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Arm's Length Transactions and Corporate Evidence in Tax Transfer Pricing Disputes

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ABSTRACT

This article outlines the establishment of arm's length standards for related party transactions and corporate standards of proof in transfer pricing audits and disputes. The arm's length principle requires that related party transactions be assessed as if they were conducted between independent parties. The HPP Law and KUP Law provide the basis for the tax authorities' authority to examine and adjust reports when prices or profits deviate from the standard of fairness, while PMK 213/PMK.03/2016 stipulates documentation requirements through Master Files, Local Files, and Country-by-Country Reports as the main instruments of evidence. The standard of reasonableness is established through comparability tests, the selection of transfer pricing methods, and the assessment of economic substance based on function, assets, and risk. The standard of proof requires traceability between contracts, transaction realization, accounting, and reporting, including evidence of service benefits, royalty bases, and the rationality of intra-group financing. During audits, the quality of documentation determines the scope for correction, while in objections and appeals, the standard of proof is re-examined according to the rules of procedure of the Tax Court. For cross-border transactions, the P3B provides a Mutual Agreement Procedure that requires consistency of evidence with the OECD Transfer Pricing Guidelines to avoid double taxation. This article concludes that the burden of proof is dynamic: the authorities present the basis for correction, then the company is required to substantiate its claim of fairness with verifiable data. Failure to meet the standard of proof results in administrative consequences under the KUP Law and may develop into a criminal tax risk if there is intent to submit false data.

INTRODUCTION

The relationship between cross-entity business activities and tax obligations places transfer pricing in affiliated transactions at the center of business law. Companies operating through multiple entities, whether within a single jurisdiction or across jurisdictions, have scope for tax planning through transaction design, intra-group financing, management services, intangible asset licensing, and margin setting policies. Transfer pricing is essentially the practice of setting prices for transactions between related parties, and in the business realm it can have economic rationality, such as supply chain consolidation, division of functions and risks, or centralized cash management. However, in the tax realm, this space intersects with compliance with the principles of fairness and business norms and the prohibition of profit shifting aimed at reducing tax liabilities. When transfer pricing is directed towards tax avoidance, the issue becomes one of normative compliance, law enforcement, and corporate governance legitimacy. Therefore, normative legal analysis is needed to map out the legal consequences for companies, ranging from fiscal corrections, administrative sanctions, potential criminal tax offences, to civil and corporate governance risks, without simplifying transfer pricing as an action that is always prohibited. This discussion on tax compliance and sanctions is in line with previous research examining taxpayer responses to sanction policies (Darmawan, 2021) and the influence of tax awareness and sanctions on compliance (Anjanarko, 2022).

The tax regulatory architecture requires companies to prove that affiliated transactions reflect

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arm's length conditions. In practice, this proof requires consistent documentation and business narratives, so that transfer pricing issues are not merely a matter of numbers. Companies must explain functions, assets, and risks; select relevant comparison methods; compile comparative analyses; and demonstrate the economic rationale behind transaction schemes. At this point, a grey area emerges between legitimate tax planning and tax avoidance efforts that deviate from the purpose of the norm. These differences are often tested by tax authorities through audits, objections, appeals, or reviews, and therefore the procedural aspects of tax law become crucial.

Furthermore, companies face strict reporting and accounting obligations, which, if not met, can trigger significant corrections. Fulfilling these obligations is not only legal, but also part of broader corporate accountability, encompassing ethics, responsibility, and legal obligations in conducting business (Darmawan, 2022). In business law, transfer pricing presents an intersection between freedom of contract, corporate governance, tax compliance, and the protection of the interests of shareholders and other stakeholders. Research on legal consequences must therefore assess material norms, formal norms, and enforcement practices in order to more accurately describe the position of companies when choosing transaction structures. The dynamics of reporting and compliance show that technological readiness and subjective norms influence the reporting behavior of taxpayers (Mardikaningsih et al., 2022).

The development of the digital economy and the dominance of intangible assets complicate the determination of arm's length value because economic value is increasingly attached to brands, algorithms, data, distribution networks, and intellectual property rights that are difficult to measure using comparable market benchmarks (Devereux & Vella, 2014). In multinational business groups, entities that are legally located in different jurisdictions can place ownership of intangible assets in certain entities, then impose royalties or service fees on operational entities, so that profits are transferred through cost structures whose fairness is difficult to verify (Grubert, 2012). Intra-group financing schemes through loans can also be used to shift profits through interest payments, with the additional issues of unreasonable debt ratios and internal creditworthiness that are difficult to prove independently (Blouin et al., 2014). When the tax authorities assess that the prices or rewards in affiliated transactions do not reflect the principles of fairness and business norms, fiscal corrections can be made so that taxable profits are increased. For companies, these corrections have direct implications in terms of additional tax burdens, administrative penalties, interest, and the potential for protracted disputes that absorb managerial and financial resources (Clausing, 2016).

From a legal certainty perspective, companies need a clear normative map regarding the parameters used by tax authorities, the standards of proof considered reasonable, and the legal consequences if the transaction structure is deemed to be tax avoidance through transfer pricing. Therefore, discussions on legal consequences need to assess the relationship between the principle of fairness, documentation requirements, and dispute resolution mechanisms available in modern international taxation systems (Zucman, 2015). Analysis of cost structures and financial behavior can be enriched by perspectives from cost behavior analysis studies (Sinambela & Djaelani, 2022).

In the realm of enforcement, transfer pricing often gives rise to information asymmetry. Companies hold internal transaction data, while tax authorities assess reasonableness based on limited comparative data or specific commercial databases. This imbalance can trigger differences in interpretation of functions and risks, method selection, and comparator selection. Transfer pricing disputes ultimately revolve around normative arguments and evidence, making documentation play a very dominant role.

On the other hand, companies face an increased compliance burden through layered documentation requirements, affiliate transaction reporting, and preparation for additional data requests. With the increasing cooperation in information exchange between cross-border tax authorities, the space to hide profit shifting schemes is narrowing, while the reputational risk for companies is increasing as public attention on corporate tax practices grows. For business law, this issue requires an examination of legal consequences that go beyond taxation alone, including internal compliance, risk control, and the directors' obligation to ensure that the company complies with laws and regulations. Therefore, the discussion of legal consequences needs to link tax norms with corporate governance principles.

At the dogmatic level, tax avoidance raises questions about the limits of permissible tax planning (Wibowo, 2024). Companies, on the one hand, have the freedom to design transactions and business structures, but on the other hand, must comply with mandatory tax norms. Tax law recognizes the principle of substance over form to a certain extent, which gives authorities the leeway to assess the economic essence of a transaction when its legal form is used to conceal deviant objectives. Transfer pricing is an instrument that is often tested in this framework because affiliated transactions have the potential to deviate from market prices due to the control of affiliated parties. In addition to fiscal corrections, legal consequences can extend to administrative sanctions, cancellation of facilities, freezing of refunds, and even preliminary investigations if there are indications of tax crimes. At the same time, companies may face the risk of double taxation if corrections occur without a corresponding adjustment mechanism in other jurisdictions. Normative legal research can map these consequences through systematic interpretation of regulations, interrelationships between norms, and institutional implications in enforcement.

