategic value for Indonesian policymakers and tax authorities in developing guidelines for intra-group service evidence that are more objective, proportional, and in line with economic substance. For taxpayers, these findings provide a basis for preparing transfer pricing documentation that is stronger and more defensible in court. For the Directorate General of Taxes, this research provides concrete recommendations on the need to improve technical guidelines for proving the benefits of services, especially in assessing intangible and cross-jurisdictional activities. Ultimately, the findings are expected to enhance the accountability of tax audits by clarifying the parameters for proving service existence and determining reasonable mark-ups. The study also offers practical guidance for taxpayers in developing transparent transfer pricing documentation grounded in measurable economic substance. For the judiciary, it provides an evaluative framework to assess the fairness of management service transactions through a balanced consideration of economic evidence and fiscal justice.

2. Research Methods

This study uses a normative-dogmatic legal method oriented towards the examination of positive

[7] Brzeziński, Lasiński-Sulecki, and Morawski, "OECD Transfer Pricing Guidelines as a Quasi Source of Law in a Post-Beps World – Legislative and Judicial Developments From a Polish Perspective."

[8] In this context, *soft law* (e.g., OECD Guidelines) refers to non-binding international standards that guide interpretation and best practices, whereas *hard law* (e.g., PMK 172/2023) denotes binding national regulations with mandatory legal force and enforceable compliance obligations.

law through systematic interpretation of the norms, principles, and doctrines that govern the application of the arm's length principle in proving the costs of cross-jurisdictional management services.[9] This method was chosen because the research problem is normative in nature, namely assessing the consistency of the application of the arm's length principle between affiliated parties in the context of national and international law. As emphasized by Rahmat[10] and M.D.[11], the normative-dogmatic legal method aims to identify, interpret, and systematize legal rules based on authoritative legal sources to answer the question of "what should be" (*das Sollen*), not "what is" (*das Sein*). This approach is qualitative in nature, focusing on a literature study of primary legal materials such as laws, implementing regulations, court decisions, and relevant legal doctrines. In the context of the PT Federal Karyatama-ExxonMobil Asia Pacific Pte. Ltd (EMAPPL) dispute, this approach was used to analyze the consistency between the Tax Court's considerations and the OECD Transfer Pricing Guidelines regarding the proof of economic benefits and reasonable prices.

The normative-dogmatic approach also serves to assess the appropriateness of national law enforcement in relation to the principles of fiscal justice and economic substance in intra-group service transactions. Thus, this method is not only descriptive of positive norms, but also evaluative of the coherence between legal theory and practice.[12] To strengthen the analysis, this study combines three doctrinal approaches, namely the statutory approach, the case approach, and the conceptual approach. The statutory approach is used to examine the alignment between Article 18 paragraph (3) of the Income Tax Law and its implementing regulations (PER-43/PJ/2010 jo. PER-32/PJ/2011 and PER-22/PJ/2013) with the OECD guidelines. The case approach is used to examine the legal arguments in Tax Court Decision Number PUT-007752.15/2023/PP/M.XIII.B Year 2025, which is the main reference in the discussion of this dispute. A conceptual approach is used to clarify the doctrinal meaning of concepts such as economic substance, benefit test, and comparability analysis within the national and international legal framework.[13]

The integration of these three approaches enables legal analysis to be conducted systematically, proportionally, and consistently between written norms, jurisprudential practice, and international tax law theory. The statutory approach provides a normative framework, the case approach presents factual applications in court, while the conceptual approach deepens doctrinal analysis to ensure the coherence of the legal system. With this methodological design, the research fulfills the principles of systematic interpretation and normative reflection that characterize modern doctrinal legal research.[14] The legal materials used consist of primary and secondary legal materials. Primary legal materials include the Income Tax Law, implementing regulations, and Tax Court decisions related to the PT Federal Karyatama-EMAPPL case. Meanwhile, secondary legal materials include academic literature such as books, scientific journals, and research results that review the arm's

---

[9] Peter Mahmud Marzuki, *Penelitian Hukum* (Jakarta: Kencana Prenda Media, 2017).

[10] Doris Rahmat, "Juridical Review of International and National Law Relationships," *East Asian Journal of Multidisciplinary Research* 2, no. 1 (2023): 357–68, https://doi.org/10.55927/eajmr.v2i1.2872.

[11] Pradeep M.D., "Legal Research- Descriptive Analysis on Doctrinal Methodology," *International Journal of Management Technology and Social Sciences*, 2019, 95–103, https://doi.org/10.47992/ijmts.2581.6012.0075.

[12] Hari S Disemadi, "Lenses of Legal Research: A Descriptive Essay on Legal Research Methodologies," *Journal of Judicial Review* 24, no. 2 (2022): 289–304, https://doi.org/10.37253/jjr.v24i2.7280; Gareth Davies, "The Relationship Between Empirical Legal Studies and Doctrinal Legal Research," *Erasmus Law Review* 13, no. 2 (2020): 3–12, https://doi.org/10.5553/elr.000141.

[13] Rahmat, "Juridical Review of International and National Law Relationships"; Oleksandra Andreieva, "Qualitative Secondary Data Analysis as a Means of Systematization and Unification of the Legal Doctrine," 2021, https://doi.org/10.36074/logos-30.04.2021.v1.19.

[14] Rob v. Gestel and Hans-W. Micklitz, "Why Methods Matter in European Legal Scholarship," *European Law Journal* 20, no. 3 (2013): 292–316, https://doi.org/10.1111/eulj.12049; Rob v. Gestel, "Quality, Methodology, and Politics in Doctrinal Legal Scholarship," *Law and Method*, 2023, https://doi.org/10.5553/rem/.000070.

length principle and the proof of intra-group service benefits. Primary sources such as tax regulations and court decisions were chosen for their authoritative legal force, while secondary sources like academic literature provide analytical depth to interpret and contextualize those binding norms within international tax law.

3. Result and Discussion

3.1. Case Position

The tax dispute in Tax Court Decision Number PUT-007752.15/2023/PP/M.XIII.B of 2025 is a case of positive correction of management service fees between PT Federal Karyatama as the Appellant and the Directorate General of Taxes (DGT) as the Respondent. This case was decided by Panel XIII B of the Tax Court on September 16, 2025, and became an important precedent in the application of the arm's length principle to cross-jurisdictional management services. The dispute originated from the results of the 2019 Corporate Income Tax audit, in which the DGT assessed that the management service fees paid by PT Federal Karyatama to ExxonMobil Asia Pacific Pte. Ltd. (EMAPPL) did not meet the principles of fairness and business norms. The transaction was based on a Management Service Agreement between the two entities, which covered the provision of general management services, quality control, training, financial services, and support for ExxonMobil's global reporting system.

