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# Demarcating Administrative Disputes and Transfer Pricing Fraud: A Corporate Mens Rea Reconstruction Model

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**Abstract:** This study addresses the legal uncertainty in distinguishing bona fide administrative disputes under the Arm's Length Principle (ALP) from criminal tax fraud in transfer pricing practices in Indonesia. Utilizing a juridical-normative approach combined with comparative legal analysis, this paper evaluates four landmark judicial precedents (PT Astra International Tbk, PT Asian Agri Group, PT Adaro Indonesia, and PT Kaltim Prima Coal) against PMK 172/2023, OECD DEMPE standards, and international corporate criminal liability doctrines. The findings indicate that the boundary between administrative adjustments and criminal prosecution relies on substantiating economic substance and corporate intent (mens rea), rather than nominal tax correction thresholds. This paper contributes three conceptual frameworks: (1) the Four-Layer Transfer Pricing Fraud Test, (2) the Corporate Mens Rea Reconstruction Model, and (3) the Forensic Early Warning Framework. Grounded in utilitarian theory and the ultimum remedium principle, the study advocates for prioritizing restorative administrative sanctions to maximize state revenue recovery while safeguarding the national investment climate.

**Keyword:** Transfer Pricing Fraud, Corporate Mens Rea, PMK 172/2023, Ultimum Remedium, DEMPE Analysis, Comparative Tax Law.

## INTRODUCTION

### Background & Context

In the In the contemporary globalized economy, corporate structures have undergone structural metamorphosis, establishing multinational networks that optimize cross-border supply chains and capital allocation. While these networks enhance operational efficiency, they frequently capitalize on regulatory asymmetries across sovereign tax regimes. Significant differentials in corporate statutory tax rates between source nations—such as

Indonesia and foreign financial hubs create financial incentives for multinational enterprises (MNEs) to execute aggressive tax planning strategies.

Within this environment, transfer pricing serves as an essential administrative tool designed to measure intercompany performance across decentralized corporate entities. In principle, transfer pricing is a neutral accounting mechanism. However, this neutrality is compromised when corporate financial targets align with loopholes in bilateral tax treaties, converting legitimate intercompany cost allocations into deliberate transfer pricing mispricing schemes.

**BEPS, DEMPE Standards, and Fiscal Sovereignty**

Global profit-shifting strategies, codified under the OECD/G20 Base Erosion and Profit Shifting (BEPS) Project, present structural challenges to the fiscal sovereignty of developing nations. The scope of BEPS has expanded from simple physical trade misinvoicing to complex schemes involving hard-to-value intangibles (HTVI), cross-border management fees, and artificial intra-group financing. To mitigate these practices, standards under BEPS Action Plans 8–10 dictate that transfer pricing outcomes must correspond with actual value creation, requiring a functional DEMPE (Development, Enhancement, Maintenance, Protection, and Exploitation) evaluation for intangible assets.

In Indonesia, the Directorate General of Taxes (DGT) integrated these standards through Minister of Finance Regulation Number 172 of 2023 (PMK 172/2023). PMK 172/2023 establishes a formal framework requiring three-tiered transfer pricing documentation: Local File, Master File, and Country-by-Country Reporting (CbCR) pursuant to BEPS Action 13. Nevertheless, procedural compliance alone cannot prevent corporate tax fraud when entities construct artificial economic substance, backdate contractual agreements, or utilize offshore shell entities.

**Problem Statement**

A fundamental challenge in Indonesian tax enforcement is the legal ambiguity in distinguishing between two distinct legal domains:

a) Bona Fide Administrative Disputes: Genuine legal and technical disagreements between taxpayers and tax authorities concerning transfer pricing methodology selection (e.g., CUP, TNMM, or Profit Split), accounting interpretations, or benchmark comparability adjustments. These matters fall within the administrative jurisdiction of the Tax Court.

b) Criminal Tax Offenses (Transfer Pricing Fraud): Intentional, unlawful acts executed with criminal intent (mens rea)—such as maintaining double ledgers, falsifying transactions, or deploying dummy companies—to defraud the state treasury under Article 39 of the General Tax Provisions and Procedures Law (UU KUP).

The absence of objective demarcation criteria creates two distinct risks: over-criminalization, which penalizes legitimate commercial risks and damages the national investment climate, and under-enforcement, which permits large-scale corporate tax fraud to avoid criminal liability, resulting in state revenue losses.

