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CORPORATE GOVERNANCE AND TRANSFER PRICING

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Abstract: The purpose of this research is to present also state the evidence empirically regarding the effect of, audit quality, multinationality, foreign ownership, tax avoidance, bonus mechanism, debt covenant, tunneling incentive, and company size on transfer pricing. The data collected in this research is Manufacutring Company that listed in Indonesia Stock Exchange (IDX) from period 2019 to 2021. The purposive sampling method is used in this research as the based to determine the result of samples with 55 companies are selected out of 168 companies data from period 2019 to 2021. The data were executed and analyzed by multiple linear regression method. The result of research showed that multinationality and foreign ownership have an effect to transfer pricing. Other than that audit quality, tax avoidance, bonus mechanism, debt covenant, tunneling incentive, and company size have not influence on transfer pricing. Multinational companies and owned by foreign parties tend to have stricter supervision so that the probability of transfer pricing is low.

Keywords: audit quality, multinationality, foreign ownership, tax avoidance, transfer pricing

INTRODUCTION

The agency theory will represent the different interest between a principal that can be called shareholders and an agent also known as management which means it will show the conflict of different interest between two parties. The positive accounting theory actually will determine directly to management in making decisions to choose accounting methods that will make earnings increase or decrease according to the need and condition of the company (Supriyati et al., 2021). The political cost theory will explain about the procedures that can make earnings reporting of a company to be postponed from the current period to the upcoming period (Indriaswari and Nita 2018).

There is a case of transfer pricing between PT. Adaro Indonesia with its subsidiary Coaltrade services International Pte Ltd, which has shown that there are indications of misuse of the transfer price system that carried out by the company. The transfer pricing actually is one of several transactional shift. Transfer pricing can be defined as the price that included in products or services from one party that is transferred to another parties within the same companies or between companies that have a special relationship (Rohaeni, Siregar, and Safitri 2021). In this case, PT Adaro Indonesia suspected sold coal below market price to its affiliated companies in Singapore in 2005 and 2006. But then it is sold again to the market according to the market price. It can be conclude from the statement above that the company have an indication to prevent their royalties being paid to the authorities or government.

PT Adaro Indonesia (PT Adaro Energy Tbk) is the second largest coal company in Indonesia that has Enviro's superior product, low-calorie and environmentally friendly coal.

The company, which has coal reserves of 928 million tons with a mining area of 34,940 hectares, that was previously owned by conglomerate Sukanto Tanoto. However, as a result of being pledged to Deutcshe Bank, the company was later purchased by a partnership of Indonesian businessmen at a low price. The partnership includes Edwin Soryadjaya, Sandiaga S Uno, Teddy Rachmat, and Boy Garibaldi Thohir who is now the president director of PT Adaro Indonesia. PT Adaro Indonesia is suspected of committing tax evasion through the transfer pricing. This is because Adaro has manipulated tax evasion by buying and selling coal unfairly (not at the international market price of coal) to its company Coaltrade Services International Pte. Ltd. from Singapore. Several years ago, Adaro entered into an agreement with Coaltrade Services International Pte Ltd, a paper company based in Singapore. The agreement states that Adaro sells coal annually at a certain price, below the prevailing market price. Coaltrade then sells them at international prices. What is sold is not just any coal, but high quality coal.

This research was conducted on the basis of the aim of showing what are factors that can affect a company's on doing transfer pricing. Where transfer pricing can cause problems such as customized tasks and also inequities in business combinations. The company's goal is to carry out transfer pricing to pay tax obligations by lowering the tax rate as much as possible, so that it can maintain its profits so that the company's financial performance looks good. So by identifying several factors, it is hoped that it will provide accurate information about the factors that affecting transfer pricing.