Cost allocation is carried out using the cost allocation key method with an additional mark-up determined based on the proportion of global costs between group entities. The DGT considers that most of these costs cannot be recognized because there is no concrete evidence of the provision of services that can be objectively verified. In its audit report, the DGT stated that supporting documents such as activity reports, internal correspondence, and proof of expenditure did not show a direct link to the benefits received by PT Federal Karyatama. The tax authority assessed that most of the activities claimed as management services were shareholder activities and duplicative services that did not provide specific economic benefits to entities in Indonesia. In addition, the DGT argued that the cost allocation mechanism used by EMAPPL was not accompanied by adequate independent benchmarks (benchmarking analysis) to prove the reasonableness of the mark-up. The DGT also assessed that there were no deliverables that showed the actual results of the services as required by the principle of substance over form.

Conversely, PT Federal Karyatama argues that all management services were actually performed by EMAPPL in accordance with a valid agreement and supported the company's operational efficiency. The taxpayer argues that these services have provided tangible economic benefits through improvements in the financial reporting system, increased cost efficiency, and consistency in global corporate policy. As evidence, the taxpayer submitted routine activity reports, electronic correspondence, cost allocation documentation, and efficiency reports showing a 46.64 percent reduction in operating costs. The Appellant emphasized that the reasonableness test for management services must follow the benefit test principle as stipulated in the OECD Transfer Pricing Guidelines 2022[15], where benefits can be measured from potential economic gains, not just physical evidence of work results. The taxpayer also asserted that the costs were not duplicative because each service had different content and functions from the company's internal activities in Indonesia.

In its defense, the taxpayer asserted that the allocated cost structure was objective and proportional based on the actual contribution of each group entity. The DGT continued to reject this defense on the grounds that the administrative evidence did not reflect sufficient economic substance. The dispute then proceeded to the appeal stage in the Tax Court. The Panel of Judges assessed that the

[15] OECD, *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022*, OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (OECD, 2022), https://doi.org/10.1787/0e655865-en.

core legal issue in this case was the existence of management services and proof of their economic benefits. The Court interpreted that the application of the arm's length principle must consider two main elements, namely the existence of services that were actually provided and benefits that could be proven economically. After examining the evidence and hearing the parties' statements, the Panel assessed that some of the services were indeed proven to have been performed and provided tangible benefits to PT Federal Karyatama's business activities. The Panel also accepted digital evidence and online communications as valid evidence due to the COVID-19 pandemic, which limited physical interaction. Based on the results of the analysis, the Court stated that the fiscal correction amounting to IDR 29,998,423,048.00 did not have sufficient legal basis and therefore the appeal was granted in its entirety.

3.2. Doctrinal Analysis

3.2.1 The Arm's Length Principle: Literature and Positive Law

The Arm's Length Principle (ALP) is a principle used by tax authorities and courts to assess the fairness of prices and terms in transactions between related parties so that they reflect the conditions that would be agreed upon by independent parties in comparable circumstances.[16] This principle aims to maintain the neutrality of the international taxation system by preventing cross-jurisdictional profit shifting and ensuring equal treatment between affiliated and independent transactions. In the context of transfer pricing disputes, the application of ALP becomes the main evaluative framework because it requires proof that the prices, functions, risks, and assets allocated between entities are in accordance with the commercial logic that applies in the free market. The core of the ALP analysis lies in two fundamental elements, namely comparability analysis and the selection of the most appropriate transfer pricing method. The OECD Transfer Pricing Guidelines systematically set out comparability criteria covering functions, assets, risks, contractual terms, economic conditions, and business strategies, all of which must be compared with independent entities with comparable characteristics.[17] The reliability of comparative data and the accuracy of method selection are crucial factors in determining whether a transaction has met the principles of fairness and business norms. Empirical literature shows that transfer pricing disputes are often triggered by weaknesses in comparative data, functional profile mismatches, or the use of inappropriate methods.[18]

Standards of proof and documentation play a central role in every transfer pricing dispute, because the application of ALP requires evidence of comparability and verifiable economic substance.[19] In judicial practice, testing is conducted on three key aspects, namely the conformity between the contract and actual economic conditions, the completeness of transfer pricing documentation explaining the functional analysis and comparability adjustments, and the existence of

---

[16] Luis D Rojo and Paul N Nina, "The Use of Paragraphs 1.119 to 1.128 of the 2017 OECD Transfer Pricing Guidelines for the Application of Transfer Pricing Rules," *Intertax* 48, no. Issue 6/7 (2020): 616–23, https://doi.org/10.54648/taxi2020056; Ruby Doeleman, "In Principle, (Im)Possible: Harmonizing an EU Arm's Length Principle," *Ec Tax Review* 32, no. Issue 3 (2023): 93–102, https://doi.org/10.54648/ecta2023015.

[17] Rojo and Nina, "The Use of Paragraphs 1.119 to 1.128 of the 2017 OECD Transfer Pricing Guidelines for the Application of Transfer Pricing Rules"; Doeleman, "In Principle, (Im)Possible: Harmonizing an EU Arm's Length Principle."

[18] R P Tambunan and Yulianti Abbas, "Evaluasi Implementasi Analisis Kesebandingan Atas Sengketa Transfer Pricing PT OCI," *Owner* 7, no. 4 (2023): 2785–95, https://doi.org/10.33395/owner.v7i4.1735; L F Neto, "Transfer Pricing and Deemed Arm's Length Approaches: A Proposal for Optional Safe Harbour Methods Based on Accurate Predetermined Margins of Profitability," *Intl. Tax Stud.* 2, no. 7 (2019), https://doi.org/10.59403/3tnbjve.

