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TRANSFER PRICING FROM THE PERSPECTIVE OF PRACTITIONERS AND ACADEMICS

Rosemarie Sutjiati
teaching staff of economic department of maranatha christian university
jalan prof. drg. surya sumantri no.65, bandung, jawa barat 40164
rosemarie.sutjiati@yahoo.com
rosemarie.sutjiati@gmail.com
+622287803645
+6282215548352

Benny Budiawan Tjandrasa
teaching staff of economic department of maranatha christian university
jalan prof. drg. surya sumantri no.65, bandung, jawa barat 40164

Abstract
Transfer pricing occurs in large companies that have many different divisions, especially when there are movement of goods and services between divisions. In practice, the appropriate transfer pricing should consider various factors such as opportunity costs, idle capacity, demand from external markets, and also the structure of the external market.. The purpose of this study was to obtain a clear opinion of the manager and owner of the company associated with transfer pricing and also to examine whether their views are influenced by demographic factors or else.
Keywords: decentralization, profit center, perfect competition market, transfer pricing, opportunity cost.

1. INTRODUCTORY

The main purpose of a company is to increase the wealth of owners of the company, in a listed company, the increase in the wealth of company owners will be reflected through the rise in the company's stock price. To increase the share price, one of the most important factor is the increase in the company's profit in the income statement. Companies owned by the state has the obligation to increase the wealth of the country because the majority owned by the state, but to make strategic decisions such as opening a subsidiary, merger, and so forth it must be with the approval of the government as state officials.

On the other hand private companies have more flexibility in making strategic decisions such as mergers, opening subsidiaries abroad and perform other management strategies as long as such actions do not violate the law. Private companies also arguably knows no national boundaries and restrictions, for example, is Mc Donald which is almost in every country including Russia, even as US relations with Russia were strained because of the crisis in Ukraine. The absence of restrictions on the ownership of capital markets because of which freely accessible by anyone, and anyone is free to buy and sell their shares to anyone.

As has been stated above, the purpose of a company is to increase the wealth of the owner which is reflected in rise in stock prices through increased corporate profits. One way to improve the company's profit is to press the various costs and expenses. Tax is one of the major expenses for the company, and in a variety of financial literature teaches one how to reduce costs through the use of tax is the tax shield by means debt. Another way that is also taught in the literature of financial management and management accounting is by moving the operating unit subsidiary to other countries that have lower operating costs and lower tax rate. This has been commonly done by a variety of world-class companies such as Apple, Sony, and even Toyota that opens assembly plant in China.

When the parent company is located in the country of origin and the establishment of subsidiaries located in other countries, the activities of transactions between subsidiaries are common and are difficult to avoid the practice of transfer pricing.

The application of decentralization resulted in each subsidiary even each division is required to function as a profit center not only as a cost center. One of the effects of the implementation of the profit center is each division will establish a transfer price which will generate profits for each division when there is demand for a product or service by other divisions.

Implementation of transfer pricing depends on the conditions faced by each division, such as whether the product or service being sold was in perfect competition, monopolistic competition market or oligopolistic competition market. Moreover, transfer pricing also depends on the presence or absence of market demand for the intermediate product for the products or services it sells.

In fact the practice of transfer pricing is seen in some people (mainly governments concerned to get the maximum tax) as a fraud or something unethical, as written by Anandita Budi Suryana, the Directorate General of Taxation Employees in the site http: //www.pajak.go.id/content/article/menangkal-kecurangan-transfer-pricing, who wrote: "Transfer pricing is a transaction of goods and services between divisions in a group at reasonable prices, can raise (mark-up) or lowering the price (mark down), mostly carried out by global corporations (Multi-National Enterprise). The goal is, first, to outsmart the amount of profit that the payment of taxes and to lower dividend distribution. Secondly, inflated profits to polish (window-dressing) financial statements. Country loses trillions of rupiah because of transfer pricing practices of foreign companies in Indonesia. (KONTAN, June 20, 2012)"

At this point there is a gap between theory and reality of management. financial management and management accounting view transfer pricing in a manner purely as a legitimate strategic actions and views of government officials who view transfer pricing as a pricing that is unnatural and negative

This study does not intend to make alignments, but to know the opinion of various practitioners regarding the transfer pricing.

