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Determinants of transfer pricing decisions in Indonesia manufacturing companies

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ABSTRACT

This research aims to investigate tax expenses, tunneling, and bonus on transfer pricing decisions in Indonesia. The practice of transfer pricing as one form of tax avoidance may threaten state revenues. This research is quantitative research with multiple linear regression models with panel data. The samples used in this research are manufacturing companies listed on the Indonesia Stock Exchange (IDX). The type of data used in this study is secondary data in the form of financial statements of companies listed on IDX from 2011 to 2015. The samples are selected using a purposive sampling method with the number of samples of 50 companies. The results suggest that tax expenses and tunneling are negatively associated with transfer pricing decisions while the bonus is not associated with transfer pricing decisions.

Introduction

What the missed achievement of tax revenues target in recent years is a big scourge for the Indonesian Tax Authority. Low tax ratio level in Indonesia shows that there are still many tax base that has not been taxed. It may be caused by a tax revenue leak. Darussalam and Septriadi (2012) stated that one of the three main causes of such leakage is the practice of transfer of profits conducted by the taxpayer generally through the transfer pricing scheme. The definition of transfer pricing is limited to "a company policy in determining the transfer price of a transaction whether it is goods, services, intangible assets, or financial transactions conducted by the company" (Setiawan, 2014). However, the term "transfer pricing" is often considered negatively in the form of transfer pricing manipulation. Therefore, transfer pricing is interpreted as a mechanism used primarily by multinationals to minimize taxes globally by diverting profits from companies in the countries with higher tax rates to companies in the countries with lower tax rates (Eden, 2009). In other words, the risks arising from the transfer pricing practice would be borne by countries applying higher tax rates.

As Piliang explained to Kontan (2010), the potential loss of tax revenue due to transfer pricing practices by companies operating in Indonesia during 2009 may reach Rp 1,300 trillion. The data is obtained from the Transfer Pricing Section which is processed based on OECD's data. The amount of potential loss of tax revenue is not surprising because the practice of transfer pricing often involves thousands of multinational corporations on a large scale. Indonesia Tax Authority through Liputan6 (2016) said that as many as 2000 multinational companies operating in Indonesia do not pay taxes up to 10 years on the grounds of losers. Surprisingly, despite continuous losses, the company's operations are still running, so further identification is needed. Of the three modes that are often used by taxpayers, the transfer pricing mode is the mode most commonly used by these multinational companies.

Many cases involving multinational companies with transfer pricing have occurred in Indonesia. The largest case ever uncovered is a case involving the companies of Adaro and Asian Agri. Based on coverage from www.inilah.com, Adaro allegedly sold coal to its Singapore-based affiliate, Coaltrade Service International Ltd, at a price below the international price standard during 2005 - 2006. Adaro's price manipulation is expected to result in a state loss of at least Rp 10 Trillion. In addition to Adaro, the largest transfer pricing case was also carried out by Asian Agri by selling a product of Crude Palm Oil to PT Asian Agri Group (AAG) to an overseas affiliate company at a price below the market price and then resold to the buyer real with high prices thereby reducing the domestic tax expense. Also, some of the overseas companies that became Asian Agri's partners turned out to be fictitious companies. The case of Asian Agri is estimated to result in potential loss of tax revenue from 2002 to 2005 to Rp 1.3 Trillion (Hadjar, Indonesian Legal Resource Center, & Indonesia Corruption Watch, 2014).

The potential loss of tax revenues leads transfer pricing as one of the big issues from Indonesia Tax Authority. The Authority efforts to overcome the practice of transfer pricing have existed since the issuance of a regulation concerning transfer pricing in Article 18 paragraph (3) of Act No. 7 of 1983 concerning Income Tax. In 2007, the focus of Indonesia Tax Authority on transfer pricing was the establishment of the Transfer Pricing Section

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as part of the Directorate of Inspection and Billing and the issuance of a policy related to the fairness of prices and business practices. At the end of 2016, the Indonesia Tax Authority publishes Minister of Finance Decree No. 213 on the Type of Documents and Additional Information Required to be saved by Taxpayers Transacting with Related Parties and the Management Procedures. In general, this rule is aimed to improve the quality of documents that taxpayers prepare for transactions to related parties to increase (Deloitte, 2017).

Although the various ways to overcome the practice of transfer pricing has been conducted, there are still many taxpayers, especially multinational companies, successfully make tax evasion through transfer pricing mechanism that directly affects tax revenue. The share of tax revenues in the state budget structure continues to increase from year to year. In 2017, tax revenues even support up to 85.6% of total state revenues. To that end, the Indonesia Tax Authority must be careful in identifying taxpayers, especially multinational companies indicated to practice transfer pricing. Therefore, research related to factors that trigger a company to transfer pricing needed. By knowing these factors, the identification process could be more precisely so that the limitations of Indonesia Tax Authority's resources could be more efficient.

Transfer pricing is not a new issue in the world of taxation. However, the research suggests different results. The main factor that could influence the company's decision to conduct transfer pricing is the tax expenses borne by multinational companies. Tax expense is the main burden used as input in decision-making by companies (Graham et al., 2017). The difference in the tax expenses in two state jurisdictions borne by two or more companies in the same ownership encourages the company to transfer pricing to obtain a minimum tax expense. In Indonesia, Yuniasih, Rasmini, and Wirakusuma (2012) found that the tax expense has a positive effect on transfer pricing. However, Marfuah and Azizah (2012) suggested that tax expense has a negative effect on transfer pricing. Also, Mispiyanti (2015) found that tax expense has no significant effect on transfer pricing.

