

# The Influences of Tax, Bonus Mechanism, Leverage and Company Size Through Company Decision on Transfer Pricing

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**Abstract**—Transfer pricing is pricing or reward connecting with interrelated goods transfer, services or technology shift between companies has different relation and systemic price manipulation to reduce artificial profits, it pretended as if the enterprise loses, avoids taxes and customs in a country. This study conducted to determine the effect of taxes, on manufacturing companies listed on the Indonesia Stock Exchange 2012-2015. The sample is determined based on purposive sampling method toward manufacturing companies listing in Indonesia Stock Exchange period 2013-2015 and found 30 samples of company so total observation in this research is 120 observations. The data used in this study are secondary data in the form of financial statements and annual reports downloaded through the official website IDX: [www.idx.co.id](http://www.idx.co.id). Data were analysed using regression and analysis of panel data processed using Eviews software version 8.0. The Hypothesis testing is using t- test statistical. The results are obtained foreign ownership, leverage and firm size, they have positive and significant influence on transfer pricing. Tax variables have positive and insignificant effect on transfer pricing while the bonus mechanism variable shows negative and not significant to transfer pricing.

**Keywords**—tax; bonus mechanism; foreign ownership; leverage; company size; transfer pricing

## I. INTRODUCTION

In multinational companies, there are various international transactions between members, one of which is the sale of goods and services. Most of these business transactions usually occur between related or inter-related companies. The pricing of various transactions between members (divisions) are known as transfer pricing or transfer price [1].

Development of the business world and business complexity, national companies is now transformed into multinational companies that business activities are not concentrated in one country only but some countries. The phenomenon nowadays, transfer pricing is often used illegally by several multinational companies due to minimize the tax burden. Pricing transfer policy is often used by multinational companies to reduce taxable income in a country by transferring prices to its affiliated companies located in a country falling into the category of tax heaven countries.

The universal transactions among taxpayers have special relations known as transfer pricing. Such privileged relationship may result in price negligence. Other costs or remuneration realized in a business transaction. Transfer pricing may result in the transfer of income or the basis of taxation and / or fees from one WP to another WP, which may be engineered to suppress the total amount of tax owed on the taxpayer with the relevant relation.

In business and economics world, multinational transfer pricing is a sensitive issue, especially in terms of taxation because transfer pricing is done by determining the amount of income earned by a company and affected to the level of state revenue from the tax side both on directly or indirectly.

In addition to taxes, the decision to transfer pricing is also affected by the bonus mechanism. If the company earns a profit, it will be awarded a bonus by the GMS to the members of the Board of Directors. Through this bonus giving system will give impact and influence to management in engineering profit of a company. Managers will tend to take an action on regulates the net profit to get the maximum bonus that will be received, included the way of transfer pricing.

Furthermore, the decision to transfer pricing is also influenced by foreign ownership. In concentrated ownership structure, the controlling shareholder is in a better position because the controlling shareholder can supervise and has better access to information than the non-controlling shareholder to be deeply involved in the management of the company. The controlling shareholder under PSAK No. 15 is an entity that owns 20% or more shares directly or indirectly so it is deemed to have a significant influence in controlling the company. The controlling shareholder may be owned by an individual, a government, or a foreign party. As share ownership of foreign controlling shareholders grows larger, foreign controlling shareholders have greater control over decisions in companies that benefit themselves including pricing policies and transfer pricing amounts. It is possible that foreign ownership may affect its slightest bit of transfer pricing [2].

Another thing that can influence the company's decision to transfer pricing is leverage. Leverage is a ratio that measures how far a company uses debt in financing. Multinational

companies usually finance group members with debt and / or capital transfers [3]. Debt and / or debt transfers are partially driven by opportunities for tax arbitration and thus, firms engaged in selective localization of debt for tax purposes are more likely to be aggressive in terms of transfer pricing arrangements [3]. It is possible that leverage may act as a substitute for transfer pricing in achieving a reduction of the group's corporate tax liabilities.

The size of the company can also be one factor in terms of the company's decision to transfer pricing. Company size is a value that shows the size of the company. The size of a company can be known from the total assets of the company. The greater is the amount of company assets the greater the size of the company. Large companies are likely to transfer pricing earnings management efforts.

Based on the background, this study was conducted to examine how much the influence of taxes, bonus mechanisms, foreign ownership, and leverage and company size to the company's decision to transfer pricing. The sample used in this study is a manufacturing company listed on the Indonesia Stock Exchange, and the period of this study is the year 2012 until 2015. In the object of research used is a manufacturing company because the manufacturing's company the possibility of transactions between parties who have a special relationship, Such as the sale of goods or services between the parent company and the subsidiary company, then in such transactions the possibility of transfer pricing.

