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Effect of Tax, Company Size, Bonus Mechanism, Foreign Ownership, and Tunneling Incentive on Transfer Pricing Decisions

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Abstract: Transfer pricing is a policy regulated by a company to determine the transfer price of a transaction, whether it is the price of goods, services, intangible assets, or financial transactions carried out by the company. This study aims to analyze the effect of tax, company size, bonus mechanism, foreign ownership, and tunneling incentives on non-financial companies listed on the Indonesia Stock Exchange in 2017-2021. Data collection technique using purposive sampling technique. A total of 160 companies have met the criteria as a unit of observation. The analytical method used is multiple linear regression analysis. The results of the study provide empirical evidence that taxes have an effect on transfer pricing decisions. Meanwhile, company size, bonus mechanism, foreign ownership, and tunneling incentives have no effect on transfer pricing decisions.

Keywords: Transfer Pricing, Tax, Company Size, Bonus Mechanism, Foreign Ownership, Tunneling Incentive.

1. Introduction

Business developments in the era of globalization have provided several significant changes to the world, where these developments have been accompanied by sophisticated technology and led to business competition. Especially for companies that are starting to develop their companies by having branches or subsidiary companies in other countries to strengthen their strategy and grow their market share for export and import of products to various countries. Various international transactions between membership (divisions) of the company occur frequently, one of which is the selling of goods or services. The majority of these business transactions take place between related companies or between companies with unique affiliations. The establishment of prices for various transactions between membership (divisions) is known as transfer pricing. Transfer pricing in sales transactions of goods or services is carried out by lowering the selling price between companies in one group and shifting profits to companies domiciled in countries with low tax rates. However, due to the unavailability of expert tools and standard regulations, transfer pricing audits are frequently won by taxpayers in tax courts, therefore that multinational companies are increasingly encouraged to carry out transfer pricing.

PT Adaro Energy Tbk. is an example of an Indonesian corporation that is suspected of carrying out transfer pricing. According to a Global Witness report, from 2009 to 2017, a large mining company in Indonesia, PT Adaro Energy Tbk., carried out transfer pricing through its subsidiary in Singapore Coal-trade Service International Adaro, using a tax payment strategy of US $ 125 million or the equivalent of IDR 1.75 trillion (exchange rate of IDR 14,000), which is lower than the taxes paid to the Indonesian government. Global Witness stated that the reports regarding Adaro Energy transferred revenues to its overseas subsidiaries. The goal is to avoid the tax burden. Adaro Energy is suspected of selling coal to international coal trade services at lower prices. The coal is then resold to other countries at a higher price to obtain significant profits but a low tax burden. As a result, income subject to tax in Indonesia is lower than what should be paid (Thomas, 2019). There is also a case where Asian Agri has been proven to have sold crude palm oil to a fictitious company in the British Virgin Islands. Lastly is Toyota Motor Manufacturing Indonesia which has avoided taxes by conducting a covert dividend scheme to its affiliated companies in Japan. (Kurniawan, 2020)

Based on this case, it was concluded that companies often take advantage of this transfer pricing practice for the benefit of an entity or individual. Companies will use transfer pricing practices in sales transactions of goods or services carried out by reducing the selling price between companies in one group and transferring profits earned to companies domiciled in countries that apply low tax rates. Transfer pricing by multinational companies is driven by tax and non-tax reasons. Several factors have an influence on transfer pricing decisions including taxes, company size, bonus mechanisms, foreign ownership, and tunneling incentives.

This research is a development of research conducted by Setyorini (2022). The development cerried out

is that researchers add the variabel, namely foreign ownership. The reason for the researcher to add the foreign ownership variable is that the presence of large foreign ownership will lead to the emergence of foreign controlling shareholders who will control the company's management, especially in making transfer pricing decisions. The second novelty, this study expands the scope of observations on non-financial companies listed on the Indonesia Stock Exchange (IDX) in the 2017-2021 period.

