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TRANSFER PRICING RISK ASSESSMENT: UN GUIDELINES, PRACTICES IN AUSTRALIA, AND RECOMMENDATIONS FOR INDONESIA

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Abstract: *The Directorate General of Taxes has implemented the Compliance Risk Management (CRM) application, including the CRM Transfer Pricing (CRM TP) program, as a tool to map risks in transfer pricing practices. However, the effectiveness of CRM TP in ensuring compliance and preventing tax avoidance still requires further evaluation. According to a study by Maydiana (2023), the implementation of CRM faces various challenges, such as lack of support, data limitations, and insufficient system integration. At the international level, the United Nations (UN) guidelines for transfer pricing risk assessment have been successfully implemented in Australia. This research will explore the transfer pricing risk assessment approach by referring to the UN guidelines and Australia's experience, as well as provide strategic recommendations for The Directorate General of Taxes. The research employs a qualitative approach, using literature review as the method of data collection. The findings indicate that the assessment criteria, both quantitative and qualitative, do not accurately cover all relevant factors. Moreover, the effectiveness of the risk identification and monitoring processes also requires improvement, particularly in the use of data analysis applications that are not yet optimal and integrated. The monitoring and feedback mechanisms also need to be evaluated to be more adaptive to changing risks. The strategic recommendations proposed include the implementation of an integrated risk assessment approach, optimization of data utilization from Country by Country Reports, development of data analysis technology and monitoring systems, application of risk classification and compliance guidelines, as well as the enhancement of governance and documentation. These steps are expected to strengthen the transfer pricing risk assessment system, improve tax compliance, and create a more transparent business environment.*

Keywords: *Transfer Pricing, Risk Assessment, Compliance Risk Management, International Tax.*

1. Introduction

In recent years, the international tax landscape has undergone significant transformation, primarily due to global initiatives such as the Base Erosion and Profit Shifting (BEPS) project initiated by the Organisation for Economic Co-operation and Development (OECD). BEPS is designed to address the practices of multinational enterprises (MNEs) that exploit gaps in the international tax system through transfer pricing arrangements that do not adhere to the arm's length principle. Its primary aim is to enhance transparency and ensure that profits are taxed where economic value is generated (OECD, 2015).

In response to BEPS, countries worldwide have tightened regulations and oversight on transfer pricing practices, promoting the adoption of more comprehensive transfer pricing documentation (TP Doc) and implementing advanced risk assessment mechanisms to identify high-risk transactions. Despite stricter policies, challenges in detecting and managing transfer pricing risks remain significant. In Indonesia, for example, difficulties in identifying transactions that shift profits to low-tax jurisdictions and limitations in risk assessment tools continue to be major hurdles (Gunadi, 2007; Spengel, 2018). These transactions often involve complex structures such as royalty transfers, management fees, and the purchase/sale of goods or services, which are difficult to identify without adequate assessment tools.

Effective risk assessment of such transactions requires a deep understanding of the structure of MNE, the relationships between involved entities, and other relevant information (UN, 2024). This is challenging as many MNE have complex and opaque structures, necessitating high-level guidance, skills, and analytical technology to detect potential tax avoidance. Without adequate systems, such as risk assessment guidelines and data analysis software, tax authorities will struggle to identify and address high-risk transactions.

The Directorate General of Taxes (DJP) faces constraints related to human resources. In 2022, there were 4,287,787 corporate taxpayers to be managed by 44,787 DJP employees (DJP, 2022). This imbalance highlights limitations in supervisory capacity, where each DJP employee must handle a very large number of taxpayers. This increases the risk of reduced quality in oversight and delays in auditing high-risk transactions.

Overall, these challenges underscore the importance of developing a comprehensive transfer pricing risk assessment strategy for MNE. This risk assessment function supports efficient and effective transfer pricing compliance assurance, emphasizing priorities and needs of countries with limited capacity (UN, 2024). Thus, DJP can be more efficient in allocating its resources and ensuring taxpayer compliance with applicable tax principles. Transfer pricing risk assessment can serve as a basis for critical decisions regarding the initiation of transfer pricing audits.

To date, DJP has been operating the Compliance Risk Management (CRM) application based on taxpayer data since July 2021. CRM is a risk management system that encompasses the identification, mapping, modeling, mitigation, and evaluation of compliance risks. One of its main programs, CRM Transfer Pricing (CRM TP), is designed to map risks associated with transfer pricing practices (DDTCNews, 2024). However, the effectiveness of CRM TP in ensuring compliance with the arm's length principle and preventing tax avoidance still requires further evaluation. Maydiana's 2023 study, although not specifically addressing CRM TP, indicates that CRM implementation in oversight and examination functions remains suboptimal, with various obstacles such as lack of support from relevant parties, data limitations, and system integration issues.

On a global scale, transfer pricing risk assessment is also a significant issue. The United Nations (UN) has published guidelines on transfer pricing risk assessment that allow tax authorities to prioritize their resources on the most high-risk transfer pricing cases, making oversight more efficient and effective. These international guidelines provide a technical framework that helps tax authorities identify and target high-risk transfer pricing cases, including risk identification methods, measurable risk assessment, and audit strategies to maximize examination efficiency. Accurate risk assessment enables tax authorities to focus more on areas most vulnerable to abuse, thus improving audit targeting accuracy and enforcement effectiveness. For example, Australia has successfully implemented a comprehensive risk assessment approach with a focus on the early identification of companies with potential high risks. This experience demonstrates that applying appropriate international frameworks can significantly enhance the efficiency and effectiveness of tax audits and can serve as a relevant model for Indonesia. This research will deeply explore the approach to transfer pricing risk assessment based on UN guidelines, the application of transfer pricing risk assessment in Australia, and provide strategic development recommendations for DJP to enhance the targeting accuracy of transfer pricing audits.