Furthermore, another factor that could trigger multinational companies to conduct transfer pricing is the presence of tunneling. Tunneling is the transfer of corporate resources in the interest of the majority shareholders, in which the burden of the transfer is borne by the minority shareholders (Johnson et al., 2000). Based on Chan, Moand, and Tang (2016), tunneling caused by majority ownership of controlling shareholders and low Corporate Governance in the company. Claessens et al. (2002) proved that companies in Indonesia have characteristics that are not much different from the company in Asia that is the concentration of ownership in certain groups. Also, Nurazi, Santi, and Usman (2015) cited the survey of Indonesian Institute for Corporate Governance (IICG) that proved the level of corporate awareness in Indonesia on the importance of Corporate Governance is still low. The fulfillment of these two conditions indicates that the possibility of tunneling in Indonesia is very high. Based on Lo, Wong, and Firth (2010), the tunneling activities conducted by state enterprises in China negatively affect the transfer of profits of a company through the transfer pricing mechanism. Furthermore, the previous studies conducted by Yuniasih, Rasmini, and Wirakusuma (2012), Marfuah and Azizah (2012) and Mispiyanti (2015) suggested that tunneling activity has a positive effect on transfer pricing decisions.

This study also highlights bonus as another factor that leads multinational companies to conduct transfer pricing. One of the hypotheses proposed by Watts and Zimmerman (1979) in agency issues is the bonus hypothesis. When bonuses awarded on earnings levels basis, management would consider increasing sales to earn bonuses. Unfortunately, according to Lo, Wong, and Firth (2010), to achieve these objectives, management often justifies any means, one of them by way of earnings management through the transfer pricing mechanism. By using a proxy for the Net Profit Trend Index, Nurjanah, Isnawati, and Sondakh (2016)found that bonuses have a positive effect on transfer pricing. However, Mispiyanti (2015) suggested that the bonus is not associated with transfer pricing even. The study used the proxy used to measure the bonus was the same using the bonus magnitude approach.

This study also uses control variables based on previous research literature. Lo, Wong and Firth (2010) used debt ratio, that measured by the total debt to total asset ratio, and related party transaction, that measured by the number of related party sales over total sales. These control variables act as controls for possible effects of the volume of debt and related party sales. Another control variable is firm size. Based on Rego (2003), firm size as one of the firm characteristics has a significant effect on average effective tax rates (ETR) in measuring tax avoidance activities in US Multinational Companies.

This study attempts to examine the effect of tax expenses, tunneling, bonus on transfer pricing decision. Based on the previous studies, there was still research gap on examining tax expenses and tunneling on transfer pricing decision. Also, the previous studies, the proxy for tax expense used Effective Tax Rate whereas the evaluation result of Plesko (2003) suggested that tax measurement using ETR often produces significant calculation errors. Therefore, the tax expense proxy in this study uses Marginal Tax Rate (MTR) which is more reliable to estimate the tax expense borne by the companies. The study conducted by Yuniasih, Rasmini, and Wirakusuma (2012), Marfuah and Azizah (2012) and Mispiyanti (2015) used the proxy used to measure the existence of tunneling activities in a company using the percentage of majority share ownership, even though the majority of companies have a concentrated ownership structure. Unlike the previous research, tunneling proxy in this study

uses related party transactions because tunneling activity in the Asian region is dramatically increasing.

Furthermore, the proxy used by Mispiyanti (2015) uses a dummy to detect companies that have bonuses. Suryatiningsih and Siregar (2008) stated that research on bonus mechanisms could use two approaches, namely through bonus components or bonus amounts. The financial statements issued by the company may not include the details of the amount of bonus given. The amount of bonus given is generally only served per certain group. Thus, this study attempts to reexamine the bonus on transfer pricing decision using bonus components to confirm the study conducted by Mispiyanti (2015). The proxy is similarly used by Nurjanah, Isnawati, and Sondakh (2016). However, the study used logistic regression, while this study uses the panel regression.

Literature Review

Jensen and Meckling (1976) explained that relationships within firms are the nexus of contract, a collection of contracts between principals as the owner of economic resources and agents as managers in the use and control of those resources. In this case, the principal includes stakeholders whether shareholders, creditors or the government. On the other hand, an agent is the management of the company. In that connection, agency problems could arise between the principal and the agent. Conflicts that occur in the agency relationship are the result of information asymmetrical because the agent is in a position that has more information about the company while on the other hand, the principal is not able to supervise the management every time. Also, there is a conflict of interest because principals and agents have a desire to maximize their profits, thus encouraging agents to act out of sync with the principal's wish (Godfrey et al., 2010).

Watts and Zimmerman (1979) illustrated the agency problem in three hypotheses, namely the debt hypothesis, the political cost hypothesis, and the bonus hypothesis. The practice of transfer pricing conducted by company management is a real picture of one of these hypotheses, namely the political cost hypothesis. The political cost hypothesis stated that the management company attempt to minimize taxes charged by the government. Management as an agent, knowing full information related to transactions conducted by the company, both regarding the parties involved in the transaction and the fair price of the transaction. On the other hand, government as a principal only knows limited information. The government is unlikely to be able to oversee all the transactions conducted one by one company taxpayer. Information obtained by the government is limited to the financial statements presented by the company. Therefore, management utilizes this imbalance of information to manipulate transfer pricing (transfer pricing manipulation) related-parties' transactions. Accordingly, the companies within higher tax jurisdictions may report a smaller profit so that it would minimize the tax expense.