2. Literature Review and Hypothesis

2.1 Agency Theory

Agency theory is defined by Jensen and Meckling (1976) as a contractual relation between principals (company owners) and agents (company management). In an agency relationship, there is a contract between the principal and the agent, in which the principal delegates the task of managing the company to the agent. As the manager of the company, the agent has detailed information about the company's current state, including both internal information and projections of the company's prospects. In accordance with agency theory, the manager (agent) is perceived as an economic man who seeks to increase prosperity for the benefit of the individual as a manager.

Differences in interests between principals and agents can lead to deviant behavior by agents altering financial accounts. This deviant action can cause information asymmetry, one way that can be done is through earnings management so that financial reports look good (Richardson, 1998). Managers can carry out earnings management by determining income associated with the recognition of expenses that can affect accounting profit. Earnings management carried out to influence the company's income can be carried out through transactions with related parties specifically by determining the transfer pricing method.

2.2 Positive Accounting Theory

Positive accounting theory is a theory that aims to describe and explain the accounting process from the beginning to the present, as well as how the accounting process can be conveyed to various stakeholders within the company (Watt and Zimmerman, 1986). This explanation entails providing reasons for the observed behavior. Positive accounting theory (PAT), for instance, explains why corporations continue to employ historical expenses and why certain companies change their accounting practices. Meanwhile, accounting practice prediction indicates that theory attempts to forecast things that have not yet been observed (Siallagan, 2020). The connection between this positive accounting theory and transfer pricing lies in the management whose remuneration is based on bonuses, will try to maximize the bonuses that will be obtained by increasing profits and ultimately can increase the distribution of bonuses, so that transfer pricing practices can be used for earnings management.

2.3 Signalling Theory

Signaling theory explains the importance of companies delivering information to the public (Morris, 1987). This theory is rooted in pragmatic accounting theory which focuses on the influence of information. One of the information that can be used as a signal is an announcement made by an issuer. This announcement is intended to have an impact on the ups and downs of the issuer companies' stock values (Suwardjono, 2011). The information provided as an announcement to outsiders will be a signal for investors in making the investment decisions. If the announcement of this information signals a good signal for investors, there will be an increase in the volume of selling the company's shares.

The correlation between signaling theory and transfer pricing is that multinational companies will strive to allocate income from high-tax countries to low-tax countries in order to minimize the total burden and increase company profits. This will be one of the indications concerning issues from the company which will be excellent news that the company has significant profits on its annual income statement, giving the impression that the company will last a long time in the future (Muhammadi, et al, 2016).

2.4 Transfer Pricing

Transfer pricing is a company policy in determining the transfer price of a transaction whether it is goods, services, intangible assets, or financial transfers made by the company. Transfer pricing is also defined as a specific selling price used in inter-divisional transactions to reflect selling division revenue and buying division costs (Simamora, 1999). Transfer pricing also referred to as intracompany pricing, intercompany pricing, interdivisional pricing, or internal pricing, is a price set for management control over the transfer of products and services between members (company groups).

Transfer pricing is usually set for intermediate products which are goods and services supplied by the selling division to the buying division. If you take a closer look, transfer pricing can deviate significantly from the agreed price. Therefore transfer pricing is also often associated with a systematic price engineering aimed at

reducing profits which will later reduce the amount of taxes or duties from a country (Yenni, 2000).

2.5 Tax

Taxes are the mandatory contributions to the state by forced individuals or entities that are paid based on law, do not receive direct remuneration, and are intended to finance government expenditures to minimize the tax burden that must be carried by companies (Mulyani et al, 2019). Companies should use the fair price principle to reduce their tax obligations, in fact companies use more transfer pricing.

One of the reasons companies make transfer pricing decisions is the existence of tax payments. High payments make companies reluctant to pay taxes, so companies do tax avoidance by means of transfer pricing. Multinational companies tend to shift their tax obligations from countries that have high tax rates to countries that apply low tax rates which is done by reducing the selling price in one group (Tania & Kurniawan, 2019)

The theory that supports this hypothesis is positive accounting theory, in which this positive accounting theory states that the greater the political costs that must be charged to the company, managers tend to prefer accounting procedures that give up on reported profits from the present to the future. In positive accounting theory there are various kinds of motives to increase the profit of the company. One of these motives is to manipulate corporate taxes into politics, which is based on political cost theory