2. Method

This research employs a qualitative approach designed to provide an in-depth understanding of social phenomena and the issues faced by society. This approach aims to create a comprehensive and complex picture of the issue being studied, presenting it through detailed verbal descriptions. Through the qualitative approach, this research seeks to capture nuances and dynamics that may not be revealed through quantitative methods (Creswell, 2014).

The data collection technique used in this research is literature review. Sarwono (2006) explains that a literature review involves examining data from various book references and previous relevant research findings to establish a theoretical foundation for the research problem. The data required for this research is obtained from library sources or documents. Zed (2014) adds that in library research, literature searching not only serves as an initial step in designing the research framework, but also to utilize library resources to obtain the necessary research data.

3. Results and Discussion

3.1. Compliance Risk Management Transfer Pricing (CRM TP)

CRM in taxation in Indonesia was first regulated through SE-24/PJ/2019 and updated in 2021 through SE-39/PJ/2021. The implementation of CRM has expanded the functions of taxation, including extension, supervision, examination, collection, services, tax education, and transfer pricing. This new regulation complements the previous monitoring, supervision, and collection functions with data analysis applications such as *Ability-To-Pay, SmartWeb,* and Transfer Pricing Compliance Risk Map to develop a compliance risk map (DJP, 2019; DJP, 2021).

According to SE-39/PJ/2021, the Transfer Pricing Compliance Risk Map illustrates the compliance risk level of taxpayers involved in transactions influenced by special relationships, based on the likelihood of non-compliance and its impact on revenue. The provisions for implementing CRM TP are as follows:

a. The CRM TP Compliance Risk Map is displayed in ApproWeb with criteria: a) Taxpayer Compliance Risk is the likelihood or uncertainty that may result in tax revenue loss from transactions affected by special relationships; b) Probability of Non-Compliance (X-axis) indicates the likelihood of failing to meet tax obligations for the transaction; c) Fiscal Impact (Y-axis) describes the consequences of non-compliance with tax obligations.
b. The CRM TP Compliance Risk Map is used as a consideration in preparing the Priority Target Potential Mining List/ *Daftar Sasaran Prioritas Penggalian Potensi* (DSP3);
c. The tax office follows up on the DSP3 by testing the application of the arm's length principle and business norms for transactions between parties with special relationships.

The CRM TP application aims to assist supervision by providing a risk map for taxpayers using transfer pricing for tax avoidance. In CRM TP, there is business intelligence in the form of SmartWeb snapshots that depict the network of special relationships within the taxpayer's business group (DDTC, 2021). Generally, DJP will profile the risk map in the application with the following risk distribution: a. Taxpayers marked in red have the highest non-compliance risk; b. Yellow indicates medium risk; c. Green indicates the lowest risk.

The two main factors in classification are Fiscal Impact and Probability of Non-Compliance. This risk map distribution helps tax officials create a list of taxpayers that need to be monitored. Other considerations in selecting taxpayers include ability levels: Very High, High, Medium, Low, and Very Low. Tax officials will target taxpayers with high to medium payment abilities. Subsequently, supervision is conducted through issuing Letter for Clarification of Data and/or Information or visits. Further supervision is carried out by proposing an audit or examining preliminary evidence by tax officials. The final stage is monitoring and evaluating the results of supervision and the collected taxes (Phinanti and Tobing, 2023).

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3.2. UN Guidelines on Transfer Pricing Risk Assessment

The UN has published a guide titled "End-to-End Transfer Pricing Compliance Assurance," specifically designed to assist developing countries in ensuring compliance with transfer pricing regulations. This guide emphasizes two main components in the compliance enhancement strategy: risk assessment and the implementation of transfer pricing audits. It outlines best practices for planning, executing, and concluding transfer pricing risk assessments.

3.2.1. Strategic Risk Assessment Plan

The guidelines describe several approaches that tax authorities can use when planning transfer pricing risk assessments for taxpayers:

a. Centralized vs. Decentralized Approach: Risk assessment in transfer pricing can be carried out in a centralized, decentralized, or hybrid manner. A centralized approach involves a dedicated team ensuring consistency of standards and expertise development. In contrast, a decentralized approach involves local transfer pricing audit teams to enhance interaction with taxpayers and broaden the scope of assessment. In a hybrid approach, local auditors collect preliminary data, and then a central board reviews it to determine if more in-depth risk analysis or specific audits are needed.

b. Global vs. Industry-Specific Risk Assessment: Risk assessment programs can either cover the entire population of taxpayers or focus on specific sectors that are crucial to the national economy or have high risk.

c. Taxpayer Classification: Taxpayers can be classified based on revenue into large, medium, and small categories. Typically, large taxpayers, often involved in international activities, require more stringent risk assessments.

d. Transactional vs. Jurisdictional vs. Risk-Based Approach: The Transactional Approach focuses on specific transactions deemed high-risk, such as mergers and acquisitions. The Jurisdictional Approach prioritizes transactions with entities in countries with low tax rates or aggressive tax rules. The Risk-Based Approach combines both transactional and jurisdictional approaches, considering additional factors such as tax compliance and excessive losses despite consolidated profits.

Effective transfer pricing risk assessment requires a deep understanding of the taxpayer, global business, and related industries, as well as the use of various sources of information. Primary information sources include tax reports, Transfer Pricing Documentation (TP Doc) (such as country reports, master files, and local files), audit and compliance reports, and information exchange between tax administrations. Additional information can be obtained from financial statements, questionnaires, and public sources such as internet searches, industry news, commercial databases, and government customs and registration data. Combining these various sources allows for cross-verification, risk identification, and better decision-making in the risk assessment process.

