THE FACTORS AFFECTING TRANSFER PRICING EVIDENCE FROM INDONESIA

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ABSTRACT

This study aims to analyze and provide empirical evidence that the independent variable Tax minimations, Bonus Plan, foreign ownership and debt ratio influence transfer pricing with control variables company size and profitability. This study uses a quantitative approach, with a sample of 14 companies listed on the Indonesian Stock Exchange during the years 2012-2016, with a sample of all manufacturing companies. Data analysis in this study uses panel data regression analysis with a random effect model. Based on the results of panel data regression analysis with random effect models using the E-views application. The result showed tax minimation significantly affect on transfer pricing, while bonus plan, foreign ownership and debt ratio does not have significant influence on transfer pricing.

Keywords: Transfer Pricing, Tax minimations, Bonus Plan, Foreign Ownership, Debt Ratio, Company Size and Profitability

INTRODUCTION

The era of technological development has an impact on increasing the trade volume among countries and expanding the company's business activities through the ease of communication and transportation (Smith, 2015). Inter-country trade activities raise tax administrators' concerns due to the diversion of international income (Augusto & Rathke, 2015). Multinational companies tend to use transfer pricing to avoid tax. Dawson, (2000) states that transfer pricing in multinational companies can be done internally or externally. Internally, the company will usually evaluate the performance of its subsidiary and encourage managers to reduce taxes, reduce foreign and domestic tax bills. Externally, multinational companies have the ability to use transfer pricing policies to maximize their global profits which is characterized by various international tax rates, government regulations, foreign exchange rates, the manipulation of currency and economic, cultural and other social factors (Randeberg & Selvik, 2014).

In Indonesia, transfer pricing has been an apprehension of the government. One example of a transfer pricing case that occurred in Indonesia is the case of PT Andaro, which carried out a transfer pricing scheme through a subsidiary located in Singapore. PT Adaro is indicated to flee its income and profits abroad so that it can reduce the taxes paid to the Government of Indonesia (0rtax, 2019). The case of transfer pricing according to the Ministry of Finance (2019) is increasingly rife because there are cross-country transactions that have the potential to abuse transfer prices and because the handling of the case of transfer prices that are less comprehensive and systemic. For the Government, transfer pricing transactions have reduced or even lost the potential of a country's tax revenue. (Huda, Nugraheni, & Kamarudin, 2017).

The purpose of this study is to analyze the impact of the factors that influence transfer pricing in manufacturing companies in Indonesia. Manufacturing companies are used in this study because there are many companies in this sector that carry out their business activities on a multinational basis. Several previous studies by Beer & Loeprick (2015), Beuselink, Deloof, & Vanstraelen (2014) stated that the transfer pricing policy would reduce the transfer of income and tax penalties. The transfer of income made by the company aims to do tax minimization.

Companies can do tax minimization by selecting transfer pricing strategies by choosing lower costs, by shifting revenues from countries that have high tax rates to countries that have low tax rates (Klassen, 2013). Revenue shifts are carried out by companies that have multinational businesses by way of a holding company buying goods at a subsidiary that has a selling price above the market price so that it makes high profits and lower taxes. So, the holding company will report low profits (Wong et al , 2011).

Companies that run their business multinational will certainly invite foreign investors to invest their capital through foreign ownership. This study examines the effect of foreign ownership in transfer pricing practices. Foreign share ownership is considered to affect transfer pricing because foreign ownership can control the company (Yulia, Hayati, & Daud, 2019).

Transfer pricing by companies is also used as an effective tool to achieve goals for employee motivation (Uyar, 2014). According to Susanti & Firmansyah (2018) one of the management motivations for transfer pricing is the interest of bonuses. Management seeks to increase profits as a basis for bonuses through transfer pricing transactions. The marketing strategy of price fixing on finished and semi-finished products between related parties is a way for companies to do transfer pricing that will create ideal performance through achieving maximum profits and impacting bonuses. According to Mahenthiran & Kershaw (2015) bonus giving will influence managers to negotiate higher transfer pricing to maximize profits.

Another factor examined in this study is debt policy. According to Dyreng, Hanlon, & Maydew (2008) Companies that have high debt will certainly benefit from tax avoidance because with a high debt ratio, the company's tax payments will be low. Debt can cause a decrease in taxes due to interest costs arising from debt owned by the company can be used as an income deduction.

Transfer pricing has a significant role in the global environment. Many previous studies have examined the factors that influence transfer pricing and conclude the results of previous studies are consistent. For this reason, this research tries to review the factors that influence transfer pricing.