The research results of Marfuah (2021), Prananda (2022) and Tania & Kurniawan (2019) provide empirical evidence that taxes affects transfer pricing decisions. Based on the description above, the second hypothesis of this study is as follows:

H_1: Tax affects on transfer pricing decisions

2.6 Company Size

Company size is the average total net sales for the year to several years. The more overall assets owned by the company, the greater the company's size. Companies with large total assets indicate that they have reached the maturity stage, where the company's cash flow has increased and it is considered to have a promising prospect for a relatively long period of time. It also reflects the fact that companies with substantial assets are more reliable and capable of generating profits than companies with small assets. Relative large compan will be judged by the community based on their performance, so company managers will be more likely to engage in transfer pricing in order to demonstrate satisfactory performance (Agustina, 2019).

The relationship between signal theory and company size is that company size becomes a signal for the consideration of potential investors. A large company size will create a good signal because it will trigger a higher intention of potential investors to invest in the company. The size of the company triggers management to be more aggressive in managing tax planning strategies than small-scale companies.

The research results of Setyorini (2022), and Agustina (2019) provide empirical evidence that company size affects transfer pricing decisions. Based on the description above, the second hypothesis of this study is as follows:

H_2: The company size influences transfer pricing.

2.7 Bonus Mechanism

The bonus mechanism is a gift given by the RUPS to directors or managers if the company makes a profit. This bonus system will influence the board of directors on earnings management. In the bonus plan hypothesis, management will choose accounting policies to maximize high profits, one of which is earnings management (Saraswati & Sujana, 2017). Managers can sell inventory to subsidiaries or companies of the same group in multinational companies at prices above the fair price, so that the company's profits will increase.

The bonus mechanism based on the amount of profit is a common way for the company owners to reward their management where the bonus mechanism is able to encourage the employee in carrying out their duties and improve their performance for the company. The greater the management's desire to receive bonuses, the more likely management is to make transfer pricing decisions in order to maximize the company's revenue.

The research results of Tania dan Kurniawan (2019) and Melmusi (2016) provide empirical evidence that bonus mechanism affects transfer pricing decisions. Based on the description above, the second hypothesis of this study is as follows:

H_3: The Bonus Mechanism influences transfer pricing decisions

2.8 Foreign Ownership

According to Law Number 25 of 2007 Article 1 Paragraph 3, foreign ownership is an investment activity carried out by foreign investors to conduct business in the territory of the Republic of Indonesia, including those who use entirely foreign capital and those who use a few foreign capitals. If the proportion of foreign investment is large, foreign ownership will be formed. If the shareholder has dominant control over the company, then the

foreign shareholder has a significant influence in determining various decisions that will be employed by the company, including decisions on the amount of pricing that can be used in transfer pricing practices.

Shares owned by foreign entities of 20% or more have an influence on company control, which are often called foreign controlling shareholders. Shareholders who control foreigners will make it possible to order management to do something that benefits themselves, one of which is by ordering management to make transfer pricing decisions.

The research results of Prananda (2020) and Kusumasari (2019) provide empirical evidence that foreign ownership affects transfer pricing decisions. Based on the description above, the second hypothesis of this study is as follows:

H_4: Foreign Ownership influences transfer pricing decisions

2.9 Tunneling Intencive

Tunneling incentives are obtained by majority shareholders through the transfer of company assets and income, but minority shareholders share the burden. One type of tunneling is the involvement of controlling shareholders in shifting company resources through specific transactions. Tunneling has emerged as a result of agency issues between majority and minority shareholders (Riyadi & Kresnawati, 2021).

Multinational companies as companies that have relationships with related parties will have the convenience of conducting tunneling incentives. This is due to the possibility of transferring assets or profits generated by the company so that the company's profits appear lower. The practice of tunneling incentives includes not paying dividends, selling company assets to majority shareholders or companies controlled by majority shareholders at lower prices than they should be, the company's key positions are occupied by majority shareholders, so that the tunneling incentive process is more easy to do (Rifan, 2019).