Agency Theory

Agency theory has a state the issue regarding the difference of interests in the relationship between a principal and its agent (Jensen & Meckling 1976). Shareholders act as principal and company executives, which is management, act as an agent. The conflicts that occur in this theory is that there is asymmetrical information that management have more information resource more rather than shareholders that are not able to always supervise the management. So, by that desire, encourage management to act is not in line with shareholders' expectations (Ifada and Puspitasari 2016). Agency problems can be occur because of the different interest between the tax payers and tax authorities with the indication that taxpayers has an objective of high return by minimizing the payment of its tax expense, while tax authorities has an objectives of high tax revenue by calculating tax income from the entity with the applicable terms of tax (Murtanto and Bonita 2021).

Positive Accounting Theory

Tried to make a good predictions of the real world and translate it to the accounting transaction is the point out of this theory. This theory makes a prediction which the sources were based on its relationship between managers and others parties such as investors, auditor, creditors, government agencies, and also capital market managers and this theory also stating the reason behind a problem that occur in certain firms regarding accounting policies. Based on this theory, the accounting procedures chosen by managers will be used to maximize their income and earn income from company owners. In fact, has been proven that the company do the self-interest in purpose to gain their wealth with certain actions that probably cause a problem faced by another parties.

Political Cost Theory

Political cost theory is a theory related to a determination. This theory explains that the greater the costs borne by the company, the greater the possibility for managers to choose accounting methods or procedures that can delay reporting earnings from the current period to future periods (Indriaswari and Nita 2018). The political cost hypothesis states that the company's management seeks to reduce the tax costs imposed by the government. Management as an agent is the party who knows complete information related to transactions carried out by the company, even about the parties involved in the transaction and the fair price of the transaction. On the other hand, the government as the principal only knows certain information because it is also impossible for the government to monitor all transactions made by individual corporate taxpayers. The information obtained by the government is only limited to the financial statements presented by the company. Therefore, management takes advantage of the government's limited access to this information to manipulate transfer pricing transactions with related parties. Thus, companies in higher tax jurisdictions can report lower profits, resulting in a much lower tax obligation (Ifada and Puspitasari 2016).

Transfer Pricing

Transfer pricing can be called as a strategy of the firm to survive in the competition of the global market with the lack of resources (Supriyati, Murdiawti, and Prananjaya 2021). According to PSAK 7 (2015), explains that a party can be said to be a party with a special relationship if one of the parties has the expertise to control the other party, or there is a significant influence on the other party in decision making. Transfer pricing will allow companies to avoid double taxation and ultimately abuse the opportunity. Transfer pricing practices are used to shift business profits to countries with lower tax rates by maximizing the value of expenses listed in the company's financial statements which can show that the company's income is reduced (Muliya and Hasibuan 2018).

Transfer pricing can be categorized into two types: (1) within a company, where the possibility of transfer pricing occurs between divisions or departments within a company; (2) between companies, where the possibility of transfer pricing occurs between different companies both domestically and abroad that have a close relationship or inherent relationship (Indriaswari and Nita 2018).

Audit Quality

The management team needs open communication to achieve the audit quality they desire. When a company is open and honest with its shareholders, the investors are better able to make informed decisions, A high level of transparency of companies to shareholders regarding tax issues is highly recommended by public authorization. However, sometimes there are some companies that act as tax aggressors where they will avoid tax reports so that corporate transparency still needs to be encouraged, the form of tax aggressiveness itself, for example from transfer pricing activities to minimize their tax obligations (Supriyati, Murdiawti, and Prananjaya 2021).

The higher the quality of an organization's audit results, the more open the organization is in reporting tax-related matters and the less likely transfer pricing practices within the organization will be. However, if a company's audit quality results are poor, the company's transparency will be diminished, and there may be indications that the company is engaging in transfer pricing practices, which may be indicative of tax evasion through transfer pricing (Marfuah, Mayantya, and Prasetyo 2021).

H_1: Audit quality has significant effect on transfer pricing.