Transfer pricing used in the case of the profit shifting from companies in the country at higher tax rates to related companies in countries with lower tax rates. The smaller the company's tax expense, the more likely it is to transfer the profit through the transfer pricing mechanism to the company. Through these efforts, the company could make tax saving by the difference between the tax paid globally. On the contrary, the greater the company's tax expenses, the less likely the transfer of profit through the transfer pricing. Companies with higher tax expenses transfer profits to companies with low expenses so that the risk of transfer pricing in the form of a decrease in the tax base is borne by the state that sets the tariff higher. Based on the above description, the first hypothesis of this research is:
H_1: The tax expense is negatively associated with transfer pricing decision

Johnson et al. (2000) use the term "tunneling" to describe the transfer of corporate resources in the interest of the majority shareholders, in which the burden of the transfer is borne by the minority shareholders. Tunneling activities increase in the presence of concentrated shareholdings and low Corporate Governance within the company (Chan, Moand, & Tang, 2016). As Claessens et al. (2002), generally, the companies in Indonesia have characteristics that are not much different from the companies in Asia which the stock ownership structure are concentrated in certain groups. Although the companies grow and become public companies, the controls held by the group are still significant. Also, Nurazi, Santi, and Usman (2015) cited the survey of Indonesian Institute for Corporate Governance (IICG) that proves the level of corporate awareness in Indonesia on the importance of Corporate Governance is still low. Based on the survey result conducted in 2012, only 31 companies or only 10% of respondents who want to participate in 332 such surveys. Therefore, the fulfillment of these two conditions indicates that the risk of tunneling in Indonesia is high.

In the case of group companies or conglomerates, the majority shareholders also own shares in another company with which the company relates. This condition triggers the emergence of tunneling activities through the transfer pricing mechanism to a related company that is still in the same ownership to benefit the majority shareholders. The Company has no objection to transfer its profit to related companies by conducting sales transactions to related parties at a price level lower than fair price. These efforts would certainly affect the decline in the ratio of the relative gross profit ratio (relative gross profit ratios) which shows the level of transfer pricing companies. Therefore, the higher the company's tunneling rate, the lower rate of transfer pricing indicated by the

low ratio of the company's relative gross profit. Based on the description, the second hypothesis of this research is:
H_2: Tunneling is negatively associated with transfer pricing

In addition to tax motivation, the company's decision to transfer pricing also arises on non-tax motivation basis. One form of non-tax motivation is the existence of the bonus given to the management. When management earns bonuses based on the earnings, then management would attempt to achieve the target profit set to obtain the promised bonus. Suryatiningsih and Siregar (2008) proved that bonus schemes for directors of SOEs provide incentives to directors to make earnings management related to bonuses they would receive. The bonus scheme uses profit as a measure of performance and achievement of last year's earnings realization as well as the achievement of the profit budget as a performance standard. When the company's management gets an additional bonus based on profit targets, management strives to achieve the set profit target. To achieve the profit target, it is possible conducted by transferring profit to the companies through the transfer pricing mechanism in transactions to related parties. The higher the profit component used as the basis of the bonus award mechanism, the higher the likelihood of the transfer of profits through the transfer pricing mechanism performed by the management company. Based on the description, then the third hypothesis of this study are:
H_3: The bonus is positively associated with transfer pricing decision

Research Method

Research Objects and Sample Selection

The type of research used in this research is quantitative descriptive research. This method is conducted by processing and analyzing the data to obtain a conclusion. The conclusion obtained in the form of influence between independent variables and dependent variables. Research-sample selected by using purposive sampling method, which is included in non-probability sampling method. Using this method, the selection is not random but based on certain criteria.

One of the criteria used to eliminate the population is the time range of the research. The time range used in this research started in 2011 to the latest data that could be obtained when the research is conducted. The determination of 2011 is based on a case study by processing data obtained from Global Financial Integrity Report 2014, found that the practice of transfer pricing in Indonesia was highest in 2008 and then decreased until 2010 (Karomatunnisa, Susiatiningsih, and Putranti., 2016). However, since 2011, the practice of transfer pricing Indonesia increased again and continued to rise in the following year. Therefore, the criteria used to eliminate the population are companies conducting IPO (Initial Public Offering) after 01 January 2011, companies that use currencies other than Rupiah in financial reporting, and companies that do not have complete data during the period 2011-2015, especially data related to related party transactions.

This study uses secondary data sourced from financial report of companies that listed in Indonesia stock exchange from the year 2011 until 2015. Data obtained by downloading financial statements from the official website of the Indonesia Stock Exchange (www.idx.co.id).

In this study, the study population includes all manufacturing companies listed on the Indonesia Stock Exchange (IDX). Selection of manufacturing companies as objects in this study because, according to Gunadi (1994), most of the multinational companies in Indonesia that are not spared from transfer pricing manipulation is engaged in manufacturing companies. The companies have a substantial internal connection with the parent company or its affiliates in foreign countries.

Based on data downloaded successfully from the official website of IDX, which totally is 537 companies. Therefore, companies engaged in manufacturing based on the classification of JASICA (Jakarta Stock Industrial Classification) are as many as 144 companies. Furthermore, purposive sampling conducted to select the research sample based on the criteria that have been determined (Table 1).

