

Why Is It Challenging to Apply Arm's Length Principle on Intragroup Financing in Indonesia? A Tax Officials Perspectives

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Abstract:

Directorate General of Taxes amends its supervision business process to require Account Representatives to conduct transfer pricing analysis. As an international standard, transfer pricing must adhere to the arm's length principle. This research aims to analyze the reasons why the arm's length principle on intragroup financing is challenging to apply in Indonesia, as perceived by Account Representatives in Jakarta Special Regional Tax Office utilizing the ADKAR model. Questionnaires and interviews are used as triangulation techniques in the study. The results show that participants were aware of the importance of conducting transfer pricing analysis and expressed a desire to participate in bringing about business process changes. Participants' knowledge and ability were major barriers to the implementation of the arm's length principle in intragroup financing. The primary hurdle in regards to knowledge is the assessment of credit ratings, whereas the ability component concerns the accessibility and expertise in utilizing the requisite tools and resources. Potential solutions suggested to Directorate General of Taxes include providing a case-based approach for training and enhancing accessibility to acquire comparable data or taxpayer credit ratings.

Keywords: ADKAR, Account Representative, Arm's Length Principle, Intragroup Financing, Transfer Pricing

Abstrak:

Direktorat Jenderal Pajak mengubah proses bisnis pengawasannya dengan mewajibkan *Account Representative* untuk melakukan analisis *transfer pricing*. Sebagai standar internasional, *transfer pricing* harus memenuhi *arm's length principle*. Penelitian ini bertujuan untuk menganalisis alasan mengapa *arm's length principle* dalam pinjaman intragrup sulit diterapkan di Indonesia melalui perspektif *Account Representatif* di Kantor Wilayah DJP Jakarta Khusus menggunakan model ADKAR. Kuesioner dan wawancara digunakan sebagai teknik triangulasi. Hasil penelitian menunjukkan bahwa *Account Representative* menyadari pentingnya melakukan analisis *transfer pricing* dan menyatakan keinginan untuk berpartisipasi. Pengetahuan dan kemampuan merupakan hambatan utama bagi *Account Representative* dalam menerapkan *arm's length principle* atas pinjaman intragrup. Hambatan utama dalam hal pengetahuan adalah penilaian peringkat kredit, sedangkan komponen kemampuan berkaitan dengan aksesibilitas dan keahlian dalam menggunakan alat dan sumber daya yang diperlukan. Solusi yang disarankan antara lain dengan memberikan pelatihan dengan pendekatan berbasis kasus dan meningkatkan aksesibilitas untuk memperoleh data pembanding atau peringkat kredit Wajib Pajak.

Kata Kunci: ADKAR, Account Representative, Arm's Length Principle, Pinjaman Intragrup, Transfer Pricing

INTRODUCTION

In response to the slow global economy after the pandemic and the budget deficit, the government has implemented stricter laws and increased tax audits to enhance national revenue (Filbery, 2022). The tax audit involves an investigation of transfer pricing. Taxpayers are also greatly concerned about transfer pricing. In 2023, a poll of 2,127 finance and tax professionals across 47 countries found that 53% of respondents expect a rise in transfer pricing audits in the next two years, a 79% increase from the 2021 survey (EY, 2023). Based on a 2019 survey, participants anticipated that transfer pricing conflicts would primarily involve transactions with goods and services, intangible assets, and intragroup financial arrangements (EY, 2019).

In affiliate transactions, MNEs commonly engage in intragroup financial arrangements. MNE's financial management focuses on managing liquidity and supporting the organization's main business (Okten & Drenth, 2021). Okten & Drenth (2021) found instances of financial agreements conducted by multinational enterprises, including long-term loans (intragroup financing), cash pooling, and hedging. Furthermore, Okten & Drenth (2021) also stated that the financial crisis resulting from the COVID-19 pandemic has led MNEs to increase their reliance on self-financing through intra-group financing to address liquidity issues and reduce third-party funding availability. Petruzzi in Prokoph (2022) said that a loan is the most common form of intragroup financial arrangement. This strategy can also help optimize tax advantages (Moerer et al., 2021). As a result, there is a likelihood of an increase in the volume of affiliate transactions associated with intragroup financing in the future. The Organisation for Economic Cooperation and Development (OECD) has focused on setting transfer pricing in financial transactions. By January 2022, they released updated Transfer Pricing Guidelines that provide guidance on financial transactions in Chapter I, Section D.1.2.2, and Chapter X, which covers intra-group financing. In 2021, the United Nations (UN) revised transfer pricing guidelines for developing nations. Chapter 9 of Section B covers intragroup financial transactions.