The need for such studies is even greater because transfer pricing regulations in Indonesia are developing through general taxation provisions, implementing regulations, and the adoption of adapted international principles. Companies must understand that compliance cannot be approached as a tax matter alone, because transaction design touches on inter-company agreements, internal pricing policies, accounting, and even director liability. In practice, transfer pricing disputes are often technical in nature, but the legal consequences are real: large corrections can affect financial statements, the ability to pay dividends, debt ratios, and project continuity. In addition, stakeholders such as investors and creditors are increasingly paying attention to material tax risks that can affect valuation. Therefore, a study that focuses on the "legal consequences for companies" is important to map the chain of consequences of alleged tax avoidance based on transfer pricing, including how the standard of proof works, how enforcement procedures work, and how companies can assess their legal position when facing audits and disputes.

Transfer pricing as a common business practice can become a legal issue when tax authorities assess that there has been a shift in profits with the aim of reducing tax liabilities. The core issue lies in determining the line between commercially justifiable pricing arrangements and pricing arrangements that are considered to deviate from the principle of arm's length. This line is often unclear because affiliated transactions have unique characteristics, especially in intra-group services, financing, and the use of intangible assets. During an audit, companies are required to prove the economic rationality of the transaction and show that the compensation is in line with what would be agreed upon by independent parties. If the evidence is deemed insufficient, fiscal corrections may be made using a method chosen by the authorities, which may differ from the company's method. Differences in methods, differences in comparables, and differences in the determination of functions and risks create uncertainty for companies, as the results of the correction will determine the amount of tax payable and penalties. This raises normative issues regarding the standard of proof, the burden of proof, and the degree of discretion of the authorities in determining fairness.

The next issue relates to the layered and interrelated legal consequences. Transfer pricing corrections can trigger administrative penalties in the form of interest and fines, as well as open up a path to tiered disputes that require high compliance costs. Under certain conditions, corrections may be accompanied by an assessment that a violation has occurred, thereby entering the realm of criminal taxation, especially if there is an element of intent or the use of misleading documents. Companies may face reputational risks when tax disputes become public, potentially affecting relationships with business partners and investors. In addition, corrections in one country may result in double taxation if reverse adjustments are not available or unsuccessful, creating an economic burden that is not in line with the principle of business certainty. Another issue arises for group companies that have many cross-border transactions, as coordinating documentation and maintaining consistency in business narratives becomes difficult. Thus, the legal problem is not simply "whether the price is reasonable", but "how the legal consequences are constructed and borne" when the authorities declare the practice to be tax avoidance.

An additional problem lies in the relationship between tax compliance and corporate governance. Transfer pricing policies are usually set at the top management or group tax unit level and then applied to various entities. The question is, when these policies result in large corrections or penalties, how is the internal accountability of directors and commissioners understood in accordance with the principles of business prudence and compliance with laws and regulations? Material tax risks can affect financial statements and disclosures to investors, making the quality of internal control over intra-group pricing policies a real business law issue. In addition, companies may face problems when documentation is created after the fact, or when intercompany agreements do not reflect actual practices, as such discrepancies are often points of attack in audits. Therefore, the research problem narrows down to the need for normative mapping of the relevant legal consequences for companies, both at the audit stage, dispute resolution, and within the corporate sphere, without assuming that every transfer pricing is a violation.

Companies are increasingly relying on group structures and intra-group transactions to conduct operations, including centralized procurement, shared services, internal financing, and brand utilization. The greater the proportion of affiliated transactions, the greater the need for certainty regarding the parameters of fairness and the standards of proof accepted by the tax authorities. At the same time, tax enforcement is evolving towards a more data-driven, information-sharing and risk-based approach, meaning that companies with certain transaction patterns may be subject to more frequent audits. As a result, understanding the legal consequences is a prerequisite for rational business decision-making, especially when companies weigh the benefits of internal efficiency against the risk of corrections and penalties. Normative legal studies provide a framework for assessing how material and procedural norms work, how the discretion of authorities is limited, and how companies can assess their legal position when formulating intra-group pricing policies. Thus, this research is relevant to compliance and risk control needs in business law.

From a governance perspective, stakeholders demand that companies be transparent about material tax risks and consistent in their compliance. Prolonged transfer pricing disputes drain resources, distract management, and affect investor perceptions of leadership quality and internal control. Furthermore, the shift in economic value towards intangible assets and knowledge-based services makes market comparables increasingly difficult to find, thereby widening the scope for differences in interpretation. These conditions reinforce the need for studies that systematically map out the legal consequences, including how these consequences may arise from documentation failures, inconsistencies in agreements, or weaknesses in the reasonableness argument. This research can help clarify the relationship between corporate policy and the taxation system, as well as provide an analytical basis for assessing options for action when companies face corrections or disputes.

This study aims to compile a normative legal analysis of the legal consequences for companies that engage in transfer pricing for the purpose of tax avoidance, as well as to formulate a mapping of the consequences in the areas of administration, disputes, and potential criminal tax offences based on the relationship between applicable norms. Theoretically, this study clarifies the limits of interpretation regarding the fairness of affiliate transactions and their relationship with the principles of legal certainty and transaction substance. Practically, this study provides a framework for companies and business legal advisors to assess their legal position, prepare evidence, and manage compliance risks through internal governance that is in line with taxation provisions.

RESEARCH METHOD

This study uses a normative legal method with an emphasis on qualitative literature review of legal norms governing income taxation, audit authority, determination of special relationships, principles of fairness and business norms, documentation of affiliate transactions, and administrative and criminal tax sanctions relevant to transfer pricing. Primary legal materials are positioned as the main reference for drawing legal consequences, including taxation laws, general taxation provisions, government regulations, ministerial regulations, director general regulations, and technical guidelines that are still valid and directly related to the assessment of affiliate transactions. Secondary legal materials are used as supporting materials to enrich the construction of arguments, such as tax law doctrines, business law studies on corporate governance, and academic studies on evidence in tax disputes. Non-legal materials are used sparingly as explanatory data, such as tax accounting terminology and documentation practices, as long as they do not replace normative analysis.

