Research Article

Influence of Profitability, Company Size and Tunneling Incentive on Company Decisions of Transfer Pricing (Empirical Studies on Listed Manufacturing Companies Indonesia Stock Exchange period 2012-2019)

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Article History: Received:11 January 2021; Accepted: 27 February 2021; Published online: 5 April 2021

Abstract: Transfer pricing greatly affects state tax revenue, so it is in Indonesia. Transfer pricing practice is carried out by diverting profits or taxable income from Indonesia to another country. The purpose of this research is to examine the effect of profitability, company size and tunneling incentives on company decisions of transfer pricing. This study uses an explanatory method, and uses secondary data in financial reports or annual reports. The population in this study are all manufacturing companies listed on the Indonesia Stock Exchange (IDX) based on 2012-2019 financial reports. The results of the analysis of this study indicate that profitability affects the company decisions of transfer pricing, while company size and tunneling incentives have no effect on transfer pricing

Keywords: Profitability, company size, tunneling incentive, transfer pricing

1. Introduction

1.1. Research background

Economic globalization, business and investment are currently growing very rapidly without knowing the boundaries of a country. To strengthen its global business, the company has established subsidiaries in various countries. The goal is to strengthen strategic alliances and grow the *market share of* exports and imports of their products in various countries (Sumarsan, 2013).

In multinational companies there are various international transactions between members, one of which is the sale of goods or services. Most of these business transactions usually occur between related companies or between companies that have special relationships (Mardiasmo, 2008).

Universally, transactions between taxpayers who have a special relationship are known as transfer pricing. This transaction may result in a transfer, tax base or the cost of one taxpayer to another that can be engineered to reduce the total amount of tax owed to taxpayers who have such special relationships (Hartati & Azlina 2014).

Prices of transfer (transfer pricing) is a pejorative interpreted as a price that is set by multinational companies for the purpose of allocating revenue from one company to another in different countries with the aim of reducing the taxable income in countries which have high tax rates and divert profits in countries that have low tax rates (Suandy, 2011).

Transfer pricing is a classic issue in the field of taxation, empowering international transactions carried out by multinational corporations. From the government side, the government believes that the practice of *transfer pricing* results in a reduction or loss of potential tax revenue from a country because multinational companies have a tendency to shift their tax obligations from countries that have high tax rates (high tax countries) to countries that have low tax rates (low tax countries). On the other hand, from the business side, companies have a tendency to seek to minimize costs (cost efficiency) including minimizing corporate income tax payments (Widiyastuti, 2011).

The issue of *transfer pricing has* become an interesting issue and has received more attention from tax authorities in various parts of the world. There are many countries in the world are starting to introduce *transfer pricing* regulations. Research shows recently that it has found that more than 80% of multinational companies (MNCs) view that *transfer pricing* as a major international tax issue, more than half of companies say that the issue of *transfer pricing* is the most important issue (Suandy, 2011).

The biggest *transfer pricing* case that occurred in Canada that happened to Cameco (Canadian Mining and Energy Corporation) which was valued at C$ 2.2 billion or the equivalent of 21.7 trillion, involving its subsidiary in Switzerland. The company reportedly set up a subsidiary in Switzerland with a long-term agreement to sell uranium for $ 10 to $ 130 per pound. The price of uranium at the time, that the case emerged was $ 30 per pound (news.ddtc.co.id).

The case of *transfer pricing* in Indonesia, occurred in the Toyota Motor Manufacturing Indonesia (TMMIN) company which was detected after the tax directorate general simultaneously examined the Toyota Motor Manufacturing annual tax return (SPT) in 2005. Recently, Toyota's taxes in 2007 and 2008 were also checked. The examination was carried out because Toyota claimed to have paid excess taxes in those years, and asked the state to return it (*restitution)*. From an examination of Toyota's tax return in 2005, tax officials found a number of irregularities. In 2004, for example, Toyota's gross profit fell by more than 30%, from Rp. 1.5 trillion (2003) to Rp. 950 billion.