Multinational Enterprise (MNE) considers transfer pricing as a valid and ethical component of its business activities to improve post-tax profits on a worldwide scale and as a method to control its internal resources (Eden & Smith, 2022). Tax authorities typically mandate that affiliate transactions adhere to the concepts of fairness and arm's length, mirroring transactions conducted by independent entities under identical conditions, deterring tax erosion and profit shifting. Eden & Smith (2022) stated that transfer pricing disputes occurred when tax authorities determine that the transfer prices established by MNEs do not adhere to the relevant regulations.

Disputes between tax authorities and taxpayers lead to increased compliance costs for both parties (Maulana, 2022). Transfer pricing issues in Indonesia stem from inadequate examinations that lack substantial evidence, a result of time limitations during the examination procedure (Zuhri, 2017). The restricted effectiveness of transfer pricing audits is a result of time limitations and obstacles encountered by tax auditors, including uncooperative taxpayers, insufficient cooperation in supplying data and documents, difficulties related to transfer pricing laws, and challenges related to organizational and human resources (Muhammadi et al., 2016). Other researchers also identified that the significant challenges for developing countries to apply the arm's length principle efficiently are that it requires significant institutional capacity and human resources (Oguttu, 2020). Muhammadi et al. (2016) emphasized the necessity of policy enhancements to increase the quality of transfer pricing audits. Zulfiqar et al. (2023) also expressed a similar opinion that improvements in the quality of transfer pricing audits are necessary due to the increasing number of significant disputes.

The OECD encourages tax authorities and taxpayers to establish a relationship based on trust and cooperation called cooperative compliance to reduce tax disputes. Cooperative compliance can be defined as a condition where taxpayers decide to work together with the tax authorities to improve their tax compliance, thereby avoiding tax audits (Manhire, 2015). In Indonesia, cooperative compliance implementation includes supervision by an Account

Representative (AR) and the Letter of Inquiries for Clarifications (*Surat Permintaan Penjelasan atas Data dan/atau Keterangan* (SP2DK)) process (Andiko, 2018). Wardana (2018) states that SP2DK can serve as a nudge and a mechanism to enhance taxpayer adherence. The AR's proficiency in conducting activities, such as analysis and supervision, impacts the enhancement of taxpayers' adherence to their tax responsibilities (Kusumayanthi & Suprasto, 2019). The high-quality SP2DK issued by AR is anticipated to decrease the likelihood of tax audits and alleviate conflicts regarding tax evaluations stemming from inevitable tax audits (Gumaila & Adiyanto, 2021). To improve coordination between law enforcement and supervision, the Directorate General of Taxes (DGT) has revised its supervisory business procedures with SE-05/PJ/2022 with the goal of ensuring continued taxpayer compliance. For taxpayers engaging in transactions with related parties, SE-05/PJ/2022 requires the AR to incorporate transfer pricing analysis and international taxation aspects into the SP2DK.

The ADKAR framework is a suitable model to be applied in this research due to its focus on employees, specifically related to the changes in business process supervision to conduct transfer pricing analysis, including intragroup financing as required by SE-05/PJ/2022. ADKAR can identify the critical links or elements that may be impeding AR in applying the arm's length principle to transfer pricing analysis and rectify them. According to Hiatt (2006), ADKAR stands for awareness, desire, knowledge, ability, and reinforcement. Awareness includes comprehending the internal and external circumstances that necessitate change and the personal advantages; desire is support and participation in the amendment; knowledge comprises the skills and education needed for executing the change; ability converts information into action; and change is maintained by reinforcement (Hiatt, 2006). The ADKAR model identifies "barrier points" to help employers recognize employee issues and support them through each stage (Kazmi & Naarananoja, 2013). The ADKAR model has provided empirical evidence regarding the elements that hinder change in public sector education in Gulf countries and Pakistan (Al-Alawi et al., 2019; Kiani & Shah, 2014).

Prior transfer pricing research on intragroup financing transactions in Indonesia was conducted by evaluating appellate court decision findings in tax court cases (Natama & Irawan, 2021; Sari & Nuryanah, 2023; Zulfiqar et al., 2023) or approaches originating from taxpayers' perspectives on the use of the arm's length principle for financing costs (Basyeban, 2020; Damani, 2019; Filbery, 2022; Kamra, 2021). The author also found limited research on the SP2DK and AR main duties. Several studies have examined the efficacy of SP2DK (Deli, 2019; Gumaila & Adiyanto, 2021; Muzaki et al., 2020; Parmono, 2016) or discussed AR tax services roles such as providing consultation and addressing taxpayer inquiries (Boroh & Mursalim, 2018; Fadhilatunisa, 2018; Kusumayanthi & Suprasto, 2019; Sarbunan et al., 2023). Previous studies did not address AR's SP2DK analytical problems or use SE-05/PJ/2022 as a regulatory reference. Unlike previous studies, this research will examine an AR perspective on supervisory functions before the tax audit process. Furthermore, this study will use the ADKAR model to examine AR's transfer pricing analysis difficulties on intragroup financings during compliance supervision business process amendments. In this context, research on the challenges faced by AR in implementing the arm's length principle regarding intragroup financing in accordance with Indonesian tax regulations based on the ADKAR model, as well as the measures that DGT can take to address these issues, is important to improve the quality of SP2DK produced, thus promoting cooperative compliance and minimizing tax disputes.