2. LITERATURE REVIEW

Multinational companies play a very major role in international trade. Not only between a multinational company and an affiliated purchaser, but trade within multinational companies is also quite large. (Clausing, 2000). In practice, many multinational companies are decentralizing decision-making rather than centralizing it.

Centralization in the sense of management science is the extent to which decision making is concentrated at a single point in the organization. While decentralization has a definition of the extent to which employees of lower tiers provide input or actually making a decision. (Robbins, Coulter 2002)

As according to Schermerhorn: 2008, decentralization is the dispercion of authority to make decisions throughout all levels of the organization, and centralization is the concentration of authority for most decisions at the top level of an organization.

So the total decentralization means that minimum barriers and maximum flexibility for managers at the lowest level of an organization to make a decision. Total centralization means maximum barriers and minimum flexibility for managers at the lowest level of an organization to make decisions (Horngren, 2009).

a. Benefits of Decentralization

Supporters of the decentralizing decision making and responsibility sharing to the manager of the subunit suggests the following benefits (Horngren, 2009):

1. Creates greater responsiveness to local needs
2. Leads to gain from faster decision making
3. Increases motivation of subunit managers
4. Assists management development and learning
5. Sharpens the focus of subunit managers

b. Costs of Decentralization

Supporters of more-centralized decision making shows these weaknesses from decentralizing decision making (Horngren, 2009):

1. Leads to suboptimal decision making (incongruent or dysfunctional decision making)
2. Focuses the manager’s attention on the subunit rather than the company as a whole.
3. Increases the costs of gathtering information
4. Results in duplication of activities

2.1 Transfer Pricing

Multinational Company (MNC) which have projects in various countries will have the inter-company transactions. In this condition the MNC will use transfer pricing, which includes payment transactions between various parties within the same company. (Madura, 2008)

Transfer pricing is becoming increasingly important for companies in today's global economy because multinational companies expanding to countries with diverse taxation and regulatory regimes. (Sikka & Willmott, 2010)

Transfer pricing refers to prices charged, both domestically and internationally, for goods, services, and technologies that are exchanged between the units concerned. (Eiteman; Stonehill & Moffett, 2001).

Meanwhile, according to Cravens (1997) internal transfer price is the price charged on raw materials, finished goods, or services when switching from one organization linked to other organizations that are in the group of consolidated companies. Transfer price can also be applied between departments, divisions, subsidiaries or business units affiliates.

According to Horngren (2009) transfer price is the price of a subunit (department or division) which are set for a product or service supplied to other subunits of the same organization. Transfer price creates revenues for the sale of the subunits and the purchase costs for the purchase of the subunits, which affects operating income of subunits. Subunit that sell products or services should be motivated to lower their costs; subunits which purchased a product or service should be motivated to utilize as efficiently as possible input. There are three methods for determining transfer prices

1. Market-based transfer prices.
2. Cost-based transfer prices.
3. Negotiated transfer prices. In some cases, a sub unit of a company is free to negotiate the transfer price between them and then decide whether to buy or sell from within the company or outside the company transacting parties.

Additionally, Mowen (2005) argues transfer pricing must also meet two objectives, namely the evaluation of performance and the amount of most optimal taxes.

Meanwhile, according to Salvatore (1993) transfer pricing occurs when the division A (of a company) sell their products to division B (the same company). Transfer pricing is important because:

1. It will affect the output of each profit center
2. The transfer price will determine the profit reported each profit center, and because of the performance of each profit center is associated with a profit, the transfer price which is set arbitrarily would damage morale.

While tax reform in general will reduce corporate tax rates globally, international tax rate differences are immutable from the global fiscal environment. In this context, multinational companies can reduce their tax payments worldwide by diverting revenues from the highly taxed jurisdiction to a location that is has lower tax rates. (Swenson, 2000)

In recent years there has been increasing concern about the activities of multinational companies profit transferred. With the international market is becoming more and more interconnected, the tax authorities find it increasingly difficult to monitor the behavior of multinational companies transfer pricing. (Schjelderup & Weichenrieder, 1998)

2.2 Transfer Pricing In Different Market Conditions from the Perspective of Management Accounting

According to Horngren (2009) the market conditions and the availability of capacity to meet market demand largely determine the transfer price. Market conditions that may occur are:

1. There is a perfect competitive market
2. There is a market that is uncompetitive
3. There is no market for the intermediate product

While the availability of capacity to meet the market demand will determine whether there is opportunity cost or not.