[19] Viacheslav Krugliak, "Implementation of a Three-Level Model of Documentation on Transfer Pricing on Ukraine," *Herald of Khmelnytskyi National University* 300, no. 6 Part 2 (2021): 49–53, https://doi.org/10.31891/2307-5740-2021-300-6/2-8; Nasikhudin Nasikhudin and Supriyadi Supriyadi, "Analysis of Interest Expense Deduction in Transfer Pricing Dispute in Indonesia," *Educoretax* 4, no. 9 (2024): 1137–48, https://doi.org/10.54957/educoretax.v4i9.1115.

commercially justifiable reasons that can be proven factually.[20] In line with this, reforms in various jurisdictions emphasize a multi-tier documentation model to strengthen transparency and facilitate dispute resolution. When discrepancies are found between actual transaction conditions and the arm's length principle, the tax authorities are authorized to make transactional adjustments, i.e., replacing prices or contractual terms that are not in line with arm's length conditions.[21] In certain legal systems, judicial institutions may even reconstruct contractual provisions to reflect reasonable economic conditions, provided that this is supported by adequate evidence. Academic debate highlights that the use of transactional adjustments has significant implications for the distribution of profits and risks between entities, and therefore their application must be subject to the principles of proportionality and strong economic evidence.[22]

In the context of inter-entity financing, the application of ALP to shareholder loan transactions, interest, and thin capitalization issues is one of the most complex areas in international disputes. Empirical analysis of various appeal decisions shows that courts focus on the consistency between loan agreements and actual economic behavior, the existence of collateral, commercial rationality, and the use of reliable comparables or objective credit rating proxies.[23] Tax authorities often use financial ratios such as the debt-to-equity ratio or market benchmarks when direct comparables are not available. This fact-based approach emphasizes that testing the reasonableness of interest rates or loan terms should not stop at formal aspects, but must reflect the economic substance of the transaction. In the realm of royalty and intangible asset valuation, disputes often arise due to the scarcity of comparable comparables and the difficulty of separating synergies between entities within a business group.[24] Therefore, taxpayers are required to prove the existence of economic benefits (benefit test) and support it with comparability analysis or alternative valuation methods that are economically acceptable. Meanwhile, tax authorities generally challenge weaknesses in functional analysis or the imposition of reasonable margins that are considered hypothetical.[25] Academic criticism of ALP highlights that this principle has not been fully able to capture the integrated economic reality of multinational corporations, especially regarding the distribution of added value arising from group synergies.[26]

Conceptually, a number of scholars have criticized the ability of ALP to reflect the complexity of globally integrated multinational corporations.[27] The limitations of comparables and the interdependent nature of entities often lead to imbalances in profit allocation. Therefore, experts

---

[20] Nasikhudin and Supriyadi, "Analysis of Interest Expense Deduction in Transfer Pricing Dispute in Indonesia"; Efi Nofita and Siti Nuryanah, "Benefit Test Analysis on Intra-Group Services Transactions in Indonesia," 2022, https://doi.org/10.4108/eai.27-7-2021.2316837.

[21] Sven-Eric Bärsch, "Case Law Notes: Landmark Transfer Pricing Case on Applying the Arm□s Length Principle to Shareholder Loans in Germany," *Intertax* 47, no. Issue 12 (2019): 1108–20, https://doi.org/10.54648/taxi2019113.

[22] A M Navarro, "Transactional Adjustments in Transfer Pricing," 2018, https://doi.org/10.59403/37fkn3b.

[23] Nasikhudin and Supriyadi, "Analysis of Interest Expense Deduction in Transfer Pricing Dispute in Indonesia."

[24] Stefan Greil, Christian Schwarz, and Stefan Stein, "Perceived Fairness in the Taxation of a Digital Business Model," *SSRN Electronic Journal*, 2018, https://doi.org/10.2139/ssrn.3303530; Dinartika Hukamawati and Arifah F Andriani, "Analisis Penerapan Arm's Length Principle Pada Transaksi Pembayaran Royalti Atas Pemanfaatan Merek Dagang (Trademark) Kepada Perusahaan Afiliasi," *Info Artha* 4 (2017): 1–18, https://doi.org/10.31092/jia.v4i4.34.

[25] Nofita and Nuryanah, "Benefit Test Analysis on Intra-Group Services Transactions in Indonesia"; Greil, Schwarz, and Stein, "Perceived Fairness in the Taxation of a Digital Business Model."

[26] Peng Chen, "The Application of the Arm's Length Principle to the Allocation of Joint Efficiencies Within MNEs," *Intl. Transfer Pricing J.* 23, no. 5 (2016), https://doi.org/10.59403/zbsk89; M Kane, "Transfer Pricing, Integration and Synergy Intangibles: A Consensus Approach to the Arm's Length Standard," *World Tax J.* 6, no. 3 (2014), https://doi.org/10.59403/dc1nf2.

[27] Markus Brem and Thomas A Tucha, "*Transfer Pricing: Conceptual Thoughts on the Nature of the Multinational Firm*," *Vikalpa the Journal for Decision Makers* 31, no. 2 (2006): 29–44, https://doi.org/10.1177/0256090920060202.

suggest combining rigorous ALP analysis with the application of safe harbor or predetermined margin-based approaches to reduce uncertainty.[28] In contemporary practice, the successful application of ALP in transfer pricing disputes is largely determined by the quality of comparability analysis, the coherence between contracts and actual economic behavior, the taxpayer's ability to prove risk control capacity, and the effectiveness of the documentation prepared.[29] Awareness of the limitations of ALP has encouraged the emergence of more transparent policy innovations that are based on economic substance and oriented towards global fiscal justice.

The arm's length principle (ALP) is the conceptual foundation for transfer pricing regulations in Indonesia, which is rooted in Article 18 paragraph (3) of Law Number 7 of 1983 concerning Income Tax as last amended by Law Number 6 of 2023 concerning the Stipulation of Government Regulation in Lieu of Law Number 2 of 2022 concerning Job Creation into Law (Income Tax Law). This provision gives the Director General of Taxes the authority to redetermine the amount of income or deductions in transactions between parties that have a special relationship with the aim of ensuring that the results of the transaction reflect economic fairness as would occur in a free market. This norm emphasizes that special relationships can affect price or profit formation, so they need to be corrected by comparing them to independent transactions. In this case, ALP functions as a fiscal correction tool to uphold the principle of tax fairness and prevent profit shifting across jurisdictions.

The development of transfer pricing regulations in Indonesia shows a normative evolution that parallels global dynamics under the OECD Transfer Pricing Guidelines framework. The initial stage began with the issuance of PER-32/PJ/2011, which stipulated transfer pricing methods including Comparable Uncontrolled Price (CUP), Resale Price Method (RPM), Cost Plus Method (CPM), Profit Split Method (PSM), and Transactional Net Margin Method (TNMM). This regulation introduced the concepts of comparability, reasonableness, and the application of the most appropriate method according to the characteristics of the transaction. This approach marked an effort to harmonize domestic policy with international practices, whereby tax authorities were given the basis to make adjustments if the prices in affiliated transactions were not in line with independent market conditions.