The analysis is conducted through thematic synthesis by grouping norms based on their regulatory function, namely definitional and scope norms (e.g. affiliate relationships and transactions being tested), material norms (parameters of business reasonableness and normality, fiscal corrections, and valuation principles), procedural norms (examination, data requests, objections, appeals, reviews, and available resolution mechanisms), and sanction norms (administrative and criminal). Each group is read systematically to assess the coherence between levels of regulation, including potential conflicts between norms, regulatory gaps, and the discretion given to tax authorities. The reasoning techniques used include grammatical interpretation to understand the formulation of norms, systematic interpretation to place a provision within the tax law framework, and teleological interpretation to examine the purpose of a norm when applied to a business transaction structure. The synthesis results are then linked to two problem formulations, resulting in research outputs in the form of a map of legal consequences and a map of standards of proof that can be tested normatively.

The literature search strategy, material selection criteria, and coding were carried out with the principle of prudence so that the sources used had authority, traceability, and direct relevance. At the screening stage, materials that were no longer valid, had no connection with affiliate transactions, or did not contribute to the mapping of legal consequences were excluded from the analysis corpus. Coding was carried out by labelling provisions containing elements of conduct, assessment parameters, authority, procedures, burden of proof, and types of sanctions, then linking these labels into a matrix that facilitated the drawing of conclusions. Quality assurance was carried out through cross-checking between normative documents to avoid incorrect references to articles, as well as checking the consistency of definitions used throughout the manuscript.

RESULT AND DISCUSSION

Construction of Legal Consequences for Transfer Pricing Assessed as Tax Avoidance

Transfer pricing as a practice that could potentially be classified as tax avoidance needs to be placed within a comprehensive and interconnected legal landscape. The legal consequences for companies when transfer pricing is deemed tax avoidance must be understood as a series of interrelated norms between substantive tax law, formal tax law, corporate law, and international tax cooperation mechanisms. Transfer pricing itself is the setting of prices for transactions between entities that have a special relationship, and in business terms can arise from group policy, division of functions, or supply arrangements. Legal issues arise when such pricing results in an unreasonable transfer of profits, thereby reducing the tax base. Developing countries have been claimed to have suffered significant tax revenue losses due to the abuse of transfer pricing by multinational companies (Mpofu & Wealth, 2022).

At the legislative level, Law No. 7 of 2021 concerning Harmonization of Tax Regulations (HPP Law) serves to amend and strengthen provisions in the taxation system, particularly the Law on General Provisions and Tax Procedures (KUP Law) and the Income Tax Law (PPh Law). Through these changes, the state has emphasized its orientation towards evidence-based compliance, transparency in reporting, and stronger sanctions. As a result, the legal consequences that may arise for companies do not stop at tax adjustments, but extend to the burden of proof, restrictions on certain fiscal rights, potential criminal taxation, and expanded governance risks for corporate bodies. Within this framework, normative legal analysis must assess the elements of the act, standards of reasonableness, the authority of the authorities, the determination procedure, and the channels for objection up to the court. Transfer pricing does not stand as a purely technical issue, but rather as a broad legal compliance issue. This multidimensional compliance is also the focus of tax compliance studies, in which taxpayer compliance is influenced by awareness, sanctions, and service quality (Masithoh & Mardikaningsih, 2022).

To understand the starting point for imposing legal consequences, attention needs to be directed at the aspect of special relationships in tax law. In the material tax system, the entry point for transfer pricing assessment lies in the definition and criteria of "special relationships" and their normative consequences. The Income Tax Law stipulates that when a special relationship exists, transactions between affiliated parties can be tested for fairness due to the potential for prices not to follow market mechanisms. The determination of a special relationship is usually read through ownership, control, or family relationships, accompanied by the ability to control financial and operational policies. This construction is important because it changes the position of a transaction from a normal transaction to one that requires special justification. At this point, the revised HPP Law signals a strengthening of compliance governance through more disciplined reporting and tax calculation obligations, as affiliated transactions require consistent documentation between agreements, bookkeeping, and tax reporting.

The first legal consequence is an increase in the standard of care companies must exercise in drafting intra-group contracts, setting service markups, determining royalties, setting loan interest rates, and establishing the basis for cost allocation. If a company fails to identify a special relationship from the outset, the next risk is a larger fiscal correction because the authorities may deem the transaction unreasonable and then reassess the taxable profit. Thus, special relationships serve as a legal trigger for the application of the principles of fairness and business norms, which then lead to corrections, sanctions, and disputes. This section emphasizes that the identification of special relationships is not a formality, but rather the initial foundation of the entire legal assessment process.

Once a special relationship has been identified, attention shifts to the authority's power to assess and adjust transactions. The basis for the authority to adjust affiliated transactions is essentially found in the Income Tax Law, which gives the tax authority the power to redetermine income and deductions for transactions with parties that have a special relationship in order to align them with the principles of fairness and business norms, often referred to as the arm's length principle. In enforcement practice, the Tax Administration Law operates as a formal legal instrument that regulates how this authority is exercised through audits, data requests, issuance of decisions, and imposition of sanctions. Normatively, this separation is important so that the analysis does not misplace the norms: the Income Tax Law explains what can be corrected and the standards of fairness, while the Tax Administration Law explains how the corrections are determined and charged. The main legal consequence of corrections is the reassessment of taxable income, which results in additional tax payable. After that, further consequences follow the administrative penalty system in the KUP Law as amended by the HPP Law, including interest or fines according to the type of decision and compliance behavior. Therefore, companies face multiple risks, starting from the assessment of reasonableness, then moving on to the formal process that results in a determination and billing. This authority structure shows that transfer pricing corrections are the result of an interaction between substantive and procedural norms.

The aspect of evidence becomes a crucial point that determines the position of the company in the audit process. The HPP Law strengthens supervisory instruments by emphasizing procedural compliance and information disclosure, including transfer pricing documentation requirements, which are regulated in more detail in ministerial regulations and tax authority regulations. In Indonesian practice, this documentation is known as the Master File, Local File, and Country-by-Country Report, which present the group structure, business profile, risk asset function analysis, transfer pricing methods, and a summary of global profit allocation. From a normative legal perspective, documentation is not merely an administrative obligation, but rather a means of proof that determines the position of a company when it is audited. If the documentation is unavailable, late, does not meet the format requirements, or is inconsistent with the financial statements and tax returns, the legal consequences may include administrative sanctions for formal violations, accompanied by an increased risk of correction due to weakened evidence of fairness. The KUP Law provides the basis for testing compliance with tax return filing and bookkeeping, while the HPP Law reinforces the data-based sanctions and compliance framework. In disputes, documentation is often the primary evidence for assessing whether prices are reasonable, whether intra-group services actually occurred, and whether the economic benefits are real. Therefore, the Master File, Local File, and CbCR requirements must be understood as a lock that connects material and procedural norms, as well as a benchmark for whether a company is acting in compliance or constructing a narrative after correction. With this position, documentation becomes a strategic element that determines the direction and outcome of fiscal testing. This strict procedural and technical compliance are also supported by the role of information technology in improving taxpayer compliance (Lestari & Sinambela, 2022).

