Financial and Non-Financial Factors in Transfer Pricing Decisions

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Abstract. This study aims to examine the influence of financial factors consisting of debt covenant and bonus plan and non-financial factors consisting of tax haven, good corporate governance (independent commissioners, board of directors, and audit committee), and foreign ownership on the decision of transfer pricing. The population of this study were all manufacturing companies listed on the Indonesia Stock Exchange. The sampling method used was purposive sampling, so that the sample obtained was 67 companies or 268 observations. Thedata used are secondary data obtained from financial statements, annual reports, and tax haven index reports. The results of this study indicate that tax haven, board of directors, and foreign ownership have a significant influence on the transfer pricing decisions. Debt covenant, bonus plan,independent commissioner, and audit committee do not have a significant influence on transfer pricing decisions. This provides evidence that non-financial factors affect the transfer pricing decisions in manufacturing companies listed on the IDX. This research contributes to policy makers by including non-financial factors in transfer pricing policy and to the development of management accounting science related to transfer pricing in multinational transactions.

Keywords: transfer pricing, tax haven, bonus plan, good corporate governance

1 Introduction

Multinational companies with cross-border business activities cause affiliated transactions with overseas companies [1]. The problem that often occurs in these affiliated transactions is related to the determinationof fair transfer prices. Transfer pricing is the pricing of transfer of goods, services, and intangible assets with related parties either within the same company or with different companies [2]. The dimensions in the transfer pricing consist of neutral and pejorative dimensions. The pejorative dimension is transfer pricing by shifting taxable income between companies within a multinational group to a country with a lower tax rate.

Grounded on the Mutual Agreement Procedure (MAP) Statistics in a report covering 89 authorities, the OECD noted that the number of transfer pricing controversies increased by 20% in 2018. In 2019, a transfer pricing case passed in Indonesia by PT

A. Azizah et al. (eds.), *Proceedings of the International Conference on Applied Science and Technology on Social Science 2023 (iCAST-SS 2023)*, Advances in Social Science, Education and Humanities Research 817,
https://doi.org/10.2991/978-2-38476-202-6_100

Adaro Energy Tbk with its subsidiary Coaltrade Services International Pte, Ltd located in Singapore. Based on a report from Global Witnesss, an international NGO, PT Adaro Energy Tbk. diverted its revenue and profits to its subsidiary Coaltrade Services International through transfer pricing. PT Adaro sells coal mined in Indonesia at a lower price to Coaltrade. Coaltrade then resells the coal at a higher price. Coaltrade booked bonuses totaling US$55 million provided by third parties and other Adaro subsidiaries. The bookkeeping was done to minimize PT Adaro's taxes, because the tax rate in Singapore is 17% lower than in Indonesia. The report also states that from 2009-2017 PT Adaro managed to pay US$ 125 million less a tax than it should have paid in Indonesia.

Previously, in 2013, one of the subsidiaries of PT Unilever Indonesia, Tbk, namely PT Nestle Indonesia also conducted transfer pricing with the aim of avoiding taxes and increasing central profit, resulting in a large turnover of money in its financial statements. PT Nestle makes the purchase price of products from the core company lower than other companies. In practice, PT Nestle breaks down into certain groups in order to manipulate profits so as to maximize profits and reduce the tax burden incurred by the company.

Judging from the transfer pricing case that occurred at PT Adaro Energy and PT Nestle, there are factors that influence companies to do transfer pricing. Factors affecting transfer pricing at PT Adaro Energy are tax minimization factors by utilizing subsidiaries located in tax haven areas and bonus factors received. Tax haven country is a country that provides low income tax rates and even tax exemptions for taxpayers. While in PT Nestle, tax avoidance factor and the increase of central profit are the factors that influence the transfer pricing decision. This phenomenon was studied by involving tax haven, tax minimization, bonus plan, and profitability factors that allegedly influence the decision to do transfer pricing. In addition, there are also debt covenant, ownership structure, and good corporate governance factors that can be a motive in transfer pricing [3]–[5].

Previous studies have not comprehensively examined the factors that influence transfer pricing. The majority of previous studies only focus on financial factors such as taxes, debt covenants, bonuses, and profitability and there are still inconsistent results in them, especially for debt covenant and bonus factors. Therefore, this study is conducted to examine financial (debt covenant and bonus plan) and non- financial factors (tax haven, good corporate governance, which includes independent commissioners, the board of directors, and audit committee, foreign ownership) in transfer pricing decisions in manufacturing companies listed on the Indonesia Stock Exchange.