Agency Theory, Tax Avoidance, and Transfer Pricing

Agency theory is a theoretical framework that pertains to the capital structure of companies, encompassing the influence of taxation as a crucial factor in the process of making funding decisions (Gabrielli, 2023). According to Gabrielli (2023), tax avoidance, which refers to a company's choice to reduce its tax liability, is a significant aspect of managing the company's capital structure by selecting debt or equity.

According to Eisenhardt (1989), agency difficulties emerge when there are disparities in objectives and risks between the principal and the agent, encompassing areas such as compensation, regulation, management, and transfer pricing. Additionally, these problems are further compounded by the absence of the principal's ability to verify the acts of the agent. In the context of transfer pricing, the government assumes the role of the principal responsible for overseeing the execution of transfer prices to ensure adherence to the arm's length principle. Conversely, the corporation is the agent responsible for implementing this practice (Nofita & Nuryanah, 2022).

Arm's Length Principle on Intragroup Financing

The arm's length principle is a globally recognized convention employed for tax purposes that involves comparing the pricing of transfers between affiliated businesses with similar transactions conducted between independent entities (PMK-172, 2023; UN, 2021; OECD, 2022). The OECD (2022) asserts that conducting transfer pricing analysis for intragroup financial transactions does not inherently differ from other related transactions, such as those involving tangible assets, intangible assets, or services. This interpretation can be derived from the tax regulations pertaining to the implementation of the arm's length principle in intragroup financing.

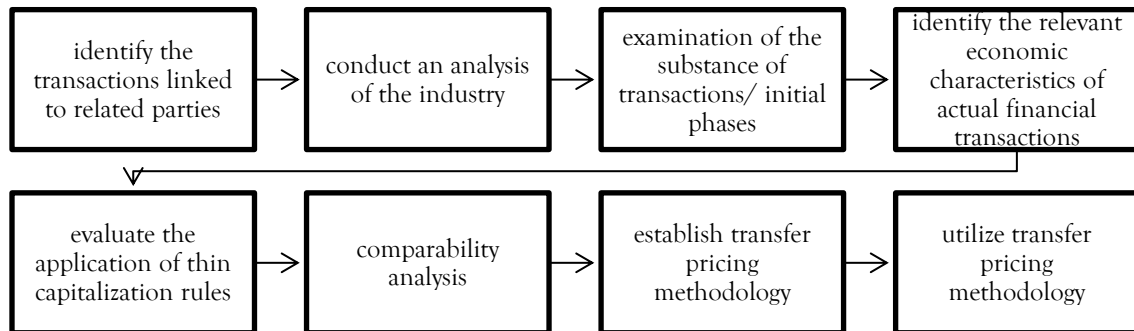


Figure 1. Working procedures for implementing the arm's length principle for intragroup financing
Source: SE-50 (2013), PMK-172 (2023) analyzed (2024)

According to Paragraph 10.62 of the OECD (2022), the primary determinant of the interest rate is creditworthiness, which is often assessed based on credit rating. Credit ratings can serve as a valuable tool for identifying prospective comparison data, enabling the assessment of the appropriateness of interest rates associated with transfer pricing transactions. The UN (2021), in accordance with the 2022 OECD Guidelines, governs the assessment of creditworthiness through a credit rating and takes into account the inherent risks associated with the financial instrument. Paragraph 9.12 of the Manual more clearly regulates the implementation of the arm's length principle in intragroup loans.

Change Management

Change is an inevitable aspect of both personal and professional life, as it is essential for ongoing growth and progress (Galli, 2018). Nevertheless, according to Joseph Galli (2018), the process of transformation can be challenging due to the presence of entrenched habits in both individuals and organizations. The ADKAR model is a change management framework that centers on comprehending change at the individual level. This is because the key to achieving success in a change initiative lies in effectively facilitating change inside an individual (Hiatt, 2006). The ADKAR framework comprises five essential components that must be implemented sequentially and cumulatively to ensure successful and enduring transformation.