LITERATURE REVIEW

Agency Theory

Agency theory according to Jensen & Meckling (1976) explains the relationship between agents and principals. Agency theory arises when there are two interrelated and intertwined parties, where one party (the principal) employs the other party (agent) to carry out a number of services. Agency theory is used in this study to explain the tendency of agents in making efforts to carry out tax minimization by utilizing transfer pricing on parties who have special relationships. Bhat (2009) in his research results revealed that taxes affect decision making, which results in managers trying to do tax minimization by coordinating and controlling multinational business transactions.

The following is the framework of this research:

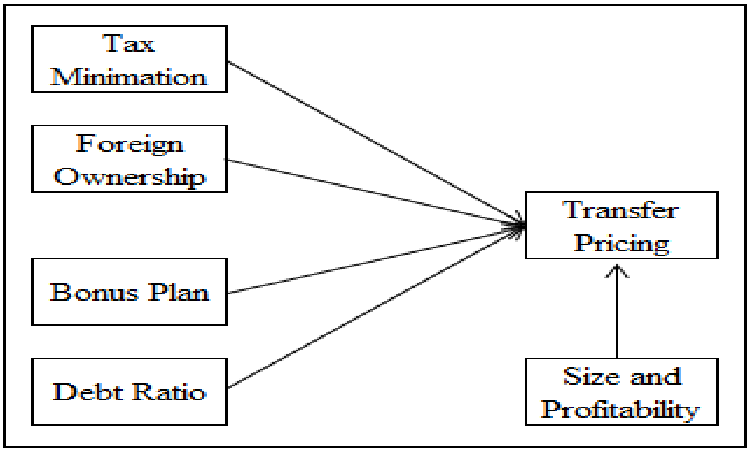

Figure 1 Thinking Framework

The hypotheses of this study are:
H1 = The Effect of tax minimization on transfer pricing
H2 = The Effect of foreign ownership on transfer pricing
H3 = The Effect of bonus plan on transfer pricing
H4 = The Effect of debt ratio on transfer pricing

Tax minimation dan transfer pricing

Agency conflict arises due to the asymmetry of information between the owner and manager of the company where individual goals tend to always be prioritized by managers rather than company goals. With the authority given by the shareholders to the manager, therefore, the assets of the entity managed by the manager have the opportunity to carry out special relationship transactions to carry out tax management.

Motivation in conducting transfer pricing is tax avoidance. Taxes are mandatory contributions for the state based on mandatory laws that are used for the benefit of the state in achieving people's prosperity. The greater tax burden is the reason companies conduct transfer pricing transactions with the aim of minimizing the burden.

Mangoting (2000) states that taxes are an expense borne by companies, so companies will try to reduce tax payments to maximize profits through transfer pricing. The greater the company tax, the smaller the profit generated by the company. The company takes the transfer pricing decision because it is triggered by a high tax, so the company tries to minimize the tax expense (Klassen, 2013).

The research conducted by Tiwa et al. (2017) show the high amount of taxes paid by businesses, which encourages them to apply transfer pricing in cases that minimize the tax burden. Transfer pricing practices minimize taxes by diverting the revenues and costs of a company with special relationships with companies in other countries with different tax rates.

The higher the tax rate in a country, the more companies have the opportunity to adopt transfer pricing practices.

Foreign ownership dan transfer pricing

The ownership structure in a company is a very important aspect to determine the performance of the company that in turn will affect the value of the company. Two aspects to consider in the property are (1) concentration of own external property and (2) property of the administrator.

In addition to tax reasons and bonuses, transfer pricing practices may be influenced by other reasons such as foreign ownership. The transfer price is a transaction with a foreign party so the foreign ownership in a company can affect the company's decision to transfer prices. When controls by foreign majority shareholders become increasingly important, foreign majority shareholders will try to allocate the company's resources in such a way as to obtain personal benefits in a variety of important decisions, including by influencing price and pricing policies. the amounts of transfer pricing transactions (Ratna & Candra, 2012).

Foreign ownership is ownership of shares owned by foreign individuals or institutions. Research conducted by (Stephanie, Sistomo, Simanjuntak, 2017) states that foreign ownership has an influence on transfer pricing. Refgia (2017) states that management in making decisions will certainly be influenced by existing foreign share ownership. Foreign shareholder has the power to be able to control sales or purchases through transfer pricing that will benefit shareholders in control.

Bonus plan dan transfer pricing

Watts and Zimmerman (1986) say managers tend to choose accounting procedures to maximize profits with the aim of pursuing bonuses set by company owners. The motivation of the bonus encourages managers to choose accounting procedures that can transfer profits from the coming period to the current period.

Researchers (Lo, Wong, & Firth (2010) bonus plan affect the increase in the reported corporate income by increasing current period earnings, one of which is the practice of transfer pricing. The bonus plan has an influence on transfer pricing because the bonus plan is management's motivation for transfer pricing. When management gets a bonus then they tend to try to reach the target to get a bonus (Susanti & Firmansyah, 2018).