To carry out distribution in the domestic market, Astra and Toyota Motor Corporation Japan then established a sole agent company under the old name, Toyota Astra Motor (TAM). In this company Astra becomes the majority shareholder by controlling 51% of the shares. the remaining shares are owned by Toyota Motor Corporation Japan. After restructuring of ownership, the combined profits of the two companies plummeted. Decreased sales profit made Toyota's tax payments to the government also reduced. The odd thing was that even though the profit fell, their sales and production turnover in that year actually increased 40%. The tax inspector found this answer when he examined Toyota's sales price and cost structure more closely. It is suspected that Toyota played the transaction price with affiliated parties and added an unreasonably high cost through royalty payments. Toyota documents reveal that a thousand cars made by Toyota Motor Manufacturing Indonesia must first be transported to the Toyota Asia Pacific office in Singapore, before being sent to the Philippines and Thailand (Tempo, 2014).

The difference of tax rates between countries causes multinational companies to maximize their tax management by transferring revenues and profits to other countries using *transfer pricing* practices (Hansen & Mowen, 2005).

The impact of transfer price is the price that is too high (overpricing), otherwise the price is too low (underpricing) (Suandy, 2011). The implication of a different transfer price from market prices is a potential shift in taxes from a country with high tax rate to another country with lower tax rate. Tax potential shift causes distortion of inter-agency taxation due to a special relationship factor. To eliminate this distortion, a recalculation is performed to determine the amount of income, one approach that can be used for recalculation is profitability, this approach assesses the fairness of the transfer price based on the fairness of the total gross profit earned by the company. (Gunadi, 1999).

Companies that earn large income will have an effect on the amount of income tax that must be paid (Richardson & Lanis, 2007). Companies with high profitability have the opportunity to carry out tax planning that can reduce the amount of tax liability (Chen et al., 2010). Companies that have good tax planning will get optimal taxes, which causes a decrease in the company's tendency to avoid taxes (Prakosa, 2014).

Low profitability in the company indicates a high probability of a shift in profit, in other words, the company has a greater suspicion of *transfer pricing* practice (Bava & Gromis, 2015).

Another factor that influences the occurrence of transfer pricing is the size of the company (Dicky & Raisa, 2016). Company size is the size of a company shown by total assets, total sales, total profit, tax expense and others (Brigham & Huston, 2010). The large value of these items also shows the size of the company. the value of the assets, it shows the amount of capital invested, the sales value shows the more turnover of money and the amount of market capitalization shows that the company is also known in public (Supriyanto & Falikhatun, 2008).

Companies that have large total assets show that the company has good prospects in a relatively longer period of time. This makes managers who lead large companies lack the encouragement to do profit management including by transfer pricing because large companies are more concerned by the public so that large companies will be more careful in doing financial reporting (Pujiningsih, 2011). Meanwhile, smaller companies are considered to have more tendency to transfer pricing to show satisfactory performance (Refgia, 2017).

Multinational transfer prices are also intended to control, mechanism of resource flow between group members and maximizing profit after tax (Suandy, 2011). The third factor that allows companies to make decisions on transfer pricing is tunneling (Marfuah & Azizah, 2014). Tunneling incentive is the behavior of the majority shareholders who transfer the company's assets and profits for their own benefit, but minority shareholders bear the costs they charge (Hartati & Julita, 2015).

Tunneling can appear in two forms. First, the controlling shareholder can transfer resources from the company to himself through transactions between the company and the owner. Such transactions can be made through asset sales, transfer price contracts, excessive executive compensation, lending, and more. Second, controlling shareholders can increase their share of the company without transferring assets through the issuance of dilutive shares or other financial transactions resulting in losses for non-controlling shareholders (Brundy et al., 2014).

Tunneling incentive is carried out by the controlling shareholder to obtain a private benefit i.e. transfer of resources out of the company for the benefit of the controlling shareholder. The company conducts this tunneling with the aim of minimizing transaction costs. By tunneling to parties who have special relationships, costs can be reduced so that it is more economical compared to those who do not have special relationships. In addition, the company tunneled with the aim of manipulating profits (Marfuah & Azizah, 2014).