Table 1. Sample research

Manufacturing companies listed on the BEI	144
Deducted by:	
1. Companies that conduct IPO after 01 January 2011	(21)
2. Companies that use currencies other than Rupiah in financial reporting	(27)
3. Companies that do not have complete data for the period 2011-2015	(46)
Total Sample (per year)	50
Number of Years	5
Total Observation	250

Operational Definition of Variables

Dependent variables

Dependent variable used in this research is Transfer Pricing (TP) Decision. Transfer Pricing (TP) describes the possibility of companies making a profit transfer through the transfer pricing mechanism. The proxy used to measure the indication of transfer pricing in this study refers to the proxy used Lo, Wong, and Firth (2010) by using the following formula:

$$\text{Transfer pricing} = \frac{\text{Gross Profit Ratio-Related Party Sales (RPTGP)}}{\text{Gross Profit Ratio-Non Related Party Sales (NRPTGP)}} \quad (1)$$

Gross Profit Ratio of Related Party Sales (RPTGP) is the ratio of gross profit obtained by the company from sales to related parties while Gross Profit Ratio of Non-Related Party Sales (NRPTGP) is the ratio of gross profit obtained by the company from sales to non-related parties (transactions reasonable). This proxy determines the level and direction of transfer pricing. The smaller the value of the TP variable means the lower the rate of profit transfer through transfer pricing into the company or the higher the rate of profit transfer through transfer pricing to outside the company, and vice versa. Also, the positive value transfer pricing (TP) variable represents the transfer of profit through transfer pricing to the company, while the negative value transfer pricing (TP) represents the transfer of profit through transfer pricing done outside the company.

Independent Variables

Tax expense (MTR)

Variable tax expenses used in this study describes the tax expense borne by a company. The result of Plesko's evaluation (2003) showed that a better proxy used in measuring corporate tax expense is Marginal Tax Rate (MTR). Marginal Tax Rate (MTR) proxy research was first developed by Shevlin (1990) which was then refined by Graham (1996) because other proxies (such as the Effective Tax Rate) could not capture the corporate tax expense especially if the company suffers from net operational loss and there are various tax incentives provided by the government. However, measuring Marginal Tax Rate (MTR) involves a non-simple mathematical calculation. To minimize calculation errors, the use of Marginal Tax Rate (MTR) proxy performed using the computer Algorithm approach used by Sinha and Bansal (2012) with slight modifications adjusting taxation rules in Indonesia. Sinha and Bansal (2012) referred to Graham (1996) model but performed using Monte Carlo simulation method with MATLAB (Matrix Laboratory) application. The Main Code used to create the Marginal Tax Rate (MTR) calculation program through the MATLAB application. Modifications or adjustments made in the use of MATLAB applications. First, adjustment of the source data includes the sample taxable income data to be stored in an excel file with the name "income.xlsx." The tax rate data article 17 paragraph (2a) or Article 17 (2b) of the Income Tax Law to be stored in an excel file with the name of "tr.xlsx." The alternative minimum tax rate data to be stored in the excel file with the name "amt.xlsx."

Furthermore, the risk free rates data obtained from the average annual BI rate to be stored in the excel file with the name "rr.xlsx". Especially for the file "amt.xlsx" is quite filled with a value of 0 (zero) because in Indonesia's Income Tax Law do not recognize the existence of the alternative minimum tax rate. Second, adjustment of input data includes the contents of the number of years of fiscal loss compensation and the year of commencement of MTR calculations. Based on Article 6 paragraph (2) of the Income Tax Law, the contents for carrying forward loss are 5 (five) years, while the stuff for carrying backward loss is 0 (zero) years. The year of commencement of the calculation of MTR is by the initial year of research that is 2011. The third is the adjustment in running application. In this research, the pushbutton button used the only pushbutton2 which is Calculate MTR using Algorithm 2 (only with carry forward losses). The selection is based on the Income Tax Law which only recognizes the loss carry forward and does not recognize loss carry backward. Also, the formula of Algorithm 2 in the application is more appropriate to measure the impact of tax policies and state revenues.

Tunneling (TUL)

The tunneling variables used in this study illustrate the existence as well as the level of tunneling activity performed by the controlling shareholders. In this study, the proxy used to measure the incentive of tunneling within the company refers to the research of Nurazi, Santi, and Usman (2015) with slight modification, i.e., the absolute value of the difference between debt and receivables to related parties (mainly from subsidiaries and/or parent companies) divided by total assets. The modified absolute value was conducted because the tunneling measurements in this study focus only on the tunneling level and do not take into account the direction of the tunneling.