Table 1. ADKAR Model

| Name | Description |
|------|--|
| A | Awareness of the need for change |
| D | Desire to support and participate in the change |
| K | Knowledge of how to change |
| A | Ability to implement required skills and behaviors |
| R | Reinforcement to sustain the change |

Source: Hiatt (2006)

Account Representative

The Account Representative is responsible for overseeing the compliance of taxpayers juxtaposed with applicable law (PMK-45, 2021). To enhance collaboration between law enforcement and efficient supervision, The DGT has revised the supervision business process through SE-05/PJ/2022 with the aim of achieving sustained taxpayer compliance. One of the modifications to the supervisory business process in SE-50, as detailed below:

Table 2. Supervision regulations

| Previous Rules | | Current Rules | |
|----------------|--|---------------|--|
| SE-07/PJ/2020 | Extensive supervision was conducted for taxpayers, but it did not encompass an analysis of transfer pricing. | SE-05/PJ/2022 | A complete assessment of taxpayer compliance was conducted, covering all aspects of taxation, including an analysis of transfer pricing. |

Source: SE-05 (2022)analyzed (2024)

The paper is structured as follows: The introduction leads to a description of the research method. The third section then contains the study's results and discussions. The conclusions and suggestions are presented in the last section.

RESEARCH METHODS

This was a problem-diagnostic case study to diagnose AR's challenges in implementing the arm's length principle on intragroup financing using the qualitative descriptive method. This study employs a triangulation approach, utilizing both questionnaires and interviews as data collection instruments. Case studies can incorporate and may be constrained by quantitative evidence (Yin, 2018). According to Swanborn (2010), case studies incorporate both qualitative and quantitative components. The author gathered information regarding the challenges AR encountered in implementing the arm's length principles on intragroup financing using questionnaires. The ARs were asked detailed interview questions to elaborate on the findings of the questionnaire and gain a comprehensive grasp of the research problems, as outlined before. This research targeted AR in several foreign investment tax offices within the Special Jakarta Regional Taxpayer Office. The foreign investment tax offices within the Special Jakarta Regional Taxpayer Office were chosen based on their higher volume of associated transactions.

Questionnaire

This study was not conducted as statistical research but rather as a means to gather opinions. Therefore, the number of participants was not of utmost importance. The design of the questionnaire was modified for implementation, drawing from Al-Alawi et al. (2019) work and enriched from the literature study, including Hiatt (2006), UN TPM (2021), OECD (2022), PMK-172 (2023), SE-50 (2013) and SE-05 (2022). The questionnaire included questions that were accompanied by a six-point Likert scale, allowing respondents to submit their answers. Yamashita (2022) and Taherdoost (2019) suggested a six-point Likert scale, taking into account the potential for respondents to respond neutrally.

The questionnaire underwent a pre-testing phase by three ARs and one supervisor who has expertise in tax supervision business procedures and the arm's length principle on intragroup financing. These individuals were provided a copy of the preliminary questionnaire and were requested to give feedback on the clarity of the questions. All of them commented that they were able to provide reasonably accurate estimates. Validity and reliability tests were performed to assess the accuracy and consistency of the research instruments employed. Validity refers to the degree to which a technique, instrument, or process accurately measures a specific notion, while reliability refers to the stability and consistency with which the instrument measures the variable (Sekaran & Bougie, 2019). Sekaran and Bougie (2019) stated that the utilization of well-validated instruments in research leads to favorable discoveries for the scientific community, as these results can be reproduced.

The validity test was conducted by comparing the estimated *r* value with the *r* table; if the calculated *r* value exceeds the *r* table value, it can be inferred that the instrument is valid (Fahrizal & Nuryanah, 2024). The reliability test utilized Cronbach's Alpha coefficient. This coefficient measures the consistency with values ranging between 0 and 1; a coefficient value above 0,6 is considered acceptable reliability (Kalpande & Toke, 2023; Marhaeni et al., 2019; Rojickinnor et al., 2023; Saragih & Jonathan, 2019). The questionnaire will be analyzed using descriptive statistical techniques. Statistical Package for the Social Sciences (SPSS) Ver.27 is used as a data processing tool. The results will be presented without any intention of making inferences or generalizing.

Interviews

A semi-structured interview style was used to validate the questionnaire results and gather opinions on the study problems. The researchers employed a semi-structured interview method for the purpose of accommodating the potential need to generate additional questions that are pertinent to the interviewee's answer (Savin-Baden & Major, 2023). A total of three AR was interviewed, with each informant from a different foreign investment tax office. The interviewers posed the following questions:

1. Please describe any challenges encountered while implementing the arm's length principle on intragroup financing as AR.
2. How would you suggest the DGT solve the challenges you encountered while implementing the arm's length principle on intragroup financing?

The verbatim transcriptions of the interviews will be examined regularly through indexing and classification (Creswell & Creswell, 2023). The results obtained from the interviews will be presented in their original form, with minor modifications made to improve comprehension.

RESULTS AND DISCUSSION

Questionnaire Results

Respondents' categories

The targeted number of participants for this questionnaire is 152 AR from four Foreign Investment Taxpayer Offices that have given their consent for the questionnaire distribution. The questionnaire participants were around 52 individuals. Thus, the obtained response rate is 34.21%. The acceptable range for the response rate is between 8% and 30% (Woodside, 2010). This research response rate is greater than 30%; therefore, the results can be analyzed.