2.3 General Guidelines For Different Situations Transfer-Pricing

The following formula helps the first stage in establishing the minimum price transfer in various situations (Horngren, 2009):

Minimum transfer price = incremental cost per unit incurred up + opportunity cost per unit to the to the point of transfer selling subunit.

Incremental cost in this context means additional costs for producing and transferring a product or service. Opportunity cost is the maximum contribution of the lost margin for selling subunit if a product or service is transferred internally.

Here incremental cost and the opportunity cost is different because financial accounting system is usually record the incremental cost but will not record the opportunity cost. (Horngren, 2009):

1. A perfectly competitive market for the intermediate product exists, and the selling division has no idle capacity.
   If the market for a product is perfectly competitive, the marketing division can sell all of its products to the external market at market prices without idle capacity. Opportunity costs occur in the marketing division due after selling its products internally they lost contribution margin due to the inability to sell to the external market. Therefore:
   Minimum transfer price per unit = incremental cost per unit+ opportunity cost per unit
   Example: a production division in a perfectly competitive market has the products required by the marketing department in the same company. The price of such products on the market is $ 6 per unit cost of production for such products is $ 4. If the production divisions do not have idle capacity to produce more, and it must meet the demands of the marketing division, then the minimum transfer price per unit which will be determined by the production division are:
   Incremental cost per unit sebesar + opportunity *cost per unit* sebesar = *minimum transfer price per unit*
   $4 + $2 = $6
   In this state the minimum transfer price per unit is equal to the market price of such products. Market-based transfer price is ideal for a perfectly competitive market when there is no idle capacity in the selling division.
2. An intermediate market exists that is not perfectly competitive, and the selling division has idle capacity.
   If the marketing division has idle capacity, the opportunity cost of selling the products internally is zero because the marketing division can still selling out (to external market). In this case:

Minimum transfer price per unit = incremental cost per unit

Example: A production division that are in imperfectly competitive market have products that are required by the marketing department in the same company. The price of such products on the market is \$ 6 per unit cost of production for such products \$ 4. If the production division has idle capacity to produce more, and it must meet the demands of the marketing division, then the minimum transfer price per unit which will be determined by the division of production is \$ 4. The determination of the transfer price above incremental cost but below market prices motivates the marketing division to send their products to the marketing division and also motivate purchase division to purchase products from the marketing division. In this situation, the company may use the cost based transfer price or allow both divisions to negotiate the transfer price among them.

3. No market exists for the intermediate product.

This situation can arise when the marketing division has the products needed by the buyers division, but such products are not desired by external parties (to external market), for example, crude oil that has a high content of tar that is not favored by the external market. Herein the opportunity cost of supplying such products internally is zero, Therefore:

Minimum transfer price per unit = incremental cost per unit

2.4 Transfer Pricing In Different Market Conditions from the Perspective of Managerial Economics

Transfer pricing by Salvatore (1993) can also be done through curves of Marginal Cost (MC) and Marginal Revenue (MR) of the divisions involved. Description of the terms used in the picture:

MRP = Marginal Revenue from the marketing division/ from production division

MCM = Marginal Cost of marketing division

MCP = Marginal Cost of production division/ Marginal Cost total

Em = Equilibrium point of the marketing division; Ep = Equilibrium pt. of production div.

Dm = Demand for product marketing division; Dp = Demand for product production division

Pm = market price on the external market

Pt= price of the transfer

2.5 Transfer Pricing With Perfect Competitive External Market

If there is an external market for the product to be transferred, the output produced by the production division is not necessarily the same as the marketing division demand because of excess production can be sold to outside markets. From the graph shows that the production division will not sell for less than \$ 6 and marketing division will not buy more than \$ 6, so the transfer price was agreed at \$ 6 or according to the market price.