Bonus (BONUS)

The bonus mechanism describes the scheme and bonus rate given to the company's management. Suryatiningsih and Siregar (2008) stated that there are two approaches that could be used to measure a bonus, bonus amount and bonus component. Since the financial statements published in Indonesian companies do not provide data regarding the amount of bonus management in detail, the approach using the bonus component is more likely to be done. In this study, the proxy used to measure bonus variables is Net Income Trend Index (NITRENId). To obtain the index, first need to calculate Net Income Trend by using the formula as follows:

$$\text{Net Income Trend (NITREN)} = \frac{[\text{Net Income}_{(t)} - \text{Net Income}_{(t-1)}]}{\text{Net Income}_{(t-1)}} \times 100\% \quad (2)$$

Furthermore, the value of the Net Income Trend (NITREN) is converted to an index that ranges from a value of 0 (zero) to 100. The conversion of this index needs to be conducted considering the bonus contract are known two terms, namely bogey, and stamp. If the profit is under bogey, there is no bonus obtained by management, so if the profit is above the management stamp would not get an additional bonus (Utomo, 2011). Due to the absence of common standards and bogey and stamp related data for manufacturing companies, the index conversion in this study still refers to Suryatiningsih and Siregar (2008) studies as follows:

- Index value 0 for net profit trend conversion $\leq 20\%$
- The index value of 100 for conversion of net profit trend $\geq 105\%$
- Index value 0 - 100 for conversion of 20% net profit trend <NITREN <105% by using the interpolation method to obtain the following formula:

$$\text{Net Income Trends Index (NITRENId)} = \frac{\text{Net Income Trends (NITREN)} - 20\%}{85\%} \times 100 \quad (3)$$

Control Variables

Debt ratio

The debt ratio represents the solvency level of the firm by showing how much the portion of the company's assets financed from the debt refer to the research Lo, Wong, and Firth (2010) as follows:

$$\text{Debt Ratio (D\_A)} = \frac{\text{Total Debt}}{\text{Total Asset}} \quad (4)$$

Related party transaction

When the sales volume to a related party in a company is high, then the buyer has a strong bargaining power that could reduce the company's gross profit ratio. The related parties' selling rate variable refers to Lo, Wong, and Firth (2010) as follows:

$$\text{Related Party Transaction (RPT)} = \frac{\text{Related Party Sales}}{\text{Total Sales}} \quad (5)$$

Firm size

Company size describes the size of the company that could be seen in the asset ownership or the company's sales level. In this study, the proxy used to calculate firm size refers to Rego (2003) as follows:

$$\text{Firm Size (SIZE)} = \text{Log Natural (Total Net Sales)} \quad (6)$$

Research Model

This research aims to examine the influence of the independent variable to the dependent variable. This study also uses control variables so independent variables and dependent variables not influenced by outside factors. The independent variables in this study include variable tax expense, tunneling, and bonus while the dependent variable in this research is the transfer pricing decision. This study also uses control variables, which include debt ratio, sale level of related parties, and company size as described previously. Based on the description, the research model described as follows:

$$TP_{it} = \alpha_{it} + \beta_1 MTR_{it} + \beta_2 TUL_{it} + \beta_3 BONUS_{it} + \beta_4 D\_A_{it} + \beta_5 RPT_{it} + \beta_6 SIZE_{it} + \varepsilon_{it} \quad (7)$$

Where:

TP_{it} = Transfer pricing for companies i years t

MTR_{it} = Marginal Tax Rate for companies i years t
TUL_{it} = Tunneling Rate for companies i years t
$BONUS_{it}$ = Bonus for companies i years t
D_A_{it} = Total Debt to Total Asset Ratios for companies i years t
RPT_{it} = Related Party Sales Over Total Sales for companies i years t
$SIZE_{it}$ = Firm Size for companies i years t
ε_{it} = Error for companies i years t

To prove the truth of the hypothesis, then based on the results of the model equation test β1 and β2 must have a negative coefficient and significant, and β3 must have a positive coefficient and significant.

Results and Discussion

Descriptive analysis

Average Transfer Pricing (TP) variable is -13.71350. A negative value on the TP variable indicates that the sample company performs a transfer pricing mechanism to shift the profit exit from the company. This result is reinforced by the median value of TP variable is also still a negative value that is equal to -0.793377. It could be concluded that the majority of companies who become research samples tend to divert profits outside the company, not into the company.

The average variable tax expense (MTR) is 0.216583. The value indicates that the average of the company that the research sample has a positive taxable income and does not meet the requirement of the reduction of the tariff of article 17 (2b) of the Income Tax Law. It is reinforced by the median value of the MTR variable of 0.25 so that the data centering is in the company area with the tax expense on the statutory tax rate range of 25%.

Average tunneling variable (TUL) was 0.039211. In other words, the average number of companies sampled in the study has a loan rate (debt and accounts receivable) of business to related parties up to 3.92% of total assets owned. Nevertheless, the median value of the tunneling variable of 0.011633 indicates that the majority of the sample firms are in the tunneling area at the level of 1.16%. This significant difference between the mean and median values indicates the presence of some firms with very high tunneling rates compared to the average sample firms. Standard deviation value of TUL variable that is equal to 0.063872 is bigger than the mean value. This result suggests the distribution of data is quite diverse.

Average BONUS variable is 75.59839. In other words, the level of achievement of bonus targets based on profit is 75.6%. This achievement is relatively high because it weighs the minimum value of BONUS variable by 0 (zero) and the maximum value of the BONUS is 100. In other words, some companies could reach the upper limit of profit increase compared to the previous year's profit to get the full bonus. Vice versa, there are companies that are not even able to achieve the lower limit of the target profit. If it refers to the median value of BONUS variable that is also 100, then the number of companies that could achieve the target bonus is more than the company that is not able to achieve the target bonus.

