

Benefit Test Analysis for Management Services Transaction in Transfer Pricing

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ABSTRACT

This paper analyzes the arm's length range of transfer pricing transactions of PT Wijaya's management services. One of the risks borne by PT Wijaya is the tax adjustment on management service transactions paid to related parties when they fail to fulfill the benefit test according to the arm's length range principle. This study employs a case study research. The method is used to dig deeper into the phenomena that occur in PT Wijaya. Thus, it can be proved by the economic or commercial benefit of PT Wijaya in improving or maintaining its business. Data collection was done by interviewing and studying documents to obtain information related to the provision of management services. The results show that the existence of services and benefits received by PT Wijaya cannot be proven because of the lack of supporting documents and the transactions are duplicative services. Duplicative services mean that the management services received should be carried out by PT Wijaya independently.

Keywords: *Transfer pricing, management service, benefit test*

1. INTRODUCTION

Multinational companies have a role in driving the world's economy. Because of the presence of multinational companies, transactions among countries are no longer limited by national boundaries. Indonesia, as one of the locations of multinational companies, is certainly accustomed to cross-country transactions. This transaction can occur among independent parties, third parties or related parties. Related party transactions take the form of transfer pricing of goods, services, or transactions for the use of intangible assets. In the aspect of taxation, transfer pricing is a policy in determining prices for transactions with a related party (Darussalam & Septriady, 2013).

One of the transactions that often occur among related parties within a group is a service provision transaction. Service transactions, also known as intragroup services in transfer pricing, are considered an effective tool in supply chain management and used in tax planning. Due to its nature, it has become one of the important issues for tax authorities (Kristin and Riandoko, 2018). Intragroup services are the provision of services carried out by one party to another in the context of utilizing the cost and revenue of each party.

Provision of services in a group needs further attention because there is an increase of tax disputes over this transaction. This also generates conflict between the taxpayer and the tax authority due to difference in interest. Taxpayers often carry out an intragroup service scheme as a form of tax planning. According to the tax authority, it is suspected that the transaction is conducted to transfer profit.

Based on a survey (Erns and Young, 2016), the increasing controversy over the issue of transfer pricing of goods transaction and the provision of services for related parties shows that the practice of transfer pricing is rather common for a number of companies. Although the transaction has become a common practice for a company, the determination of arm's length price of the transaction is very difficult, especially for service provision transaction (Adinda, 2012). This is because, in reviewing the offer for services, the company is not only looking for the right comparable companies, but also obliged to prove the existence of those services. In addition, the company must prove the economic benefits received for services performed or given.

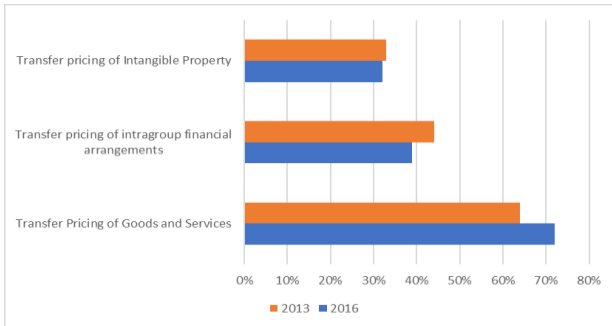


Figure 1. Transfer Pricing Controversy.

Referring to the results from the Audit Result Notification Letter dated 11 May 2018 for the examination of the 2016 financial year of PT Wijaya, correction for adjustment of management service fee is found. This is explained by the tax audit that the tax inspector does not believe that there is economic benefit, as explained in (Direktorat Jenderal Pajak, 2013) Tax Regulation Article 17 Paragraph 7 concerning the utilization of intangible asset by related party transaction. Therefore, PT Wijaya must provide an explanation and proof of the economic benefit received regarding the audit result of the transaction.

Analysis of economic benefit is one of the steps in reviewing the arm's length range in transfer pricing. Before conducting an economic analysis, the reviewer must ensure that the transactions actually take place, and then an analysis of economic benefits can be done by proving the existence of additional commercial value of the company and willingness to pay when the transaction is done by a third party (OECD, 2017). In addition, in Direktorat Jenderal Pajak Surat Edaran Dirjen Pajak Nomor 50 (2013), it is stated that companies must also be able to ensure that these services are not a shareholder activity, duplicate service, incidental benefit, passive association, or on call service. Therefore, it is important to prove the existence of services and economic benefit as well as the realization of services between groups before reviewing the arm's length range of the payment of services.

