

Transfer Pricing: Purpose of Determination and Factors Affecting Transfer Pricing Determination

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Abstract

The study discusses several things, including the factors that influence the determination of transfer pricing and the methods used in determining transfer pricing. Factors that influence transfer pricing include tax considerations, dance calculations, competitive factors, environmental risk, calculation of performance appraisals and accounting contributions. The method used in determining transfer pricing. Methods in determining transfer pricing include traditional methods, traditional methods consist of several ways including the comparable uncontrolled price method, cost-plus method, and resale price method. Transactional profit method: split profit and transactional net margin method

Keywords: Transfer Pricing, Traditional Methods, Transactional Methods

Introduction

The current economic development has a major influence on business patterns and attitudes of business people. Investments are increasingly being made by investors, especially foreign investors, which have resulted in cross-border transactions. Initially transfer pricing was known in management accounting as a pricing policy that was applied to the delivery of goods or services between divisions/departments within a company with the aim of measuring the performance of each of these divisions/departments. Along with the times, multinational companies, which usually implement decentralization of operations by dividing their companies into responsibility centers, both cost centers and income centers, have taken advantage of transfer pricing as a means of avoiding or embezzling taxes by minimizing the tax burden that the company must bear. Through the practice of transfer pricing, efforts to minimize tax burdens are carried out by transferring the income and costs of a company with a special relationship from one country to companies in other countries with different tax rates. The problem of allocating income and expenses of multinational companies must be properly and clearly regulated by each country involved in international transactions. Good and clear arrangements are expected to prevent and detect acts of tax manipulation through transfer pricing which is often carried out by multinational companies to avoid tax evasion. Transfer Pricing, according to Tono et al. (2018), is defined as a special selling price or value used in inter-divisional exchanges to record sales division income and buying division costs. Transfer pricing is also called intracompany pricing, intercorporate pricing, interdivisional or internal

pricing which is a price calculated for management control purposes over the transfer of goods and services between members.

According to Sikka & Willmot (2010) Transfer pricing is the total price for the delivery of goods or compensation for the delivery of services that have been agreed upon by both parties in financial business transactions and other transactions. Transfer pricing can occur within a group of companies and between companies that are bound in special relationships. In a group of companies, transfer pricing is often referred to as intracompany pricing, intercorporate pricing, interdivisional pricing, and internal pricing. This term indicates that the price setting is not limited to inter-company price setting within a group of companies, but also inter-division price setting in one company.

The definition of transfer pricing as a price arising from the delivery of goods, services and intangible assets, as mentioned above is a neutral definition. However, the term transfer pricing is often connoted as something that is not good (abuse of transfer pricing), namely the transfer of taxable income (taxation income) from a multi-national company to countries with low tax rates in order to reduce the total burden tax from the national group of companies.

The definition of transfer pricing manipulation itself is defined as an activity to increase costs or reduce invoices which aim to reduce the amount of taxes owed. Thus, transfer pricing manipulation can be done by increasing costs or reducing sales through a transfer pricing mechanism with the aim of reducing tax payments. Thus, transfer pricing manipulation occurs by setting the transfer price to be "too big or too small" in order to minimize the amount of tax owed. Because by reducing the amount of tax owed, the profits received by multi-national companies will be even greater. So it can be concluded that transfer pricing is a mechanism for fixing unreasonable prices for transactions of the supply of goods or the delivery of services by parties that have a special relationship (related parties). Transfer pricing is usually carried out by multinational companies. With these unhealthy practices, it results in the loss of potential taxes that should be received by the state. This is why these manipulative activities are often associated with losses to the State.