## II. METHOD

The method of analysis in this study is a method of quantitative data analysis using panel data regression method. Analysis is done by processing data through Eviews program version 8.0 to see descriptive statistics and regression of panel data generated.

The sample is determined based on purposive sampling method toward manufacturing companies listing in Indonesia Stock Exchange period 2013-2015 and found 30 samples of company so total observation in this study is 120 observations. The data used in this study are secondary data, in the form of financial statements and annual reports downloaded through the official website IDX: [www.idx.co.id](http://www.idx.co.id). Data were analysed by using regression analysis of panel data processed using Eviews software version 8.0. Hypothesis testing is using t-test statistical.

TABLE I. SAMPLE SELECTION PROCEDURE

No	Description	Amount
1.	Manufacturing companies listed in Indonesia Stock Exchange (IDX) period 2012-2015	143
2.	The Company has no ownership interest above 20% as a controlling shareholder by a foreign company	(51)
3.	Companies that do not publish annual reports (consecutive annual reports) in a row	(7)
4.	Manufacturing companies that do not earn profit consecutively for the period of 2012-2015	(41)
5.	Manufacturing companies that use foreign currency in financial reporting period 2012-2015	(8)
6.	Of those who meet these criteria there are some who do not have the necessary data in this study	(6)
	The number of research samples	30

### A. Development of Hypotheses

Based on the above formulas then the hypothesis in this study are as follows:

1) *H1: Tax positively affects transfer pricing:* One of the reasons companies transfer pricing is taxes. It usually companies avoid paying very high taxes. The company reported lower earnings on its financial statements, one of the ways that firms practice to lower profits is transfer pricing. Companies should use the principle of fair price to reduce tax liabilities, but companies use transfer pricing more. In transfer pricing multinational companies tend to shift their taxation obligations from countries that have high tax rates to countries that apply low tax countries by reducing the selling price between companies in one group. Therefore, a large tax burden prompted the company to transfer pricing in the hope of reducing the burden. However, due to the unavailability of standard tools, experts and regulations, the transfer pricing checks are often won by taxpayers in tax courts, which of course will be exploited by multinational companies to reduce the tax burden [4].

2) *H2: Bonus mechanism has a positive effect on transfer pricing:* To improve employee's performance usually companies use bonuses, so the greater the company's overall profit. It is supported by the opinion of Horngren that the greater the company's overall profit generated, the better the image of directors in the eyes of the owners of the company. Therefore, directors have the possibility to do everything possible to maximize corporate profits including transfer pricing In study, that there is a tendency of management to utilize transfer pricing transactions to maximize bonus that will be accepted if the bonus is based on company profit. The conclusion is managers tend to take action to manage earnings by use transfer pricing practices to maximize the bonus to be received.

3) *H3: Foreign Ownership positively affects transfer pricing:* Foreign Ownership is management behaviour or controlling shareholder (majority) transfers company's assets and profits for their own benefit. This causes the non-controlling shareholder (minority) to be in the weakest position so that the controlling shareholder (majority) may misuse his / her own controlling rights . The exercise of the right of control is to maximize personal well-being with the distribution of wealth from other parties called expropriation. One common way of expropriation is through transfer pricing: the foreign controlling shareholder sells the product from the company he controls to his private company at a price below the market. The existence of expropriation by foreign controlling shareholders intended for personal gain will affect the company's decision including influencing pricing policy as well as the amount of transfer pricing. It is possible to affect many slightest transfers pricing that occurs.

4) *H4: Leverage has a positive effect on transfer pricing:* The company has various sources of funding in running its business, one of them with debt. Leverage measures the size

of a company's assets financed by debt. The larger the debt the taxable profit will become smaller because the tax incentives on the debt interest are greater [5]. The Ozkan Research provides evidence that firms with high tax liabilities will choose to reduce the tax burden then it can be mentioned that the company is aggressive against taxes. Multinational companies usually finance group members with debt and / or capital transfers [3].

5) *H5: Company size has a positive effect on transfer pricing*: The size of a company can be defined as an effort to assess the size or size of a company. In general research in Indonesia uses total assets as a proxy of firm size. The size of the company will be very important for investors because it will be associated with the investment risk [6]. Companies with large assets show that the company has reached the maturity stage where in this stage the company's cash flow has been positive and is considered to have good prospects for a relatively longer period of time [6]. Transfer pricing is a transaction made between related parties and related parties. study conducted by Wijaya shows that firm size negatively affects related party transactions thus it is possible that firm size negatively affects transfer pricing [7].

