



Can Taxes, Foreign Ownership and Tunneling Incentives Affect Transfer Prices?

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Abstract

This research aims to knowing and testing the effect of taxes, foreign ownership, and tunneling incentives on transfer pricing in primary and chemical industrial sector companies on the IDX for the 2018-2020 period. The population in this study is the financial statements of all primary and chemical industrial sector companies listed on the Indonesia Stock Exchange in the 2018-2020 period, totaling 64 companies obtained through the official website of the Indonesia Stock Exchange, namely www.idx.co.id. The sample in this study was obtained using the purposive sampling method. Based on the sample selection process in this study, the number of samples used was 39 financial statements from 13 companies in the primary and chemical industry sector in the 2018-2020 period that had met predetermined criteria. The data collection technique in this research is the documentation observation method by looking at the company's financial statements as the sample. By collecting data on the company's financial statements from 2018-2020. The analytical method used is multiple linear regression. The results of this study indicate that tax has a positive and significant effect on Transfer Pricing. While Foreign Ownership and Tunneling Incentive no significant effect on Transfer Pricing.



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1 Introduction

Globalization has allowed the economy to develop rapidly without knowing national borders. This caused the company to open branches and subsidiaries in various countries. In the business development process, the company will continue to work hard to improve the efficiency and effectiveness of realizing the company's profit growth goals. To achieve this goal, one of the methods that can be used is transfer pricing. Transfer pricing is a policy that sets the transfer price in the form of goods or services. Companies can use transfer pricing to reduce tax burden through strategies like shifting profits to countries with low tax rates. The greater the profit earned by the company in an accounting period, the greater the tax burden that the company will bear. Therefore, it is possible to apply transfer pricing. Every country has regulations and policies. The application

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of transfer pricing in the context of tax avoidance can cause problems for the tax authorities in their efforts to maximize state revenues from the taxation sector, which is one of the largest sources of the State Budget (APBN) (Hidayat, 2020). Companies are increasingly misusing transfer pricing companies to manipulate their tax payments to be kept to a minimum. The initial purpose of transfer pricing is getting lost due to errors in its application in a company. This makes many people think that transfer pricing is one of the causes for the state to be harmed because the taxes paid are small (Mangoting, 2000).

The case related to transfer pricing practices in 2017 that happened to Standard Chartered was related to the transfer of funds worth US\$1.4 billion from Guernsey, England, to Singapore by a client from Indonesia. In this case, the rules regarding tax transparency have not been introduced. Another case occurred in Indonesia with PT Toyota Motor Manufacturing Indonesia. The Director-General of Taxes accused the PT Toyota Motor Manufacturing Indonesia (TMMI) company of evading taxes of Rp 1.22 trillion. This case began to unfold because the taxpayer made an application for tax refunds (restitution) for 2005, 2007, and 2008. The tax officer considers PT Toyota Motor Manufacturing to carry out transfer pricing outside the principle of appointed business obligations to reduce Indonesian tax payments. The case can be concluded that these companies have carried out transfer pricing to avoid the company's tax burden.

Agency theory has two conflicts in agency theory; the first is a conflict between company owners and company management; company management tends to operate the company for management's profit which sometimes harms company owners who aim to maximize the addition of wealth from company profits. Based on agency theory, managers have the opportunity to manage the amount of tax, one of which can be done by transferring profits to companies in other countries that have lower tax rates. Furthermore, foreign shareholders will try to get maximum return on capital by using transfer pricing practices through tunneling incentives and motivating the company's management to carry out transfer pricing. Transfer pricing is part of tax avoidance or an effort to make tax savings. Tax is a burden that reduces the company's net profit, so the company tries as much as possible so that the tax paid can be to a minimum (tax avoidance). The Taxation Law mentions the term transfer pricing with transactions between parties that have a special relationship. This is as regulated in 18 paragraph (4) No. 36 of tahun 2008 concerning Income Tax. Law Number 36 of 2008 concerning Income Tax also has rules that deal with transfer pricing issues.

Transfer pricing rules usually cover several things: the definition of special relationship, the authority to determine the ratio of debt and capital, and the authority to make corrections in case of transactions that are not arm's length. With the tax will be detrimental to the company, then much fraud appears in paying taxes. Companies do many things to minimize tax payments to the state. Thus, to avoid paying high taxes, one of the things that companies do is transfer pricing. Research result (Purwanto & Tumewu, 2018) and (Rachmat, 2019) found that taxes have a positive and significant effect on transfer pricing. The growing tax burden triggers companies to carry out transfer pricing in the hope of minimizing the corporate tax burden that must be paid to the destination country to optimize the increase in corporate profits (Cledy & Amin, 2020).