2. LITERATURE REVIEW

2.1. Agency Theory

Agency theory is a fundamental theory in a company's business activity. Agency theory (Jensen and Meckling, 1976) is a contract that occurs among one or more principals to agents in the context of delegating tasks in accordance with the interest of the principal. In this case, the agent is authorized in decision making. According to Waluyo (2017), the delegation of duties from the principal to the agent is due to the lack of knowledge or expertise from the principal to complete the duties independently.

Agency theory is the basis of conflicts over transactions that occur between related parties. Transaction of related parties can be considered as an opportunistic transaction or an efficient transaction, where agency problems arise because of a conflict of interest (Waluyo, 2018). The conflict of interest in question is the difference in interest arising from the agent, namely the taxpayer, and the principle, namely the tax authority. In line with the conflict, companies tend to push their tax burden as low as possible or utilize the tax burden efficiently (Gunadi, 2007).

2.2. Intragroup Services

Intragroup services are activities provided by parties within the business group that benefit members of other business groups. Intragroup services include administration, technical, financial, or commercial services in which independent parties want to pay (willing to pay) or carry out these activities. Therefore, the provision of services is one of the crucial aspects for business activity among parties within a group.

3. RESEARCH METHOD

This research employed a mixed method, using more than one method in data collection. This research can be categorized using between-methods triangulation, which is based on the work of Denzin (1978). Between-methods triangulation is research that uses a combination of qualitative and quantitative approaches.

This research was conducted by collecting data, through interviews, observation, and document study. In processing the data, quantitative method was used by processing and analyzing the data available through documents that were obtained previously. The qualitative data were processed through descriptive method.

3.1. Type and Source of Data

Qualitative and quantitative data were used in this research. Quantitative data are numerical data such as the amount of PT Wijaya's financial statement in the form of income statement, while qualitative data are non-numerical data such as an explanation of PT Wijaya's general description of the human resources, letter of examination results, information, and explanations of the process provision for services from related parties. Quantitative data support and justify the qualitative data in this research.

3.2. Data Analysis

Data analysis of this research was carried out qualitatively and quantitatively. Data processing on the company's internal data was completed by collecting

written evidence on management service contracts and other information such as budgeting, accounting, tax, IT, marketing, payroll, and supporting data to prove the economic benefit and the existence of management services paid by PT Wijaya to the parent company. Quantitative data were analyzed by comparing financial data from several years. The aim of this research was to observe the increase or decrease that occurs in the company. Thus, the factors causing this particular condition can be analyzed. Data analysis was also developed descriptively to analyze other factors in the benefit test for the existence and economic benefits of management services paid by PT Wijaya.

4. RESULT AND DISCUSSION

PT Wijaya is a subsidiary of PT XM. PT XM as the holding company owns the business activities as a holding company. However, PT XM also conducts other activities to support the company's operations by providing services to PT Wijaya and several other subsidiaries. Management services provided include tax assistance, provision of tax administration assistance, and the provision of Microsoft database, as well as tax training.

Management service transactions have been carried out since 2008. This management service is carried out only when the company owns additional businesses other than as a holding company (Denzin, 1978). The largest management service activities carried out by PT XM are mostly charged for profit and the market share in running a business.

Based on the examination of PT Wijaya in 2018 by tax audit, it is concluded that the management services paid by PT Wijaya had no economic benefits. Therefore, PT Wijaya must conduct a tax adjustment if it cannot prove the benefit. In proving economic benefits, an analysis can be done by showing the existence of services as well as the commercial increase received by the company. On the other hand, the step of analyzing management services transaction in transfer pricing also consists of the existence test, which is performed before economic benefit test. The last test is to calculate the arm's length price for management fee that have been paid.

The following is an affiliated transaction scheme in XM group for management service.



Figure 2. Management Fee Scheme.

4.1. Analysis of Existence Test

Analysis of the service existence is conducted to prove that the services have actually been provided by the parent company. The methods taken in the analysis of the existence of services are by looking at the process of service necessities to the result of the services provided.