**Research Objectives and Novel Contributions**

**Explicit Novelty Statement:**

This study introduces an integrated legal-forensic diagnostic methodology that bridges statutory administrative requirements under PMK 172/2023 with corporate criminal liability standards under PERMA No. 13 of 2016. Unlike previous tax literature that treats administrative transfer pricing adjustments and criminal tax enforcement in isolation, this paper provides a unified model that objectively demarcates technical methodology disputes from deliberate criminal fraud using empirical evidence from landmark Indonesian tax court precedents and comparative legal doctrines.

**Research Objectives:**

a) To establish objective legal criteria for demarcating administrative transfer pricing disputes from criminal tax fraud using a four-layer diagnostic framework.
b) To construct a corporate mens rea reconstruction model tailored to PERMA No. 13 of 2016 and international corporate liability doctrines (UK Bribery Act/Criminal Finances Act and US corporate culture frameworks).
c) To evaluate PMK 172/2023 against global OECD DEMPE standards and propose an early warning framework aligned with the ultimum remedium principle.

## Literature Review And Theoretical Framework

### Theoretical Framework Synthesis

Rather than operating independently, the theoretical frameworks governing fiscal law and corporate liability form an integrated, hierarchical continuum:

**[ Utilitarian Theory (Bentham, 2021) ]**
↓
**[ Ultimum Remedium Principle (Hiariej, 2024) ]**
↓
**[ Tax Compliance & Social Engineering (Braithwaite, 2020) ]**
↓
**[ Comparative Corporate Criminal Liability (Bhattacharjee, 2023; PMK 172) ]**

a) Utilitarian Theory & The Ultimum Remedium Principle: Grounded in Bentham's (2021) utilitarian model, law enforcement in fiscal matters must maximize social utility by prioritizing state revenue recovery while preventing unnecessary disruption to corporate productivity. Incarcerating corporate managers without recovering tax deficits reduces overall economic welfare. Therefore, the ultimum remedium principle (Hiariej, 2024) positions criminal prosecution as a measure of last resort, utilizing restorative administrative fines under Law No. 7 of 2021 on the Harmonization of Tax Regulations (UU HPP) as the primary instrument for state loss recovery.
b) Tax Compliance Theory & Social Engineering: Tax compliance operates on a dual spectrum combining economic deterrence (Allingham & Sandmo, 1972) and social-psychological procedural justice (Braithwaite, 2020). Under Mochtar Kusumaatmadja's (2021) Development Law Theory (law as a tool of social engineering), regulatory instruments like PMK 172/2023 function to guide corporate taxpayer behavior toward structural transparency and verified economic substance.
c) Comparative Corporate Criminal Liability (CCL) Doctrines (2023–2026 Synthesis): Establishing corporate mens rea in transfer pricing requires moving beyond traditional common law Identification Doctrines, which struggle to attribute intent within complex MNE organizational structures (Bhattacharjee, 2023). Modern international scholarship synthesizes the US Respondeat Superior & Corporate Culture doctrines with the UK Failure to Prevent model (Section 7 UK Bribery Act 2010; Criminal Finances Act 2017). Indonesia's PERMA No. 13 of 2016 mirrors this synthesis by allowing courts to infer corporate criminal intent when an entity accepts illicit gains, tolerates systemic non-compliance, or fails to implement internal tax compliance mechanisms.

## METHOD

### Research Design

This study utilizes a juridical-normative (doctrinal) methodology enriched with qualitative comparative legal analysis. Normative legal research is conducted to examine statutory ambiguities within Law No. 6/1983 (UU KUP as amended by UU HPP) and PMK 172/2023, while comparative legal analysis benchmarks Indonesian corporate tax enforcement against international standards.

### Purposive Case Selection & Triangulation Criteria

Landmark court cases were selected using a purposive sampling strategy based on three criteria: (1) Jurisdictional Finality (inkracht van gewijsde), (2) Typological Divergence (contrasting pure administrative methodology disputes against deliberate criminal tax fraud), and (3) Substantive Scale (involving cross-border transactions, intangibles, or natural resource pricing).