The data used in this study is the annual time series data (annual) for 4 years from 2012 to 2015 and cross section data as many as 30 manufacturing companies that have been selected based on predetermined criteria.

According to Hsiao, stated the use of panel data has several main advantages over the data type cross section and time series [8].

- Panel data can give researchers a large number of observations, increase the degree of freedom, data have great variability and reduce the linearity between independent variables so as to produce an efficient estimate.
- Panel data can provide more information that cannot be provided only by cross section or time series data.
- Panel data can provide better resolution in dynamic change inference than cross section data.

### B. *Dependent (Y) Transfer Pricing*

Transfer pricing in this research is calculated by using dichotomy approach to see the existence of sale to relate party. Measured using the dummy variable, a company that sells to a related party is assigned a value of 1 and that does not sell to a related party is rated 0.

### C. *Independent Variable (X)*

1) *Tax (X1)*: The taxes in this study are proxied using the ratio of effective tax rates (ETR). ETR in this study only use the main model used Lanis and Richardson [3], the income tax expense divided by the company's pre-tax income. The ETR ratio is measured by the following calculations :

$$ETR = \frac{\text{Income Tax Expense}}{\text{Income before Income Tax}}$$

ETR describes the percentage or ratio of corporate income tax expense to be paid to the government from the total income before tax.

2) *Bonus mechanism (X2)*: The Bonus Mechanism is one of the preferred ways companies choose a method that enlarges profit, this is described in positive accounting theory. For this variable will be calculated using dummy variables, i.e. companies that do bonus plans are given a value of 1 and who do not do a bonus plan given a value of 0.

3) *Foreign ownership (X3)*: Foreign ownership is proxied with the percentage of ownership of shares above 20% as the controlling shareholder. The criterion of ownership structure is concentrated based on Capital Market Law no. IX.H.1 which explains the controlling shareholder, is a party owning equity shares or securities of 20% or more. PSAK No. 15 also states about the significant influence held by shareholders with a percentage of 20% or more.

4) *Leverage (X4)*: Leverage describes the proportion of long-term debt to total assets owned by the company. This is done to determine the funding decision made by the company. Based on Lanis and Richardson leverage is measured by model [3]:

$$\text{Leverage (LEV)} = \frac{\text{Long-term debt}}{\text{Total assets}}$$

The ratio use to measure how much a company's assets are financed with long-term debt. The higher the ratio indicates the greater the amount of loan capital the company uses to invest in assets to generate profits for the company

5) *Company size (X5)*: Large size of the company (Size) can be expressed in total assets, total sales and market capitalization value. The greater the total asset the larger the size of the company and the more capital invested.

In this study, the indicator use to measure the size of the company is the total value of assets. Total asset value is used as an indicator to measure firm size because its value is relatively stable compared to total value of sales and market capitalization.

The total asset value represents the overall value of current assets and non-current assets of a company. The total value of total assets can be seen in the statement of financial position. Given the total value of this asset is very large, then the value of natural logarithm (Ln) of total assets to be not too large and the same unit to be incorporated into the equation model.

$$\text{Company Size} = \text{Ln Total Assets}$$

## III. RESULTS AND DISCUSSION

### A. *Accounting Theory*

It defines presents a systematic picture of the phenomenon of accounting that explained the relationship among variables and other variables in the structure of accounting and the intent to explain and predict phenomena that may arise. The notion of theory is a set of interrelated concepts, definitions, and

propositions. Theory contains assumption statements and hypotheses. In study, there are theories to support the research. Among them will be discussed several theories relating to the variables to be studied are agency theory, positive accounting theory and signalling theory.

#### *B. Agency Theory*

Agency theory is a theory arises when two mutually bound parties agree to use services. The agency relationship is a contract, in which one or more persons (principal) employ other persons or parties (agents) to carry out a number of services and delegate authority to make decisions. This can be seen that management obliged to account for all decisions to users of financial statements; including investors; stakeholders; shareholders; and creditors.

Agent conflicts can be detrimental to the principal (owner) because the owner is not directly involved with the management of the company so as not to have access to adequate information, the asymmetric information also causes problems in the principal-agent relationship when the agent has more information about actual performance and goals have the potential to create moral hazard and adverse selection. Adverse selection occurs because the difference in the amount of information owned by the principal and agent, so, the principal is unable to distinguish whether the agent is doing something good or not. In this context agents tend to hide information for personal gain. In addition, management as an agent is authorized to manage the company's assets, so, it has an incentive to transfer pricing due to lower tax payable.