Minister of Finance Regulation No. 213/PMK.03/2016 is an important milestone in the national transfer pricing documentation system. This PMK regulates the obligation to prepare transfer pricing documentation consisting of a master file, local file, and country-by-country report (CbCR). The regulation aims to ensure that taxpayers can demonstrate the conformity of affiliated transactions with PKKU based on measurable economic evidence. These documents also serve as evidence for taxpayers in facing audits and potential corrections by the tax authorities. Through PMK 213/2016, Indonesia explicitly adopted the three-tiered documentation approach as recommended by OECD BEPS Action 13, which places transparency and traceability of cross-border transactions as key elements of accountable tax governance.

Furthermore, PMK Number 22/PMK.03/2020 regulates the implementation of Advance Pricing Agreements (APAs) as a preventive instrument to reduce transfer pricing disputes. Article 8 stipulates that the principles of fairness and business norms are used to determine fair transfer prices through transaction value, gross profit, or net operating profit indicators. Through the APA mechanism, taxpayers can agree on transfer pricing methods and assumptions in advance with the tax authorities, either unilaterally or bilaterally, thereby reducing fiscal uncertainty. This PMK

[28] Kane, "Transfer Pricing, Integration and Synergy Intangibles: A Consensus Approach to the Arm's Length Standard."

[29] Rojo and Nina, "The Use of Paragraphs 1.119 to 1.128 of the 2017 OECD Transfer Pricing Guidelines for the Application of Transfer Pricing Rules"; Bärsch, "Case Law Notes: Landmark Transfer Pricing Case on Applying the Arm□s Length Principle to Shareholder Loans in Germany."

strengthens the function of ALP not only as a retrospective correction tool but also as an ex-ante instrument in encouraging voluntary compliance.

The next conceptual reform was realized through PMK Number 172 of 2023, which replaced the previous provisions, including PMK 213/2016 and PMK 22/2020. PMK 172/2023 expands the definition of special relationships to include ownership, control, and blood or in-law relationships within one degree. This provision reflects a substantive approach to the control and influence test, which assesses the extent to which the economic independence of the parties is affected. In addition, this PMK emphasizes the obligation to apply PKKU in every transaction affected by a special relationship through systematic stages, including the identification of affiliated parties, industry analysis, comparability analysis, selection of transfer pricing methods, and determination of fair prices. This procedural approach reflects the principle of substance over form, which prioritizes economic reality over formal legal form.

From a methodological perspective, PMK 172/2023 introduces technical refinements in the application of ALP, including the requirement to prove economic benefits in service transactions, the existence and value of intangible assets, and the feasibility of intragroup loans. In the event that a transaction does not meet these requirements, PMK emphasizes that the transaction is not considered to comply with the principles of fairness and business norms. This norm strengthens the position of the tax authorities in making adjustments to expenses or income that do not have sufficient economic substance (non-deductible expense adjustment). Thus, PMK 172/2023 emphasizes that the burden of proof lies not only with the tax authorities, but also with taxpayers, who must demonstrate the economic value of each affiliate transaction.

Conceptually, the periodization of ALP regulations in Indonesia shows a transition from a normative approach to a substantive and risk-based approach. PER-32/PJ/2011 emphasizes pricing methods, PMK 213/2016 focuses on documentation and transparency, PMK 22/2020 introduces a preventive approach through APA, while PMK 172/2023 integrates all these instruments into a comprehensive framework based on economic substance. These changes indicate a paradigm shift from compliance-based regulation to substance-based tax governance, where the reasonableness of prices is measured not only by numbers, but also by economic benefits and needs. Furthermore, the consolidation of rules in PMK 172/2023 indicates adaptation to developments in international standards from the OECD and the United Nations Practical Manual on Transfer Pricing, which emphasize the connection between functional analysis and economic value contribution. In this context, the principles of fairness and business norms are the main tools for ensuring that profits are linked to economic activities that create value (value creation alignment).

The implementation of ALP, integrated with industry, function, asset, and risk analysis, strengthens fiscal justice and reduces the risk of base erosion and profit shifting. In addition to providing legal certainty for taxpayers, the application of ALP in Indonesia also strengthens tax audit accountability. PMK 172/2023 provides an evaluative framework that allows tax authorities to assess whether reported profits reflect independent market conditions. Thus, ALP serves as an objective evaluation standard that integrates legal, economic, and fiscal justice aspects. From a tax law perspective, this principle reinforces the implementation of the principles of lex certa and lex aequitas in determining taxable income. Empirically, the refinement of ALP regulations is also in line with the increasing complexity of cross-border affiliate transactions and the need to prevent treaty shopping. PMK 172/2023 explicitly stipulates that special relationships may arise not only from ownership, but also from managerial control or participation in operational decision-making. This formulation broadens the scope of supervision over de facto control, which is often used by multinational companies to transfer profits to low-tax jurisdictions.

3.2.2. Doctrinal Comparison of Domestic Norms and OECD Transfer Pricing Guidelines

The arm's length principle (ALP) is an important principle in international transfer pricing policy as regulated in the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (OECD, 2022). This principle emphasizes that transactions between parties with special relationships must be conducted as if the transactions occurred between independent parties in comparable market conditions. In the Indonesian context, this principle is embodied in the concept of the Principle of Fairness and Business Norms as stipulated in PMK 172/2023, which is doctrinally a local adoption of ALP (doctrinal differences can be seen in Table 1). However, this adoption is not entirely identical because it is influenced by the national legal context, the approach to evidence, and domestic fiscal needs. The OECD emphasizes four key elements in the application of ALP, namely the existence of service, economic benefit, cost allocation method, and mark-up reasonableness. These four elements are used as a framework to distinguish between transactions that have real economic substance and those that are merely administrative in nature.