According to the debt covenant hypothesis, directors will increase profits and assets to reduce the cost of debt contracts when the company breaks its debt agreement. Companies that have a high debt rate will avoid violating the debt contract by choosing accounting methods that increase commercial gains [6], [7]. Thus, the lesser the debt ratio of the company, the lesser the threat of violating the debt contract, so that directors will make transfer pricing decisions to maximize corporate profits and reduce the cost of debt agreements. While in the bonus plan hypothesis, directors will choose accounting methods that can increase gains to maximize compensation, so that the tendency of operation to do transfer pricing is getting bigger because of the transfer of gains between divisions in related deals.

Transfer pricing can be done by execising tax haven countries to move gains to related companies located in tax haven countries. Thus, when a company has a subsidiary in a tax haven country, the lesser the occasion to conduct transfer pricing with the aim of avoiding taxes. Illegal transfer pricing conditioning can be overcome by strengthening the GCG structure in the company. Adding the supervisory function by independent commissioners and audit committees on management activities carried out by the board of directors can minimize the possibility of transfer pricing due to information asymmetry and moral hazard from the operation. Meanwhile, the larger number of the board of directors provides an occasion for directors to act for particular interests related to transfer pricing decision making. Agency problems can also do in the relationship between controlling and non- controlling shareholders, including when the controlling shareholders correspond from foreign investors. This will increase control exercised by foreign investors in transfer pricing decisions related to profit shifting to tax havens to maximize gains. The hypothesis formulated in this study is:

H1: Debt covenant has a significant influence on transfer pricing decisions

H2: Bonus plan has a significant influence on transfer pricing decisions

H3: Tax haven has a significant influence on transfer pricing decisions

H4a: Independent commissioner has a significant influence on transfer pricing decisions

H4b: The audit committee has a significant influence on transfer pricing decisions

H4c: The board of directors has a significant influence on transfer pricing decisions

H5: Foreign ownership has a significant influence on transfer pricing decisions

2 Research Method

The sampling method uses purposive sampling method because not all companies in the population of this study conduct multinational financial transactions. As for the sample criteria selected based on the purposive sampling method, namely manufacturing companies listed on the IDX for the period 2019-2022, a complete company financial report and annual report data for 2019-2022, companies did not experience losses in the 2019-2022 period, and there was foreign ownership in the company, so that a sample of 67 companies or 268 observations was obtained. The data source used is secondary data consisting of financial reports, annual reports, company ownership percentage reports, and tax haven index reports. Independent variables in this study consist of debt covenant, bonus plan, tax haven, independent commissioner, the audit committee, board of directors and foreign ownership. While the dependent variable is transfer pricing.

Transfer pricing is measured using the transfer pricing index with a aggregate of 5 scores [8]. Measurement of variable debt covenant using the ratio of total debt to total equity. Measurement of the bonus plan variable by dividing net income in year t by net income from year t - 1. Measurement of tax haven country variable using a dummy variable by giving a score of 1 for companies with at least one subsidiary in a tax haven country listed on The Corporate Tax Haven Index and a score of 0 for companies that don't have [9]. Independent commissioners are calculated by the rate of independent commissioners to the total members of the board of commissioners, while the audit committee is measured by a dummy variable, value 1 is givenif the number of audit committees is 3 or more people, and value 0 if the audit committee members arelower than 3 [10]. Measurement of the board of directors variable by calculating the number of members of the board of directors and foreign ownership is measured based on the percentage of foreign ownership to total ownership in the company.