Administrative legal consequences are often the most tangible impact of transfer pricing corrections on a company's fiscal position. The most immediate legal consequence after a transfer pricing correction is the issuance of a tax assessment or tax bill that increases the company's fiscal burden. A high tax burden can provide an incentive for companies to engage in more cautious and transparent transfer pricing practices in order to avoid unwanted taxation risks (Shindy, 2023). The KUP Law regulates the mechanism for issuing tax assessment letters when there is underpayment of tax, including the consequences of interest and penalties according to the type of violation. Following the amendments through the HPP Law, the design of administrative sanctions has moved towards an interest formula that is more closely linked to a specific reference interest rate and the period of the violation, so that the burden of sanctions can be significant in the case of large corrections. In transfer pricing, corrections often increase taxable profits by a material amount, so that administrative sanctions also increase because they are calculated based on the amount underpaid and the length of the period.

In addition, the collection process follows the provisions of the KUP Law and tax collection regulations, so that companies may face active collection measures if they fail to pay. Normatively, this situation has legal consequences in the form of changes in the company's liquidity position, accounting reserve obligations, and the need for tax risk disclosure. The KUP Law also regulates bookkeeping and document storage obligations, so that when companies fail to provide the requested audit data, the assessment may result in corrections based on data available to the authorities. Thus, administrative sanctions and tax assessments are the core direct consequences, which then trigger a chain of other consequences such as disputes and criminal risks. This sequence places transfer pricing corrections as the initial trigger for the escalation of broader legal consequences. The essence of controlling these burdens and risks is also reflected in cost control studies through break-even analysis to maintain the financial health of companies (Sinambela et al., 2022).

If the correction is not accepted by the taxpayer, the legal system provides a formal channel that transfers the issue to the realm of dispute. The objection and judicial channels form the next legal consequence when a company rejects a transfer pricing correction. The KUP Law regulates objections as administrative efforts that require the fulfilment of certain formalities and time limits, as well as opening up space for reassessment by the authorities. After that, the dispute can move to an appeal in the Tax Court, which is institutionally based in the Tax Court Law. Normatively, the existence of the Tax Court confirms that transfer pricing corrections are not final and binding decisions, but rather administrative decisions that can be tested through a special adjudication mechanism. The legal consequence for companies is the need to build a strong, consistent and structured dispute file, including arguments regarding functions, assets and risks, pricing methods, selection of comparables, and consistency with accounting and financial reporting (Eden, 2012).

As this research is based on normative jurisprudence, it focuses on how procedural norms affect the burden of proof, including the obligation to provide complete reasons for corrections and objections, meet deadlines, and pay certain portions of the assessment if required by tax procedural law (Rixen, 2011). Transfer pricing disputes also carry the risk of double taxation if corrections in one jurisdiction are not immediately offset by corresponding adjustments by the counterparty in another jurisdiction. This risk has been widely identified as a significant source of uncertainty in the modern international taxation system (Picciotto, 2015). Therefore, the consequences of disputes are not limited to legal costs, but also include uncertainty inherent in financial statements, investor perceptions, and long-term business planning, especially for multinational business groups operating across jurisdictions (Beer et al., 2014). At this stage, transfer pricing changes from a fiscal issue to a strategic issue that affects business stability.

Tax law also recognizes repressive consequences. Beyond administration and disputes, the KUP Law contains criminal tax consequences that may arise if transfer pricing is used as a means of manipulating tax obligations. The article that is often referred to is the criminal provision related to deliberately not submitting a tax return, submitting a tax return with incorrect or incomplete information, or misusing books and documents, thereby causing losses to state revenue. Legally, the elements of "intentionally" and "causing loss" are key. Transfer pricing that is merely debated in terms of methods and comparisons tends to fall within the realm of administration and disputes, while transfer pricing accompanied by document falsification, fictitious transactions, or the presentation of data known to be incorrect can move into the criminal realm. The KUP Law also recognizes a special procedure for handling indications of criminal acts, including preliminary evidence examination within the tax enforcement structure. The criminal law consequences for companies and their management can include imprisonment and fines, in addition to the obligation to pay the tax owed. For corporations, this risk transforms transfer pricing from an issue of numerical compliance to one of document integrity, internal communication, and reporting governance. The line between administrative and criminal disputes becomes highly dependent on the quality of the company's intentions and evidence.

The interpretation of these criminal consequences cannot be separated from national fiscal policy reforms. The construction of criminal tax consequences must also be read in conjunction with the HPP Law, which updates several aspects of the KUP system, including the design of sanctions and compliance incentives. Normatively, the HPP Law emphasizes prevention through increased procedural compliance, more transparent reporting, and a strengthened database. In transfer pricing, this strengthening is evident in the emphasis on documentation and reporting of affiliate transactions, which allows authorities to assess risks earlier. If companies ignore these obligations, the legal consequences that arise can include administrative sanctions for formal violations, more intensive audits, and a shift in the authorities' assessment of the taxpayer's good faith in the event of a dispute.

The HPP Law also changes several parameters that affect the number of penalties, so companies need to recalculate their risk exposure when corrections occur. Legally, this change means that transfer pricing consequences must be analyzed with due regard to the provisions in force in the relevant tax year, as penalty provisions and procedures may differ between periods. In addition, the HPP Law places information disclosure as a pillar of compliance, so that companies that are not transparent may experience restrictions on access to certain fiscal rights, such as facilities, expedited services, or refunds that require a good compliance profile. These consequences are preventive in nature as they discourage profit shifting through intra-group transactions that are difficult to verify. With this orientation, procedural compliance serves as a risk mitigation instrument from the outset.

The consequences of transfer pricing also resonate in the realm of corporate law. The legal consequences do not stop at taxation, because corporate governance under Law No. 40 of 2007 on Limited Liability Companies (PT Law) places the board of directors as the body responsible for managing the company in accordance with laws and regulations and the articles of association (Listyawan, 2020). In this construction, transfer pricing policy as a group policy and management policy can be assessed as a management decision that must take into account tax compliance and legal risks. Therefore, transfer pricing strategies must be managed as an integral part of optimal corporate risk management, which aims to prevent financial losses and maintain company stability (Irfan & Al Hakim, 2022). If transfer pricing is set for the purpose of tax avoidance and results in losses for the company, such as large fines, high interest rates, freezing of certain activities, or disruption of cash flow, then there is room for director liability based on standards of error or negligence in performing management duties.