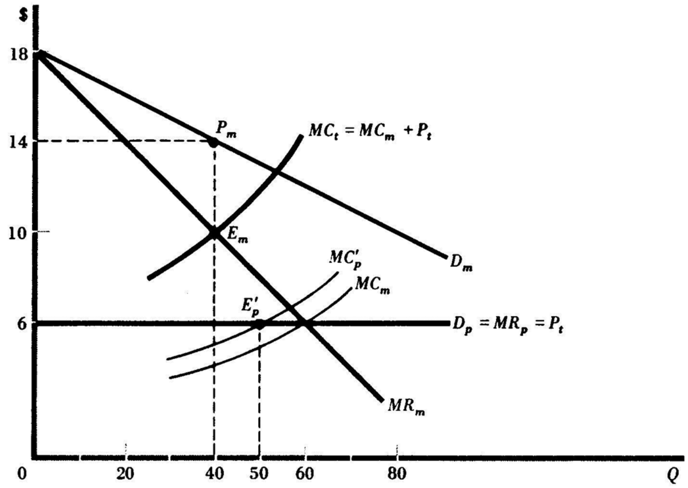

Figure 1. External Transfer Pricing With the Perfect Competitive Market (source: Managerial Economics, Dominick Salvatore)

2.6 Transfer Pricing in Non Competitive External Market

External markets are often characterized by imperfect competition. In this case the production division may set different prices for the marketing department and external markets.

Products can be sold to the marketing division with a minimum transfer price of \$ 4. \$ 4 Figures obtained when MC_P curve intersects the MR_P curve at a price of \$ 4 with the number of 40 units. A total of 20 units can be sold to the marketing division at a price of \$ 4 (minimum transfer price) and 20 units were sold to the external market at a price of \$ 6.

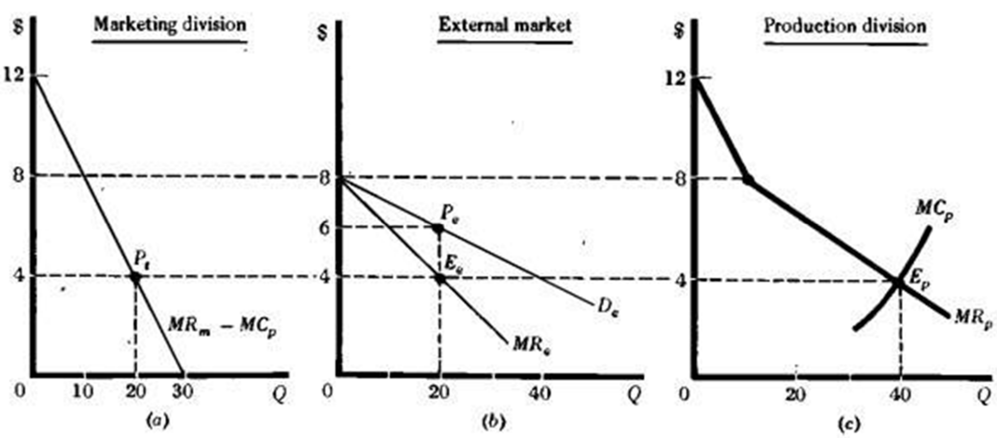

Figure 2. Transfer Pricing With non Non Competitive External Markets (source: Managerial Economics, Dominick Salvatore)

2.7 Transfer Pricing In Case There's No External Markets

If there is no external demand for half-grown products, the production division can only sell the product internally to other divisions of the company. Example: the marketing division purchase products from the production division. In this case the minimum transfer price of the production division for \$ 6 which is when MC_P curve intersects the MR_P curve.

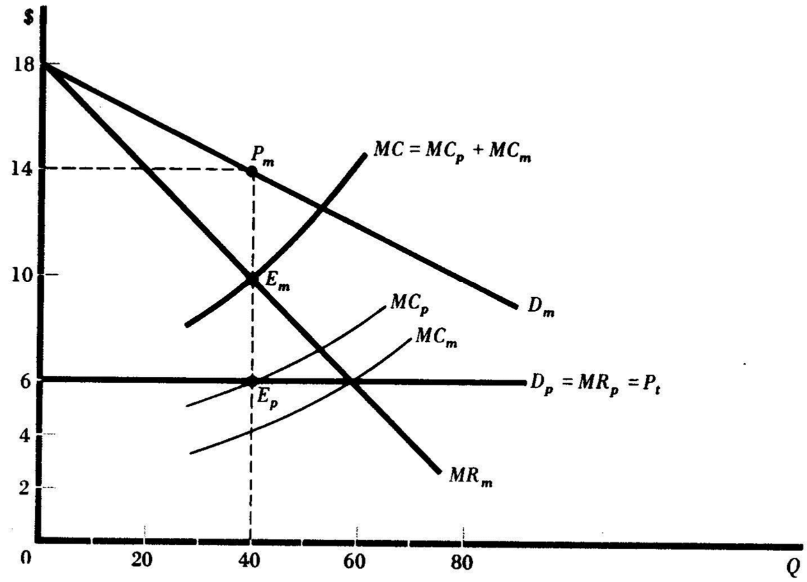

Figure 3. Transfer Pricing In Case There's No External Markets (source: Managerial Economics, Dominick Salvatore)