Table 2. Descriptive statistical analysis

	TP	MTR	TUL	BONUS	D_A	RPT	SIZE
Mean	-13.71350	0.216583	0.039211	75.59839	0.481137	0.176271	12.43539
Median	-0.793377	0.250000	0.011633	100.0000	0.482512	0.046456	12.30562
Maximum	15.97489	0.250000	0.377936	100.0000	1.248573	0.945000	14.30471
Minimum	-1148.627	0.000000	0.000000	0.000000	0.050458	0.000000	10.94209
Std. Dev.	79.36430	0.067101	0.063872	36.13280	0.225305	0.255147	0.718363

Regression Test Results

The value of determination coefficient in this research is shown in Adjusted R-squared value is equal to 0.425556. This result means that the variation of the transfer pricing value explained by the independent variable and the control variable in this research is 42.6%. Other factors outside the research model explained the rest (57.4%).

The t-test is conducted to determine the effect of independent variables partially on the dependent variable. If an independent variable has a p-value below the significance level of 0.05, then the variable would be judged significant so that Ha is accepted. However, if the p-value is above 0.05, then Ha is rejected, and H0 is accepted. Table 3.

Table 3. Regression Test Results

Variable	Coefficient	t-Statistic	Prob.
MTR	-69.79673	-3.582605	0.0002
TUL	-32.96455	-1.717391	0.0438
BONUS	-0.037818	-1.447968	0.0746
D_A	-89.96677	-4.290724	0.0000
RPT	17.13983	3.555144	0.0003
SIZE	-5.167105	-1.244119	0.1075
C	110.0749	2.199161	0.0145
R-squared	0.552441		
Adjusted R-squared	0.425556		
F-statistic	4.353864		
Prob(F-statistic)	0.000000		

H1: The effect of the tax expense on transfer pricing decisions.

The p-value of the tax expenses (MTR) is 0.0002. Due top-value less than 0.05 then the tax expense has a significant effect on transfer pricing decisions. P value is also negative so it could be concluded that the tax expense is negatively associated with transfer pricing decision.

H2: The effect of tunneling on transfer pricing decisions.

The value of the p-value of tunneling (TUL) is 0.0438 then tunneling has a significant effect on the transfer pricing decision. P value is also negative so it could be concluded that tunneling is negatively associated with the transfer pricing decision.

H3: The influence of bonus on transfer pricing decisions.

The p-value of the bonus (BONUS) is 0.0746. Since the value of the p-value is more than 0.05, the bonus does not significantly affect the transfer pricing decision.

Discussions

The effect of tax expense on transfer pricing decisions

The result of this study suggests that the tax expense is negatively associated with transfer pricing decision. The result is also in line with the result of research conducted by Lo, Wong, and Firth (2010) in China, which suggested that the tax expense has a negative effect on transfer pricing decisions. Differences in tax rates in two or more countries where companies position are mutually related the main gateways for the company to open up opportunities for profit transfer through the transfer pricing mechanism — differences in tax rates and tax facilities applied to a country impact on the tax expenses borne by the company. Through this difference, the company conducts tax savings by minimizing the tax expense globally. Companies could take efforts in a diversion of profits — companies with high tax expense transfer profit to companies with the lower tax expense. Thus, the profits of the company would be reduced if the company has a higher tax expense so that the tax expense paid becomes smaller.

On the other hand, firms with lower tax expenses earn additional profits from the transfer of profits, so that the company's profits become larger. The tax expense paid by the company is indeed larger. However, the diversion of profits must have been through a careful calculation. The additional tax expense is paid by a company that receives a transfer of profit is less than a reduction in the tax expense enjoyed by the company that diverts the earnings. In fact, in extreme cases, companies transfer profit to a related company that is losing or has a fiscal loss compensation facility. Accordingly, the company that receives a profit transfer is virtually unnecessary to pay the additional taxes paid on the transfer of such profits. The difference between the tax expenses paid globally is the tax savings for the company. Through these mechanisms, it is clear that the country that bears the risk of profit shifting is a country with higher taxation jurisdiction. As already mentioned in the previous chapter, the tax rate applied in Indonesia is higher than in other ASEAN countries. As a country with tax revenues as the biggest support of the state budget, the risks resulting from the diversion of profits could certainly threaten the state's fiscal balance.

The transfer of profit, in this case, could be conducted through the transfer pricing mechanism. The company set the transfer price outside the fair price in conducting transactions to related parties. When a company intends to make a profit transfer into the company, the company sets a higher price when conducting transactions with related parties. Thus, the company's earnings could be higher than if the company conducts transactions with

non-relations parties. The transfer pricing mechanism is used to transfer earnings into a company is usually conducted by a company domiciled in a country with a lower or under-taxation jurisdiction in a loss condition.

Similarly, when the company intends to make a diversion of profits outside the company, the company sets a lower price when conducting transactions with related parties. Thus, the company's earnings could be lower than if the company made transactions with non-relations parties. The transfer pricing mechanism is used to transfer earnings outside the company is usually done by companies domiciled in countries with higher tax jurisdictions. The country ends up losing the tax base and enduring the potential loss of tax revenue due to transfer pricing. This is evident from the result of this study, which shows that the tax expense has a negative effect on transfer pricing. The negative direction in the result of this study means that when a company's tax expense is lower, then the transfer pricing rate is higher. Increased transfer pricing is due to more and more profits are transferred to the company. For countries with lower tax jurisdictions, this may indeed be an additional tax base and increase revenues from the tax sector even though these additions are much smaller than the potential loss of tax revenues from countries with higher tax jurisdictions. However, it recalled that the transfer of profits through the transfer pricing mechanism is common to take advantage of the condition of a losing related company. Accordingly, additional earnings transfers do not result in additional taxes payable to companies receiving income transfers. In other words, countries with lower tax jurisdictions may not necessarily benefit from the transfer of profits through the transfer pricing mechanism. The result of this study could be a consideration for the Indonesian government to participate in the tariff war. The certain countries are willing to lower tax rates to a minimum to increase investor appeal.