3.2.2. Detailed Risk Assessment

Initial Phase

After collecting and analyzing preliminary information, quantitative analysis using profitability indicators and industry comparisons can assist in the initial screening of MNE groups for risk assessment and prioritize cases that require more in-depth qualitative analysis. To achieve this, calculate key financial ratios of taxpayer performance over several years and conduct industry comparisons. These ratios should be based on tax and financial data and calculated for a

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sufficiently long period (3-5 years).

The table below summarizes the ratios useful at the initial stage of risk assessment. It is important to consider the trends in these ratios over multiple years, and the relevance of specific ratios will depend on the type of activities carried out by the taxpayer, such as research and development, manufacturing, or service provision.

Table 1. Calculation Indicators

Indicator	Calculation
Profit Margin	EBIT/Total Revenue or Operating Profit/Sales Revenue or Gross Profit/Sales Revenue
Effective Tax Rate	Income Tax Recognized/EBIT
Profit per Unit of Economic Activity	EBIT/Number of Employees or EBIT/Salary Costs or EBIT/Tangible Assets
Return on Equity Before Tax	EBIT/(Declared Capital + Retained Earnings)
Return on Equity After Tax	(EBIT less Recognized Income Tax)/(Declared Capital + Retained Earnings)
Return on Assets Before or After Tax	EBIT/Total Assets or (EBIT less Recognized Income Tax)/Total Assets
Dependence on Intra-group Transaction	Affiliate Revenue/Total Revenue or Affiliate Costs/Total Costs

Source: UN (2024)

To identify patterns that may indicate higher or lower tax risk levels, indicators from the tested entity should be evaluated against indicators from potential comparable. The performance of the tested entity can be compared with:

- Industry Benchmarks: Results from standard practices in the same industry.
- Overall Group Results: Performance of the entire group.
- Related Entities: Results from related entities operating in other jurisdictions.
- Historical Performance: Results of the company in previous periods.

Transfer pricing risk indicators emerge if the company's financial results significantly deviate from industry standards. A continuous decline in performance or persistently low profits may also signal risks that need further investigation.

At this stage, documentation and quantitative analysis should be complete to provide an overview of the taxpayer's risk. This analysis helps focus on taxpayers requiring further attention, considering not only visible risks but also potentially hidden ones, such as significant roles not reflected in documentation.

The red flags table from the initial analysis helps identify areas that require further investigation. Data from several years should be examined to detect trends or deviations. Each red flag should be assessed to determine if deviations can be explained by other factors. The table below can serve as a guide for transfer pricing risk.

Table 2. Red Flags for Transfer Pricing Risk

Red Flags	Description
Group Footprint in Jurisdictions	A company group with a small footprint in a country may appear to have a low tax risk, but this can be deceptive if their actual activity is

Red Flags	Description
	larger than it appears. Pay attention to structures such as agents or commissionaires that only report intermediary costs rather than sales revenue, as this could indicate tax avoidance.
MNE Group Results Differ from Comparable	Differences between local MNE performance and comparable might be due to TP manipulation and warrant further investigation.
MNE Group Results Differ from Industry Standards	Deviations of MNE results from industry standards may indicate TP manipulation that requires further investigation.
Jurisdictions with Significant Profits but Limited Activity	Profits might be shifted from jurisdictions with actual economic activity. Check transactions with related entities in those jurisdictions.
Jurisdictions with Significant Profits but Low Taxes	Low tax rates might indicate tax avoidance and should be examined to see if transactions involve related entities in jurisdictions with BEPS risks.
Jurisdictions with Significant Activity but Low Profits	Profits attributed to a jurisdiction might be shifted through transfer pricing manipulation.
Groups Operating in Jurisdictions with BEPS Risks	Transactions with jurisdictions at risk of BEPS should be carefully examined.
Transfer of Intangible Assets to Related Parties	These transactions raise challenging valuation questions, especially if the intangible assets are unique and there are no comparable.
Business Restructuring	Risk associated with restructuring vary by jurisdiction. Capital jurisdictions might face asset valuation issues, while subsidiary jurisdictions might experience profit reduction.
Certain Types of Payments	Payments such as interest, insurance premiums, and royalties often pose higher risks due to their highly mobile nature, which can lead to payments not reflecting the true value.
Significant Transactions with Related Entities in Low-Tax Jurisdictions	Transactions with related entities in low-tax jurisdictions are at risk of mispricing, leading to excessive profit allocation.
Excessive Debt	Debt that appears excessive or interest rates that are too low or high compared to market rates.
Local Companies with Low Profits or Losses	Persistent losses or low profits in local companies (especially if the MNE group as a whole is profitable) may indicate that reported results do not reflect the true value.
Presence of Centralized Supply Chain Entities in Favorable Tax Jurisdictions	The presence of centralized supply chain companies in low-tax jurisdictions can be used to shift profits through transfer pricing manipulation.
Substantial Business Relationships with Entities in Jurisdictions with Safe Harbours	Significant deviations from the arm's length principle in transfer pricing rules in a jurisdiction can affect the pricing of transactions with related entities in that jurisdiction.
Poor Tax Compliance	A history of poor tax compliance behavior by taxpayers should be

Red Flags	Description
History	carefully evaluated.
Lack of Documentation to Support Transfer Prices	Poor or non-existent TP Doc can raise doubts about the reliability of the transfer prices themselves.