The PT Law also allows shareholders to file lawsuits under certain circumstances, and emphasizes the principles of prudence and good faith in management. Normatively, this interconnection results in two levels of transfer pricing consequences: the state collects taxes and imposes sanctions through the KUP and PPh regulations, while shareholders or companies can reassess management decisions that cause losses and reduce the value of the company. In the board of commissioners, the supervisory function is also relevant because weak supervision of material tax risks can be questioned as a failure to carry out supervisory obligations. Thus, the PT Law extends the consequences from the fiscal to the realm of corporate organ accountability. This dimension places transfer pricing as a compliance issue across legal regimes.

In addition to the special tax regime, general criminal law remains present as a normative background. From a general criminal law perspective, the discourse on the application of the Criminal Code (KUHP) to acts related to transfer pricing needs to be carefully placed so as not to confuse tax offences with general offences. However, normatively, if a series of transfer pricing is accompanied by acts that fulfil the elements of a general offence, such as document forgery or fraud, then the KUHP can be used as an additional basis outside the KUP Law. Article 372 of the KUHP on embezzlement, and in its dogmatic interpretation, its application to tax cases requires proof of the element of unlawful control of another person's property, so it is not automatically applicable to every tax dispute. Nevertheless, the Criminal Code remains relevant as a warning that the use of false documents, transaction manipulation, or fictitious records may intersect with certain general offences if the elements of the offence are fulfilled. In enforcement practice, the tax system is often prioritized because the KUP Law provides specific offences that directly punish acts that cause losses to state revenue. The analytical consequence is that companies should not feel secure in assuming that all risks stop at tax administration; when there are acts that go beyond differences in valuation methods and enter into document manipulation, the risk of criminal liability can be layered. Therefore, companies need to assess the integrity of contracts, evidence of services, evidence of benefits, and internal correspondence, as these aspects can determine whether a case remains administrative or moves into the criminal realm. This concept emphasizes that the boundaries between administrative and criminal matters are substantive, not merely formal.

The consequences of transfer pricing are also linked to the architecture of international tax law. The connection with the international order is evident in the adoption of the Base Erosion and Profit Shifting (BEPS) principle and the use of double taxation avoidance agreements (DTAs). Legally, DAPAs as applicable international agreements regulate the division of taxation rights between countries and usually provide a Mutual Agreement Procedure (MAP) as a channel for resolution in the event of double taxation due to transfer pricing corrections. The legal consequence for multinational companies is that there is an additional channel outside of domestic disputes to seek correspondence adjustments so that the same profits are not taxed twice. However, MAP does not automatically eliminate domestic obligations; companies must still manage stipulations, payment procedures, and national legal deadlines in accordance with the KUP Law and tax court procedural law.

The adoption of BEPS is also reflected in CbCR obligations and the strengthening of information exchange, making it easier to trace group structures and cross-border profit allocations. The normative legal consequence is an increased possibility of global data-based corrections and heightened expectations for consistency between reporting in different jurisdictions. In addition to MAP, Indonesia recognizes Advance Pricing Agreements (APAs), which are regulated within the framework of tax administration authority through implementing regulations, as an instrument for preventing disputes by agreeing on pricing methods for a specific period. For companies, the existence of MAP and APA shows that legal consequences can be managed through cooperative channels, while still operating within the limits of domestic norms governing evidence and collection. Transfer pricing risk management is both national and transnational.

The aspect of procedural compliance is the common thread that ties all these consequences together. The HPP Law emphasizes information disclosure as a prerequisite for compliance, and in transfer pricing this is realized through the reporting of affiliate transactions and the readiness of documents when requested. The legal consequences of procedural non-compliance are often tangible, although not always criminal. Companies may face intensified scrutiny, repeated audits, or higher risk assessments in the following tax year. In some administrative systems, compliance profiles influence access to certain services, including expedited administrative processes or facilities that require compliance. Normatively, this creates a preventive consequence: companies that choose to withhold information or prepare documents carelessly bear higher compliance costs and lose the administrative conveniences that should be available to compliant taxpayers.

In the interpretation of the KUP Law, the obligation to submit accurate and complete tax returns, the obligation to maintain traceable records, and the obligation to provide data during audits form the parameters of formal compliance. When transfer pricing is used for tax avoidance, reporting patterns often leave traces of irregularities that are detected in risk analysis, such as sharply deviating margins, high royalties without comparables, or intra-group service costs that are not commensurate with activities. The legal consequences that arise then move from requests for clarification, audits, corrections, to disputes, so that procedural compliance functions as a risk control (Heckemeyer & Overesch, 2013). At this point, compliance is not only legally valuable, but also strategically valuable.

In addition to formal impacts, transfer pricing also has non-legal implications that have the potential to trigger further legal consequences. Reputational and governance consequences need to be separated from formal legal consequences, but remain relevant as they can trigger further legal action. When a company is perceived to be engaging in tax avoidance through transfer pricing, stakeholders' perception of compliance integrity may decline, and this may lead to closer scrutiny from authorities and greater caution from investors and creditors. In the business legal system, reputation is often translated into financing agreement clauses, disclosure obligations, or risk assessments that affect capital costs. The stability of business relationships and the prevention of disputes depend heavily on the effectiveness of contractual instruments in managing risk, including reputational risk arising from practices such as transfer pricing (Wibowo et al., 2021).

Normatively, the Limited Liability Company Law requires corporate bodies to maintain compliance with laws and regulations, so that reputational damage can become an issue of management responsibility if it is proven that transfer pricing decisions were made without adequate internal controls. This series of consequences shows that transfer pricing as tax avoidance produces a chain effect: fiscal corrections result in sanctions, disputes result in costs and uncertainty, criminal risks pose a threat to management, and governance risks give rise to demands for internal accountability. Academically, this series shows how tax norms force companies to change their behavior in managing intra-group transactions. These reputational implications reinforce the pressure of legal norms on corporate behavior.

To conclude the analysis, these consequences form a complete legal construct. Overall, the construct of legal consequences for companies engaging in transfer pricing that is considered tax avoidance is layered and follows a sequence from material assessment to formal enforcement. The first layer is fairness correction based on the Income Tax Law on special relationship transactions, which leads to the reassessment of taxable income. The second layer is administrative consequences based on the Tax Administration Law as amended by the HPP Law, in the form of underpayment, interest, fines, and collection procedures. The third layer is dispute consequences through objections and the Tax Court, with the burden of proof largely determined by the quality of transfer pricing documents. The fourth layer is criminal tax consequences if intent and acts that constitute offences under the Tax Administration Law are found, particularly in relation to the submission of tax returns and the use of incorrect documents. The fifth layer is corporate consequences under the Limited Liability Company Law, which may give rise to the liability of directors and commissioners for decisions that violate the law or cause losses to the company. Additional layers may arise from the Criminal Code if there are separate general offences, as well as from international tax agreements through MAP to reduce double taxation. This sequence emphasizes that transfer pricing should not be positioned as a risk-free zone; it is an area of compliance that demands fairness, transparency, and consistency of evidence. With this layered structure, transfer pricing requires a comprehensive and sustainable compliance approach.