Purpose of Determining Transfer Pricing

The purpose of transfer pricing is to transmit financial data between company departments or divisions as they use each other's goods and services. In addition, transfer pricing is sometimes used to evaluate the performance of divisions and motivate managers of sales and buyer divisions towards decisions that are consistent with the overall goals of the company. According to Horngren et al. (2010) transfer pricing should help achieve the company's strategy and objectives and be in line with the company's organizational structure. In particular, transfer pricing should support the suitability of goals and the level of effort of top management. Subunits selling products or services should be motivated to lower their costs; subunits that buy products or services should be motivated to obtain and use inputs efficiently. Transfer pricing should also help top management evaluate the performance of individual subunits and their managers. If top management supports a high degree of decentralization, transfer pricing should support a high degree of subunit autonomy in decision making. This means that the subunit manager who wants to maximize the operating profit of his sub-unit should have the

freedom to make transactions with other subunits of the company (based on transfer prices) or to make transactions with external parties. Based on the territorial reach of the company's operations, transfer pricing can also be classified into domestic transfer pricing and multinational transfer pricing. Domestic transfer pricing is the price for the transfer of goods or services between entities of a group of companies or between divisions within a company within one country's sovereign territory, while multinational transfer pricing deals with interdivision transactions in one legal unit or between legal units in an economic unit covering various areas of state sovereignty. Some of the objectives to be achieved in the context of transfer pricing applications, both for domestic companies and for multinational companies, are among others: (1) Performance Evaluation (measuring the results of operations of each unit), (2) Management Motivation (preparation of production and profit orientation for all unit), (3) Price control to better reflect the "Cost" and "margin" that should be received from subscriptions and optimal pricing, (4) Control of the market to secure the company's competitive position. The multinational transfer pricing application policy aims: (a) Maximizing global income. (b) Secure the competitive position of subsidiaries / branches and market penetration. (c) Evaluating the performance of foreign subsidiaries / branches. (d) Avoiding foreign exchange controls. (e) Controlling the credibility of the association. (f) Reducing monetary risk, (g) Managing adequate cash flow of subsidiaries / branches, (h) Maintaining good relations with local administrations, (i) Reducing the burden of tax and import duties, (k) Reducing the risk of go.

Factors Affecting Transfer Pricing Determination (Transfer Price)

Transfer pricing is a fairly recent source. As the company expanded internationally, the issue of pricing direct shipping became a more serious problem. It is estimated that 60% of all international trade consists of shipments between related business entities. Transactions between countries also expose multinational companies to environmental influences that create and destroy opportunities to increase corporate profits by fixing shipping prices. Following are the factors that influence firms with transfer pricing:

Tax Considerations

If this is not eliminated by law, company profits can be increased by setting shipping prices to transfer profits from subsidiaries located in high-tax countries to subsidiaries located in low-tax countries.

Dance Calculations

Tariffs on imported goods also affect the transfer pricing policies of multinational companies. For example, a company exporting goods to a branch company that is domiciled in a high-cost country can reduce its tariff by reducing the price of merchandise sent there. In addition to all of these links, multinational companies must account for additional costs and benefits, external and internal. Externally, MNCs have taxation authorities that are contrary to the official customs of import countries and the administrators of income tax from export and import countries. The higher rate is paid by the importer which reduces the base tax for income tax. Internally, companies must evaluate the advantages of lower (higher) income taxes in importing countries against higher (lower) import activities, as well as the large (small) income taxes paid

by companies in export countries. Government takeovers.

Competitive Factors

To facilitate the establishment of overseas branches, the parent company can support the branch companies using invoices at very low prices. All branch prices of this company can be eliminated periodically when the company's branch strengthens its position in the overseas market. Likewise, low transfer prices can be used to fortify existing businesses from the impact of foreign competition in the local market or other markets, in other words the profits earned from one country can support penetration into other markets. Indirect effects of competition can also occur. In order to improve the access of foreign branch companies to the capital market, setting low transfer prices for inputs and setting high transfer prices for outputs can support its income statement and financial position. Sometimes, transfer pricing can be used to weaken a competing company branch.

Environmental risk

Given that overseas competition calculations may impose low transfer costs for overseas branches, the risk of high price inflation may be the opposite. Inflation erodes the purchasing power of corporate cash. Higher transfer prices for goods or services expose the company's branches to high inflation which can scorch all existing cash from the branch.

Performance Assessment Calculation

Pricing policies are also influenced by their impact on managerial actions and are often the main determinants of firm performance. For example, if the mission of an overseas branch company is to provide inventory for the remaining company systems, the right transfer price allows company management to give the subsidiary a revenue stream that can be used in performance comparisons. However, it is difficult for decentralized companies to set transfer prices between firms that (1) encourage managers to make decisions that maximize profits and are in line with the general targets of the company and (2) provide a sufficient basis for assessing the performance of managers and companies.