Table 3. Questionnaire Data Collection

| | N | Percentage |
|-------------------------|-----------------|------------|
| Targeted respondent | | 152 |
| Questionnaires returned | 52 | 100 |
| Response rate | 52/ 152 = 34.21 | |
| Invalid | 8 | 15.38 |
| Valid | 44 | 84.62 |

Source: Primary data, analyzed (2024)

Out of the 52 questionnaires returned in this study, 8 were deemed unsuitable due to the fact that 2 respondents never conducted transfer pricing analysis and 6 respondents never performed transfer pricing analysis on intragroup financing. Thus, 84.62%, or a total of 44 questionnaires, have met the criteria for the research sample. The survey participants comprise 68.18% males and 31.82% females. The respondents aged 35 to 40 accounted for 50% of the total respondents. 38.64% of the respondents were between 40 and 45 y.o., while 6.82% were above 45 y.o., and only 4.55% of the respondents were under the age of 35. 75% of the respondents received a Diploma IV or Bachelor's degree, while 22.73% hold a Master's degree. Only 2.27% of the respondents held a Diploma III degree.

52.27% of the total respondents have been working as AR for 5 to 10 years, while 34.08% have work experience as AR between 10 and 15 years; additionally, 11.36% of the respondents have over 15 years of work experience, and only 2.27% of respondents have less than 5 years of work experience as AR. Over the past three years, 75% of respondents have conducted transfer pricing analysis on intragroup financing 1–3 times, 11.36% conducted the analysis 4–6 times, and the other 11.36% conducted more than 6 times of transfer pricing analysis on intragroup financing, whereas 2.27% have not conducted any analysis during that period. Out of the 44 respondents, 9.09% never received transfer pricing training from DGT.

Validity and reliability test

Based on the results of the validity test, it can be inferred that all tests are deemed valid since the Pearson Correlation > r table.

Table 4. Validity Test

| | Pearson Correlation | r table | Sig. (2-tailed) | Conclusion |
|---------------|---------------------|-------------|-----------------|------------|
| Awareness | .516 - .765 | .297 | 0,000 | Valid |
| Desire | .739 - .931 | .297 | 0,000 | Valid |
| Knowledge | .347 - .866 | .297 - .312 | 0,000 - 0,021 | Valid |
| Ability | .472 - .904 | .297 | 0,000 - 0,001 | Valid |
| Reinforcement | .718 - .810 | .297 | 0,000 | Valid |

Source: Primary data, analyzed (2024)

According to the findings of the reliability test, all of the variables have been deemed reliable. Each variable scored a Cronbach's Alpha value > 0.6

Table 5. Reliability Test

| | Cronbach's Alpha | Conclusion |
|---------------|------------------|------------|
| Awareness | .751 | Reliable |
| Desire | .847 | Reliable |
| Knowledge | .891 | Reliable |
| Ability | .918 | Reliable |
| Reinforcement | .733 | Reliable |

Source: Primary data, analyzed (2024)

Descriptive statistic

The mean response was crucial for making comparisons between the five essential factors. Among the five factors, the variable "knowledge" had a considerably low score, with a mean of 4.24 and a standard deviation of 0.594. The variable "ability" achieved a relatively low score, only slightly higher than the "knowledge" variable (M = 4.31, SD = 0.654). Emphasizing the variable "desire" is of utmost importance, as the participants obtained high scores (M = 5.01, SD = 0.602). The remaining two did not demonstrate a substantial score, with awareness (M = 4.95, SD = 0.512) and reinforcement (M = 4.85, SD = 0.537).

Table 6. Descriptive Statistics

| | N | Minimum | Maximum | Mean | SD | Result |
|--------------------|----|---------|---------|--------|---------|----------------|
| Awareness | 44 | 3.67 | 6.00 | 4.9583 | 0.51238 | Agree |
| Desire | 44 | 4.00 | 6.00 | 5.0114 | 0.60269 | Agree |
| Knowledge | 44 | 2.79 | 5.79 | 4.2486 | 0.59427 | Somewhat Agree |
| Ability | 44 | 3.27 | 5.87 | 4.3111 | 0.65480 | Somewhat Agree |
| Reinforcement | 44 | 4.00 | 6.00 | 4.8580 | 0.53754 | Agree |
| Valid N (listwise) | | | | | | |

Source: Primary data, analyzed (2024)

ARs demonstrate both the awareness and desire to implement the arm's length principle in their transfer pricing analysis on intragroup financing. Nevertheless, there is a significant disparity between their awareness and desire with their knowledge and ability to comply with the business process changes, as shown by the level of knowledge possessed and the accessibility of necessary tools for conducting transfer pricing analysis on intragroup financing.