Multinationality

Taking advantage of differences in the tax rules between countries, as well as relocating operations to low-tax jurisdictions, are two ways in which multinational corporations can lower their corporate tax burdens (Cassidy et al. 2014). Multinational companies in practice tend to minimize their operating costs by reducing their tax duties, the motivation behind transfer pricing is considered to be done because of management has realized that different tax rate of countries can be act as an opportunity to moving their products to be sold in a certain country who has subsidiary company, so the tax burden can be minimize (Supriyati, Murdiawti, and Prananjaya 2021). Multinational companies have a greater opportunity or possibility to be involved in manipulating transfer prices because of differences in tax rates and profitability between countries (Cassidy et al. 2014).

H_2: Multinationality has significant effect on transfer pricing.

Foreign Ownership

Foreign ownership as share ownership held by individuals or organizations based outside of the country (Refgia, 2017). Concentrated ownership structures are common in Asian companies, especially in Indonesia, and can cause friction between management and controlling shareholders as well as management and non-controlling shareholders (Yulia, Hayati, and Daud 2019). The controlling shareholders have more powerful to supervise the act of management and also getting more access of information.

Controlling shareholders, including foreign controlling shareholders, can order management to engage in related party transactions that are harmful to non-controlling shareholders but beneficial to themselves because of the greater control rights they hold (Dyanty et al., 2011). Transfer pricing is an example of a transaction involving a related party (Marfuah, Mayantya, and Prasetyo 2021). When a company has a large number of foreign shareholders, those shareholders will use their influence to push for transfer prices in an effort to increase the company's bottom line (Supriyati, Murdiawti, and Prananjaya 2021).

H_3: Foreign ownership has significant effect on transfer pricing.

Tax Avoidance

Taxation Act No.36/2008 states taxpayers, whether individuals or businesses, have an obligation to pay taxes and should not expect any form of recompense for doing so; instead, the money collected from such payments is used to fund governmental programs. The increasing tax burden triggers companies to conduct transfer pricing because they want to reduce the burden (Marfuah, Mayantya, and Prasetyo 2021; Mulyani, Prihartini, and Sudirno 2020). However, issues arise when businesses engage in transfer pricing in an effort to reduce their tax liability.

As the main entry point for companies to initiate profit transfer opportunities through transfer pricing mechanisms, differences in tax rates and tax facilities applied by a country have an effect on the tax burden borne by the company operating in multiple jurisdictions. When a company reduces its tax liability by making a profit transfer, the receiving company must shoulder a greater tax burden than the transferring company. By shifting earnings to a company that pays less in taxes, the recipient company is able to reap additional benefits and ultimately see a rise in its bottom line (Maulida & Wahyudin 2020). The company, not the employees, pays a larger share of taxes. While profits can be transferred, this process requires precise accounting (Ifada and Puspitasari 2016).

The company can reduce its tax liability by using transfer pricing ((Wijaya & Widianingsih 2019). If a company has a low effective tax rate, it may be able to avoid paying taxes by engaging in aggressive transfer pricing. However, if the effective tax rate is high, the business is more likely to engage in transfer pricing. Transfer pricing is used by businesses to reduce their taxable income (Supriyati, Murdiawti, and Prananjaya 2021; Pratama Septiyani, Ramadhanti, and Sudibyo 2018).

In dealings with related parties, the Company sets the transfer price beyond the fair market value. Some businesses intentionally overcharge their related parties in order to funnel more money back into the company. This can lead to higher profits for the company than would be possible if it only dealt with unaffiliated third parties. Companies based in countries with less favorable jurisdictions or under-taxation often

use transfer pricing to transfer revenue to their home country (Ifada and Puspitasari 2016).
H_4: Tax avoidance has significant effect on transfer pricing.