Table 1. Doctrinal Comparison of Domestic Norms and OECD Transfer Pricing Guidelines

Aspect	OECD Transfer Pricing Guidelines	Indonesian Domestic Norms	Doctrinal Comparative Analysis
Fundamental Principle (ALP)	States that related-party transactions must reflect conditions agreed upon by independent parties under comparable market circumstances.	Interprets ALP as the *Principle of Fairness and Business Norms* (PKKU), requiring affiliated transactions to reflect arm's-length dealings among independent entities.	Substantively aligned, but ALP under Indonesian law constitutes binding *hard law*, while under OECD it functions as non-binding *soft law* guidance.
Legal Status	*Soft law* - international guidance without binding force but widely recognized by global tax authorities.	*Hard law* - formal regulation within Indonesia's positive legal system, mandatorily enforceable by taxpayers and the tax authority.	OECD provides interpretive flexibility; Indonesia emphasizes legal certainty and administrative compliance.
Evidentiary Approach	Based on the *reasonable expectation of benefit* principle - potential benefit is sufficient if economically reasonable.	Requires *actual deliverables* - taxpayers must prove that the service was genuinely rendered and yielded tangible benefits.	OECD applies a probabilistic paradigm; Indonesia adopts an empirical paradigm with a higher evidentiary threshold.
Existence of Service	Assessed through a *benefit test*—whether the recipient obtained economic benefit from the service.	Must be substantiated by eight criteria under Article 13 of PMK 172/2023, including documentation and proof of actual benefit.	Domestic norms are stricter and more formal; OECD relies more on economic substance and reasonable expectations.
Economic Benefit	Determined through *value creation* and the functional contribution of entities within the global value chain.	Determined through *Functional, Asset, and Risk (FAR) analysis* that must be verifiable through documentation.	Indonesia adopts the OECD concept but adds administrative verifiability to strengthen the tax authority's position.
Cost Allocation Method	Allows both *direct* and *indirect charge* approaches based on proportionality of economic benefits.	Requires objective justification for cost allocation through the *cost-plus* method (Article 9).	OECD permits reasonable estimation keys; Indonesia demands direct correlation between cost and benefit—more conservative.
Mark-Up Reasonableness	Determined via *comparability analysis* under the *best method rule*, without hierarchical order.	Prioritizes *CUP* and *Cost Plus* methods as primary approaches (Article 10).	OECD emphasizes flexibility and substance; Indonesia applies a hierarchical *rule-based* structure for consistency.
Intragroup Services Treatment	Potential benefit is sufficient to justify deduction if commercially reasonable.	Costs are disallowed if no material evidence proves the service was performed.	Core difference: OECD's *potential benefit* vs. Indonesia's *actual evidence* approach.
Value Creation Principle	Profits should be allocated where economic value is created.	Profits must reflect the actual functions, assets, and risks of contributing entities.	Indonesia aligns conceptually but emphasizes formal verification of economic substance.

Normative Objective	To ensure parity of treatment between related and independent parties.	To safeguard domestic tax revenue and prevent tax avoidance.	OECD prioritizes global equity; Indonesia focuses on national fiscal justice.

In the OECD Guidelines, the existence of services is assessed based on the benefit test principle, namely whether the recipient of the services obtains tangible economic benefits from the services provided. Indonesia, through Article 13 paragraph (1) of PMK 172/2023, stipulates that proof of services must include eight criteria, including that the services are actually provided, needed, and provide economic benefits to the recipient. At this point, domestic norms show a stricter tendency because they require factual proof (actual deliverables) rather than merely potential benefits as emphasized by the OECD. This epistemological difference reflects the orientation of Indonesian tax law, which is more based on hard evidence than the OECD's expectational principle, which relies on reasonable commercial assumptions. In practice, tension arises when tax authorities refuse to recognize service costs because sufficient documentary evidence cannot be found, even though economic benefits may have actually occurred. This shows that Indonesia places proof as a substantive prerequisite, not merely an administrative one, in assessing the reasonableness of service transactions between affiliated entities.

The second element, namely economic benefits, is measured in the OECD Guidelines through value creation and the functional contribution of each entity in the global business chain. The OECD emphasizes the importance of function, asset, and risk (FAR) analysis to ensure the proportional allocation of profits to actual economic activities. PMK 172/2023 also adopts this concept through Article 7 paragraph (1) letter b, but adds the requirement that functions and risks must be verifiable through documentation. This difference has significant epistemological implications, namely that the OECD emphasizes economic substance, while Indonesia emphasizes traceability and formal compliance. In the context of tax audits, this difference causes potential tension between taxpayers who base their documentation on the principle of substance over form and tax authorities who demand detailed administrative evidence.

Furthermore, in terms of cost allocation methods, the OECD Guidelines provide a high degree of flexibility by allowing the use of both direct charge and indirect charge approaches based on economic benefit proportionality. Indonesia has also adopted a similar approach through Article 9 of PMK 172/2023 with the cost-plus method, but with greater emphasis on objective justification for the allocation of costs charged to affiliated entities. The OECD allows the use of reasonable allocation keys, while Indonesia requires a direct correlation between costs and activities that generate benefits. As a result, cost sharing agreements in Indonesia are often deemed not to meet ALP if they are not accompanied by evidence of the actual contribution of each entity. This approach shows that Indonesia's domestic norms tend to be conservative, prioritizing strict fiscal oversight of potential base erosion.

Regarding the reasonableness of mark-ups, the OECD Guidelines emphasize evaluation based on comparability analysis, taking into account the functions and risks of the party being tested. PMK 172/2023, specifically Articles 9 and 10, also regulates five transfer pricing methods: Comparable Uncontrolled Price (CUP), Resale Price, Cost Plus, Profit Split, and Transactional Net Margin Method, which are identical to those of the OECD. However, the PMK gives hierarchical priority to the CUP and Cost Plus methods as the main approaches, while the OECD emphasizes the best method rule principle without a formal order of priority. This shows a difference in paradigm, with the OECD promoting flexibility based on transaction substance, while Indonesia regulates methodological preferences to maintain consistency and administrative certainty. As a result, in practice, Indonesian tax authorities often reject the application of the transactional net profit method because it is considered to not adequately reflect the actual transaction price.

A more profound doctrinal difference can also be seen in the relationship between OECD soft law and national hard law. The OECD Guidelines serve as non-binding international standards (non-binding guidance) that provide member countries with broad room for interpretation. In contrast, PMK 172/2023 is a positive law regulation that has full force in the Indonesian legal system. Consequently, in the event of an interpretative conflict, taxpayers cannot use the OECD Guidelines as a basis for legal defense, except in the context of a tax treaty. This tension creates a methodological dilemma between global harmonization and national fiscal sovereignty. Conceptually, Indonesia seeks to maintain a balance between fiscal sovereignty and international alignment, but the dominance of the hard law approach creates rigidity in the application of the principle of fairness based on a dynamic commercial context.

In terms of the standard of proof, the OECD promotes the principle of reasonable expectation of benefit, which is the potential benefit that would reasonably be expected by an independent party in comparable circumstances. Indonesia, on the other hand, requires concrete evidence in the form of documents, service reports, and actual proof of payment. This difference highlights the epistemological tension between the OECD's probabilistic paradigm and Indonesia's empirical paradigm. The OECD relies on economic inference, while Indonesia relies on legal verification. The implication is that in tax disputes, the burden of proof in Indonesia tends to be heavier for taxpayers, because expectations of benefits are not considered sufficient without material evidence.