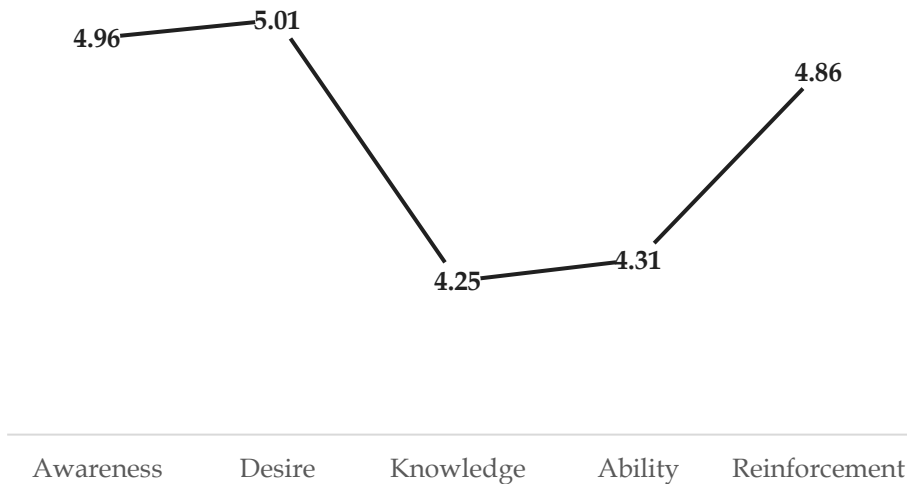


Figure 2. AR Perception using ADKAR framework

Source: Primary data, analyzed (2024)

Awareness perception involves an understanding of the need for change as well as the underlying reasons. With an average Likert scale of 4.96, it can be concluded that AR already has an awareness aspect in conducting transfer pricing analysis. The findings from the questionnaire indicate that respondents, on average, gave high scores for both the statements “I understand the logical reason for the obligation to conduct transfer pricing analysis” (M = 5.18) and “I understand the purpose of the obligation to conduct transfer pricing analysis” (M = 5.14). On the other hand, the statement “I received appropriate feedback from my supervisor on my transfer pricing analysis” (M = 4.48) requires attention because some respondents reported not receiving the expected feedback. In general, the awareness variable does not pose a barrier to the implementation of the arm's length principle on intragroup financing.

Desire perception is utilized as a metric for assessing the inclination of AR to apply arm's length principle analysis on intragroup financing. On average, respondents indicate that AR already has the desire aspect of conducting transfer pricing analysis, with a Likert scale of 5.01. The statement “I continuously seek to enhance my approach to conducting transfer pricing analysis” and the statement “I am committed to contributing optimal efforts to performing transfer pricing analysis to accomplish sustainable taxpayer compliance” exhibit the highest mean value (M = 5.14). Nevertheless, the assertion “I am inclined to engage in transfer pricing analysis” has the lowest mean value (M = 4.86) due to the presence of respondents who hold a moderate level of

disagreement with the statement. While the desire variable is typically not a constraint in the execution of the arm's length principle on intragroup financing, DGT must enhance the motivation of AR in conducting the transfer pricing analysis.

Acquiring knowledge is essential for AR to possess the requisite expertise and abilities to implement the arm's length principle on intragroup financing effectively. AR has demonstrated an adequate level of knowledge on transfer pricing analysis, as reflected by an average Likert scale of 4.25 in the knowledge component. The statement "I know there are guidelines that I can follow when conducting transfer pricing analysis on intragroup financing" obtained the highest average (M = 4.84). However, the statement "I solely replicate transfer pricing documentation when working on analysis of transfer pricing on intragroup financing" exhibits the lowest mean value (M = 3.75), while "I possess the knowledge to ascertain credit ratings when applying the arm's length principle on intragroup financing" follows closely behind (M = 3.89). The significantly low outcome indicates that the primary challenge in adopting the arm's length principle on intragroup financing is the lack of knowledge in assessing credit ratings, which can lead to AR simply duplicating the transfer pricing documentation created by the taxpayer.

The perception of ability is used to make sure AR has the tools and resources essential to apply the arm's length principle on intragroup financing properly. The respondents, on average, said that AR had a moderate level of ability in conducting transfer pricing analysis, with a Likert score of 4.31. The statement that obtained the highest average score (M = 5.18) pertains to the perception that fellow ARs are inclined to impart their expertise in conducting transfer pricing analysis to their colleagues. It is crucial to highlight the statement "I am able to use the tools to employ the arm's length principle in assessing credit ratings for intragroup financing (e.g., statistical formulas, probability of default models, and credit scoring tools like Moody's KMV Riskcalcs)" that possesses the lowest average value (M = 3.59), in addition to the statement "I have complete access to all the information and resources required to execute transfer pricing analysis" (M = 3.73). The two statements that possess the lowest average value suggest that the necessary resources to facilitate the implementation of the arm's length principle are presently unavailable and that there may be challenges in utilizing the available resources.