On the one hand, the position of tax rates in Indonesia is high enough to bring the risk of losing tax revenue due to the practice of profit transfer through the transfer pricing mechanism. On the other hand, the tariff reduction does not necessarily eliminate the risk. It is precisely the other risks such as the decline in tax revenue that become the state budget directly accepted due to the reduction of tax rates.

Besides the influence and direction of the research result proving that the tax expense has a negative effect on the transfer pricing, one more thing that needs to be observed from the result of this study is the value of the variable coefficient of the tax expense. The result of this study indicates that any increase/decrease of 1 basis points of the tax expense would result in the possibility of companies making a transfer of profit through transfer pricing decreased/increased up to 69.79673 basis points. This high coefficient value indicates that the impact or influence of variable tax expense is very sensitive to transfer pricing. The result of this study provides attention (warning) for the government to be more careful in every tax policy that affects the tax expense of companies in Indonesia. Such policies may include the establishment of a tax rate, a tax reduction rate facility, and a fiscal loss compensation policy although the determination of these policies must have been through a mature calculation and done to achieve certain goals, such as increasing the attractiveness of investors, giving space for companies in certain industries to grow, and others. However, the tangible benefits should be greater than the risk received given that any slight increase/decrease in tax expense could have a considerable effect on the decline/increase in transfer pricing rates in Indonesia.

Also, the result of this study is also in line with the results of previous research conducted by Marfuah and Azizah (2012), Nurjanah, Isnawati, and Sondakh (2016), and Yuniasih, Rasmini, and Wirakusuma (2012), whereas all previous research conducted in Indonesia use different proxies. The sample and timelines of the studies are also varied. All previous research conducted in Indonesia measured the tax expenses by using ETR proxy and measuring transfer pricing by using dummy variables related to the presence or absence of related party transactions. The consistency of the result of this study corroborates evidence that over time, in different samples, even by different measurements, the tax expense has a negative effect on transfer pricing.

The effect of tunneling on transfer pricing decisions

The result of this study suggests that tunneling is negatively associated with transfer pricing decision. The result is in line with Lo, Wong, and Firth (2010), and the theory and some previous research both performed in China by Lo, Wong, and Firth (2010) contrary to the results of research conducted in Indonesia by Marfuah and Azizah (2012), Mispiyanti (2015) and Yuniasih, Rasmini, and Wirakusuma (2012). The difference in the result of the study may be due to the difference in proxies used to measure transfer pricing. It leads to different interpretations of the dependent variables that impact different hypothesis submissions. The hypothesis proposed in this study is similar to the hypothesis proposed by Lo, Wong, and Firth (2010) which stated that the higher the incentive of tunneling within a company, the company might transfer pricing lower. The proxy used to measure transfer pricing is the level of gross profit ratios from related party transactions.

As the incentive of tunneling within a company increases, the company tends to shift the exit from the company to a related company by buying, not selling, to a related party. The direction of the negative variable tunneling coefficient means that any increase/decrease in tunneling leads to a decrease/increase in the transfer

pricing variable. The decrease in transfer pricing variables in this study means that the transfer of profits made through the mechanism of transfer pricing into the company is getting smaller, or even has a tendency to transfer the profit is conducted out the company. When the level of tunneling within a company is high, the greater the likelihood that the company would utilize the tunneling incentive by shifting profits through transfer pricing mechanisms outside the company. The company has no objection to book a smaller profit and transfer its profit to related companies. The related company is usually a company that has majority shareholders, key management, or incorporated in the same group company. The impact of a decrease in the profits of companies that transfer profits would be borne by the minority shareholders.

On the other hand, the majority shareholders seem to consider a decrease in profits in the company, but in fact, the majority of shareholders could obtain benefit from a related company that gains a profit transfer. Such benefits may be a higher rate of return from a related company in the case of a transfer of resources made within a group company or majority shareholders also owning shares in a related company. Another acceptable benefit is to help the going concern of the related company. For the majority of shareholders, the business continuity of the related company could be very crucial such as for the development of the group business line or guarantee the return on the shares owned by the related company. Therefore, the majority shareholders who normally also contribute to the key management of the company does not mind to transfer profits to a related company, whereas the minority shareholders are not interested in the sustainability of the related company, but the minority shareholders also bear the burden of at least a declining stock return company.

The effect of bonus on transfer pricing decisions

The result of this study suggests that the profit-based bonus is not associated transfer pricing decision. This result is different from the results conducted by Lo, Wong, and Firth (2010) and Nurjanah, Isnawati, and Sondakh (2016) and confirms the result conducted by Mispiyanti (2015). Based on the result of this study, although the company's management obtains additional bonus based on profit, it does not affect the company's decision to make a profit transfer through the transfer pricing mechanism. In other words, the profit-based bonus does not then encourage management to increase its profits through illegal acts such as profit diversion. This difference could be understood by looking at the transfer of profits through the mechanism of transfer pricing in the larger picture. Indeed, when the company decides to transfer profits into the company, the impact of the activity is not just on the bonuses that management receives. The transfer of profits through the transfer pricing mechanism is a major scheme often undertaken by global companies. When the company decides to divert profits into the company, management may indeed get the promised bonus.