#### *C. Positive Accounting Theory*

Mentions positive accounting theory related to the prediction of a decision in accounting principles by corporate managers and how managers will respond to new accounting standards. Positive accounting theory assumes that manager has a rational nature such as investors and managers will choose accounting policies provide benefits for themselves.

#### *D. Signalling Theory*

The signalling theory explained a good financial statement is a signal or sign the company is giving positive and negative signals to users. Signalling theory emphasizes the importance of information released by firms on investment decisions outside parties. Information is an important element for investors and business people because information essentially presents information, notes or descriptions for both the past, present and future circumstances for the survival of a company and how its market effects. Complete; relevant; accurate; and timely information are needed by investors in the capital market as an analytical tool to make investment decisions.

Information published as an announcement will provide a signal for investors in making investment decisions. If the announcement contains a positive value, it is expected that the market will react at the time the announcement is received by the market. When information is announced and all market participants have received the information, market participants first interpret and analyse the information as a good signal or bad signal. If the announcement gives information as a good

signal for investors, there is a change in the volume of stock trading.

Announcement of accounting information gives a signal the company has good prospects in the future (good news), so, investors are interested in trading stocks, the market will react as reflected through changes in trading volume. The relationship among the publication of information whether the financial statements, financial and socio-political conditions to the fluctuations of stock trading volume can be seen in market efficiency.

The signalling theory in this study explained the management of the company as a party gives a signal in the form of financial statements of the company. Parts of the financial statements used in this study are taxes, bonuses and foreign share ownership.

#### *E. Tax*

There are varieties of tax definitions according to experts: According to Mardiasmo, taxes are a public fee to state coffers by law (which can be enforced) by not getting a direct and demonstrable repayment (contrapret) that is used to pay public expenses.

#### *F. Tax Rates Effective*

One way to measure how well a company manages its taxes is by looking at its effective tax rate. By ETR, the company will be able to find out what part of the income the company actually paid for taxes. If the company has an ETR percentage higher than the tariff set in the taxation rules, the company is less than maximized in maximizing existing tax incentives, because with companies utilizing existing tax incentives it can reduce the percentage of tax payments from commercial profits.

Price Waterhouse Coopers (PWC) formulates the effective tax rate (ETR) as an indebted income tax divided by pre-tax income. Taxable income is calculated based on the provisions of the taxation legislation (KPP) while the pre-tax income is calculated based on the Financial Accounting Standard (SAK). Therefore, the income tax base for the purposes of the Income Tax calculation differs from the base of the calculation of income for the commercial, or in other words, due to significant differences in the two bases. The calculated income tax based on the taxable income is actually paid to the government, referred to as "Income Tax-Income Tax Payable or Income Tax Liability" while Income Tax calculated on the basis of Pre-Tax Income, referred to as "Income Tax Expense or Income Tax Expense Provision for Income Taxes".

Part of the differences between the Income Tax and the Tax Expense are insofar as it concerns temporary differences, should be recorded and reflected in the commercial financial statements, in the deferred tax account of both deferred tax assets and its deferred tax liabilities. Deferred tax assets can be likened to more taxes which will be replaced in the future at the time of recovery of temporary differences. At the same time, deferred tax liabilities such as underpayments of taxes, which would be payable in the future at the time of recovery of the temporary differences in net deferred tax assets result in a

reduction in the tax burden of the company whereas the net deferred tax liabilities increased the tax burden.

As previously discussed, deferred tax assets and deferred tax liabilities arise from temporary differences between bookkeeping and taxes while the permanent differences between bookkeeping and taxes have no effect on the calculation of tax burden according to the books and the calculation of tax payable.

This temporary difference is the most effective and popular tax planning in reducing taxes and maximizing time value of money. Since the temporary differences are realized in the future then to measure the effective tax rate on the actual tax paid by the company is used cash ETR (tax payment in cash) as a proxy in this study. Cash ETR is the ratio of cash payments (paid taxes paid) to the company's earnings before income tax.

### *G. Transfer Pricing*

The transfer pricing is the pricing or reward in relation to the transfer of interrelated goods, services, or technology transfer and a systematically manipulated price in order to reduce artificial profits, make the company as a loss, Or duty in a country.

The purpose of transfer pricing is to transmit financial data between departments or divisions of the company when they use each other's goods and services. There is another purpose of transfer pricing that is typically used to evaluate divisional performance and motivate sellers and buyers division managers toward decisions that match the overall corporate objectives.