Reasonableness Standards and Standards of Proof in Transfer Pricing Audits and Disputes

The discussion of the arm's length principle in related party transactions stems from the basic construction of modern taxation principles. The standard for assessing the arm's length principle in related party transactions in the taxation system is based on the principle that transactions between parties with a special relationship must be treated as equivalent to transactions between independent parties. The arm's length principle requires that prices, profit margins, or other compensation reflect fair market conditions, so that taxable profits are not shifted through intra-group arrangements. Within the framework of Law Number 7 of 2021 concerning Harmonization of Tax Regulations (HPP Law) and the Law on General Provisions and Tax Procedures (KUP Law), the standard of fairness serves as a benchmark for assessing whether tax reporting represents a reasonable economic situation (Mulya et al., 2023). This principle is not understood as a prohibition on affiliate transactions, but rather as a binding evaluation standard when such transactions affect taxable income. Therefore, tax audits of taxpayers who transact with affiliates are essentially a process of assessing the consistency between fiscal reports, accounting records, and the economic circumstances of the transaction.

At the initial stage, the tax authorities will assess the business profile, cost patterns, margins, and reported transaction structures, then examine whether there are any irregularities that warrant further investigation. From this, it can be seen that the reasonableness standard is constructed as an operational legal standard, as it guides how to assess data and how to conclude whether corrections are necessary. This position places arm's length as an active evaluative instrument in tax supervision.

The arm's length principle is not only normative in nature, but is also upheld through clear enforcement powers. The authority of the tax authorities to make adjustments to affiliate transactions that do not reflect arm's length is positioned as a pillar of arm's length enforcement. In relation to Article 18 paragraph (3) of the KUP Law as the basis for this authority, it is treated as a norm that legitimizes adjustment actions when affiliate transactions result in reporting that deviates from the parameters of arm's length. The adjustment authority means that the DGT can redetermine the amount of income, deductions, or tax base based on measures considered reasonable according to market standards. To prevent this authority from being exercised as unlimited discretion, the KUP Law places it within an examination procedure that involves stages, document requests, explanations, and the issuance of legal products in the form of decrees. At the examination stage, the standard of reasonableness is realized through testing whether the reported price or profit is comparable to independent peer companies or in line with relevant industry patterns (Sari et al., 2020). At this point, the standard of reasonableness is not merely a final result, but rather a set of legal questions: whether the transaction actually occurred, what its economic substance is, whether the division of functions and risks is reasonable, and whether the chosen method is justifiable. In this way, the authority to make adjustments is constructed as a legal mechanism to maintain the tax base, while also providing space for taxpayers to prove their reasonableness. Through this construction, the authority to make corrections is understood as a balancing tool between the interests of the state and the taxpayer's right to defense.

The standard of reasonableness is then reinforced through a regime of proof imposed on taxpayers. Minister of Finance Regulation No. 213/PMK.03/2016 on Transfer Pricing Documentation (PMK 213/2016) establishes the main standard of proof that applies to taxpayers when transacting with affiliated parties. Through PMK 213/2016, evidence is not understood as a reaction after correction, but as an obligation that must be prepared from the beginning of the tax year through the preparation of a Master File, Local File, and Country-by-Country Report for those who meet the criteria. The Master File presents an overview of the business group, value chain, transfer pricing policy, and allocation of functions and intangible assets at the group level. The Local File focuses on the transactions of entities in Indonesia, details of affiliated transactions, comparability analysis, method selection, and conclusions of fairness. The Country-by-Country Report provides an overview of the allocation of income, profits, taxes, and economic activity indicators per jurisdiction, so that the authorities can assess the alignment of profits with activities. The standard of proof in PMK 213/2016 requires data traceability, consistency between documents, and the ability to explain the reasons for selecting comparables and comparability adjustments. If the documents are prepared merely as a formality, the legal risk increases because weak documents tend to reduce the scope for defense during an audit. Thus, PMK 213/2016 transforms evidence into a measurable compliance obligation, as the format, content, and timeliness of the documents become assessable elements. At this stage, documentation serves as the main foundation of a company's fiscal defense. Compliance in documenting these transactions is a logical extension of the self-assessment system, in which tax technology plays an important role in mitigating the risk of tax avoidance (Sinambela & Putra, 2021).

The implementation of such evidence is evident in the tax audit mechanism. The structure of evidence in tax audits according to the KUP Law moves from data requests to fairness evaluations, then to correction conclusions. At the data request stage, the authorities have the right to request books of account, intra-group contracts, invoices, correspondence, proof of delivery of goods or services, proof of service benefits, and the basis for pricing. The standard of proof requires companies to demonstrate a logical relationship between legal documents, transaction execution, accounting records, and fiscal treatment. In intra-group service transactions, for example, proof requires evidence that the services were actually provided, that the benefits were real for the recipient, and that the compensation was in line with the benefits and market practices. In royalty transactions, evidence requires proof of the licensed rights, their economic value, the basis for the rate, and the relationship between the use of intangible assets and income.

In intra-group financing, verification requires rationality of debt, ability to pay, equality of loan terms, and reasonableness of interest rates. This process shows that verification is not merely a matter of presenting documents, but rather of constructing a coherent and testable narrative. The KUP Law provides a formal framework for testing compliance and reporting accuracy, so failure to prepare evidence will increase the scope for correction. Thus, the standard of proof is constructed as an active obligation, not a passive one, as companies must explain and defend their transfer pricing choices. This construction shows that the quality of evidence greatly determines the direction and outcome of the audit.

As part of the reasonableness test, the substantive approach plays an important role in the examination stage. The standard for assessing reasonableness in an examination is also developed through an approach that assesses the economic substance of the transaction, including an examination of the functions, assets, and risks of the parties. The approach, often referred to as the rule of reason, encourages examiners to assess whether the transaction structure has a reasonable business rationale and whether the profit allocation results are in line with the economic contributions of each entity. In this test, the authorities will assess who performs the core functions, who bears the market risk, inventory risk, credit risk, and who controls strategic decisions related to these risks. The assessment of assets includes tangible assets, unique assets, and intangible assets that affect the ability to generate profits. The assessment of risk emphasizes risk control, not just contractual clauses, so that a contract stating that one party bears the risk can be disregarded if the operational reality shows that risk control lies with the other party. This framework is important because the arm's length standard does not stop at comparing margin figures, but assesses whether those figures are consistent with the operational reality.

From an evidentiary perspective, companies must present their organizational structure, business process descriptions, decision documentation, risk management policies, and evidence of activities showing who does what. Thus, the standard of reasonableness is constructed as an assessment tied to economic facts, while the standard of proof is constructed as the ability to demonstrate those economic facts in writing and consistently. This approach emphasizes that reasonableness is understood as a reflection of actual economic conditions, not merely the result of numerical calculations.