Accounting contributions

Management accountants can play a significant role in measuring targets in transfer pricing strategies. The obstacle is maintaining a global perspective when mapping benefits and costs that are compatible with transfer pricing decisions. The first thing that happens is the impact on decisions in the company's system. Measuring a number of agreements is difficult because environmental influences must be accounted for as a group, not individually. There are several methods in determining transfer pricing, including:

Traditional Method

Comparable Uncontrolled Price Method

The price comparison method between independent parties (comparable uncontrolled price) or abbreviated as Comparable Uncontrolled Price Method is a method of determining transfer prices carried out by comparing prices in transactions between parties with a special relationship with prices in transactions between parties who do not have a special relationship

under comparable conditions or circumstances. The right conditions for using this Comparable Uncontrolled Price Method are: (1) The goods or services being transacted have identical characteristics in comparable conditions; or (2) Conditions of transactions between parties that have a Special Relationship and parties who do not have an identical Special Relationship or have a high level of comparability or can be accurately adjusted to eliminate the effects of the difference in conditions that arise. If none of the above conditions are suitable, then the Comparable Uncontrolled Price Method cannot be used and the taxpayer must use other appropriate methods.

Cost-Plus Method

Fair market price is determined by adding the level of fair gross profit obtained by the same from transactions with unrelated parties or the level of fair gross profit obtained by other companies from comparable transactions with unrelated parties to the cost of goods sold which has been in accordance with the principle of fairness and business practice. The right conditions for using the Cost-Plus Method are: (1) Semi-finished goods are sold to parties who have a Special Relationship; (2) There is a joint facility agreement or long term buy and supply agreement between the parties having a Special Relationship; or (3) The form of transaction is the provision of services. If none of the conditions above are suitable, the Cost-Plus Method cannot be used and the taxpayer must use other appropriate methods.

Resale Price Method

The resale price method is a method of determining the transfer price by comparing the price in a product transaction made between related parties with the resale price of the product after deducting the fair gross profit, which reflects the function, asset, and risk, for the resale of the product to other unrelated parties or the resale of the product which is carried out under fair conditions.

The appropriate conditions for using this method are: (1) A high degree of comparability between transactions between Taxpayers who have a Special Relationship and transactions between Taxpayers who do not have a Special Relationship, in particular the level of comparability based on the results of functional analysis, even though the goods / services are being traded different and (2) The reseller does not provide significant added value for the goods or services being traded.

Transactional Profit Method

This method is used when the comparative data is not complete enough. Profit from transactions between related parties can be determined by analyzing the functions of the business activities they carry out.

Transactional Net Margin Method

This method is also used if the comparative data is not complete enough. Comparing net income with the cost of goods sold, sold or assets used to generate the net profit, thereafter net income on transactions between related parties. Other Methods: The OECD Guidelines do not allow for any other method of determining fair market prices because these methods do

not reflect true fair market prices. This method consists of a global split method as well as a formulary application method.

The Problems of Tax Avoidance Practices

Transfer pricing is a classic issue in the field of taxation, especially regarding international transactions conducted by multinational corporations. From the government side, transfer pricing is believed to result in a reduction or loss of a country's tax revenue potential because multinational companies tend to shift their tax obligations from countries that have high tax rates (high tax countries) to countries that apply low tax rates (low tax) countries). On the other hand, from the business side, companies tend to try to minimize costs (cost efficiency), including minimizing corporate income tax payments. For global scale companies (multinational corporations), transfer pricing is believed to be one of the effective strategies to win the competition for limited resources.

In a multinational company environment, there are various transactions between members which include the sale of goods and services, license rights and other intangible assets, provision of loans and so on. The determination of prices for various transactions between members of the corporation is known as in a multinational company environment, there are various transactions between members which include the sale of goods and services, license rights and other intangible assets, provision of loans and so on. Pricing for various transactions between members is known as transfer pricing. In Indonesia, transactions between members of multinational companies are subject to transfer pricing engineering, especially by foreign investment taxpayers and branches of foreign companies in Indonesia that are included in the category of permanent establishment. Most of these companies are engaged in manufacturing and have substantial internal links to their parent companies or affiliates in foreign countries. Companies in Indonesia are mainly used to manufacture their intermediate goods or raw materials. These Indonesian manufactured products are marketed to local markets or exported to third countries.