The hypothesis in this study was tested using the SPSS 21 application which consists of two stages,namely the classic assumption test and hypothesis testing. The regression model in this study is shownin the following equation:

$$TP = a + b1\ DC + b2\ BP + b3\ TH + b4\ IC + b5\ AC + b6\ BD + b7\ FA + e$$

Description:

a= constant	DC= debt covenant
b1= regression coefficient of debt covenant variable	BP= bonus plan
b2= regression coefficient of bonus plan variable	TH= tax haven
b3= regression coefficient of tax haven variable	IC= independent commissioner
b4= regression coefficient of independent commissioner variable	AC= audit committee
b5= regression coefficient of audit committee variable	BD= board of directors
b6= regression coefficient of board of directors variable	FA= foreign ownership
b7= regression coefficient of foreign ownership variable	

3 Results and Discussion

3.1 Descriptive Statistics

Table 1 shows descriptive statistical data from 268 observations. The average transfer pricing activity carried out by the company is 1 type of transfer pricing activity or 0.1876, with the highest number of transfer pricing activities as many as 4 activities or 0.80. The average debt covenant value is 0.732 withthe highest amount of 4.772 and the smallest of 0.07. This shows that the average sample company has ahigh level of debt compared to the amount of equity. The bonus plan variable has an average value of 1.574 with the highest value of 49.056 and the smallest value of 0.007. This shows that the average the company has a larger current year profit than the previous year, so the planned bonus plan is getting bigger.

The good corporate governance variable consisting of independent commissioners, audit committees and boards of directors. The independent commissioner and board of directors have an average amount of 0.421 and 4.98, respectively. This shows that the average sample company has an independent commissioner composition of 42% and the average number of the board of directors is 4.98 or 5 members. The average value of the foreign ownership variable is 28.679. This shows that foreign investors control companies with a percentage of foreign ownership above 20%.

Table 1. Descriptive Statistics

Variables	N	Minimum	Maximum	Mean
Transfer Pricing (TP)	268	0	0,80	0,1876
Debt Covenant (DC)	268	0,0700	4,7720	0,7324
Bonus Plan (BP)	268	0,0077	49,0563	1,5746
Independent Commissioner (IC)	268	0,2500	1	0,4218
Board of Directors (BD)	268	2	12	4,98
Foreign Ownership (FA)	268	0,0010	98,2100	28,6793

3.2 Testing the Classical Assumptions

The normality test results in the Table 2 show that the significance value of Kolmogorov Smirnov is above 0.05. This means that the residual values in the regression model are normally distributed.

Table 2. Normality Test Results

Unstandardized Predictive Value	
Test Statistic	2,120
Sig.	0,234

The multicollinearity test results in Table 3 show that the Variance Inflation Factor (VIF) value is not more than 10 and the tolerance value is less than 0.10. This means that there is no correlation between the independent variables.

Table 3. Multicollinearity Test Results

Variables	Colinearity Statistics	
	Tolerance	VIF
Debt Covenant (DC)	0,846	1,181
Bonus Plan (BP)	0,996	1,004
Tax Haven (TH)	0,899	1,112
Independent Commissioner(IC)	0,948	1,055
Audit Committee (AC)	0,945	1,059

Variables	Colinearity Statistics	
	Tolerance	VIF
Board of Directors (BD)	0,882	1,134
Foreign Ownership (FA)	0,914	1,094

The heteroscedasticity test results in Table 4 show that the significance value of the Glejser test is above 0.05. This means that the variance of the regression model residuals has the same or constant value.

Table 4. Heteroscedasticity Test Results

Variables	Sig
Debt Covenant (DC)	0,702
Bonus Plan (BP)	0,184
Tax Haven (TH)	0,512
Independent Commissioner (IC)	0,626
Audit Committee (AC)	0,323
Board of Directors (BD)	0,614
Foreign Ownership (FA)	0,112

3.3 Hypothesis Test Results

The simultaneous test results in the Table 5 show that debt covenant, bonus plan, tax haven, independent commissioner, the audit committee, board of directors, and foreign ownership variables jointly affect the transfer pricing decision. The significance value of the F test is 0.000. The coefficient of determination test results show the R2 value of 0.160. This means that 16% of the dependent variable variance can be explained by the independent variables in the regression model.

Based on the results of hypothesis testing in table 5, the regression coefficient value of the debt covenant variable is -0.001 and the significance value is 0.933. The result of this study shows that debt covenant has no a significant influence on transfer pricing decision, therefore H1 is rejected. The regression coefficient value of the bonus plan variable is -0.015 and the significance value is 0.319. The result of this study shows that bonus plan has no a significant influence on transfer pricing decisions, therefore H2 is rejected. The regression coefficient value of the tax haven variable is 0.074 and the significance value is 0.015. The result of this study shows that tax haven has a significant influence on transfer pricing decisions, therefore H3 is accepted.