Based on agency theory, there is a relationship between agents and principals. The company's shareholders are foreign controlling shareholders where foreign controlling shareholders try to obtain maximum return on capital from their level of ownership by arranging management to conduct transactions with related parties which will harm non-controlling parties, one of which can be done is to carry out transfer pricing (Indriaswaril & Aprilia, 2021)

The research results of Setyorini (2022), Indriaswaril (2021), and Hidayat (2019) provide empirical evidence that tunneling incentive affects transfer pricing decisions. Based on the description above, the second hypothesis of this study is as follows:

H_5: Tunneling incentives affect transfer pricing decisions

3. Methodology and Procedures

3.1 Population and Sample

Table 1: Research Sample Selection Process

No	Criteria	Amount
1	Non-financial company listed on the Indonesia Stock Exchange (IDX) in the 2017- 2021 period.	608
2	The sample companies have published financial reports for 5 (five) years, namely 2017-2021.	(220)
3	Non-financial companies that did not experience losses in the observation period 2017-2021.	(193)
4	Companies that provide data information that will be used as a factor analysis of each variable during the observation period 2017-2021	(163)
Total of research samples = 32 x 5 years		160
Outlier data during processing time		(21)
Total research samples		**139**

Source: Data Process 2023

Based on the sample selection table above, the data used in this study are secondary data, in the form of tax, company size, bonus mechanism, foreign ownership, tunneling incentive and transfer pricing decisions obtained through the documentation method by taking through the annual report of each non-financial company which can be accessed through the website www.idx.co.id and the company's official website. The object of this research is all non-financial companies listed on the Indonesia Stock Exchange (IDX) that publish annual reports from 2017-2021. Based on the sample criteria that have been determined in this study, a research sample

of 32 companies was obtained for each year. So that the total number of samples used is 160. Four samples being outliers, so that the sample that met the criteria was 139 samples.

This study use the following for each variables measurements:

Table 2: Measurement of variable

Variable	Indicators	Source
Transfer Pricing	$PAT = \frac{\text{Receivables from Related Parties}}{\text{Total Receivables}} x\ 100\%$	Refgia (2017)
Tax	$ETR = \frac{\text{Tax Expense}}{\text{Income Before Tax}}$	Saraswati & Sujana (2017)
Company Size	Company Size = Ln Total Asset	Khotimah (2018)
Bonus Mechanism	$ITRENDLB = \frac{\text{Net Profit of the Year t}}{\text{Net Profit of the Year t-1}} x\ 100\%$	Santosa & Suzan (2018)
Foreign Ownership	$FO = \frac{\text{Number of Foreign Ownership}}{\text{Number of Shares Outstanding}} x\ 100\%$	Rahmawati (2018)
Tunneling Incentive	TI = Percentage of Ownership above 20%.	Andraeni (2017)

3.2 Data Analysis Technique

In this study hypothesis testing use multiple regression analysis. The multiple linear regression method is uses to determine the correlation of each independent variable to the dependent variable.

$$\mathbf{TP = \alpha + \beta_1 T + \beta_2 CS + \beta_3 BM + \beta_4 FO + \beta_5 TI + e}$$

4. Result and Discussion

Result

The normality test is carried out using the Central Limit Theorem (CLT) assumption, namely if the number of data studied is more than 30, then the data results are getting closer to normal. This study uses data that totals 160 which is greater than 30, so this indicates that the data studied can be said to be normally distributed. The Inflation Factor Value (VIF) is 1.036-1.444 and the tolerance value is around 0.692-0.966 so it can be concluded that the regression model is free from multicollinearity. The autocorrelation test results obtained a DW (durbin watson) value of 0.847. If the DW value is below -2, then there is positive autocorrelation. If the DW value is above 2, then there is negative autocorrelation. If the DW value lies between -2 and 2, then there is no autocorrelation (Santoso: 2012). Based on the test results above, the DW value (Durbin Watson) is 0.847 and the DW number is between -2 to +2, so the data does not have autocorrelation. From table 5, the results of the heteroscedasticity test using Spearman's rho show that the significant value of each variable is above 0,05. So it means that there is no heteroscedasticity in the regression equation of this study.