2.8 Comparison between the Manajerial Economic Theory and Accounting Management Theory in Determination of Transfer Price

In essence, both approaches gave similar results to the determination of the transfer price of a product, but each theory has the advantages of each.

Managerial economics theory presents a chart that explains the steps transfer pricing:

1. Starting from the optimization of profits, namely when marginal revenue (MR) of the marketing division is equal to marginal cost (MC) thus produced equlibrium point.
2. Further equilibrium point will be projected onto the curve of demand from marketing departments in order to get the price of transfer and the amount of product that should be produced.
3. The price of the transfer and the amount of product produced depends on the shape demand curves marketing division, whether the form of the curve is perfectly elastic or inelastic.
4. The market price for the products sold to external market by buyers division is also determined by the point of equilibrium and demand curves that are owned by division of the buyer.

The advantages of the graphs presented from managerial economics theory is able to explain why certain incremental cost (marginal cost) has been chosen as the basis for determining the transfer price and how many units are the most optimal to produce. Surely selected marginal cost is intersected by marginal revenue.

While from the viewpoint of management accounting, steps to determine transfer pricing are:

1. Review whether the division which will sell its products to other divisions within the same company still has idle capacity or not.
2. Review whether there is market demand for such products.
3. If there is a market demand, the market is perfectly competitive market or not.
4. Specify whether there is opportunity cost that will be borne by the marketing division and if there is, the opportunity cost should be added to the incremental cost per unit to get the minimum transfer price

The advantages of the formula presented to management accounting approach is the emphasis on opportunity cost and market structure so that the transfer price that has been set will have a positive impact for the company, namely:

1. The division that sells products will be motivated to lower costs
2. Division who buy products or services will be motivated utilize input as efficient as possible

3. RESEARCH METHODS

The method used is a descriptive study. To analyze the data used twoway analysis of variance

3.1 Operational Variables

Operationalization of variables using the dependent variable: respondents' level of tolerance towards the practice of transfer pricing, while the independent variables in this study were: gender, education level and type of company.

3.2 Population and Sample

The type of sampling used in this research is purposive sampling because respondents were selected based on certain criteria (have now & Bougie, 2010). In this study the respondent is the person considered most knowledgeable about the issues, and what was said by the respondent can be trusted.

3.3 Data Collection Instrument

This study used a structured interview as data collection techniques. This technique is used when the researcher has to know exactly what information will be obtained (Sugiyono, 2010). In this interview each respondent was given the same question, some questions provide specific answers to the open while measuring tolerance respondents to transfer pricing presented in a Likert scale.

4. RESULT

Forty-one head of the company that manages both government enterprises and non-governmental interviewed and were asked about the level of their tolerance of transfer pricing. Of the 41 managers of the company's 21 of them are men and 20 women with educational levels ranging of high school (2), Level 1 (12), Tier 2 (15), and Tier 3 (12). The type of company that is managed is 18 governmental and 23 non-governmental enterprise (private-owned enterprises and private companies that have gone public).

Between-Subjects Factors

		N
Gender	1.00	21
	2.00	20
Education	1.00	2
	2.00	12
	3.00	15
	4.00	12
Company	1.00	18
	2.00	23

Explanation:

Gender : 1 = Male, 2 = Female

Education: 1 = Senior High School, 2 = Undergraduate, 3 = Graduates. 4 = Post Graduate

Company: 1 = Governmental Company, 2 = Private Company Non-governmental

Levene's Test of Equality of Error Variance produce p-value = 0.12, the value is greater than the value of α = 0.05 which gives an indication of the homogeneity of variance are met.