Doctrinally, the alignment between the OECD Guidelines and PMK 172/2023 appears strong at the principle level, but diverges at the operational level. Both recognize ALP as the main foundation and encourage comprehensive comparability analysis. Indonesia's position reflects a selective convergence model, which adopts relevant global principles but adapts them to domestic fiscal needs. This approach is in line with the OECD's post-BEPS (Base Erosion and Profit Shifting) strategy, which allows room for adaptation for developing jurisdictions, but still raises challenges of interpretative harmonization in cross-border dispute resolution forums.

3.2.3. Discussion

The case of PT Federal Karyatama concretely illustrates how the epistemological tension between the OECD's soft law approach and national hard law affects the assessment of the fairness of cross-jurisdictional management services transactions. In its ruling, the Tax Court assessed that proof of management services must include the existence of services that were actually performed (existence of service) and tangible economic benefits (economic benefit), two key elements that also form the pillars of ALP according to the OECD. However, the interpretation of these two elements shows a fundamental divergence between the tax authorities, who demand material evidence in the form of actual deliverables, and taxpayers, who base their defense on the OECD's benefit test principle, which recognizes reasonable expectation of benefit as a measure of economic normality.

This difference in approach confirms that Indonesia still prioritizes an empirical paradigm that demands concrete evidence of economic benefits, unlike the OECD, which emphasizes a substantive approach based on rational commercial expectations. In this context, the taxpayer's argument that all management services were performed, as evidenced by activity reports, correspondence, and proportional cost allocation in accordance with the cost allocation key, is an attempt to satisfy the economic benefit test. However, this approach is not entirely in line with Article 13 paragraph (1) of PMK 172/2023, which requires factual proof of the existence of services and actual benefits received. This discrepancy indicates a doctrinal gap between the OECD's version of potential benefit and the domestic norm's version of actual benefit. Meanwhile, the tax authorities rejected the claim, arguing that most of the costs reflected duplicative services and shareholder activities, which according to the OECD should not be charged to the subsidiary. Although this argument appears consistent with the OECD, in practice, the Indonesian tax authorities apply it in a more formalistic manner, demanding detailed

documentary evidence rather than conducting a function- and risk-based assessment as mandated by the FAR (Functional, Asset, and Risk) analysis.

The rigidity of applying this hard law approach has resulted in a mismatch between the flexible spirit of the OECD principles and the legalistic administrative reality in Indonesia. On the other hand, the Tax Court's consideration in recognizing digital evidence and online communications as valid evidence reflects an interpretative shift towards a more substantial approach that is closer to that of the OECD. This decision demonstrates the court's courage in adopting the principle of substance over form, whereby the validity of evidence is determined more by economic substance than by the physical form of documents. Nevertheless, the panel of judges' acceptance of some of the evidence shows that Indonesia's standards of evidence remain stricter, as not all services were recognized as having provided verifiable economic benefits. This shows that operationally, Indonesia's legal position still applies the principle of selective convergence, adopting the OECD concept normatively but adjusting it to domestic fiscal administrative capacity.

In the context of cost allocation methods, differences in perception also arise between taxpayers and tax authorities. The OECD allows the use of direct charge and indirect charge methods as long as they are proportional to the economic benefits obtained. Meanwhile, Indonesia, through Article 9 of PMK 172/2023, requires a direct correlation between costs and activities that generate benefits, as well as objective justification for each charge. In the Federal Karyatama case, the tax authorities argued that the cost allocation mechanism used by EMAPPL was not accompanied by adequate independent benchmarking analysis to prove the reasonableness of the mark-up, resulting in a positive fiscal correction. However, the results of the court's examination showed that the cost allocation structure based on functional contribution and commercial rationality reflected the proportionality required by the OECD. Thus, this doctrinal tension shows that the cost-plus approach in national law tends to be more restrictive than the flexibility of the OECD's best method rule, which prioritizes the substance of the transaction.

Meanwhile, the tax authorities' reason for rejecting management service claims is also rooted in a literal interpretation of the economic benefit principle. The tax authorities argue that without measurable deliverables, the benefits of the services cannot be legally proven. However, the OECD emphasizes that economic benefits are not always physical in nature, but can take the form of increased efficiency, transfer of expertise, or improvement of internal systems. This epistemological difference has significant legal consequences for the burden of proof. Taxpayers in Indonesia bear a heavier responsibility because the principle of reasonable expectation of benefit is not recognized as a valid defense without material evidence. This condition indicates a shift in the national tax law paradigm from an expectational proof model to an empirical verification model, which requires objective evidence of actual benefits. Within the OECD framework, this approach risks creating an imbalance between legal certainty and fiscal justice, as it ignores non-tangible economic substance.

On the other hand, the Tax Court, in its considerations, placed the balance between legal formalism and economic substance as the key to the application of ALP. The court emphasized that the existence of services and their benefits must be proven objectively, but must also be assessed proportionally to the global operational context of the company. This stance reflects the application of the principle of substantive proportionality, namely the balance between empirical evidence requirements and an understanding of the economic dynamics of multinational corporations. By recognizing online communication and digital deliverables during the COVID-19 pandemic, the Court demonstrated a progressive interpretation of electronic evidence as a form of adaptation to modern business realities. This approach broadens the scope of economic benefit evidence and is in line with OECD recommendations that emphasize the importance of value creation analysis in assessing low value-adding intra-group services.

Another significant difference is apparent in the aspect of mark-up reasonableness. The OECD stipulates that mark-up evaluations must consider the functions and risks of the entity being tested through a comparability analysis. However, PMK 172/2023 establishes a hierarchy of methods that places Comparable Uncontrolled Price (CUP) and Cost Plus Method as the primary methods, in contrast to the OECD, which prioritizes the best method rule principle. In the Federal Karyatama case, the tax authorities assessed that the mark-up applied did not have adequate independent comparables, while the taxpayer assessed that the cost structure and mark-up were proportional to EMAPPL's contribution in providing global management services. The court ruled that the mark-up applied was still within reasonable limits because it reflected real coordination and administrative support functions.