In this study, hypothesis testing was carried out using multiple linear regression analysis models. The following is a table of multiple linear regression analysis:

Tabel 3: Multiple Linier Regression Analysis Test Results

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	.864	.397		2.178	.031
	Tax	-1.206	.386	-.298	-3.122	.002
	Company Size	-.017	.012	-.117	-1.375	.171
	Bonus Mechanism	.065	.050	.110	1.314	.191
	Foreign Ownership	-.047	.119	-.037	-.390	.697
	Tunneling Incentive	.268	.178	.149	1.502	.135
	F				2,805	,019[b]
	Adjusted R Square					,061

Source: Data process, 2023

Based on Tabel 3, the results of the F test have a significance value of 0.019. the significance value

shown by the F test is less than 0.05, so it can be concluded that the regression model with the dependent variable transfer pricing decisions and five independent variables namely tax, company size, bonus mechanism, foreign ownership, and tunneling incentive is feasible to use or fit regression models. The coeficient of determination shows that the Adjusted R Square value is 0,061 or 6,1%. This shows that the independent variables, namely tax, company size, bonus mechanism, foreign ownership and tunneling incentive are very limited in explaining the variation in the dependent variable, namely transfer pricing decisions of 0,061 or 6,1% while the remaining 93,9% is explained by other variables not included in this study.

Based on the results of multiple regression tests that the calculation results of each variable can describe the effect of each independent variable on the dependent variable, namely as follows:

The test results state that taxes have a significance value of 0.002 < 0.05 proving that taxes have an effect transfer pricing decisions so that **H_1 is accepted**. The results of this study are consistent with the research of Marfuah, et al (2021), Prananda (2020), and Tania & Kurniawan (2020) which conclude that taxes has an effect on transfer pricing decisions. Taxes are proxied by the effective tax rate (ETR), a low ETR value indicates tax aggressiveness in a company. High taxes will result in companies taking actions that can minimize the amount of taxes that companies must pay, one of which is by making transfer pricing decisions. According to the findings of this study, the smaller or lower the tax that a company wishes to pay, the higher the company's desire to engage in transfer pricing with parties having unique links abroad. The more companies are likely to practice transfer pricing, the smaller the tax that will be received in a country, resulting in lower overall tax payments. In accordance with positive accounting theory, accounting practices carried out by companies have goals, one of which is tax motivation. Companies with high income are required to pay their taxes based on the profits earned. This is burdensome for companies that have to reduce their profits to pay taxes to the state. Therefore, company managers tend to transfer pricing to groups or corporate entities in other countries so that the tax burden is minimized.

The findings show a significant value of 0.171 demonstrating that firm size has no effect on transfer pricing decisions, therefore the **H_2 is rejected**. The result of this study are consistent with research of Apriyanti, et al (2020), Agustina (2019), and Kusumasari, et al (2018) which conclude that company size has no effect on transfer pricing decisions. This indicates that the company's transfer pricing is not based on the size of the company, and so the size of the company has no bearing on the company's decision to implement transfer pricing. Companies that have large total assets indicate that the company has reached the maturity stage where in this stage the company's cash flow is positive and is considered to have better prospects in a relatively longer period of time. Companies that are substantially larger will be monitored by the public for their performance, prompting their boards or management to be more cautious and transparent in reporting their financial position. Companies with good performance will improve public and government trust. Company size is not a determining factor for companies to make transfer pricing decisions. Having high profits and even tending to be stable will illustrate that the company has good performance and is not easily used for things that can damage the company's image.