Debt ratio and transfer pricing

Tax is important and is a major concern for corporate strategy in terms of decision making (Anouar & Houria, 2017). Determination of capital structure through debt policy is also said to have an impact on taxes. Companies that have high debt tend to take advantage to minimize taxes. If the debt ratio exceeds the limit, then try to avoid violating the debt contract by choosing an accounting method that increase the company profit (Dyreng et al., 2008). One way of transfer pricing is the selection of accounting procedures through reports of changes in the profit for the next period to the current period. Richardson, Taylor, & Lanis (2013) stated that debt policy has an influence on the company determination in carrying out transfer pricing.

RESEARCH METHOD

The independent variable in this study consisted of tax minimization, a foreign ownership and debt ratio bonus plan. The dependent variable in this study is transfer pricing. This study makes company size and profitability as control variables. The following are explanations and measurements related to the variables used.

Transfer pricing is a systematic operation of price manipulation with the intention of reducing profits, making it look like the company is losing, avoiding taxes or duties in a country (Liu, 2017). The manipulation can exploit tax rates in a country by shifting profits to the lowest tax rates. The transfer pricing variable is measured by a proxy of related party transaction which is a comparison of related party receivables divided by the company's total receivables. (Lo et al., 2010).

Tax minimization is a way that is carried out by companies to reduce the tax expense (Blaufus et al., 2016). Tax minimization in this study is proxied by effective tax rate which is the ratio of tax expense minus deferred tax expense divided by taxable income (Bernard, Jensen, & Schott, 2006).

Foreign ownership is the portion of share owned by a foreign party. Foreign ownership determines company productivity through capital, work skills and operational scale. (Aybars, 2017). Foreign ownership can be measured in accordance with the proportion of ordinary shares owned by foreigners, calculated by the number of foreign ownership shares divided by the total outstanding shares. (Lee, 2008).

Bonus plan is one of the motives for choosing an accounting method that is inseparable from positive accounting theory. Bonus plan is a component of calculating the amount of bonus given by company owners or shareholders through the GMS to members of the board of directors each year if they make a profit (Suryatiningsih, Neneng, & Siregar, 2009). This variable will be measured by the calculation component of the net profit trend index (ITRENDLB), which is the net income for the year divided by the previous year net profit.

Debt ratio according to Masri & Martani (2012) explains that companies choose debt as a source of funding. Debt policy can be measured by Debt to Asset Ratio (DAR). DAR is the ratio used to assess debt to assets. This ratio is found by comparing all debt, including current debt and all assets. This ratio is useful to find out the amount of funds provided by creditors with company owners relating to the company's debt policy (Kasmir, 2015).

The control variable in this study uses the size of the company measured by Log and profitability.

The population of the object in this research is manufacturing companies listed on the Indonesia Stock Exchange in 2012-2016 through the site www.idx.go.id. The sample selection is done using the purposive sampling method, with the criteria for issuing complete financial statements during the observation period, using the rupiah currency, not experiencing losses and having a percentage of foreign ownership of more than 20%. After going through the criteria, the samples in this study were 14 companies with 5 years observation.

This research is a quantitative study using panel data. Data testing was performed using e-views software. The initial stage of the test is to conduct a classic assumption test that aims as a parameter to measure whether the data used in this study is BLUE (Best Linear Unlimited Estimator) or not. The next test is the t test to see the effect between the independent and dependent variables in this study. Following are the statistical equations in this study.

$$\mathbf{TP = \alpha + \beta 1TM + \beta 2FO + \beta 3BP + \beta 4DR + \beta 5Control + \beta 6Control + e}$$

Notes:

Tp = Transfer Pricing, TM = Tax Minimization, BP = Bonus Plans, DR= Debt Ratio, Control = Size and Profitability, e = error

RESULT

In this study, the object of research came from the annual reports of manufacturing companies for the 2012-2016 period which were published on the Indonesia Stock Exchange obtained through the official website of the Indonesia Stock Exchange, www.idx.co.id. The sample in this study were 14 companies with a 5 year observation period.

Descriptive statistics used in this study explain the characteristics of the data used in this study using the minimum, maximum, average (average), and standard deviation values.