From a positive law perspective, Article 18 paragraph (3) of the Income Tax Law provides a legal basis for tax authorities to make adjustments to transactions between parties that have a special relationship. However, the implementation of this article requires a proportional interpretation so as not to shift the function of ALP as a corrective tool into a fiscal penalty instrument. In this case, the DGT appears to interpret the ALP as a negative proof mechanism that focuses on the absence of evidence of services, rather than on an assessment of economic fairness. This approach has the potential to cause overcorrection that obscures the purpose of the ALP as a principle of independent transaction equality. The court, on the other hand, restored the ALP to its basic function, which is to ensure that the prices or costs set reflect reasonable economic conditions and are not manipulative. The court's approach reflects the understanding that substance over form is not merely a formal doctrine, but a reflection of the balance between legal certainty and fiscal justice in the international tax framework.

A comparative analysis of the OECD Transfer Pricing Guidelines and PMK 172/2023 shows that alignment at the principle level does not necessarily guarantee uniformity at the implementation level. The tension between economic substance and formal verification is a dominant pattern in tax audit practices in Indonesia. In the Federal Karyatama case, the court successfully navigated these differences by emphasizing that the proof of the existence of services and economic benefits must be case-specific and proportional to the taxpayer's capacity to provide evidence. This approach is consistent with the spirit of the post-BEPS OECD, which emphasizes the contextual application of ALP for developing countries with limited comparative data and audit capacity. Thus, the court's decision can be assessed as a form of adaptive harmonization that is, the contextual application of global principles without sacrificing national fiscal sovereignty.

Normatively, the results of this study show that the successful application of ALP in the context of management services depends on the synergy between the integrity of comparative documents, the economic rationality of transactions, and the ability of judicial institutions to interpret evidence proportionally. The imbalance between the burden of proof on taxpayers and tax authorities reflects the need for reform in the transfer pricing audit approach to emphasize economic substance over administrative formalities. In the context of policy strengthening, the results of this study support the need to develop technical guidelines for the verification of intra-group services that are tailored to the characteristics of low value-added services and the development of economic digitalization.

4. Conclusion

This study concludes that the application of the arm's length principle (ALP) in proving cross-jurisdictional management service costs requires a balance between legal certainty and economic substance. The analysis of the PT Federal Karyatama-ExxonMobil Asia Pacific Pte. Ltd. case shows that the paradigm difference between the tax authorities and taxpayers reflects the doctrinal tension between the OECD's soft law approach and national hard law as stipulated in PMK

172/2023. The tax authorities emphasize material evidence and administrative compliance, while taxpayers are oriented towards potential economic benefits recognized in the OECD Transfer Pricing Guidelines (OECD, 2022). The Tax Court, through its decision, shows a compromising orientation by recognizing digital evidence and substantive benefits, thereby emphasizing the importance of a proportional approach based on economic substance. Doctrinally, this study finds that Indonesia adheres to a selective convergence model, namely adopting OECD principles normatively but adjusting them to domestic fiscal needs and national evidentiary capacity. The implications of these findings indicate that the standard of proof in transfer pricing practice in Indonesia is still conservative and tends to be rule-based, thus potentially giving rise to interpretative disputes.

Theoretically, this study contributes to strengthening the arm's length principle (ALP) doctrine in the context of Indonesian tax law by showing how the tension between OECD soft law and national hard law can be reconciled through a substance-based proportionality approach. This study broadens the academic understanding of how the principle of fairness and business norms in PMK 172/2023 represents a form of selective convergence with the OECD Transfer Pricing Guidelines, while also confirming the epistemological dimension between the expectational and empirical paradigms in proving economic benefits. Conceptually, these findings enrich the literature on the relationship between proving the benefits of services and the principle of fiscal justice by placing factual proof as an integral element of the validity of intra-group transactions.

From a practical standpoint, this study provides implementable recommendations for the Directorate General of Taxes to strengthen the Advance Pricing Agreement (APA) and Mutual Agreement Procedure (MAP) mechanisms as instruments for dispute prevention, through technical guidelines for proving the benefits of services that are more adaptive to the characteristics of low value-added services. These recommendations can reduce the frequency of fiscal corrections caused by differences in interpretation between potential and actual benefits, thereby strengthening transfer pricing audit accountability. For taxpayers, the results of this study offer a documentation framework that emphasizes economic rationality, functional justification, and proportional evidence to meet globally recognized standards of fairness. For policymakers, these results provide a basis for designing evidence-informed regulation policy instruments that balance legal certainty and economic flexibility. However, this study has limitations because it focuses on a single case study, so it cannot describe variations in interpretation across sectors and jurisdictions. Further research is recommended to examine the effectiveness of bilateral APA and multilateral MAP in resolving transfer pricing disputes in the service and digital sectors, which have non-physical economic benefits. With the expansion of the research object, the next research agenda is expected to identify a more contextual model of international tax law harmonization for developing countries such as Indonesia.

5. References

Andreieva, Oleksandra. "Qualitative Secondary Data Analysis as a Means of Systematization and Unification of the Legal Doctrine," 2021. https://doi.org/10.36074/logos-30.04.2021.v1.19.

Astuti, Melani D. "Country Note: Implementation of BEPS Recommendations in Indonesia's New APA and Transfer Pricing Rules." *Intertax* 48, no. Issue 12 (2020): 1145–54. https://doi.org/10.54648/taxi2020114.

Bärsch, Sven-Eric. "Case Law Notes: Landmark Transfer Pricing Case on Applying the Arm' s Length Principle to Shareholder Loans in Germany." *Intertax* 47, no. Issue 12 (2019): 1108–20. https://doi.org/10.54648/taxi2019113.

Bilaney, S K. "Concept of Pass-Through Costs and Their Treatment." *Intl. Transfer Pricing J.* 25, no. 1 (2018). https://doi.org/10.59403/35k6h7k.

Brabenec, Tomáš. "Transfer Pricing of Intangible Assets and R&D Services in Service Level Agreement." *Český Finanční a Účetní Časopis* 2011, no. 2 (2011): 58–71. https://doi.org/10.18267/j.cfuc.105.

Brem, Markus, and Thomas A Tucha. "<i>Transfer Pricing: Conceptual Thoughts on the Nature of the Multinational Firm</I>." *Vikalpa the Journal for Decision Makers* 31, no. 2 (2006): 29–44. https://doi.org/10.1177/0256090920060202.

Brzeziński, B, Krzysztof Lasiński-Sulecki, and Wojciech Morawski. "OECD Transfer Pricing Guidelines as a Quasi Source of Law in a Post-Beps World – Legislative and Judicial Developments From a Polish Perspective." *Intl. Transfer Pricing J.* 27, no. 3 (2020). https://doi.org/10.59403/8p0kjq.