Some of the goals to be achieved in transfer pricing include the following:

- Maximize global earnings.
- Securing competitive position of subsidiaries / branch companies and market penetration.
- Evaluate the performance of subsidiaries / branches of foreign companies.
- Avoid foreign exchange control.
- Associated creditable association.
- Reducing monetary risk.
- Arrange adequate cash flow of the child / branch.
- Fostering good relations with the local administration.
- Reduce the burden of imposition of taxes and import duties.
- Reduce the risk of a government takeover.

Managerial transfer pricing has important functions, such as:

- To motivate management in order to achieve the goal of incorporation of a subsidiary.
- Provide flexibility to the management of subsidiaries to achieve its objectives.

- To further improve the company's overall profit.

Transfer pricing often triggers a problem, especially at the price of the deal, as it involves two units, namely the buyer unit and the seller unit, and the transfer price also affects the unit profit measurement, the high transfer price will harm the purchaser unit while the transfer price is too low will harm the unit seller, then transfer pricing becomes very important

Leverage is defined as the book value of total long-term debt divided by total assets. Leverage is predicted to have a positive relationship with risk, because the greater the leverage the greater the obligation to pay in the long term. Leverage measures how much the company is financed with debt.

The size of the company can be based on total asset value, total sales, market capitalization, and employment and so on. The greater the value of these items then the larger the size of the company. The greater the asset, the more capital invested, the more sales the more the velocity of money and the greater the market capitalization, the greater is known in society [9].

### *H. Result of the Study*

Based on the results showed the effect of taxes, bonus mechanisms, foreign ownership, leverage and firm size to the company's decision to transfer pricing. Empirical study of manufacturing companies listing in Indonesia Stock Exchange (BEI) period 2012-2015, it can conclude as follows:

- Tax variables indicate taxes have positive and insignificant effect on Transfer Pricing. The result of the regression test shows the probability for the tax variable (X1) is 0.1547. This value is greater than the level of significance of 0.05 so it can conclude the tax individually no significant effect on Transfer Pricing. The regression coefficient for Tax (X1) is positive 0.252638. Based on the above test results can conclude H1 which states the Tax significantly affect Transfer Pricing, rejected.
- Variable Bonus Mechanism indicates Bonus Mechanism have negative and insignificant effect to Transfer Pricing. The result of the regression test shows the probability number for the Bonus Mechanism variable (X2) is 0.5191. This value is greater than the significance level of 0.05 so it can conclude the Bonus Mechanism individually no significant effect on Transfer Pricing. The regression coefficient for Bonus Mechanism (X2) is negative 0.036170. Based on the above test results can conclude H2 which states the Bonus Mechanism has significant effect on Transfer Pricing, rejected.
- Hypothesis in this study is Foreign Ownership has a positive and significant impact on Transfer Pricing. The result of the regression test, shows the probability number for Foreign Ownership (X3) variable is 0,0276. This value is smaller than the level of significance of 0.05 so it can conclude Foreign Ownership individually significantly affecting Transfer Pricing. The regression coefficient for Foreign Ownership (X3) is positive 0.412391. Based on the above test results it can

conclude H3 which states that Foreign Ownership has a significant effect on Transfer Pricing, accepted.

- Leverage has positive and significant effect on Transfer Pricing. The result of the regression test showed the probability number for Leverage (X4) variable is 0.4921. This value is greater than the significance level of 0.05 so it can conclude Leverage individually no significant effect on Transfer Pricing. The regression coefficient for Leverage (X4) is positive 0.021771. Based on the above test results can conclude H4 which stated that Leverage significant effect on Transfer Pricing, rejected.
- Hypothesis is the size of the company has a positive and significant effect on Transfer Pricing. The result of the regression test, shows the probability number for the variable of Company Size (X5) is 0,5776. This value is greater than the level of significance of 0.05 so it can conclude the size of the Company individually no significant effect on Transfer Pricing. The regression coefficient for Company Size (X5) is positive 0.010335. Based on the above test results can conclude that H4 which states the size of the Company significantly affect Transfer Pricing, rejected.

#### IV. CONCLUSION

The results showed on the effect of taxes, bonus mechanisms, foreign ownership, and leverage and firm size to the company's decision to transfer pricing. Empirical study of manufacturing companies listing in Indonesia Stock Exchange (BEI) period 2012-2015, it can be concluded as follows:

- Tax variables indicate taxes have a positive and insignificant effect on Transfer Pricing.

- Variable Bonus Mechanism indicates Bonus Mechanism have negative and insignificant effect to Transfer Pricing.
- Hypothesis is Foreign Ownership has a positive and significant impact on Transfer Pricing.
- Variable showed Leverage has positive and significant effect on Transfer Pricing.
- Hypothesis is the size of the company has a positive and significant effect on Transfer Pricing.

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