Table 1 shows the descriptive statistics of variables used in this study:

Table 1 Descriptive Statistics

	RPT	ETR	KEPASING	BONUSPLAN	DEBTRATIO	LNFIRMSIZE	ROA
Mean	**0.441282**	**0.314518**	**0.639953**	**1.144587**	**0.775013**	**15.32828**	**0.142597**
Median	0.379995	0.250175	0.608350	1.084750	0.628191	14.91942	0.108850
Maximum	**0.973960**	**1.934830**	**0.981790**	**3.096620**	**2.559700**	**18.33547**	**0.403800**
Minimum	**0.019930**	**-0.081540**	**0.288490**	**0.297640**	**0.142200**	**12.97964**	**0.023000**
Std. Dev.	**0.296131**	**0.268780**	**0.213131**	**0.513982**	**0.553733**	**1.529705**	**0.101181**
Observations	70	70	70	70	70	70	70

T-test is executed to find out whether the independent variable influences the dependent variable. Statistical t-test is executed by comparing the probability value to α (0.05).

Table 2 T-test

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-0.148224	0.362386	-0.409023	0.6839
TM	-0.535069	0.145440	-3.678964	0.0005
FO	-0.329748	0.166703	-1.978060	0.0523
BP	0.107860	0.061639	1.749872	0.0850
DR	-0.052827	0.060912	-0.867264	0.3891
Ln Firm Size	0.068796	0.026560	2.590268	0.0119
ROA	-1.179727	0.353663	-3.335738	0.0014

The following is the equation in this research

$$TP = \alpha -0.535069TM-0.329748FO+ 0.107860BP+ -0.052827DR +0.068796Size -1.179727ROA+ e$$

Tax minimation and transfer pricing: Hypothesis 1 in this study was accepted with a probability value of 0.0005. The results show that the probability value is 0.0005> α value (0.05). Tax minimization has a significant and negative effect on transfer pricing, the company decision to do transfer pricing will result in lower tax payments. Companies that have multinational business tend to gain benefit by shifting incomes from countries with high tax rates to countries with low tax rates. So that the greater the possibility of the company doing transfer pricing practices, the higher the company will do tax minimization and the paid taxes will be smaller. The self-assessment principle adopted by the taxation system in Indonesia allows taxpayers to count, calculate, pay and report their own taxes so that taxpayers can minimize their tax payments.

Foreign ownership and transfer pricing: The results of software Eviews from foreign ownership show a probability value of 0.0523 with a probability value greater than 0.05 The results show that foreign ownership is not always able to control companies to implement transfer pricing practices. This means that foreign ownership does not have the control to instruct management to conduct transfer pricing practices. Hypothesis 3 in this study was rejected.

Bonus plan and transfer pricing. Hypothesis 3 in this study is rejected, the results show that the bonus plan has no effect on transfer pricing. This research shows that the policy of transfer pricing mechanism carried out by the company is not a motivation for management to get a bonus. The results of software Eviews show the probability value of 0.0850 is greater than 0.05.

Debt Ratio and transfer pricing. Hypothesis 3 in this study is rejected, the results show that debt ratio has no effect on transfer pricing. The results of software Eviews show that the probability value of 0.3891 is greater than 0.05. The results of this study prove that the company's debt policy does not affect the company decision in carrying out transfer pricing practices.
The control variable in this study has an influence on the transfer pricing policy.

The following are the conclusions of the hypotheses test in this study

Table 3. Hypothesis Test Results-Summary

Hypothesis	Significant	Conclusion
The effect of tax minimation on transfer pricing	0.0005	H1 Accepted
The effect of foreign ownership on transfer pricing	0.0523	H2 Rejected
The effect of bonus plan on transfer pricing	0.0850	H3 Rejected
The effect of debt ratio on transfer pricing	0.3891	H4 Rejected
The effect of firm size on transfer pricing	0.0119	Accepted
The effect of ROA on transfer pricing	0.0014	Accepted

Table 4 Coefficient Determination Test

Adjusted R-squared	McFadden R-squared	0.246890

Based on the above table, the McFadden R-squared value is 0.246890. This means that the Transfer Pricing variable can be explained by the independent variables in this study by 24%, while 76% is explained by other independent variables outside the research model.

Table 5 F-Statistic Test

F-statistic 4.770014	Prob. (F-statistic) 0.000457

Based on the above table, it can be seen that the value of the f-test probability in this study is 0.000457, which is less than 0.005 and it can be concluded that the model in this study can be accepted.

CONCLUSION

This study examines the factors that influence transfer pricing. The results showed that tax minimization has a negative influence on transfer pricing. This proves that the taxation rules in Indonesia are comprehensive enough to regulate the transfer pricing practices that have not been able to minimize tax avoidance and fraud committed by companies. So that the practice of transfer pricing has a detrimental impact on state tax revenues. The results of this study show that Foreign ownership, Bonus plan, Debt ratio has no effect on transfer pricing.

The limitation of this study is the limited sample because the number of manufacturing companies listed on the Indonesia stock exchange is limited. The next researcher can choose a different sample and further research not only uses financial performance but can also add non-financial performance variables as dependent variables such as environmental factors.

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