Source: UN (2024)

At the end of the initial quantitative analysis, tax authorities should be able to perform a cost/benefit evaluation to determine the tax risk and the amount of tax potentially involved. This includes assessing the need for administrative resources and whether it is better to focus on other cases. If the tax risk posed by a taxpayer is deemed low, further compliance action may not be necessary, allowing resources to be redirected to more risky cases.

In this initial quantitative analysis, Country by Country (CbC) reports can play a significant role in providing valuable information to tax authorities to better understand how local MNE activities fit within the larger MNE group activities. Taxpayers can be compared with other entities in the same MNE group, as well as with entities from other groups, to identify discrepancies that may be indicators of increased risk in certain jurisdictions. However, CbC information should not replace detailed transfer pricing analysis of transactions and individual prices based on functional analysis and comparability analysis.

Execution Phase

The initial quantitative analysis aims to give a preliminary indication of transfer pricing risk. Once a broad list of potentially risky taxpayers is compiled, the subsequent phase should concentrate on narrowing this list through detailed analysis and by soliciting additional information from the taxpayers.

For this purpose, the examination should shift from entity-level quantitative risk analysis to a more qualitative transaction-level risk analysis. Risks identified in the early phase should be linked to the transactions carried out by the taxpayer to understand whether transfer pricing could be the cause of these risks. Transfer pricing risks can arise in the following three transaction scenarios:

a. Recurring Transactions with Related Parties: Transactions that have the potential to reduce the tax base.
b. Large or Complex One-Time Transactions: Transactions that have a significant impact on the tax position.
c. Lack of Effective Tax Control Framework: An absence of an effective control framework to review related party pricing.

During this phase, initial functional analysis is crucial to understanding transfer pricing risks. This analysis determines the functions, assets, and risks of each party and is a core part of transfer pricing analysis. While complete functional analysis is not always required, high-level analysis can help determine whether detailed analysis is needed, given the limitations of tax administration resources.

Initial functional analysis can be conducted in two steps:

a. Review Functional Profile: First, review the functional profile of the company involved in the covered transactions, considering the delineation of the actual transactions. For instance, if an MNE claims it is performing distribution activities through a low-risk distributor, the tax administration should evaluate whether the functions, assets, and risks of the distribution entity align with the profile of a low-risk distributor.

b. Evaluate Transfer Pricing Methodology: Second, assess whether the transfer pricing methodology and its application by the taxpayer are consistent with the identified functional profile. Consistency of the methodology can be evaluated against the chosen transfer pricing methods (including profit level indicators, if applicable) and comparability (considering comparability adjustments) used by the taxpayer to set the prices of the reviewed transactions.

At this stage, functional analysis should be primarily based on information from documents available to the tax administration. If TP Doc is not available, the tax administration can request additional information through questionnaires, covering financial data, statistics, functional information, and explanations of transfer pricing analysis.

The Results Phase

Estimating risk levels cannot be done with a rigid method and requires a thorough assessment and understanding of the existing facts. In evaluating the risk of a transaction, tax authorities need to consider:

- The magnitude of the potential tax involved;
- The number and significance of identified risk factors;
- The presence of systematic or recurring risks that need to be addressed.

If the identified risk is low, no further compliance action is necessary. However, for moderate risks, additional compliance measures or starting an audit may be required for high or systematic risk cases. Tax authorities can use the criteria outlined in the table below to analyse each transaction.

Table 3. Risk Classification and Further Compliance Activities

Risk Classification	Further Compliance Activities
High Risk	Tax audit
Medium Risk	Monitoring activities, continuous communication with taxpayer
Low Risk	No further action

Source: UN, 2024

The final decision on implementing an audit, including the type of audit to be conducted, usually requires relative consideration, prioritizing identified risks in accordance with the availability of compliance resources. The risk identification and assessment process should be thoroughly documented and approved to ensure good governance and control. This documentation should be stored in a central repository, such as a case database, to facilitate monitoring and management, regardless of whether the outcomes lead to a detailed audit or tax assessment.

3.3. Case Study: Australia

3.3.1. Australia's Risk Assessment Approach

The Australian Taxation Office (ATO) has developed a detailed data screening and risk ranking system to support the implementation of transfer pricing laws in Australia. In the self-assessment system in place, income tax returns are generally not examined in detail before the risk assessment is issued. Instead, the ATO applies a review and audit system to ensure taxpayer compliance with their income tax obligations.

To allocate compliance resources efficiently, the ATO conducts a thorough case selection process through the application of risk screening on the International Dealings Schedule (IDS) submitted by taxpayers. Taxpayers who engage in cross-border transactions with related parties exceeding the de minimis threshold, currently set at AUD 2 million, are required to complete and submit the IDS along with their annual income tax return. This IDS provides critical data sources for the ATO to effectively identify and assess potential transfer pricing risks.

In Taxation Ruling 98/11 (TR 98/11), the ATO emphasizes that taxpayers with significant and frequent cross-border transactions reporting high-risk losses are subject to transfer pricing review. This process includes the analysis of several key aspects, including:

- The type and magnitude of international transactions;
- Compliance with the Arm's Length Principle;
- Completeness and relevance of documentation;
- Realism of the commercial outcomes of the transactions.

When determining whether a transfer pricing review should escalate to a full audit, the ATO considers factors such as the quality of the taxpayer's internal processes, the adequacy of contemporaneous documentation, and the commercial realism of the international transaction outcomes.

Cases with low-quality documentation and processes, along with commercially unrealistic outcomes, are more likely to be audited by the ATO. Conversely, taxpayers who demonstrate high attention and compliance through careful analysis and adequate documentation are likely to face lower review risks. Nonetheless, the ATO remains committed to understanding the spectrum of international risks holistically and does not conduct transfer pricing reviews or audits automatically (Butler, et al., 2015).