**Table 1. Landmark Case Selection and Methodological Function**

| Case Name | Legal Reference | Primary Dispute Issue | Methodological Purpose |
|---|---|---|---|
| PT Astra International Tbk | Supreme Court Decisions No. 108/B/PK/PJK/2015 to 112/B/PK/PJK/2015 | Disallowance of management fees and royalty allocations. | Validates Layer 1 & 2 (Bona fide administrative methodology dispute). |
| PT Asian Agri Group (AAG) | Supreme Court Decision No. 2239 K/PID.SUS/2012 | Systematic transfer pricing manipulation via tax haven shell companies and double ledgers. | Validates Layer 3 & 4 (Deliberate criminal tax fraud and Corporate Mens Rea). |
| PT Adaro Indonesia | Tax Court Rulings on Coal Export Pricing / Singapore Marketing Hub | Under-invoicing export prices through offshore marketing intermediaries. | Tests economic substance & DEMPE functional boundaries in resource sectors. |
| PT Kaltim Prima Coal (KPC) | Tax Court & Supreme Court Judicial Reviews | Foreign affiliate intermediaries utilized for commission profit shifting. | Demonstrates transition from administrative risk to potential forensic audit. |

### Legal Material Analysis, Interpretation, and Triangulation Methods

Data analysis followed a systematic qualitative legal interpretation process:

a) Grammatical & Systematic Interpretation: Analyzing PMK 172/2023 alongside Article 39 KUP to define the statutory elements of tax fraud versus technical adjustments.
b) Comparative Synthesis: Benchmarking PERMA 13/2016 against UK/US corporate criminal liability standards.
c) Data Triangulation: Methodological triangulation was achieved by cross-analyzing three independent streams of legal evidence: Primary Statutory Data (tax laws, MoF regulations, Supreme Court rulings), Secondary Empirical Evidence (trial records, expert testimony transcripts, court ratio decidendi), and Tertiary International Benchmarks (OECD Transfer Pricing Guidelines 2022 and BEPS Action Plans).

### Criteria for Model Validation

The proposed models were validated using three criteria:

a) Internal Doctrinal Consistency: Ensuring alignment with Indonesian statutory tax law and criminal procedure.
b) Empirical Fit: Testing whether the Four-Layer Test accurately classifies historic court cases without miscategorizing administrative disputes as criminal acts.
c) Comparative Harmonization: Confirming compatibility with OECD DEMPE standards and international corporate criminal liability frameworks.

## RESULT AND DISCUSSION

### Empirical Validation: The Four-Layer Transfer Pricing Fraud Test

**Table 2. Diagnostic Application of the Four-Layer Test Across Landmark Precedents**

| Diagnostic Layer | Legal & Operational Parameter | Administrative Dispute Benchmark (PT Astra) | Criminal Tax Fraud Benchmark (PT Asian Agri) |
|---|---|---|---|
| Layer 1: Procedural & Formal Compliance | Compliance with PMK 172/2023 documentation timelines and three-tiered structure (Local File, Master File, CbCR). | PASSED: Contemporaneous TP documentation maintained; procedural filing deadlines met. | FAILED: Documentation missing, intentionally misleading, or fabricated post-hoc. |
| Layer 2: Economic Substance & DEMPE Analysis | Verification of actual commercial purpose, physical presence, and functional DEMPE contributions. | PASSED: Technical support and royalty fees corresponded to real business operations and measurable economic value. | FAILED: Foreign affiliated entities in tax havens lacked offices, staff, and commercial purpose (paper entities). |
| Layer 3: Systematic Pattern Analysis | Longitudinal analysis detecting repetitive, structural price distortions across multiple tax years. | NEGATIVE: Non-compliance resulted from technical accounting disputes regarding arm's length range calculations. | POSITIVE: Multi-year systematic under-invoicing of CPO sales combined with artificially inflated expenses. |
| Layer 4: Corporate Mens Rea (Criminal Intent) | Direct material evidence proving conscious intention to defraud tax authorities (dolus malus). | ABSENT: No double ledgers, unrecorded accounts, or direct employee instructions to falsify data. | PROVEN: Uncovered 'black ledgers', executive email directives, and intentional creation of fictitious transactions. |

Judicial Demarcation Boundary: Legal non-compliance limited to Layers 1 and 2 constitutes an administrative dispute subject to adjustments under Tax Court jurisdiction. When an investigation establishes positive findings at Layer 3 combined with direct material evidence at Layer 4, the case meets the legal threshold for criminal tax fraud under Article 39 KUP.

### Visual Framework: Conceptual Models Integration

```
[ Layer 1: Formal Compliance ] ──► (PMK 172/2023 TP-Doc / CbCR Filings)
            │
            ▼
    [ Layer 2: Economic Substance ] ──► (DEMPE / Commercial Purpose Verification)
            │
            ├──────────────────────────────┐
            ▼                              ▼
  [ Administrative Dispute ]   [ Layer 3: Systematic Pattern Analysis ]
  (Tax Court Jurisdiction)                 │
                                           ▼
                               [ Layer 4: Corporate Mens Rea ]
                                           │
                                           ▼
                             [ Criminal Tax Fraud ]
                             (Article 39 KUP Law)
```