The next stage focuses on translating the test results into fiscal consequences. The correction determination stage in the audit tests the quality of evidence through comparability analysis and method selection. PMK 213/2016 directs taxpayers to present a comparability analysis, including the characteristics of goods or services, functions performed, contract terms, economic conditions, and relevant business strategies. From these elements, the method used must be able to explain why the transaction is within the range of reasonableness.

In practice, differences in comparative data often lead to differences in results, so the standard of proof requires an explanation of the data source, the reasons for sample selection, the reasons for exclusion, adjustments for differences, and the reasons for selecting the period. In manufacturing transactions, for example, companies need to explain production capacity, utilization, and extraordinary events that affect margins. In distribution transactions, it is necessary to explain marketing functions, inventory ownership, and accounts receivable risk. In commission transactions, it is necessary to explain why certain commissions reflect limited functions. The KUP Law provides a framework that audits aim to test compliance and accuracy, so that when the evidence is weak, corrections are easier to determine. This means that the standard of proof is built through testable justification requirements, while the standard of reasonableness is built through analysis results that can be compared with independent parties. At this point, the quality of technical arguments becomes a determining factor in the strength or weakness of a company's fiscal position.

When differences of opinion are not resolved at the examination stage, the process continues to the dispute mechanism. When a tax dispute arises, the standard of proof shifts from the examination forum to the objection and appeal forum. The KUP Law regulates the objection procedure as an administrative mechanism that reassesses decisions and regulates formal requirements such as deadlines, the form of the application, and the reasons submitted. At the objection stage, the company must prepare a legal argument that links the facts of the transaction, the provisions of the law, and the reasonableness analysis that has been prepared. The standard of proof here requires consistency, as the documents submitted in the objection will be compared with those submitted during the examination.

If there are changes to the narrative or corrections to documents without credible explanations, the position of the evidence weakens. After the objection, the dispute may proceed to an appeal in the Tax Court based on the Law on Tax Courts. In this forum, the evidence becomes more adversarial, as the company and the authorities will test the validity of the methods, comparisons, and assessment of the facts. The standard of reasonableness remains centered on arm's length, but the standard of proof becomes stricter as it is read within the discipline of tax court proceedings, including the procedures for submitting evidence, examining evidence, and the assessment of the panel. Thus, the dispute pathway establishes a tiered standard of proof, from administrative to judicial, which demands higher quality evidence. This change of forum shows that evidence is not a static process, but rather evolves as the dispute escalates.

In this context, the distribution of the burden of proof takes on strategic significance. The construction of the burden of proof in transfer pricing disputes is often understood as a dynamic burden. In the initial stage, the authorities need to demonstrate the basis for the examination and the basis for the correction, for example, the existence of indications of irregularities or inconsistencies in the report. Once the correction has been determined, the company has a legal interest in proving that the reported transaction was reasonable in accordance with the arm's length principle. Transfer pricing regulations that are in line with arm's length standards create a fictitious assumption, whereby the profit obtained from a controlled transaction is calculated by taking into account the results that would be agreed upon by unrelated parties in the same circumstances (Navarro, 2018). In this area, the term reverse burden of proof is often used to describe that companies cannot wait for the authorities to prove all elements completely, because companies control internal data, pricing policies, and business justifications.

Within the framework of the KUP Law, the obligation to maintain accounting records and store documents strengthens the position of the authorities to assess that the absence of evidence from the company is a factor that is detrimental to the company's position. With this design, the company's standard of proof is constructed as the ability to prove matters within the company's control, including cost structures, reasons for mark-ups, cost allocation policies, and evidence of benefits. If a company fails to meet this standard, corrections tend to be upheld in disputes because there are insufficient grounds to overturn them. Therefore, dynamic proof becomes a core part of the legal construction of audits and disputes, as it determines who bears the risk of factual uncertainty. This condition places documentation readiness as a crucial element from the outset of reporting.

At the judicial level, assessments focus on the strength of evidence and consistency of analysis. Assessments by the Tax Court generally emphasize the quality of written evidence and the validity of analysis. In transfer pricing disputes, the panel assesses the consistency between contracts and implementation, the consistency between accounting records and tax returns, and the reliability of comparability analysis. The standard of reasonableness is not decided through unilateral claims, but through a reading of the evidence showing how prices or margins were set, how comparables were selected, and whether adjustments for differences were made reasonably. The court may also assess whether the economic substance is consistent with the formal form, so that transactions that appear neat on paper may lose weight if the operational evidence does not support them.

In practice, companies must manage evidence systematically, including by presenting business process charts, group policies, decision-making minutes, service activity reports, and evidence demonstrating actual risk control. This approach is in line with developments in transfer pricing evidence standards that emphasize economic substance and the relationship between functions, assets, and risks with profit allocation (Lang et al., 2013). Evidence standards also require readability and traceability, as evidence that is unstructured or not logically connected to legal arguments will be difficult to use to contest tax adjustments (Schön, 2012). Thus, tax courts establish evidence standards that require forensic document discipline and analysis, not merely formal completeness. The assessment of reasonableness remains rooted in independent measures and the alignment of profits with economic contributions that can be factually proven through decision-making and risk control functions (Avi-Yonah, 2015). This approach emphasizes that the success of a defense in a transfer pricing dispute is highly dependent on the company's ability to present a consistent, documented, and objectively testable economic narrative. This shows that the judicial forum places evidence at the center of legal evaluation. Understanding of these strict standards of proof should be supported by ongoing educational efforts to increase taxpayer awareness and compliance (Lestari et al., 2021).

Regulatory developments also influence how reasonableness is proven and assessed. The HPP Law expands the tools related to audits and disputes by strengthening data-based tax administration and compliance. Although this answer focuses on reasonableness assessment and proof standards, the changes brought about by the HPP Law are important because they influence how authorities access information, assess risk, and impose reporting obligations.

In cross-border transactions, reporting obligations such as CbCR and information exchange increase the likelihood of authorities obtaining an overview of group profit allocation, thereby testing reasonableness standards through cross-jurisdictional consistency. At the level of evidence, companies need to ensure that the narrative in the Local File is consistent with the global overview in the Master File and in line with group data in the CbCR. The HPP Law also affects the design of administrative sanctions and several procedures, so that errors in fulfilling formal obligations can have an impact on the company's position during an audit, including an assessment of compliance. This does not mean that every formal non-compliance automatically proves unreasonableness, but in evidentiary reasoning, formal non-compliance often reduces the credibility of the data submitted. Therefore, the HPP Law establishes a more demanding environment for evidence, as the quality of reporting and consistency of data are prerequisites for maintaining claims of reasonableness. Thus, the standards of reasonableness and evidence move from being merely technical issues to measurable standards of compliance governance.