The background of the process of service necessities actually occurs because of a management decision at the parent company, PT XM. PT XM is a holding company that only receives dividend income, for the sake of facilitating activities and interactions among subsidiaries. PT XM conducts business management services and charges its subsidiaries. For this reason, the process of service necessities is analyzed from the PT XM side, not based on needs analyzed by PT Wijaya.

The process of services selection by PT Wijaya is done because, in the context of efficiency, services are provided by PT XM as the parent company. This is done because there is some internal information that cannot be known by third parties. Similarly, the service negotiation is assessed by PT XM by looking at the condition of all subsidiaries including PT Wijaya.

The service is done by the arrival process from PT XM to PT Wijaya, to analyze the problems faced by PT Wijaya. Furthermore, the company discusses alternatives to find a solution so that it can be resolved in accordance with the applicable provisions. For example, an examination at PT Wijaya, in this case PT XM, provides a proposal for the process of appointing a tax consultant who meets the criteria of consultation requirements from the results of the examination. However, the arrival process is not documented by both parties.

Documents provided in the process of service procurement are contract and payment service invoices. This contract contains the scope of provided services and the value of management fees that must be paid. A billing invoice is usually given at the end of each month. In this case, documents on contracts and invoices are not strong enough to support the verification of services provided because service contracts can be made at any time when needed by the concerned parties.

The parties involved in providing services and implementing services are the heads of divisions of each company. In its implementation, the head of the division of PT XM's role is to provide supervision by PT XM for the services provided. Supporting documents on the parties involved were not provided by PT XM or PT Wijaya.

Based on the analysis of the existence of services, it can be concluded that the services provided by PT XM to PT Wijaya do not represent strong enough evidence to support the existence of services received. When the existing transaction cannot be proven acceptably as an existing management fee transaction, then the paid management fee cannot be recognized and tax adjustment is needed (Respondent 1, 2019). Some components of the analysis of service provision do not

have supporting evidence as either strong document or explanation, even though, in some cases, services have been provided and contracts for service agreements already exist.

4.2. Analysis of Benefit Test

Analysis of economic benefits can be done in several steps, including by analyzing the financial condition of PT Wijaya. Economic benefits can be seen by increasing sales, higher level of company profitability compared to similar companies, the ability to maintain market share, and the efficiency and effectiveness of the production process in a sustainable manner (Llanes and Mukanov, 2012).

The comparison of financial statements for the last for years shows that the income of 2016 has decreased, with the amount of Rp. 240,312,624,000. This does not mean that management services in PT Wijaya have no benefit, because the sales dropped significantly to almost 50%. It is more likely to be caused by market condition that is currently declining. However, PT Wijaya cannot provide valid evidence that PT Wijaya received the benefit as previously explained. Therefore, economic benefit in the form of efficiency for services provided by the parent company cannot be proven.

Table I. Financial Reports for Multiple Years

Akun	Tahun			
	2013	2014	2015	2016
Revenue	Rp 420,278,960,000	Rp 450,569,726,000	Rp 500,681,889,000	Rp 260,369,265,000
COGS	Rp 277,925,218,000	Rp 293,780,462,000	Rp 321,712,979,000	Rp 158,712,979,000
Gross Profit	Rp 142,553,742,000	Rp 156,789,264,000	Rp 178,968,910,000	Rp 101,656,286,000
SE & GA	Rp 37,146,360,000	Rp 40,690,280,000	Rp 42,259,130,000	Rp 49,298,461,000
Operating Income	Rp 105,407,382,000	Rp 116,098,984,000	Rp 136,709,780,000	Rp 52,357,825,000
ROTC	33,5%	34,7%	37,6%	25,2%
ROS	25,4%	25,8%	27,3%	20,1%

On the other hand, the expenses borne by PT Wijaya from year to year have relatively increased. This shows that efficiency in company productivity cannot be demonstrated through paid management fee. The company cannot conduct a verification through the expenses that have been paid.

Revenues received from the sale of construction equipment and expenses incurred in connection with merchandize and general administration do not indicate the existence of economic benefit received. The decline in sales occurred due to other conditions, and the increased burden also occurred in COGS, meaning that they are related to the products produced and not an office-related burden, one of which was management service burden. The company's revenue and operating profit declined intensely in 2016. The decline in income that occurred in PT Wijaya is likely due to other factors, one of which was due to decreased demand from customers (Markham, 2005).