Entities whose ownership is concentrated on one party are likely to tunnel through transfer pricing transactions. If the shareholders have a large ownership in a company, then automatically they also want a large return or dividend. So the majority shareholder prefers to transfer pricing by transferring the company's wealth for its own benefit rather than dividing its dividends minority shareholders. Therefore, the greater the share ownership, the more trigger the transfer pricing (Saraswati, 2017).

Based on the background outlined, this research will test Influence of Profitability, Company Size and *Tunneling Incentive* on Company Decisions of *Transfer Pricing*. This study used a sample of manufacturing companies listed on the Indonesia Stock Exchange in 2012-2019.

1.2. Problem identification

In accordance with the explanation above, the identification of this research problem is as follows:

1. Does profitability affect the company's decision to transfer pricing?
2. Does the size of the company affect the company's decision in transfer pricing?
3. Does tunneling incentive affect the company's decision in transfer pricing?

2. Theoretical Framework

2.1. Transfer pricing

According to the OECD (Organization for Economic Cooperation and Development) (2009), transfer pricing is:

"Price at which a company undertakes any transactions with associated enterprise. When a company transfers goods, intangible property or services to a related company, the prices charged is defined as a transfer price."

Transfer pricing is the determination of prices or rewards in connection with the delivery of goods, services, or transfer of technology between companies that have a special relationship (Gunandi in Suandy, 2011).

Transfer pricing in the perspective of taxation, is a price policy in transactions conducted by parties who have a special relationship. In business practice, transfer pricing is often carried out by multinational companies that are in one group with the company (Feinschreiber in Darussalam, 2013).

2.2. Profitability

According to Munawir (2014), profitability is defined as follows:

"Rentability or profitability is indicating the ability of the company to make a profit during a certain period. The company's profitability is measured by the success of the company and the ability of the company to use its activities productively, thus the rentability of a company can be measured by comparing the profit earned in a period with the amount of assets or the amount of capital of the company".

According to Sartono (2010), profitability is:

"Profitability is the ability of the company to earn profit in relation to sales, total assets, as well as its own capital".

2.3. Company size

According to Riyanto (2008:313) the size of the company is:

"The size of the company is seen from the amount of equity value, sales value or asset value".

The size of the company is basically a grouping of companies into several groups, including large, medium and small companies. While the company is a measure used to reflect the small size of a company based on the total assets of the company (Suwito & Herawaty, 2005).

In research, the size of the company can use asset benchmarks. Because the company's total assets are of great value, this can be simplified by reforming into the natural logarithm (Hartono, 2016) so that the size of the company can also be calculated by:

Size = Ln Total Assets

2.4. Tunneling incentive

Tunneling is the transfer of resources out of the company to the controlling shareholder (Johnson et al., 2000). Hartati and Julita (2015) stated that tunneling incentive is the behavior of the majority shareholders who transfer the company's assets and profits for their own benefit, but minority shareholders bear the costs they charge. Meanwhile, according to Kalessen, et al. (2013), tunneling incentive is the activity of majority shareholders who put their own interests first and harm minority shareholders.

2.5. Profitability to transfer pricing

Rentability or profitability is indicating the ability of the company to make a profit during a certain period. The profitability of the company is measured by the success of the company and the ability of the company to use its activities productively, thus the profitability of a company can be measured by comparing the profit earned in a period with the amount of assets or the amount of capital of the company (Munawir, 2014).

Investors use profitability as one of the basis for making investment decisions to be made. With good profitability the possibility of investors making or maintaining their investments will increasingly Great. This is because profitability can describe the company's condition in generating profit. Profitability also has an important meaning in the company's efforts to maintain its long-term viability, as profitability indicates whether the company has a good chance in the future (Malerosa, 2018).

Richardson and Lanis (2007) stated that the greater the income earned by the company, the greater the amount of income tax to be paid. Companies with high profitability have the opportunity to position themselves in tax planning that can reduce the amount of tax liability burden (Chen et al., 2010). Companies that have good tax planning will get optimal taxes, this results in the tendency of companies to do tax avoidance will decrease (Prakosa, 2014). The lower the profitability of a company, the higher the likelihood of profit shifts occurring, in other words the greater the company's expectations of transfer pricing practices (Bava & Gromis, 2015).