The reinforcement perception is used to determine whether continuous support and recognition impede the application of the arm's length principle on intragroup financing. According to the questionnaire results, the average respondent indicates that AR possesses the reinforcement variable when conducting transfer pricing analysis, with a Likert scale of 4.86. The statement "I feel that my performance has been regularly reviewed by my superiors" got the highest mean score (M = 5.00). The statement "I believe that qualitative performance measurement is necessary for transfer pricing analysis" gets the lowest mean value (M = 4.61). The study suggests that the reinforcement variable does not pose a barrier to the implementation of the arm's length principle on intragroup financing.

Interview Results

The informants of this interview are Account Representatives at the Foreign Investment Taxpayers Office. Informants also have experience conducting transfer pricing analysis on intragroup financing over the past three years. Table 7 shows the socio-demographic characteristics of the informants.

Table 7. Socio-demographic Characteristics of the Informants

| Name | Gender | Education | Working Experience as AR | Number of Intragroup Financing Cases |
|-------------|--------|-------------------|--------------------------|--------------------------------------|
| Informant A | Male | Master's Degree | 5 to 10 years | 1 - 3 |
| Informant B | Male | Master's Degree | 5 to 10 years | > 6 |
| Informant C | Male | Bachelor's Degree | 5 to 10 years | > 6 |

Source: Primary data, analyzed (2024)

The questionnaire revealed that "awareness," "desire," and "reinforcement" do not pose a barrier to the implementation of the arm's length principle on intragroup financing. This finding

aligns with the outcomes derived from the interview. Everyone understands the need to conduct transfer pricing analysis and the underlying reasons. The following interviews results illustrate this:

OK, of course, a transfer pricing analysis for those of us in the special regional taxpayer office area is very important because our taxpayers are multinational enterprises. AR's job is to measure and quantify... one of which is measuring the performance of our company or taxpayers. Taxpayers or multinational companies usually use transfer pricing to minimize the amount of tax paid through price analysis between divisions. For this reason, in my opinion, transfer pricing analysis for the special Jakarta regional taxpayer office is very important – A.

I think that's one of the right reasons because it actually started a long time ago... it's been almost more than five years... and there have been a lot of group affiliate transactions that could actually cause losses in terms of state revenue... – B

All of them also have the motivation to conduct transfer pricing analysis and arm's length principle on intragroup financing because they see this as beneficial.

.... Yes, maybe this is my opportunity to upgrade myself and maybe increase my knowledge about transfer pricing. Transfer pricing is quite interesting - A

.... incorporating transfer pricing analysis into comprehensive taxpayer compliance supervision is both reasonable and advantageous – C.

One of the challenges in applying the arm's length principle on intragroup financing is the difficulty in obtaining comparable data to determine interest rates. The underlying cause of these challenges can be attributed to the accessibility and proficiency of using the available tools. The following interview findings indicate this:

.... Maybe the obstacles are related to data because DGT itself cannot provide flexibility for AR to access data. If you are in the Special Jakarta area office, fortunately, you are given access to TP Catalyst or Orbis. However, not all ARs understand how to operate it. We also have difficulty accessing it ourselves because the assistance is very minimal, so we explore it ourselves.... – A

....ooh, it turns out we don't have one like that (the tools). The only thing (tools) we have that I'm familiar with so far is Orbis. Orbis is also not easy to access.... Outside the special (Jakarta) regional (taxpayer) offices, it might be even more challenging to get the data from far away.... the person may not be there... the operator... – B

.... There are many references. Perhaps the easiest is the BI rate. However, there is also SIBOR, LIBOR, JIBOR, or now SOFR, SONIA, and others. So, from the reference, n% must be added according to the credit rating. Yes...for us to determine the n% value according to the credit rating at the AR stage is too difficult in my opinion. Unless AR uses the tax auditor's audit results or previous analysis results, this may be easier. – C

Respondents also stated that DGT did not provide tools to determine taxpayer credit ratings.

As far as I know, there aren't any (credit rating tools). The DGT doesn't provide that tool – A

... .. indeed there are still (tools) obstacles too... especially the (credit) rating.... – C

ARs also have time constraints related to the reinforcement of the arm's length principle on intragroup financing.

...we have time management, AR if more than 60 days (SP2DK) have not been paid (by taxpayers), then the points (SP2DK completion) will be small. So, AR has a rhythm that is actually faster than that of tax auditors. We (AR) can't do the analysis for too long... -B

.... The second obstacle might have to do with the discussion partners. Discussion partners who truly understand this intragroup loan.... - A

Several suggestions were provided by the informants:

.... In my opinion, there should be more specific training, for example, special training for intragroup loans, case studies, and all that. Because each case is unique, the more information we obtain, the greater our insight. Thank You. - A

....so what is better? Because the era of openness is now, it's better, (DGT) can display the orbis data in our system... which is what we say (the system) will change later... - B

...regarding (credit) rating should probably be provided from CRM with WP (credit) rating data...rather than AR having to calculate it himself. - C

The questionnaire revealed that the key elements "knowledge" and "ability" exhibit the lowest average level of perceived challenges. This finding is consistent with the results obtained from the interview.