H1: Tax has a positive and significant effect on transfer pricing.

In addition to tax factors, transfer pricing is also influenced by foreign ownership. Foreign ownership is the number of shares owned by foreign parties both by entities and individuals in companies located in Indonesia. In contrast to the ownership structure in Europe and the United States, the majority have a concentrated ownership structure in Asia. This ownership is concentrated on control rights to certain parties called controlling shareholders. The concentrated ownership structure will trigger the controlling shareholder to manage the company much more controlled. When foreign shareholding is getting bigger (Hasnawati & Sawir, 2015). Research results (Akhadya & Arieftiara, 2018) and (Yanti & Pratiwi, 2021) found that foreign ownership negatively affects transfer pricing. This means that if a foreign party conducts a transaction with a related party but does not provide a profit, the company's tendency to conduct transfer pricing will decrease. The greater the level of foreign ownership in the company, the smaller the company's tendency to transfer pricing. Transfer pricing is carried out by implementing a price policy using an outrageous price through transactions with related parties.

H2: foreign ownership has a negative and significant effect on transfer pricing

Another factor that affects transfer pricing is tunneling incentive. Tunneling can be transferred to the parent company through related party transactions or dividend distribution. Related party transactions are more commonly used for dividend payments because companies listed on the Indonesia Stock Exchange must distribute dividends to their parent companies and other minority shareholders. The concentrated structure of capital ownership in Indonesia can lead to agency conflicts between majority and minority shareholders. In this case, the majority shareholder can control the management, where the majority shareholder has more control over decision-making when compared to the minority shareholder. Research result (Hartati & Desmiyati, 2015) and (Putri, 2019) found that tunneling incentive positive and significant effect on transfer pricing. The company performs this tunneling to minimize transaction costs. By doing tunneling to parties who have a special relationship, costs can be reduced to be more economical than parties who do not have a special relationship. In addition, the company conducts tunneling to manipulate profits (Apriani et al., 2020).

H3: tunneling incentive positive and significant effect on transfer pricing.

This research refers to research that has been conducted by (Tiwa et al., 2017), which uses the variable taxes, foreign ownership, and transfer pricing. The difference between this study and (Tiwa et al., 2017), i.e., adding variable tunneling incentives. Tunneling can be in the form of transfers to the parent company made through related party transactions or in the distribution of dividends, which will affect transfer pricing. Another difference with (Tiwa et al., 2017), namely the research site. A study (Tiwa et al., 2017) was carried out in the manufacturing industry, while this research was carried out in primary and chemical industry sectors on the Indonesia Stock Exchange. The purpose of this study was to determine and examine the effect of taxes, foreign ownership, and tunneling incentives on transfer pricing in primary and chemical industrial sector companies on the Indonesia Stock Exchange for the 2018-2020 period.

2 Research Method

This study uses quantitative methods, namely data collection techniques obtained from the results of questionnaires distributed to test the effect of taxes, foreign ownership, and tunneling incentives on transfer pricing. The population in this study is the financial statements of all primary and chemical industrial sector companies listed on the Indonesia Stock Exchange in the 2018-2020 period, totaling 64 companies obtained through the official website of the Indonesia Stock Exchange, namely www.idx.co.id. The sample in this study was obtained using the purposive sampling method. Based on the criteria that have been determined, in order to obtain companies that meet the criteria in this study in terms of the company's financial statements are as follows:

Table 1. Research Sample Selection Process

No	Sample Criteria	Total
1	Companies listed on the Indonesia Stock Exchange (IDX) in the 2017-2019 period in the basic and chemical industrial sectors.	64
2	Companies that do not publish financial statement data consecutively in the 2017-2019 period.	(9)
3	Companies whose controlling share ownership is below 20%.	(15)
4	Companies that experience losses during the observation period.	(17)
5	Companies that do not present their financial statements in rupiah.	(10)
Number of companies		13
The number of samples used in the study are 13 financial statements X 3 years		39

Source: Processed Data, 2021

Based on the sample selection process in this study, the number of samples used was 39 financial statements from 13 companies in the primary and chemical industry sector in the 2018-2020 period that had met predetermined criteria. The data collection technique in this research is the documentation observation method by looking at the company's financial statements as the sample. By collecting data on the company's financial statements from 2018-2020 and calculating taxes, foreign ownership, tunneling incentives, and transfer pricing. The multiple linear regression equation models are as follows:

$$Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + e$$

Description :

Y	= Transfer Pricing
α	= Constant
$\beta_1 - \beta_3$	= Regression Coefficient
X1	= Tax
X2	= Foreign Ownership
X3	= Tunneling Incentive
e	= Standard Error

3 Result and Discussion

Result

By looking at the normality test using the Kolmogorov-Smirnov it can be seen that the tested data is normally distributed, the results of the Normality test can be seen in the following table 2.