Bonus Mechanism

Manager of a company would love an income statement showing a high level of income in the hopes of receiving bonuses from shareholders (Rachmat 2019). However, just because an income statement shows a high level of income doesn't mean that directors will receive bonuses; the factor of management performance should also be noticed. It is clear from the preceding explanation that managers are eligible for a guaranteed bonus if they are successful in raising their company's Net Profit Trend Index (Supriyati, Murdiawti, and Prananjaya 2021). To maximize the bonus that the company receives based on profit, the company's management will tend to use transfer-pricing practices (Lo et al. 2010). So it can be concluded that managers will tend to take actions such as adjusting net income by means of transfer pricing practices in order to maximize the bonuses they receive (Marfuah, Mayantya, and Prasetyo 2021; Rahman and Cheisviyanny 2020).

If the bonus is tied to the company's earnings, and the management performs transfer pricing to maximize it, the bonus will be paid (Sulistyowati and Kananto 2019; Fuadah and Nazihah 2019). The problem also arise while the directors and the owners have difference interest whereas directors want to receive bonuses based on income received by manipulating the amount of salaries and different with owners where their goal is to increase entity profits (Solikhah, Aryani, and Widiatami 2021).
H_5: Bonus mechanism has significant effect on transfer pricing.

Debt Covenant

A debt covenant is an agreement between a lender and a borrower that places restrictions on the borrower's behavior designed to protect the value of the loan and the lender's ability to recoup its investment in it (Supriyati, Murdiawti, and Prananjaya 2021). To the contrary, if more businesses resort to debt financing, the effective tax rate will fall (Solikhah, Aryani, and Widiatami 2021).

Good company performance can make creditors more confident that their credit funds are guaranteed. Therefore, company managers must always make decisions to increase profits and asset values through transfer pricing because creditors usually like companies with strong assets to cover or cope with their debts. It also means transfer pricing can be appearing when entities show well done performance of high income and high value of assets (Supriyati, Murdiawti, and Prananjaya 2021).
H_6: Debt covenant has significant effect on transfer pricing.

Tunneling Incentive

Tunneling incentive is an action taken by the majority shareholder in transferring the company's assets or selling the company's assets at a price below the current market (Hidayat et al. 2019), The intention of not distributing the dividends and even transferring profits, but in its action, the minority shareholder shares the burden (Baroroh, Malik, and Jati 2021).

For the same reason that there are now more tunneling incentives within a company, businesses are changing the way they exit the market by focusing on acquisitions rather than sales to related parties. The majority shareholder's tunneling incentive increases the likelihood that the company will make transfer pricing decisions favoring related parties (Murtanto and Bonita 2021) or it done by the likelihood of transfer company’s assets to the other countries to avoiding tax obligations (Baroroh et al., 2021). Furthermore, since the tunneling coefficient is going in a negative direction, it follows that with each boost in/decrease in tunneling causes a decrease/increase in the transfer pricing variable

(Wijaya and Widianingsih 2019; Ifada and Puspitasari 2016).

H_7: Tunneling incentive has significant effect on transfer pricing.

Company Size

Company size can be explained by how big or small a company is, it means that big company definitely has a bulk of business and financing activities rather than smaller company which indicated that big company have more opportunity to minimizing their tax obligations because they can produce higher income that can be shifted to other company with lower tax (Yulia, Hayati, and Daud 2019). Transfer pricing is carried out for the purpose of managing profits so that the company's credibility is maintained both in the eyes of shareholders and creditors (Hikmatin and Suryarini 2019). Taking action on transfer pricing is one example of the sort of operational decision that can boost a company's performance. Businesses with locations in more than one country or region are not uncommon among those that engage in transfer pricing (Fuadah and Nazihah 2019; Wijaya and Widianingsih 2019).

H_8: Company size has significant effect on transfer pricing.

RESEARCH METHODS

The research object that used in this research is the manufacturing companies which those are listed in Indonesia Stock Exchange (IDX) from the period 2019-2021. Below are the summaries for sampling criteria needed for this research.