**Figure 1: The Four-Layer Transfer Pricing Fraud Test**

```
              ▲
             / \
            /   \
           /  1  \     1. DIRECTING MIND DIMENSION
          /───────\       (Executive Memos, Board Authorizations)
         /    2    \   2. ORGANIZATIONAL CULTURE DIMENSION
        /───────────\     (Absence of Tax Compliance Controls)
       /      3      \3. MATERIAL INSTRUMENTALITY DIMENSION
      /───────────────\   (Black Ledgers, Fictitious Invoices)
```

**Figure 2: Corporate Mens Rea Reconstruction Model (Perma 13/2016)**

## Critical Discussion

### 1. Comparative Analysis: PMK 172/2023 vs. International Consensus

PMK 172/2023 aligns Indonesian tax administration with international tax standards. By incorporating OECD DEMPE criteria, the regulation mandates that economic substance takes precedence over contractual arrangements. In resource-extraction disputes (e.g., PT Adaro and PT KPC), this framework prevents MNEs from routing commodity profits through foreign marketing intermediaries that lack operational substance.

### 2. Implementation Challenges in the Indonesian Tax System

While theoretically robust, applying these proposed frameworks within Indonesia's tax enforcement ecosystem presents several practical challenges:

a) Institutional Capacity Asymmetries: Conducting functional DEMPE assessments and digital forensic audits require highly specialized expertise. Tax authorities frequently face information asymmetries when requesting functional data from parent entities located in foreign jurisdictions.

b) Judicial Consistency & Specialist Training: Indonesian general criminal courts, which handle corporate tax fraud cases under PERMA 13/2016, often lack specialized training in complex international transfer pricing formulations, leading to potential inconsistencies in interpreting economic substance versus criminal intent.

c) Burden of Proof & Procedural Safeguards: Reconstructing corporate mens rea requires high evidentiary standards. Over-reliance on circumstantial organizational culture evidence without direct material artifacts (dolus malus) risks infringing on taxpayer rights and violating criminal legal standards.

### 3. Counterarguments and Scholarly Rebuttal

**Counterargument:**

Critics argue that introducing a multi-layered diagnostic test creates procedural delay, potentially allowing tax evaders to delay criminal prosecution by framing intentional tax fraud as technical methodology disputes.

**Rebuttal:**

This risk is mitigated by integrating the Four-Layer Test into the DGT's Core Tax System digital audit workflows. Layer 1 and Layer 2 evaluations are performed automatically during initial compliance screening. If Layer 3 flags a multi-year systematic pattern, digital forensic units can immediately examine high-risk taxpayers for Layer 4 indicators. Rather than delaying enforcement, this approach protects administrative resources by reserving criminal prosecution for clear instances of tax fraud while securing prompt financial recoveries through administrative channels.

## CONCLUSIONS AND RECOMMENDATIONS

### Conclusion

This study provides a legal framework to distinguish between administrative transfer pricing adjustments and criminal tax fraud in Indonesia:

a) Objective Demarcation: The Four-Layer Transfer Pricing Fraud Test demonstrates that the boundary between administrative disputes and criminal prosecution depends on establishing economic falsification (Layer 3) and direct corporate intent (Layer 4), rather than nominal tax correction amounts.

b) Reconstruction of Corporate Mens Rea: Under PERMA No. 13 of 2016, corporate intent must be established using a three-dimensional model combining executive directive evidence, corporate culture analysis, and material evidence of deception.

c) Policy Alignment: PMK 172/2023 provides a regulatory basis for early warning mechanisms, reinforcing that criminal prosecution should remain an ultimum remedium to prioritize state loss recovery and maintain investment stability.

**Study Limitations**

a) Doctrinal & Sample Boundaries: This research relies primarily on normative doctrinal analysis and a purposive sample of four landmark Indonesian tax precedents. Consequently, the findings may not capture every operational variation across small and medium enterprise (SME) intercompany transactions or emerging digital platform models.

b) Judicial Focus: The empirical observations are derived from published court rulings, which may not fully reflect unresolved pre-trial administrative settlements or ongoing tax audits.

**Future Research Directions**

To extend this theoretical framework, future scholarship should:

a) Empirical Forensic Validation: Conduct empirical quantitative studies examining larger datasets of tax audit adjustments post-PMK 172/2023 implementation to measure the predictive accuracy of the Four-Layer Test.

b) Judicial & Practitioner Surveys: Engage in qualitative field research—including interviews with Tax Court judges, DGT forensic investigators, and corporate tax directors to evaluate the practical feasibility of PERMA No. 13/2016 in complex corporate fraud trials.

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