Further analysis of economic benefit is done by analysing all functions in the provision of services. In general, all functions performed by PT Wijaya in the company's main business as construction equipment manufacturing companies are borne entirely by the company, as are the assets used and the risks borne by PT Wijaya. In this case, PT Wijaya is a fully fledged manufacturer. However, the management services received by PT Wijaya are services that are not directly related to the type of business of the company, because these services are additional services for the company's operational assistance. In addition, management services paid by PT Wijaya include several service components. As explained in the previous subsection, the services provided are accounting and financial services, HR services, IT services, licensing services, export and import services, and business development services. The details of each service are tailored to the needs of each year on the basis of the previous year's charges (2015 budgeting).

After function and cost analysis, the next step is an analysis of services that cannot be billed to determine that the services received are services that can be recognized as costs that must be paid by the service recipient because of the addition of commercial value. In this case, PT XM does not charge the activities carried out by PT XM to PT Wijaya, such as cost in preparing the consolidated report; PT XM pays for the provision of this report because the contract for audit services is included in the payment of consolidated report. In addition, there are operating expenses, costs of goods sold, costs of management service and direct cost (Respondent 2, 2018). This expense is borne entirely by PT XM without assistance from other affiliated parties. However, PT Wijaya can perform its own activities on management services provided by PT XM. The management service activities provided by PT XM are available at PT Wijaya in each department. Thus, the services provided by PT XM are considered a duplicative service and these services should not be charged because additional benefits cannot be proven (Linnenbaum and Stillhart, 2012).

Based on an analysis of the economic benefit made using several existing indicators, the company is not proven to receive economic benefit because it does not have sufficient evidence and there is no increase in commercial benefit that is directly or indirectly obtained by PT Wijaya. Therefore, the management services provided by PT XM to PT Wijaya cannot be financed, because PT Wijaya should be able to provide these services independently. Thus, these services can be classified as services that cannot be billed, where the parent collects an amount from PT Wijaya because PT Wijaya is only part of the PT XM group. However, the service has no benefit to PT Wijaya and it can provide these services independently. Using support agency theory, there are differences in interests and asymmetrical information, where the information provided by PT Wijaya to the DGT is incomplete. The parties that are aware of this activity are PT Wijaya and PT XM itself.

Because the transaction of management services does not meet the existence and economic benefit test, it will create a risk of tax adjustment. The burden of management services paid cannot be taxed, in this case referred to as primary adjustment. Then, the primary adjustment that occurs raises an additional correction on the corporate income tax, which is called a secondary adjustment. On the opposite side of the transaction, tax adjustment should also be made; if the burden is corrected, then the opposite side of the transaction is also corrected for management service income. This is referred to as the corresponding adjustment. This is in line with the theory of justice that every transaction that occurs must be implemented in accordance with the applicable guidelines. However, this is not commonly done by the tax authority. In addition, according to the

accounting principles of substance to form, this management service is considered as a deemed dividend in accordance with Income Tax Article 4 letter g (Pemerintah Republik Indonesia, 2008). Even though the form of this transaction is management services, substantially, the transaction falls into the category of dividend.

5. CONCLUSIONS AND IMPLICATION

Based on the result of analysis related to payment for management services, PT Wijaya did not fulfill existence test and benefit test analysis and the tax service will be adjusted for the service, so that the services rendered are considered as deemed dividends.

In this case, the process of the proof of existence and economic benefit tests becomes important. Even though the company has calculated the arm's length range of the transaction, if the existence of the services and the benefits cannot be proven, then the tax adjustment will be made (correction) by tax audit.

6. RESEARCH LIMITATIONS

This study has a limitation, that is the analysis is carried out only on PT Wijaya because the conditions in PT Wijaya are in accordance with the background of the problems discussed in the previous section. This study also only answers the benefit analysis test, which is a test of economic assistance and benefits, so that the reasonableness calculation of the transaction value carried out is not necessary in this study. From the limitations of this study, it is hoped that further research can complement the existing limitations so that suggestions can be improved for arm's length analysis for management services.

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