Chen, Peng. "The Application of the Arm's Length Principle to the Allocation of Joint Efficiencies Within MNEs." *Intl. Transfer Pricing J.* 23, no. 5 (2016). https://doi.org/10.59403/zbsk89.

Davies, Gareth. "The Relationship Between Empirical Legal Studies and Doctrinal Legal Research." *Erasmus Law Review* 13, no. 2 (2020): 3–12. https://doi.org/10.5553/elr.000141.

Disemadi, Hari S. "Lenses of Legal Research: A Descriptive Essay on Legal Research Methodologies." *Journal of Judicial Review* 24, no. 2 (2022): 289–304. https://doi.org/10.37253/jjr.v24i2.7280.

Doeleman, Ruby. "In Principle, (Im)Possible: Harmonizing an EU Arm's Length Principle." *Ec Tax Review* 32, no. Issue 3 (2023): 93–102. https://doi.org/10.54648/ecta2023015.

Gestel, Rob v. "Quality, Methodology, and Politics in Doctrinal Legal Scholarship." *Law and Method*, 2023. https://doi.org/10.5553/rem/.000070.

Gestel, Rob v., and Hans-W. Micklitz. "Why Methods Matter in European Legal Scholarship." *European Law Journal* 20, no. 3 (2013): 292–316. https://doi.org/10.1111/eulj.12049.

Greil, Stefan, Christian Schwarz, and Stefan Stein. "Perceived Fairness in the Taxation of a Digital Business Model." *SSRN Electronic Journal*, 2018. https://doi.org/10.2139/ssrn.3303530.

Hukamawati, Dinartika, and Arifah F Andriani. "Analisis Penerapan Arm's Length Principle Pada Transaksi Pembayaran Royalti Atas Pemanfaatan Merek Dagang (Trademark) Kepada Perusahaan Afiliasi." *Info Artha* 4 (2017): 1–18. https://doi.org/10.31092/jia.v4i4.34.

Jupp, Andrew R, K Heggs, and John Rigby. "Transfer Pricing End-of-Year Adjustments in the United Kingdom." *Intl. Transfer Pricing J.* 31, no. 7 (2024). https://doi.org/10.59403/20xjafx.

Kane, M. "Transfer Pricing, Integration and Synergy Intangibles: A Consensus Approach to the Arm's Length Standard." *World Tax J.* 6, no. 3 (2014). https://doi.org/10.59403/dc1nf2.

Kobetsky, Michael. "The Status of the OECD Transfer Pricing Guidelines in the Post-Beps Dynamic." *Intl. Tax Stud.* 3, no. 2 (2020). https://doi.org/10.59403/2rpcabz.

Krugliak, Viacheslav. "Implementation of a Three-Level Model of Documentation on Transfer Pricing on Ukraine." *Herald of Khmelnytskyi National University* 300, no. 6 Part 2 (2021): 49–53. https://doi.org/10.31891/2307-5740-2021-300-6/2-8.

Lupu, Mihai. "International Cooperation and Solving Transfer Pricing Disputes: A Discussion about Mutual Agreement Procedures." In *Proceedings of the International Conference on Business Excellence*, 17:236–45, 2023.

M.D., Pradeep. "Legal Research- Descriptive Analysis on Doctrinal Methodology." *International Journal of Management Technology and Social Sciences*, 2019, 95–103.

https://doi.org/10.47992/ijmts.2581.6012.0075.

Marzuki, Peter Mahmud. *Penelitian Hukum*. Jakarta: Kencana Prenda Media, 2017.

Matsubara, Yuri, and Clémence Garcia. "OECD Transfer Pricing Guidelines and International Tax Law," 2023, 535–54. https://doi.org/10.1093/oxfordhb/9780192897688.013.32.

Nasikhudin, Nasikhudin, and Supriyadi Supriyadi. "Analysis of Interest Expense Deduction in Transfer Pricing Dispute in Indonesia." *Educoretax* 4, no. 9 (2024): 1137–48. https://doi.org/10.54957/educoretax.v4i9.1115.

Navarro, A M. "Transactional Adjustments in Transfer Pricing," 2018. https://doi.org/10.59403/37fkn3b.

Neto, L F. "Transfer Pricing and Deemed Arm's Length Approaches: A Proposal for Optional Safe Harbour Methods Based on Accurate Predetermined Margins of Profitability." *Intl. Tax Stud.* 2, no. 7 (2019). https://doi.org/10.59403/3tnbjve.

Nofita, Efi, and Siti Nuryanah. "Benefit Test Analysis on Intra-Group Services Transactions in Indonesia," 2022. https://doi.org/10.4108/eai.27-7-2021.2316837.

OECD. *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022*. OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations. OECD, 2022. https://doi.org/10.1787/0e655865-en.

Rahmat, Doris. "Juridical Review of International and National Law Relationships." *East Asian Journal of Multidisciplinary Research* 2, no. 1 (2023): 357–68. https://doi.org/10.55927/eajmr.v2i1.2872.

Rojo, Luis D, and Paul N Nina. "The Use of Paragraphs 1.119 to 1.128 of the 2017 OECD Transfer Pricing Guidelines for the Application of Transfer Pricing Rules." *Intertax* 48, no. Issue 6/7 (2020): 616–23. https://doi.org/10.54648/taxi2020056.

Sporken, E, D Brouwers, and R d. Looze. "OECD Report on Business Restructuring: Dutch Transfer Pricing Perspective." *Intl. Transfer Pricing J.* 17, no. 6 (2010). https://doi.org/10.59403/1stpmva.

Sporken, E, and Pieter J Visser. "BEPS Guidance on Transfer Pricing Aspects of Intangibles and the Need for Substance and Transfer Pricing Documentation." *Intl. Transfer Pricing J.* 22, no. 1 (2015). https://doi.org/10.59403/43kxhh.

Sutton, Paul D. "HM Revenue &Amp; Customs Takes a Tougher Stance With New TP Guidelines." *Intl. Transfer Pricing J.* 32, no. 1 (2024). https://doi.org/10.59403/ty28zk.

Szymczak, Magdalena. "Good Practice for Transfer Pricing in Selected OECD Countries." *Prace Naukowe Uniwersytetu Ekonomicznego We Wrocławiu* 64, no. 9 (2020): 119–30. https://doi.org/10.15611/pn.2020.9.09.

Tambunan, R P, and Yulianti Abbas. "Evaluasi Implementasi Analisis Kesebandingan Atas Sengketa Transfer Pricing PT OCI." *Owner* 7, no. 4 (2023): 2785–95. https://doi.org/10.33395/owner.v7i4.1735.