On the other hand, however, firms must bear higher tax expense and could not take advantage of their tunneling incentives. Therefore, it is not surprising that management chooses to minimize its own company's earnings, although it should lose the promised additional bonuses based on profit targets. Of course, the sacrifice has been calculated by the benefits earned that should be greater than the number of bonuses promised. If it is associated with other independent variables used in this study, then there are at least two benefits obtained. First, management could minimize the tax expense globally considering that the tax rate set in Indonesia is higher than the tax rate set by other countries, especially in the ASEAN region. Second, the management of a company in the form of a conglomerate company is also a part of the majority shareholders, capable of transferring resources to the company for the benefit of its group. Ultimately, the benefits are also enjoyed by the company's management although not explicitly in the form of additional management bonuses. Evident on the results of this study suggest that two other independent variables in the form of tax expense and tunneling have significant effects on transfer pricing. It could be assumed that the benefits derived from minimizing the tax expense and utilizing tunneling incentives are greater than the cost of opportunity to obtain bonuses.

Conclusions

Based on the results and discussions, there are three conclusions from this study. First, the tax expense is negatively associated with the transfer pricing decision. The lower tax expense of the company, the higher the possibility the company would make a profit transfer to the company. On the contrary, the higher tax expense of the company, the lower the possibility of companies making a transfer of profit into the company. Profit is transferred to a related company that has a lower tax expense to minimize global taxes. The difference between the additional tax payable by the company receiving the profits and the tax deductions that the income-generating company should pay is a tax saving earned on a profit transfer using a transfer pricing mechanism for the enterprise. Second, tunneling is negatively associated with transfer pricing decisions. As the rate of tunneling within a company increases, it is likely that companies are shifting profits outside the company as well. The transfer of profits outside the company results in a gross profit ratio from transactions to related parties reduced or negative so that the transfer pricing rate

decreases. The company seeks to utilize tunneling incentives through transfer pricing mechanisms by transferring profits to related companies in the interest of majority shareholders. The transfer of profits causes the company's profit to become smaller so that the expense or consequences arising from such activities are borne by the minority shareholders. Finally, the bonus is not associated with transfer pricing decisions. Company management does not mind keeping a smaller profit and losing the opportunity to earn extra bonuses, for greater benefits. Referring to two other independent variables used in this study, there are at least two benefits that could be accepted by the company. By diverting earnings outside the company and posting a smaller profit, the company could bear a smaller tax expense and could even make tax savings by minimizing taxes globally. The transfer of profits to the outside companies through transfer pricing mechanism is conducted in the framework of the transfer of resources in the interest of the majority shareholders.

Based on research conducted, still, there are several limitations of this study. This study focuses only on companies that have data related to the gross profit ratio of transactions to related parties compared to the ratio of gross profit on transactions to non-relations parties. Also, the time range used in this study is the year 2011-2015. For future research, it could add more research samples and time range to obtain better results. Considering the need for data related to the transfer pricing activities performed by the taxpayer could be more fulfilled with the issuance of Minister of Decree No. 213 of 2016. Furthermore, it should take into account all facilities that may affect corporate tax expense in using MTR proxies as well as using the indexing base associated with a more appropriate bonus for manufacturing companies.

Regarding the results of this study, for the Indonesia Tax Authority, it is important to consider in the development of taxation policies that may affect corporate tax expense. Changes in transfer pricing rates are susceptible to changes in the tax expense the company bears. Preparation of policies that may affect the tax expense of the company should also take into account the taxation policies implemented by other countries, especially countries that more into place the position of the company's related parties. This is certainly done without ignoring the consideration of the conditions and capabilities in Indonesia itself. Also, the reduction in tax rates does not necessarily eliminate the risks arising from the practice of profitability through the transfer pricing mechanism. Profit-transfer schemes through transfer pricing mechanisms could be conducted by transferring profits to companies in Indonesia who are losing or enjoying fiscal loss compensation facilities. Therefore, tariff reductions may reduce the possibility of shifting profits outside the company, but do not rule out that it could not recover the potential for lost tax revenues — secondly, suggestions related to Ministry of Finance Decree No. 213 of 2016. The regulation has not yet included the obligation to detail the percentage of gross profit obtained from transactions to related parties. If the type of goods delivered in transactions either to nonrelated parties or related parties is the same, then the cost of goods sold on both transactions is the same. Therefore, the difference between the gross profit ratio of transactions to related parties and the ratio of gross profit on transactions to non-contacts is caused by the transfer pricing differences. Thirdly, Suggestions related to tax audits conducted by the Indonesia Tax Authority. By using the gross profit ratio of transactions conducted to related parties, identification could be done more quickly, easily and accurately. In other words, tax audits could be done more effectively and efficiently to minimize the risks posed by profit-transfer practices through transfer pricing mechanisms in Indonesia.

Furthermore, based on this study, The Indonesia Financial Services Authority (OJK) needs to issue a policy or rate fixing to a standard related party for a company with a certain majority shareholder. Other policies may be policies that focus on protecting the rights of minority shareholders and efforts to improve corporate governance for companies in Indonesia by holding to common indices such as the OECD index. Also, policy-making related to disclosing details of bonus amounts (e.g., bonuses for the top three lines of company management) strongly supports the development of research in Indonesia regarding bonus variables.

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