3.3.2. Risk Rating System

The ATO explains the assessment system used to evaluate the quality of taxpayers' transfer pricing documentation and profitability. TR 98/11 initially detailed the assessment process in four steps. Since the changes effective June 29, 2013, the authorities have replaced the four-step process with a five-step process outlined in Practice Statement – Law Administration 3673 (PS LA 3673). This five-step process provides a practical methodology applied by the ATO in assessing transfer pricing documentation during transfer pricing risk reviews. The five steps are as follows:

- Step 1: Identify the actual circumstances related to commercial or financial relationships;
- Step 2: Select the most appropriate and reliable method for determining arm's length conditions;
- Step 3: Identify comparable circumstances relevant for determining arm's length conditions;
- Step 4: Apply transfer pricing rules in a manner that achieves the best consistency with relevant material guidance; and
- Step 5: Monitor, assess, and update transfer pricing as necessary.

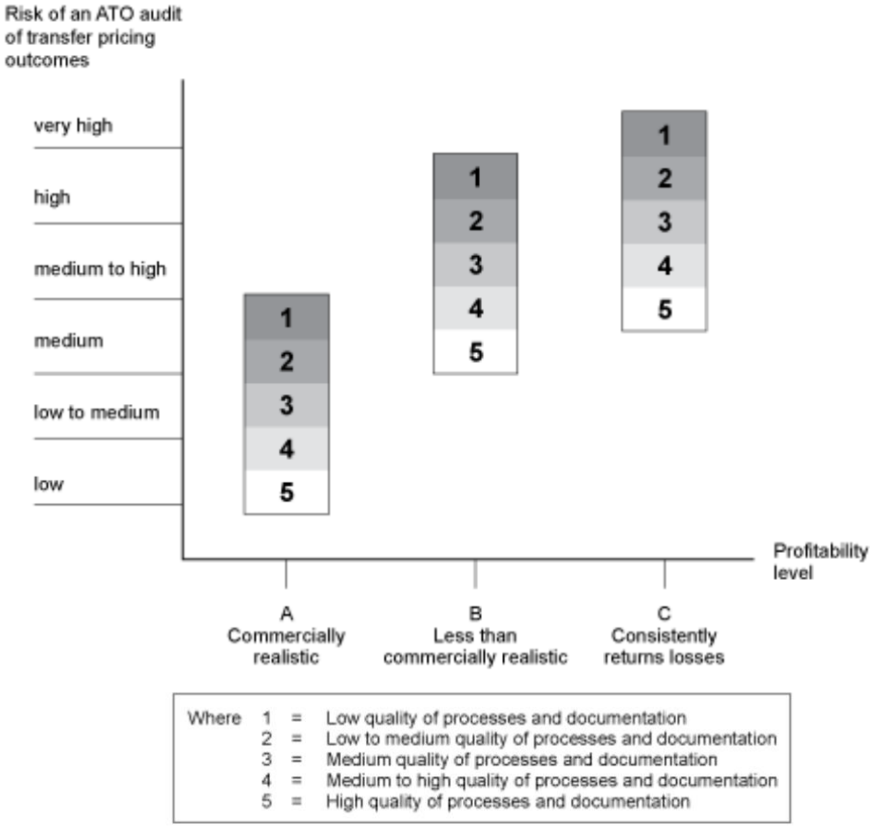
The ATO summarizes how they evaluate the quality of processes and documentation as detailed in Table 4.

Table 4: Levels of Process and Documentation Quality for International Transactions with Related Parties

1	2	3	4	5
Low Quality	**Low to Medium Quality**	**Medium Quality**	**Medium to High Quality**	**High Quality**
No analysis of functions, assets, risks, market conditions, and business strategy.	No analysis of functions, assets, risks, market conditions, and business strategy.	Analysis of functions, assets, risks, market conditions, and business strategy is inadequate.	Analysis of functions, assets, risks, market conditions, and business strategy is adequate.	Analysis of functions, assets, risks, market conditions, and business strategy is adequate.
No documentation or process for examining methodology selection.	Documentation or process is inadequate for examining methodology selection.	Limited contemporary documentation supports the method selection.	Contemporary documentation fully supports the method selection.	Contemporary documentation fully supports the method selection.
No comparable used. No effort to apply and review transfer pricing policy according to arm's length principles.	No comparable used. No effort to apply and review transfer pricing policy according to arm's length principles.	Comparable used are not appropriate or based on data from external related parties. Some contemporaneous documentation supports the application of the method.	Comparability based on limited data from independent transactions. Reliability assessed. Contemporaneous documentation fully supports the application of the method.	Comparability based on adequate data from independent transactions. Reliability considered in selecting comparable. Contemporaneous documentation fully supports the application of the method.

Source: ATO, 2024

The ATO then describes the interaction between the level of quality and commercial realism, in determining transfer pricing audit risk, as shown in Figure 1.



Source: ATO, 2024
Figure 1. Transfer Pricing Audit Risk

For example, a business that maintains high-quality transfer pricing documentation and records commercially realistic business results will be categorized as risk A5, thus facing a low risk of transfer pricing audit. Conversely, a business with low-quality transfer pricing documentation and consistently recording low profits or losses will be categorized as risk B1 or C1, and will face a risk of transfer pricing audit ranging from medium to high.

TR 98/11 explicitly states that the ATO will review taxpayers with significant international relationships with related entities who consistently experience losses as they are at the highest risk in the context of transfer pricing. In such cases, the ATO will pay special attention to these cases, as there is an indication that the transfer pricing arrangements may not reflect arm's length conditions, thus requiring a more detailed review.