Table 1. Sampling Criteria

Samples Criteria	Company	Data
Manufacturing companies that are listed in Indonesia Stock Exchange (IDX) from the period 2019-2021.	168	504
Manufacturing companies are not using IDR currency in their financial statements.	(38)	(114)
Manufacturing companies that do suffer losses.	(57)	(171)
Manufacturing companies that do not have its subsidiary companies.	(18)	(54)
Total companies selected as a sample for years 2019-2021	**55**	**165**

Transfer pricing is done by company to minizing their tax liability and they usually will gain internal relation with other parties to do transfer pricing often, so earnings can be gain easily (Baroroh, Malik, and Jati 2021). Transfer pricing can be measure using Related Party Transaction (RPT)

$$RPT = \frac{Total\ Receivable\ of\ Privilege\ Entities}{Total\ Receivable\ of\ the\ Company}$$

Audit quality is explained as the need for auditors to provide quality services to gain the trust of investors and other users of financial statements (Kehoe and Jarvis 1996). Audit quality was measured using dummy variables. The indication to categories this variable are the financial statements of company if audited by a Public Accounting Firms that affiliates with The Big Four Auditors which are: (1) Deloitte, (2) PricewaterhouseCoopers, (3) Ernst & Young, and (4) KPMG, it will be give a score of 1. Then, the financial statements of company which not affiliated with The Big Four Auditors will be give a score of 0 (Marfuah, Mayantya, and Prasetyo 2021).

(Cassidy et al. 2014) found that multinational companies have a higher chance of avoiding corporate taxation than purely domestic companies. Richardson, et al. (2013) said that Multinationality is proxies by the number of subsidiaries.

$$MN = \frac{Number\ of\ Subsidiary\ in\ Abroad}{Total\ Subsidiary}$$

Foreign entities that own 20% or more shares are certainly considered to have significant influence in controlling the company which can be referred to as foreign controlling shareholders (Rohaeni, Siregar, and Safitri 2021).

$$FO = \frac{Number\ of\ Foreign\ Shareholdings}{Number\ of\ Shares\ Outstanding}$$

The companies who own several subsidiaries have a high chance in doing tax avoidance through transfer pricing. Tax liabilities can be measured using Current Effective Tax Ratio (CETR). It reflects to find out that the companies do tax avoidance act.

$$CETR = \frac{Tax\ Liability}{Post - tax\ Net\ Profit}$$

The bonus mechanism based on the amount of profit will make management try to manipulate earnings and even take action by regulating net income in order to maximize the bonus it can receive (Indriaswari and Nita 2018). Bonus mechanism can be measured by using Net Profit Trend Index (NPTI)

$$NPTI = \frac{Net\ Income\ Year\ t}{Net\ Income\ Year\ t - 1}$$

Debt covenant is measured by leverage ratio or Debt-to-Equity Ratio (DER). Increasing leverage using DER may affect the higher transfer pricing (Solikhah, Aryani, and Widiatami 2021).

$$DER = \frac{Total\ Liabilities}{Total\ Equity}$$

The tunneling incentive reflects with the value of debt and receivables with related parties and total assets of company (Firmansyah, 2018).

$$TI = \frac{Related\ Accounts\ Receivable}{Total\ Assets}$$

Asset size is used as an indicator to measure company size because its value is relatively stable and even fixed compared to the total sales value and market capitalization (Sulistyowati and Kananto 2019).

$$Company\ Size = Ln\ Total\ Assets$$

This research will use the multiple linear regression analysis to test the hypothesis shows below:

$TP_{it} = \alpha_{it} + \beta_1 AQ_{it} + \beta_2 MN_{it} + \beta_3 FO_{it} + \beta_4 TA_{it} + \beta_5 BM_{it} + \beta_6 DC_{it} + \beta_7 TI_{it} + \beta_8 CS_{it} + \varepsilon_{it}$

Where:

TP_{it} Transfer Pricing for companies in years t
AQ_{it} Audit Quality for companies in years t
MN_{it} Multinationality for companies in years t
FO_{it} Foreign Ownership for companies in years t
TA_{it} Tax Avoidance for companies in years t
BM_{it} Bonus Mechanism for companies in years t
DC_{it} Debt Covenant for companies in years t
TI_{it} Tunneling Incentive for companies in years t
CS_{it} Company Size for companies in years t
ε_{it} Error for companies in years t