Table 2. Normality Test Results

		Unstandardized Residual
N		39
Normal Parameters, b	mean	.0000000
	Std. Deviation	.03666763
Most Extreme Differences	Absolute	.089
	Positive	.089
	negative	-.071
Test Statistics		.089
asympt. Sig. (2-tailed)		.200c,d

Based on table 2, it is known that the significance value is 0.200, which means that this value is more significant than 0.05, so it can be concluded that the tested data is usually distributed. As a result of heteroscedasticity in the regression results, the variance is no longer minimum, the test of the regression coefficient becomes less intense, the estimator coefficient is biased, and the conclusions drawn are wrong. The results of the heteroscedasticity test can be seen in the following table 3:

Table 3. Heteroscedasticity Test Results (Glesjer Test)

Model		Sig.
1	(Constant)	.020
	Tax	.390
	Foreign Ownership	.760
	<i>Tunneling Incentive</i>	.153

Based on the table 3, it can be seen that the significance value of the Tax variable is $0.390 > 0.05$, the Foreign Ownership variable is $0.760 > 0.05$, and the Tunneling Incentive variable is $0.153 > 0.05$. This means that the variables of Taxes, Foreign Ownership, and Tunneling Incentives do not occur heteroscedasticity problems in the regression model.

Table 4. Multicollinearity Test Results

Model	Collinearity Statistics	
	Tolerance	VIF
1 (Constant)		
Tax	.924	1.083
Foreign Ownership	.883	1.132
<i>Tunneling Incentive</i>	.952	1.050

Based on table 4, it is known that the Tolerance and VIF values on the Tax, Foreign Ownership, and Tunneling Incentive variables obtain a Tolerance value > 0.10 and $VIF < 10$, meaning that there is no multicollinearity in these variables. In the Multicollinearity test, said meet if the value of Tolerance > 0.10 and $VIF < 10$, then there is no symptom of Multicollinearity. Thus it is concluded that this data meets the Classical Assumption test on the Multicollinearity Test.

Table 5. Autocorrelation Test

Model	Durbin-Watson
1	1,673

Based on the results in table 5 shows that the results of the autocorrelation test with the Durbin Watson (DW) value of 1,673 will be compared with a significance of 5%, the number of samples (n) 39, then the value of $k = 4$ and $n = 39$ (Table Durbin - Watson (DW) at = 5%). So that the value of lower bound (dL) = 1.2734 and the value of upper limit or upper bound (dU) = 1.7215. Durbin Watson (DW) count = 1.673 This value will be compared with the 5% significance table value, with (n=96) and the number of independent variables (K=5) dL= 1.2734 and dU= 1.7215. These results explain that $1.2734 (dL) < 1.673 (DW) < 1.7215 (dU)$. Because of the value of $DW > dL$ and $DW < dU$, it can be concluded that the autocorrelation coefficient is equal to zero, meaning that there is neither positive autocorrelation nor negative autocorrelation.

Table 6. Coefficient of Determination Test (Test – R2)

Model	R	R Square	Adjusted R Square
1	.434a	.188	.118

Source: SPSS processed data (2021)

From the results of the R2 test, the R2 value is 0.188 or 18.8%. This shows that Transfer Pricing can be explained by 18.8% by the independent variables, namely Tax, Foreign Ownership, and Tunneling Incentive. At the same time, the remaining 81.2% variation in Transfer Pricing is explained by variables outside the independent variables of this study.