3.4. Identification of CRM TP/ Risk Assessment Shortcomings in Indonesia

In optimizing the implementation of transfer pricing risk assessment in Indonesia, managing compliance risk through CRM TP becomes a key factor. Although CRM TP offers various benefits, there are significant shortcomings that need to be identified and addressed to ensure the system functions optimally.

3.4.1. Quantitative and Qualitative Criteria

CRM TP needs to have appropriate criteria to assess compliance risk, involving two main aspects: quantitative (numerical) and qualitative (assessment-based). Quantitative criteria, such as Fiscal Impact—i.e., the extent of its effect on the state revenue—and Likelihood of Non-Compliance—how likely it is for the taxpayer to be non-compliant—are essential elements in risk assessment. Meanwhile, qualitative criteria may include other factors such as transaction complexity.

However, if these criteria do not cover all important factors or are inaccurate, CRM TP will not be able to assess risk accurately. For instance, if Fiscal Impact and Likelihood of Non-Compliance do not reflect the actual risk, then attention and resources will not be focused on genuinely high-risk areas. As a result, risk management efforts may become ineffective, overlooking potential issues that actually require special attention.

Therefore, an assessment of the quantitative and qualitative criteria in the Compliance Risk Map is necessary to ensure that all important factors affecting taxpayer compliance are covered, and to verify whether risk indicators such as Fiscal Impact and Likelihood of Non-Compliance accurately reflect the risks.

3.4.2. Risk Identification and Monitoring

Risk identification is the process of finding high-risk taxpayers, while monitoring is the process of tracking them after identification. If the identification and monitoring processes are not effectively conducted, CRM TP may fail to identify and monitor truly high-risk taxpayers. This could result in taxpayers who should be under strict supervision not receiving sufficient attention, allowing them to potentially evade their tax obligations without detection. Therefore, it is crucial to evaluate the risk identification and monitoring processes to ensure that DSP3 effectively directs attention to genuinely high-risk taxpayers.

3.4.3. Use of Data Analysis Applications

CRM TP utilizes data analysis applications, such as Ability-To-Pay, SmartWeb, and Transfer Pricing Compliance Risk Map to identify and classify risks, with the hope of providing in-depth information for better decision-making. However, if these applications are not used properly or are not effectively integrated, the resulting data may be incomplete or inaccurate. Additionally, the consistency of the Tax Office in applying arm's length principles and business norms is also important, as inconsistencies in applying these principles can make the analysis results inadequate for accurate decision-making. Therefore, the use of data analysis applications and follow-up processes by Tax Office need to be thoroughly evaluated.

3.4.4. Monitoring and Feedback Mechanisms

Monitoring and feedback mechanisms in CRM TP function to evaluate the results of supervision and adjust strategies based on changes in risks and market dynamics. However, if these mechanisms are not effective, CRM TP may fail to adapt to changes in risk patterns or current market conditions. This could lead to outdated or irrelevant strategies, reducing the effectiveness of risk management. Therefore, evaluating the effectiveness of monitoring and feedback mechanisms is crucial to ensure that CRM TP can adapt to changes and identify areas that require improvement or adjustments in existing strategies and policies.

3.5. Strategies for Risk Assessment Development in Indonesia

Guidance from the UN on risk assessment can be an important reference for Indonesia in formulating effective strategies. By deeply understanding the existing shortcomings in Indonesia’s CRM TP, it is hoped that appropriate strategic measures can be implemented to improve and enhance the CRM TP system. Here are some strategies that need to be developed:

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3.5.1. Implementation of Integrated Risk Assessment Approach

The development strategy for transfer pricing risk assessment in Indonesia can leverage an integrated approach to enhance effectiveness and efficiency in monitoring and enforcing tax compliance. This approach involves a combination of centralized and decentralized methods, requiring close collaboration between central and local teams. Such collaboration is crucial to ensure consistency in applying risk assessment standards and providing comprehensive oversight across Indonesia.

In the context of case selection for transfer pricing risk assessment, several methods can be applied, including transactional, jurisdictional, and risk-based approaches. The transactional approach focuses on high-value or high-risk transactions, while the jurisdictional approach prioritizes transactions involving entities in jurisdictions with low tax rates or aggressive tax rules. The risk-based approach integrates elements from both approaches, making it more relevant for identifying risk indicators comprehensively.

In comparison, in Australia, the case selection process for transfer pricing risk assessment is heavily focused on IDS or cross-border affiliate transactions. This approach allows the ATO to use resources more efficiently by concentrating on transactions deemed most at risk.

Currently, Indonesia not only focuses its oversight on cross-border transactions but also on domestic transactions. According to the Platform for Collaboration on Tax (PCT) supported by OECD, UN, World Bank, and IMF (2021), companies that only transact with affiliated companies within the same jurisdiction, provided both are subject to the same tax rules, may be categorized as small and low-risk taxpayers. Therefore, these companies are exempt from the obligation to prepare TP Doc.

Indonesia could adopt the IDS approach applied in Australia and the recommendations from OECD, UN, IMF, and the World Bank to ensure that resources are optimally allocated to high-risk cases. Focusing on cross-border transactions as a primary priority in transfer pricing risk assessment offers several significant strategic advantages. First, cross-border transactions often involve jurisdictions with different tax regulations, which can increase the risk of tax avoidance. By concentrating oversight on cross-border transactions, Indonesia can be more effective in detecting and addressing cases of potential transfer pricing manipulation that could harm tax revenue.