Discussion

The introduction outlines the purpose of ascertaining the obstacles encountered by AR in the implementation of the arm's length principle in intragroup financing transfer pricing analysis. The requirement to perform transfer pricing analysis stems from a change in the compliance supervision business process. The utilization of questionnaires and interviews appears to have effectively accomplished the stated objective of identifying these issues. No notable surprises emerged from the questionnaire and interview results, but they did provide crucial data for conducting an objective analysis. The subsequent section presents an analysis of the research findings.

The most significant barrier to the mandatory use of the arm's length principle in AR's transfer pricing analysis of intragroup financing is the factor of "knowledge." This study aligns with previous research undertaken by Sebele-Mpofu et al. (2021), which highlights the challenges encountered by Zimbabwe as a developing nation in applying the arm's length principle, such as insufficient skills and experience and limited access to comparable data and databases. Oguttu (2020), in his research in several African countries, also revealed that significant institutional capacity and human resources are important for the arm's length principle to be implemented efficiently. The findings of the research conducted by Muhammadi et al. (2016) and Zulfiqar et al. (2023) align with the notion that tax auditors in Indonesia have challenges related to transfer pricing audits, primarily stemming from a lack of "knowledge." According to a study conducted by Sari and Nuryanah (2023), it is recommended to enhance competency in order to bolster the evidence supporting the improper application of the arm's length principle by taxpayers. Tambunan (2022) also provided comparable recommendations.

In the implementation of the arm's length principle on intragroup financing, the assessment of creditworthiness plays a significant role in the determination of interest rates (OECD, 2022). Creditworthiness is typically quantified by the term credit rating. The utilization of credit ratings can

serve as a valuable instrument for identifying plausible comparable data, enabling the evaluation of the fairness of the interest rates in transfer pricing transactions. Consistent with the OECD (2022), the UN (2021) likewise governs the assessment of creditworthiness, as indicated by a credit rating, and takes into account the inherent risk associated with the financial instrument.

The SE-50 (2013) incorporates a reference to the credit rating that determines the fair interest rate for related-party transactions. According to the SE-50 (2013), independent parties often decide the interest rate by utilizing a certain interest rate (such as SIBOR, LIBOR, or JIBOR) and including a specific value depending on the loan recipient's credit rating or other relevant factors. However, the methodology for assessing the credit rating lacks a comprehensive explanation. The findings derived from the questionnaires and interviews indicate that the primary challenge encountered by AR within the scope of "knowledge" is the assessment of credit ratings.

The findings of the questionnaire also indicate the presence of ARs who have not undergone any training pertaining to transfer pricing. The DGT is required to improve the employees' capacity to perform their duties effectively. According to the respondents, the most appropriate method for enhancing understanding of transfer pricing is through training that adopts a case study approach and theme analysis depending on the specific type of affiliated transaction.

One of the primary obstacles encountered by AR in the implementation of the arm's length principle in the analysis of transfer pricing for intragroup loans is related to the "ability" component. The aspect of "ability" pertains to the accessibility and proficiency in utilizing the requisite instruments and resources. The results of administering questionnaires and conducting interviews reveal that the available tools for credit rating assessment and obtaining comparable data are limited. A small number of offices possess paid access, whereas a restricted number of individuals have the capability to operate the tool. Respondents have proposed embedding the credit rating calculation tool in the taxpayer supervision information system (approweb), taking into account the ongoing PSIAP project by DGT to develop an information system for data-driven decision-making purposes.

CONCLUSIONS

The research findings indicate that the primary barriers to implementing the arm's length principle in intragroup loans by AR are knowledge and ability. The main "knowledge" barrier in adopting the arm's length principle on intragroup financing is the lack of knowledge in assessing credit ratings. The "ability" constraints show that the necessary resources to facilitate the implementation of the arm's length principle are presently unavailable and that there may be challenges in utilizing the available resources. Based on these findings, this study recommends that DGT enhance knowledge and skills in order to properly utilize transfer pricing analysis by AR for the purpose of increasing tax collections and mitigating the chance of tax disputes. It is suggested that DGT conduct a case-based approach for training and enhancing accessibility to acquire comparable data or taxpayer credit ratings. The distribution of the questionnaire to only four foreign investment taxpayer offices that granted research approval may not have comprehensively captured all aspects of the challenges encountered by AR. Further research could be conducted to examine the effects of the implementation of the arm's length principle on intragroup financing by AR in the transfer pricing tax audit process.

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A Tax Officials Perspectives

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