RESEARCH RESULT

Below is the result of descriptive statistic test in this research that explains the data of minimum, maximum, mean, and standard deviation:

Table 2. Descriptive Statistic Variable Result

Variable	N	Minimum	Maximum	Mean	Standard Deviation
TP	165	0,000850	1,000000	0,911843	0,188353
AQ	165	0	1	0,339394	0,474945
MN	165	0,000000	1,000000	0,148012	0,248866
FO	165	0%	85%	15%	26%
TA	165	0,005168	3,122994	0,276855	0,461449
BM	165	0,029697	14,192316	1,606279	2,086476
DC	165	0,071274	4,771648	0,875375	0,751814
TI	165	0,000000	0,292974	0,029970	0,066163
CS	165	26,462673	33,537230	29,109197	1,545022

Source: Data processing results

The table below showing the result of t test:

Table 3. t Test Result

Variable	B	Sig.
(Constant)	0,955	0,003
AQ	-0,043	0,273
MN	0,115	0,05
FO	-0,190	0,004
TA	0,052	0,116
BM	-0,007	0,345
DC	0,001	0,964
TI	0,196	0,478
CS	-0,002	0,880

Source: Data processing results

Audit quality (AQ) has significant value of 0,273 which is the value is greater than the value of α for 0,05 The result give the conclusion that H_1 rejected which means that audit quality do not have an effect to transfer pricing.

Multinationality (MN) has significant value of 0,05 which is the value is equal to the value of α for 0,05. The result give the conclusion that H_2 accepted which means that multinationality has a positive effect to transfer pricing.

Foreign ownership (FO) has significant value of 0,004 which is the value is lower than the value of α for 0,05. The result give the conclusion that H_3 accepted which means that foreign ownership has a negative effect to transfer pricing.

The table 3 above shows that tax avoidance (TA) has significant value of 0,116 which is the value is greater than the value of α for 0,05. The result give the conclusion that H_4 rejected which means that tax avoidance do not have an effect to transfer pricing, this is would not influence the decision making in company to do the transfer pricing act.

Bonus mechanism (BM) has significant value of 0,345 which is the value is greater than the value of α for 0,05. The result give the conclusion that H_5 rejected which means that bonus mechanism do not have an effect to transfer pricing.

Debt covenant (DC) has significant value of 0,964 which is the value is greater than the value of α for 0,05. The result give the conclusion that H_6 rejected which means that debt covenant do not have an effect to transfer pricing.

Tunneling incentive (TI) has significant value of 0,478 which is the value is greater than the value of α for 0,05. The result give the conclusion that H_7 rejected which means that tunneling incentive do not have an effect to transfer pricing.

Company size (CS) has significant value of 0,880 which is the value is greater than the value of α for 0,05. The result give the conclusion that H_8 rejected which means that company size do not have an effect to transfer pricing.

CONCLUSION

The companies sample that are used in this research are 55 manufacturing companies that are listed in Indonesia Stock Exchange (IDX) for period 2019 until 2021. With that requirements to fulfill this research, so there are several conclusion which Multinationality and foreign ownership have an effect to transfer pricing. Audit quality, tax avoidance, bonus mechanism, debt covenant, tunneling incentive, and company size do not have an effect to transfer pricing. Multinational companies and owned by foreign parties tend to have stricter supervision so that the probability of transfer pricing is low.

The researcher realizes that the research still has some limitations that are expected to be investigated and developed by ther researchers, the sample used in this research which is manufacturing companies listed in IDX still quite a bit, the period of this research only a few which is use 3 years period successively and there is a lack moderating factors to the transfer pricing, so the result a little bit inefficient. To improve the research, there are several recommendation, adding the criteria which has strong relation with the topic without removing or eliminating many sample, adding several period of sampling data to found and collect more realiable data.

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