Table 7. Partial Test Results (t-test)

Model	t	Sig.
(Constant)	-.663	.412
Tax	2.498	.016
Foreign Ownership	-1.188	.352
1 <i>Tunneling Incentive</i>	-1,967	.240

Based on the table 7, the regression equation formed in this regression test is:

$$Y = -0.035 + 0.513 X_1 - 0.015 X_2 + 0.043 X_3 + e$$

The research results have proven that the first hypothesis is accepted because the thit value of 2,498 is greater than the ttab value at the 95% confidence level, the t tab value = 2,030 with a significance of $0.016 < 0.05$. This means that taxes have a positive and significant effect on transfer pricing. This is because the greater the income tax burden paid by the company will impact the income earned by a company. This is what causes the company to be motivated to take transfer pricing actions that aim to reduce the cost of income tax incurred so that the company does not suffer losses. The results of this study are in line with agency theory, where managers have the opportunity to manage the amount of tax, one of which can be done by transferring profits to companies in other countries that have lower tax rates and motivating company management to transfer pricing. The results of this study support the statement (Pondrinal et al., 2020) that companies often use transfer pricing transactions to minimize the amount of tax that should be paid. In transfer pricing activities, multinational companies tend to shift their tax obligations from countries with high tax rates to countries with low tax rates by reducing the selling price between companies in the same group. Thus, the higher the applicable tax rate, the more it will trigger companies to carry out transfer pricing in the hope of getting a tax burden that can reduce the existing tax burden. This study also supports research results (Purwanto & Tumewu, 2018; Rachmat, 2019) that taxes have a positive and significant effect on transfer pricing. The growing tax burden triggers companies to carry out transfer pricing in the hope of minimizing the corporate tax burden that must be paid to the destination country to optimize the increase in corporate profits. (Cledy & Amin, 2020). The research results have proven that the second hypothesis is rejected because the thit value of -0.188 is smaller than the ttab value at the 95% confidence level, the t tab value = 2.030. Because the value of thit < t tab with a significance of $0.352 > 0.05$.

This means that Foreign Ownership has no significant effect on Transfer Pricing. The results of this study do not support agency theory, where foreign shareholders will try to get the maximum return on capital with transfer pricing practices. However, the results of this study are in line with the results of (Tiwa et al., 2017); foreign ownership has no significant effect on the implementation of transfer pricing. This means that the controlling shareholder does not carry out transfer pricing in the context of expropriation. Given that the companies studied are foreign companies that have control over branch companies and subsidiaries without any special relationship in the form of blood relatives, then all decisions within the company are on an organizational scale that requires an agreement from the company's directors so that expropriation to maximize personal welfare is irrelevant. It could happen, but this will decrease the performance of the controlled subsidiaries. After all, they feel they are not getting the benefits they should because they have to sell their products below the market price to the parent company. The results of this study are not in line with (Yanti & Pratiwi, 2021), who found that foreign ownership hurts transfer pricing. The greater the level of foreign ownership in the company, the smaller the company's tendency to transfer pricing. When foreign share ownership increases, the foreign shareholder has greater control in making decisions in companies that can benefit him, including policies in determining prices and the number of transfer pricing transactions (Surjana, 2020). The research results have proven that the third hypothesis is rejected because the thit value of -1.967 is smaller than the ttab value at the 95% confidence level, the ttab value = 2.030. Because the value of thit < t tab with a significance of $0.240 > 0.05$. This means that Tunneling Incentive has no significant effect on Transfer Pricing Share ownership in public companies in Indonesia tends to be concentrated, so there is a tendency for majority shareholders to the tunnel.

This study does not support the agency theory, which explains that tunneling incentives will motivate company management to transfer pricing. However, the results of this study are in line with the results of (Jumaidi et al., 2017; Pondrinal et al., 2020). They found that tunneling incentive does not have a significant effect on the implementation of transfer pricing. However, the results of this study do not support the results of the study (Putri, 2019; Mineri & Paramitha, 2021) that tunneling incentive has a significant effect on the implementation of transfer pricing. Most companies have wise decision-makers in seeing the mutual benefit between the largest shareholder and the lowest shareholder. The majority of companies decide to transfer

pricing not based on the majority shareholder's profits but also the company's profits so that minority shareholders get the same benefits.

4 Conclusion

Based on the descriptions that the authors have described on the research data that has been collected, then processed, it can be concluded that Taxes have a positive and significant effect on Transfer Pricing in Basic and Chemical Industry Sector Companies during the period 2018-2020, while Foreign Ownership and Tunneling Incentives have no significant effect on Transfer Pricing for companies in the primary and chemical industry sector, during the period 2018-2020. This study provides suggestions for further researchers to research Taxes, Foreign Ownership, and Tunneling Incentives in a focused and applicable manner and is expected to add other variables such as bonus mechanisms and develop other variables related to Transfer Pricing.

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