The results of this study show a significant value of 0.191 proving that the bonus mechanism has no effect on transfer pricing decisions, so the **H_3 is rejected**. The result of this study are consistent with research of Setyorini (2022), Prananda (2020) and Marfuah, et al (2021) which conclude that bonus mechanism has no effect on transfer pricing decisions. In this study, the bonus mechanism is measured by the profit trend, the high value of the profit trend indicates that each current year's profit is higher than the previous year's profit. In this study, the value of the profit trend tends to be stable. With a stable value, this shows that the company is less interested in manipulating profits (earnings management) and transferring pricing to maximize bonuses. The larger interest is to maintain the company's value in the eyes of the public and the government by presenting financial reports that are in accordance with reality and can be used for more important decision-making purposes for the company in the future. In addition, this study uses a sample that includes a wide range of non-financial companies in Indonesia, where these companies are supervised by the public and the government, where it can be seen that there is engineering, so this will have an adverse impact on the company's value in the eyes of society and the government. The company will anticipate fraud that can occur by having an audit committee that has the capacity and capability in financial accounting so that it can detect irregularities committed by management. Companies that have good stakeholder oversight mechanisms will eliminate the intention of the directors or management to manipulate these profits in order to get maximum profits so as to get higher bonuses.

The results of this study show a significant value of 0.697 indicating that the foreign ownership variable has no effect on transfer pricing decisions, so the **H_4 is rejected**. The result of this study are consistent with research of Marfuah, et al (2021) and Kusumasari (2018) which conclude that foreign ownership has no effect on transfer pricing decisions. Foreign ownership is not a motivating factor for companies to make transfer pricing decisions; that is, whether a company has a high or low level of foreign ownership, the company does

not make transfer pricing decisions. The desire of foreign controllers to increase personal welfare is irrelevant because foreign ownership in the sample companies is not in the form of blood relatives, so that takeover is not easy to do because managerial decision making requires the approval of the directors. The lack of influence of foreign ownership on transfer pricing practices is likely due to foreign controlling shareholders preferring the company's long-term sustainability so they do not use their position to influence decisions that could harm the company in the long term. As a result, the relatively high percentage of foreign ownership does not necessarily make it a controlling position in making transfer pricing decisions.

The study's findings demonstrate that the tunneling incentive variable has no effect on transfer pricing decisions, with a significant value of 0.135 and **H_5 is rejected**. The result of this study are consistent with research of Mulyani (2019 and Asyinta (2021) which conclude that tunneling incentive has no effect on transfer pricing decisions. The controlling shareholder does not take advantage of transfer pricing in the context of expropriation against minority shareholders because it risks causing conflict which will have an impact on decreasing the value of the company and giving a bad assessment that can cause investors to be reluctant to invest their funds in the company. Furthermore, an effective oversight mechanism, both internally and externally, such as the presence of an independent board of commissioners and an auditor, will prevent controlling shareholders from engaging in expropriation acts such as transfer pricing in order to increase personal welfare. The results of this study support agency theory which explains the relationship between company management (agents) and shareholders (principals). Company management will manage the company as well as possible so that there are no deviant acts and disclose company information in accordance with reality.

5. Conclusion

This study aims to empirically examine the effect of tax, company size, bonus mechanism, foreign ownership, and tunneling incentives on transfer pricing decisions in non-financial companies listed on the Indonesia Stock Exchange for the 2017-2021 period. Based on the test findings and discussion in the previous chapter, the following can be concluded:

1. Taxes affect a company's decision to make transfer pricing, the high and low taxes of a company affect the company's decision to make a transfer pricing.
2. Company size has no effect on transfer pricing decisions, the size of a company has no effect on transfer pricing decisions.
3. The bonus mechanism does not affect the company's decision to carry out transfer pricing. The level of the bonus mechanism in a company does not affect the company's decision to carry out transfer pricing.
4. Foreign ownership does not affect the company's decision to carry out transfer pricing, the level of ownership in a company does not affect the company's decision to carry out transfer pricing.
5. Tunneling incentives do not affect the company's decision to transfer pricing. The level of tunneling incentives does not affect transfer pricing decisions.

Based on the conclusions of this study, the researchers provide the following suggestions:

1. This study uses a sample of non-financial companies listed on the Indonesia Stock Exchange in the 2017-2021 period. For further researchers, they can extend the research period, for example seven years or ten years so that the results can describe conditions in the long term and provide more accurate results.
2. Future research can pay attention to other variables that can also influence a company's decision to carry out transfer pricing, for example exchange rates, profitability, and multinational to increase the value of R-Square. With a higher R-Square value, it can be said that the variables studied in a study have a greater influence than other variables not examined in that study.

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