Additionally, focusing attention on cross-border transactions allows for more efficient resource allocation. Given the limited resources of tax authorities, focusing on areas with the highest risk will help reduce unnecessary workload and enhance enforcement effectiveness. This approach also aligns with international practices implemented in developed countries, such as Australia, where IDS serves as a primary tool for identifying and managing transfer pricing risks.

Furthermore, by limiting the focus to cross-border transactions, Indonesia can avoid potential duplication of audits on domestic transactions that are subject to the same tax rules. This will help prevent uncertainty and excessive administrative burden for taxpayers, especially for small and medium enterprises operating solely domestically. Thus, this strategy not only enhances tax compliance enforcement, but also creates a more conducive business environment.

Finally, focusing on cross-border transactions also sends a clear signal to international investors that Indonesia has a robust tax system committed to combating tax avoidance while supporting sustainable economic growth. This is crucial for boosting investor confidence and maintaining Indonesia's competitiveness on the global stage, as well as establishing a reputation as a country with a transparent and fair tax system.

This development strategy is well-suited to address the deficiencies in Indonesia’s CRM TP related to the assessment of quantitative and qualitative criteria in the Compliance Risk Map. By implementing an integrated risk assessment approach, Indonesia can ensure that all critical factors

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are covered and that the risk indicators used accurately reflect the conditions.

3.5.2. Optimization of Country-by-Country Reporting (CbC) Data Usage

As previously explained, the UN identifies CbC reports as additional data that can be used for in-depth analysis and risk identification. CbC reports contain information on global income distribution, profits, taxes paid, capital, and employees, as well as certain indicators regarding the location of economic activities in the tax jurisdictions where MNE group entities operate. Given the level and type of information provided in CbC reports, these reports become a vital tool for tax authorities in the risk measurement phase and potential planning, setting, and conducting audits (Tapia and Jalan, 2022).

In September 2017, the OECD released guidelines on using CbC reports for tax risk assessment, explaining how countries can effectively disseminate data and perform risk assessments. This guidance is part of a well-designed risk assessment framework to assist tax authorities in analyzing and assessing transfer pricing risks.

There are several risk indicators that countries might find during CbC reports reviews, including (Silberztein and Le Naoures, 2018):

- Measuring the scale and capacity of MNE group operations, including revenue size, assets, or employee numbers across different jurisdictions. This indicator helps understand the extent of economic activities performed by the group in each country.
- Assessing whether MNE groups engage in low-risk activities in certain jurisdictions, such as administrative tasks or data storage, to identify if high-risk activities are placed in more tax-favorable locations.
- Measuring the extent of income derived from transactions between related entities in specific jurisdictions.
- Comparing report data with data from comparable entities to find discrepancies or inconsistencies in financial results. Such discrepancies can indicate issues in transfer pricing policies or tax strategies.
- Comparing MNE group financial performance with relevant market trends to assess whether the performance aligns with market expectations or shows indications of tax avoidance.
- Evaluating whether profit levels are consistent with the type and level of substantial activities conducted. For example, high profits with low activity levels might indicate potential tax manipulation.
- Comparing profit levels with the amount of taxes paid to evaluate whether taxes paid are proportional to the generated profits.
- Examining whether the level of economic activity in a jurisdiction is consistent with the reported profits. Inconsistencies may indicate tax avoidance risks or improper transfer pricing.
- Identifying high-risk jurisdictions related to BEPS practices, such as profit shifting to low-tax countries or avoidance of tax obligations.
- Observing whether easily movable activities (such as services or non-physical activities) are shifted to low-tax jurisdictions to reduce tax burdens.
- Assessing changes in the MNE group's organizational structure and asset locations to identify potential profit shifting or aggressive tax strategies.
- Checking if IP locations are separate from substantive economic activities in the MNE group, which might indicate IP shifting to low-tax jurisdictions to minimize taxes paid.
- Evaluating whether marketing activities are located in jurisdictions different from the primary markets, which might signal efforts to shift profits or manipulate taxes.
- Identifying if procurement entities are placed in different jurisdictions from manufacturing

locations, which could indicate potential tax avoidance through profit shifting.

- Comparing taxes paid with reported income to assess whether the taxes paid align with the reported income.
- Examining whether entities are considered tax residents in more than one jurisdiction, which might indicate attempts to exploit international tax differences.
- Identifying if entities lack residency or a permanent establishment in certain jurisdictions, which could suggest structures designed to avoid tax obligations.
- Assessing whether income lacks clear nationality or is registered in irrelevant jurisdictions, which might indicate tax avoidance or profit shifting.
- Comparing data in CbC reports with information provided by constituent entities to find discrepancies or inconsistencies that might indicate issues in transfer pricing or tax reporting.
- Implementing CbC reports in Indonesia involves developing a system that automatically calculates risk ratios to focus resources on MNE groups with high tax risks.

This strategy is relevant to CRM TP deficiencies in Indonesia related to risk identification and monitoring processes, as well as the use of data analysis applications. CbC reports can provide valuable insights that aid in effective risk identification and data analysis.

3.5.3. Development and Integration of Data Analysis Technology

High-level risk assessment can often be automated using quantitative information, especially once initial focus areas and risk indicators have been identified. Technologies such as data mining and machine learning are highly effective for analysing data to uncover trends, outliers, and anomalies.

To enhance data analysis capabilities, it is recommended to utilize advanced technologies such as big data analytics and artificial intelligence (AI) to improve accuracy and speed in risk mapping. The use of additional tools such as Ability-To-Pay, SmartWeb, and Transfer Pricing Compliance Risk Map can provide a more comprehensive view of compliance risks. Furthermore, it is important to develop more sophisticated monitoring systems integrated with real-time monitoring and trend analysis capabilities. This will allow for earlier detection of non-compliance and facilitate quicker responses to potential risks.