The regression coefficient value of the independent commissioner variable is -0.020 and the significance value is 0.860. The result of this study shows that the independent commissioner has no a significant influence on transfer pricing decisions, therefore H4a is rejected. The regression coefficient value of the audit committee variable is 0.021 and the significance values is 0.818. The result of this study shows that the audit committee has no a significant influence on transfer pricing decisions, therefore H4b is rejected. The regression coefficient value of the board of directors variable is 0.085 and the significance value is 0.012. The result of this study shows that the board of directors has a significant influence on transfer pricing decisions, therefore H4c is accepted. The regression coefficient value of the foreign ownership variable is 0.031 and the significance value is 0.000. The result of this study shows that foreign ownership has a significant influence on transfer pricing decisions, therefore H5 is accepted.

Table 5. Hypothesis Testing Results

Variables	Unstandardized Coefficients	Sig.
Debt Covenant (DC)	-0,001	0,933
Bonus Plan (BP)	-0,015	0,319
Tax Haven (TH)	0,074	0,015
Independent Commissioner (IC)	-0,020	0,860
Audit Committee (AC)	0,021	0,818
Board of Directors (BD)	0,085	0,012
Foreign Ownership (FA)	0,031	0,000
Sig. F	0,000	
R Square	0,160	

3.4 Discussion

Tax haven, the board of directors, and foreign ownership variables which are non-financial factors have a significant influence on transfer pricing decisions, while independent commissioners and audit committee do not have a significant influence on transfer pricing decisions. Financial factors consisting of debt covenant and bonus plan also do not have a significant influence on transfer pricing decisions. Tax havens are countries with low taxrates or even tax-free, which provide an advantage for companies that have affiliates in the country to be able to make transfer pricing decisions in order to avoid high tax payments. The results of this study shows that companies that have affiliates in tax haven countries will have bigger chances to make transfer pricing decisions. This result of this study support the results of previous studies [1]–[3]. Foreign investors who have control over the company can influence the company's management decision making, including transfer pricing decision. Foreign ownership makes the company conduct transfer pricing that benefits the investor with affiliates located abroad that are included in the tax haven region. The results of this study support the phenomenon and in line with previous research [5].

GCG factors consisting of independent commissioners and audit committees have no effect on transfer pricing decisions. This can be caused by the number of independent commissioners and audit committees that have been regulated in OJK and IDX regulations, which are at least 30% and 3 people.Based on the results of this study, the majority of independent commissioners and audit committees are in accordance with OJK and IDX regulations, so they do not have significant influence on transfer pricing decisions. This result of this study support the results of previous studies [4]. While the average number of board of directors of sample companies is 5 people, with a maximum number of 12 people. This shows that the company has a fairly high number of board of directors when compared to the average independentcommissioner of 1 to 2 people, so that the supervisory function of control activities by the board of directors is not comparable. Therefore, the opportunity for information asymmetry related to transfer pricing decisions between independent commissioners and the board of directors is getting bigger. Theresults of this study provide new findings for the development of theory in the field of management accounting, especially related to transfer pricing.

Financial factors consisting of debt covenant and bonus plan are not proven to influence transfer pricing decisions. Based on the debt covenant hypothesis, managers of companies that violate credit agreements tend to choose accounting methods that have the impact of increasing profits. The debt-to- equity ratio of the observed companies on average does not exceed the value of their equity, so the probability of violating the credit agreement is getting smaller. Therefore, debt covenant does not have significant influence on the transfer pricing decision. The results of this study support the results of previous studies [6], [8], [11], [12]. Meanwhile, directors will choose accounting policies that can increase profits to maximize compensation of the bonus plan hypothesis. Based on the data of this study, the average company that has a larger current year profit than the previous year does not conduct transfer pricing with affiliates located abroad. The average of companies that do transfer pricing is only 18%. Therefore, a bonus plan is not a factor that motivates companies to take transfer pricing decisions. The result of this study supported the previous studies [4], [13].

4 Conclusion

The conclusion of this study is that tax haven, board of directors, and foreign ownership have a significant influence on the transfer pricing decision. Meanwhile, debt covenant, bonus plan, independent commissioner, and audit committee do not have a significant influence on the transfer pricing decision.

Acknowledgments

Thanks to the Ujung Pandang State Polytechnic (PNUP) and the Center for Research and Community Service (P3M PNUP) who have fully supported financially so that this research can be carried out in 2023.

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