The notion of tax avoidance is always defined as the activity of minimizing the tax burden without violating taxation provisions (legal), while tax smuggling (tax evasion) is defined as an activity to minimize the tax burden by violating (illegal) taxation provisions. The question arises as to whether tax avoidance can always be said to be legal. In many countries tax avoidance is differentiated into acceptable tax avoidance / tax planning / tax mitigation and unacceptable tax avoidance. In other words, tax evasion can be categorized as either legal or illegal. A tax evasion is said to be illegal if the transaction is carried out solely for the purpose of tax avoidance or the transaction does not have a good business purpose (bona fide business purpose). Therefore, to prevent tax avoidance practices by multinational companies, most countries have anti-tax avoidance provisions (Brian et al., 2005).

The transfer pricing scheme that is often used by multinational companies is by diverting their profits from countries with high tax rates to countries with low tax rates. To prevent a diversion of profit through various ways, including: (1) Tax authorities in various countries make strict transfer pricing rules such as the application of penalties or sanctions. (2) Complete document requirements. (3) Tax audit of companies engaging in transfer pricing practices.

Regarding the provisions of transfer pricing, it must be determined which countries are entitled to tax the profits generated by companies that run their business in more than one country. For profit-oriented companies, multinational companies will try to minimize the tax burden through tax avoidance practices in countries that do not strictly regulate anti-tax avoidance provisions. In Indonesia, to counteract the transfer pricing scheme, a special unit (at the level of section) has been created within the inspection and collection directorates, namely the sub-directorate for special transaction examination of the Transfer Pricing section. To reduce transfer pricing practices, several things need to be studied: (1) Activating the role of public accountants. Provisions paragraph 9 letter d Public Accountant Professional Standard No. 34 regulates the role of the auditor to test the reasonableness of the calculation of the number of related parties transactions disclosed in the financial statements. (2) Extending the transfer pricing criteria to not only related parties, but also to all transactions indicated under fair market prices, including those with non-affiliated companies. (3) Using external comparative data from reporting to detect fund flows and underlying export transactions. In Bank Indonesia Regulation, all foreign exchange proceeds from exports must go through a Foreign Exchange Bank, where exporters are required to submit information on export proceeds including information on the date of notification of export of goods, Customs office code, registration number of notification of export of goods, and the exporter's tax identification number. (4) Announcing to the public about the appeal process by taxpayers conducting transfer pricing, as a form of moral pressure. It should be noted that Article 50 paragraph (1) of Law concerning Tax Courts states that tax courts are open to the public. With the Government announcing the course of the tax court, it will open the public's eyes that these well-known companies are actually committing fraud to avoid taxes. (5) There needs to be a data center, such as the Indonesian Coal Index, which updates the latest mining commodity prices. The latest commodity prices are required to assess the fairness of sales turnover in the mining company's annual tax return. (6) Establishment of a single document window between countries that have implemented a tax treaty, and multilateral forums, such as the Asia Pacific Economic Corporation

Conclusion

Transfer Pricing is defined as the price determined by one part of an organization for the delivery of goods or services to another part of the same organization. Transfer pricing can also be interpreted as a special selling price or value used in inter-divisional exchanges to record sales division income and buying division costs (buying division). In terms of taxation, the definition of transfer pricing is the price charged by a company for goods, services, intangible assets to a company that has a special relationship.

The purpose of transfer pricing is to transmit financial data between company departments or divisions as they use each other's goods and services. In addition, transfer pricing is sometimes used to evaluate the performance of divisions and motivate managers of sales and buyer divisions towards decisions that are consistent with the overall goals of the company. However, in practice, it is often found that transactions between members of multinational companies are not immune from transfer pricing engineering. In order to prevent tax avoidance practices due to non-arm's length price determination, the Director General of Taxes establishes

guidelines for determining transfer prices which discuss the application of fairness and business practice principles (arm's length principles) related to transactions between taxpayers and parties with special relationships. This rule requires taxpayers to use fair market value in transactions with related parties.

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