3.5.4. Implementation of Risk Classification

To improve effectiveness in risk management, it is essential to implement clear risk classifications to determine appropriate compliance actions, such as conducting tax audits for high-risk cases and continuous monitoring for medium-risk cases. High-risk cases need to be identified and handled thoroughly to reduce potential tax avoidance and improve compliance levels.

In some situations, maintaining the confidentiality of certain risk indicators can be beneficial so that taxpayers do not evade detection by hiding those indicators. However, in other cases, tax administrations may choose to publish information about compliance priorities or certain risk indicators, particularly those related to arrangements, behaviours, or outcomes considered problematic. Publishing such information can guide taxpayers on areas that may attract the attention of the tax administration, allowing them to avoid risky arrangements or behaviours, or at least be more cautious in documenting them. Additionally, this information can serve as educational material for taxpayers.

Tax administrations can present this information in the form of administrative safe harbours or self-assessment tools that can be used by taxpayers. For example, some administrations publish compliance guidelines that detail ranges of outcomes considered low, medium, or high risk for specific types of activities or transactions. These guidelines should carefully define applicable criteria and calibrate risk ranges precisely—being too lenient could render the guidelines irrelevant, while being too stringent could create unnecessary compliance challenges.

An approach with multiple risk ranges, such as green zone for low risk, yellow zone for medium risk, and red zone for high risk, allows for more in-depth analysis compared to single-range or point designations. Some jurisdictions may also apply safe harbours to specific types of transactions to simplify and reduce compliance and administrative burdens. If such safe harbours are established in laws, regulations, or administrative guidelines, they should be used as references in the risk assessment process. In other words, if a transaction falls within a transfer pricing safe harbours, it should be excluded from further compliance actions related to transfer pricing. By developing and implementing these strategies, Indonesia can strengthen its transfer pricing risk assessment system, improve tax compliance, and reduce potential tax avoidance.

This strategy is relevant to CRM TP deficiencies related to the implementation of monitoring mechanisms and feedback. With clear risk classifications, tax administrations can determine appropriate actions based on risk levels.

3.5.5. Enhancement of Governance and Documentation

To ensure effectiveness and transparency in the risk identification and assessment process, several crucial steps need to be implemented. First, it is important to establish comprehensive documentation systems at each stage of the process to ensure accountability and transparency. Documentation results should be managed in a central repository that is easily accessible, facilitating ongoing monitoring, management, and risk assessment. During risk assessment, effective governance mechanisms are crucial to maintaining the quality, consistency, and integrity of the process. Many tax administrations conduct random case reviews at various stages to ensure that recommendations regarding case outcomes and status are accurate. This centralization process aims to ensure that risk assessment results and resource allocation across jurisdictions are properly calibrated. After the formal risk assessment phase is completed, it is important to prepare a brief report on the process as feedback for future improvements. This report helps assess whether cases require further monitoring or if initial risk indicators need recalibration. Finally, the risk assessment process should be periodically evaluated to ensure its effectiveness and identify opportunities for improvement, keeping the system relevant and responsive to changing risk dynamics. This strategy is crucial for CRM TP deficiencies related to the effectiveness of monitoring and feedback mechanisms. Good documentation and governance systems can ensure accountability and transparency.

4. Conclusion

The "End-to-End Transfer Pricing Compliance Assurance" guide from PBB offers a strategic approach to transfer pricing risk assessment. This guide addresses various approaches such as centralized versus decentralized systems, and global versus industry-specific risk assessments, including transactional and jurisdictional approaches. Emphasis is placed on a deep understanding of taxpayers and the utilization of various information sources for effective risk assessment.

In comparison, in Australia, the ATO uses a data screening and risk rating system to support compliance with transfer pricing laws. The ATO conducts risk assessments through the IDS and specifically focuses on the quality of documentation and compliance with the Arm's Length Principle. Cases with poor-quality documentation and unrealistic outcomes have a higher risk of being audited.

Overall, in both Indonesia and Australia, the use of risk management systems and data analysis tools plays a crucial role in detecting and managing transfer pricing risks. These tools help enhance tax compliance and ensure efficiency in tax oversight.

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Indonesia has a CRM TP for assessing and monitoring transfer pricing risks, but the CRM TP has the following deficiencies: a) Quantitative and qualitative criteria do not cover all important factors; b) The process for identifying and monitoring high-risk taxpayers is not effective; c) Data analysis applications are not optimally used or integrated; and d) Feedback mechanisms must be capable of adapting strategies to changes in risk and market conditions.

To develop transfer pricing risk assessment more effectively, Indonesia needs to adopt several strategic steps, including:

a. Implementing an integrated risk assessment approach to ensure consistency in risk assessment standards and comprehensive coverage of oversight;
b. Optimizing the use of CbC report data for in-depth risk analysis to enhance the effectiveness of risk assessment and audit processes;
c. Developing and integrating data analysis technologies to improve accuracy and speed in risk analysis. More advanced monitoring systems are needed for earlier detection of non-compliance and quicker responses;
d. Applying clear risk classifications and using compliance guidelines, including safe harbours, to manage compliance actions more effectively; and
e. Enhancing governance and documentation to ensure transparency and accountability in risk assessment.

By implementing these strategies, Indonesia can strengthen its transfer pricing risk assessment system, improve tax compliance, and reduce the potential for tax avoidance. These steps will also contribute to creating a more conducive and transparent business environment.

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