Levene's Test of Equality of Error Variances[a]

Dependent Variable:Transfer_Price

F	df1	df2	Sig.
2.798	13	27	.12

Tests the null hypothesis that the error variance of the dependent variable is equal across groups.

a. Design: Intercept + Gender + Education + Company + Gender * Education + Gender * Company + Education * Company + Gender * Education * Company

Gender and education level did not significantly influence transfer pricing means that the level of tolerance to transfer pricing is not affected by gender bias and level of education, but in fact a non-government company managers are more likely to tolerate the practice of transfer pricing than the managers of state companies. This can be seen from the results of tests of between-subjects effects which are only significant for the type of company.

Tests of Between-Subjects Effects

Dependent Variable:Transfer_Price

Source	Type III Sum of Squares	df	Mean Square	F	Sig.
Corrected Model	76.432[a]	13	5.879	10.165	.000
Intercept	236.259	1	236.259	408.474	.000
Gender	.241	1	.241	.417	.524
Education	2.262	3	.754	1.304	.294
Company	49.719	1	49.719	85.960	.000
Gender * Education	.203	2	.101	.175	.840
Gender * Company	.023	1	.023	.040	.842
Education * Company	.845	3	.282	.487	.694
Gender * Education * Company	2.216	2	1.108	1.916	.167
Error	15.617	27	.578		
Total	530.000	41			
Corrected Total	92.049	40			

a. R Squared = .830 (Adjusted R Squared = .749)

5. CONCLUSSION AND SUGGESTION

From the results of a structured interview in which the result (the tolerance level of the corporate leaders) then inserted in a Likert scale and statistically processed, it can be concluded that the level of tolerance (on transfer pricing) of corporate leaders interviewed were more influenced by on what kind of company those corporate leaders located. For the leadership of the government company they do not tolerate the practice of transfer pricing in their company even though on the other hand they support the use of debt as a tax shield. This is because of government policies that prohibit transfer pricing by companies due to be considered detrimental to the national tax (tax opportunity) and the leadership of the government company is highly dependent on government career. Its different with the corporate leaders of non-governmental which is more tolerant toward the practice of transfer pricing in their company and without a doubt will make transfer pricing whenever there is a chance because they think it is not a matter of breaking the law and transfer pricing are considered as well as the tax shield on the company debt. From interviews with leaders of non-governmental company leaders, company is an entity that does not have borders since the company was formed to increase the company's value andnot the wealth of the country. Furthermore, gender and education level did not affect the level of tolerance of corporate leaders to transfer pricing.

From the results of this research, it is revealed that the polemic regarding transfer pricing is not going to settled for the company was founded with the aim of increasing the wealth of the owners of capital, and indeed the fact that the capitalist system is what has been taught in universities in Indonesia and even more ways to make transfer pricing does taught in a variety of economic books and is regarded as commonplace. To suppress transfer pricing, it is not enough if the government just issued an appeal but the government should provide the business climate and the attractive investment atmosphere for business in Indonesia so that the profits of their company will be invested back in Indonesia and will automatically reduce the practice of transfer pricing. This is in line with the opinion of (Gordon and Mackie-Mason.1995) where they said the company will continue to be in the country only if the prices of other factors (especially for land and labor) have been enough to offset the company's pre-tax expenditures so as to provide owners of capital rate of return after tax. But if if the prices of other factors are not enough to offset the company's pre-tax expenditures then the company will bear thinking of switching to another country, so it is important to eliminate the distortions that inhibit capital investment in the country.

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APPENDIX:

Research Instrument

Respondent

Name:

Gender: Male ( ) Female

Age: ( ) 25-35 ( ) 46-55
( ) 36-45 ( ) > 55

Education: ( ) SMA ( ) S2
( ) S1 ( ) S3

Working Years: ( ) 1 - 5 ( ) 11 - 15
( ) 6 - 10 ( ) 16 - 20
( ) >20

Company: ( ) Government ( ) Private:

	Question	**Answers**
1	Do you have the role as the company's decision maker?	
2	What management function do you manage in the company?	
3	Do the company you manage has subsidiaries abroad?	
4	What do you know about transfer pricing?	
5	If the company could obtain greater profits by transfer pricing are you going to do that?	
6	Your company often do transfer pricing	
7	Do you think transfer pricing is detrimental to the country?	
8	Do the company you manage have debt?	
9	Interest from debt will reduce tax paid (tax shield), do you think this is good?	
10	Do you think tax shield is detrimental to thr country?	