In a cross-jurisdictional context, dispute resolution mechanisms take on an additional dimension. In cross-border transactions, reasonableness and proof standards intersect with the Mutual Agreement Procedure (MAP) mechanism available through applicable double taxation agreements (DTAs). MAP provides a channel for taxpayers to request the competent authorities to resolve disputes that give rise to double taxation, including as a result of transfer pricing adjustments. In MAP, the standard of reasonableness generally refers to principles that are in line with the OECD Transfer Pricing Guidelines, so that the evidence presented must be understandable and assessable by both jurisdictions. Importantly, OECD principles recognize that governance is part of a broader macroeconomic context, in which legal and institutional frameworks play a major role (Lu & Batten, 2023). For companies, this requires global consistency in documentation and methods, as differences in approach between countries can complicate resolution. MAP does not automatically replace domestic processes, so companies need to manage parallel procedures, including deadlines in the KUP Law for objections or appeals and deadlines in MAP procedures according to P3B. Even so, there are conditions where MAP cannot resolve disputes related to transfer pricing adjustments that occur in cross-border transactions. Although each country's tax treaty states that disputes regarding transfer pricing adjustments between countries can be resolved through MAP, in practice, this is not always the case (Ilham et al., 2022). From an evidentiary perspective, MAP adds to the types of audiences that need to be convinced, as documents must satisfy more than one authority. Effective standards of proof at the domestic level may not necessarily be adequate at the MAP level if they are not in line with the expectations of the partner jurisdiction. Therefore, P3B and MAP form an additional layer in the structure of evidence, which requires higher quality arguments and data that are more organized, structured, and compatible with the international standards referred to. This layer highlights the complexity of evidence in cross-border transactions.

Failure to meet standards has real legal implications. The consequences of failing to meet standards of reasonableness and proof are established through a system of sanctions and corrections, but at this stage the focus is on the link between failure to prove and the results of the examination or dispute. When a company does not prepare documentation in accordance with PMK 213/2016 or prepares it without a testable analysis, the authorities have a stronger basis for imposing corrections because the reasonableness claim is not supported by adequate evidence. If corrections are imposed, the Tax Administration Law provides for administrative consequences such as interest or fines in accordance with applicable provisions, and failure to provide evidence will make corrections more difficult to overturn in objections or appeals. In certain circumstances, failure to provide evidence may transform into an issue of reporting accuracy if there are indications of intentional submission of false data, which opens up the risk of criminal tax prosecution under the criminal provisions of the Tax Administration Law. It should be noted that not every difference in methods and comparisons leads to criminal charges, but the use of misleading documents or engineered transactions carries a different level of risk. From a normative legal perspective, this structure shows that the standard of proof is the main safeguard: it determines whether a difference will be resolved as an administrative correction or develop into a more serious dispute. Therefore, the standards of reasonableness and proof must be understood as legal instruments that determine the consequences of an audit and the consequences of a dispute. These implications confirm the direct relationship between the quality of evidence and the level of legal risk.

Ultimately, the relationship between reasonableness and evidence forms a coherent framework. The standards for assessing the reasonableness of affiliated transactions and corporate evidence standards are constructed through a combination of arm's length principles, documentation requirements, economic substance assessments, and the examination and dispute procedures provided for in the regulations. The HPP Law and KUP Law lay down principles and procedures, PMK 213/2016 operationalizes evidence through a document structure, the Tax Court Law provides a stricter testing forum, and P3B through MAP expands the scope of resolution for cross-border cases with reference to OECD guidelines. From this structure, the arm's length standard operates as a measure of outcome, namely whether the price and profit are comparable to independent parties, while the standard of proof operates as a measure of process, namely whether the company can demonstrate the reasons, data, and implementation of transactions that support that outcome. Companies that wish to maintain their fiscal position must treat documentation as a system of evidence, not as an administrative attachment, and ensure consistency between contracts, operations, accounting, and reporting. Audits and disputes are ultimately a process of reading evidence against norms. Therefore, the arm's length standard and the evidence standard form a single entity that determines whether an affiliate transaction is accepted fiscally or corrected. This unity concludes the analysis with the assertion that substantive compliance and strong evidence cannot be separated.

CONCLUSION

The standard of reasonableness for related party transactions and the standard of proof for companies in tax audits and dispute resolutions is established through a series of norms that bind transaction results to the arm's length principle and bind the method of proof to documentation requirements and testing procedures by authorities and courts. The HPP Law and KUP Law place the authority to make corrections as a legal consequence when the results of related party transactions deviate from the measures commensurate with independent party transactions, while PMK 213/PMK.03/2016 translates the burden of proof into the obligations of Master File, Local File, and Country-by-Country Report along with the requirements of comparability analysis, method selection, and data traceability. In the examination process, the assessment of reasonableness relies on economic substance tests, including function, assets, and risk, while corporate evidence is assessed based on the consistency between contracts, implementation, accounting, and reporting. In disputes, the standard of proof is re-examined through objections and appeals, so that the quality of evidence and consistency of argumentation determine whether corrections can be upheld or overturned.

These standards have implications for tax compliance governance, requiring companies to treat transfer pricing documentation as a system of evidence prepared before disputes arise, rather than as reactive documents issued after corrections are published. As examinations assess the economic substance and implementation trail of transactions, companies need to ensure that each affiliate transaction has an explainable business basis, accompanied by evidence of benefits, evidence of delivery or work, and a methodological explanation that can be tested through comparative data and comparability adjustments. At the dispute level, procedural discipline under the Tax Court Law encourages more structured evidence, so that weaknesses at the examination stage are easily carried over and narrow the scope for defense. For cross-border transactions, the existence of double taxation agreements and mutual agreement procedures adds to the need for cross-jurisdictional consistency of evidence so that corrections do not result in double taxation, making group data coordination and business narrative consistency a real compliance requirement.

Companies should develop documented internal transfer pricing policies that are aligned with their operations, including a map of functions, assets, and risks, as well as procedures for archiving evidence of affiliated transactions that can be traced down to the transaction level. The preparation of Master Files, Local Files, and Country-by-Country Reports needs to be done with clearly sourced comparative data, justifiable reasons for sample selection, and transparent explanations of comparability adjustments. At the examination stage, companies need to prepare a consistent set of evidence between tax returns and financial statements, as well as measured responses to data requests, so that the clarification process does not develop into extensive corrections. At the dispute stage, objections and appeals must be structured with clear legal and factual arguments, including transaction summaries, method selections, and conclusions on the range of reasonableness, as well as readiness to pursue MAP in accordance with P3B if corrections have the potential to result in double taxation.

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