Research conducted by Richardson et al. (2013), Eling and Abdullah (2018) show that profitability affects the company's decision to practice transfer pricing.

2.6. Company size of transfer pricing

The size of the company is a small size of a company in the show with total assets, total sales, total profit, tax expense and others (Brigham & Huston, 2010). The greater the value of these items, the larger the size of the company. The larger the asset, the more capital invested, the more sales, the more money turnover and the greater the market capitalization, the greater it is known in society (Supriyanto & Falikhatun, 2008).

Companies that have large total assets show that the company has good prospects in a relatively longer period of time. This makes managers who lead large companies lack the encouragement to do profit management including by transfer pricing because large companies are more noticed by the public so that large companies will be more careful in doing financial reporting (Pujiningsih, 2011). Meanwhile, smaller companies are considered to have more tendency to transfer pricing to show satisfactory performance (Refgia, 2017).

Research conducted by Bernard et al. (2006) showed that the size of the company influenced the company's decision to transfer pricing. In line with Richardson et al. (2013) proved that the size of the company influenced the company's decision to transfer pricing.

2.7. Tunneling incentive for transfer pricing

Tunneling incentive is the behavior of the majority shareholders who transfer the company's assets and profits for their own benefit, but minority shareholders bear the costs they charge (Hartati & Julita 2015).

There are two things that are considered as encouragement for companies to tunnel. First, the ownership structure. Second, the availability of financial resources to the company to be tunneled. With significant control and influence, controlling shareholders can take policies that benefit him, including contractual policies with parties with special relationships (Marfuah & Azizah, 2014).

Tunneling incentive is carried out by the controlling shareholder to obtain a private benefit i.e. transfer of resources out of the company for the benefit of the controlling shareholder. The company conducts this tunneling with the aim of minimizing transaction costs. By tunneling to parties who have special relationships, costs can be reduced so that it is more economical compared to those who do not have special relationships. In addition, the company tunneled with the aim of manipulating profits (Marfuah & Azizah, 2014).

Entities whose ownership is concentrated on one party are likely to tunnel through transfer pricing transactions. If the shareholders have a large ownership in a company, then automatically they also want a large return or dividend. So the majority shareholder prefers to transfer pricing by transferring the company's wealth for its own benefit rather than dividing its dividends to minority shareholders. Therefore, the greater the share ownership, the more trigger the transfer pricing (Saraswati, 2017).

Research on tunneling incentive has been conducted by Santosa and Suzan (2018) which concluded that tunneling incentive has an influence on transfer pricing decisions. In line with previous research Mispiyanti (2015) and Marfuah (2014) also stated that tunneling incentives influence transfer pricing decisions.

2.8. Research hypotheses

Based on the frame of thought that has been made, the research hypothesis is stated as follows:
H1: Profitability affects the company's decision to transfer pricing.
H2: The size of the company affects the company's decision to transfer pricing.
H3: Tunneling incentive affects the company's decision to transfer pricing.

3. Research Objects and Methods

In this study, the object of research by the author is Profitability (X1), Company Size (X2) and Tunneling Incentive (X3) as independent variables and The Company's Decision to Transfer Pricing as a bound variable (Y).

The analytical units in this study are manufacturing companies listed on the IDX (Indonesia Stock Exchange) for the period 2012-2019. The population in this study was a manufacturing company listed on the IDX (Indonesia Stock Exchange) for the period 2012-2019. The samples in this study were manufacturing companies from 2012 to 2019 that met the sample withdrawal criteria. Secondary data in this study consists of financial statements and independent auditor reports of manufacturing companies listed on the Indonesia Stock Exchange for the period 2012-2019.

The method used in this research is explanatory research. The purpose of this research is to test the hypothesis and explain the relationship of the variables studied. This research uses a quantitative approach. While the characteristics of this research are replication, so the results of hypothesis tests must be supported by previous studies, which are repeated with other conditions that are more or less the same.

To test the hypothesis proposed, the variables proposed in this study are classified into two, namely:

1. Dependent Variables – Company Decision to Conduct Transfer Pricing Practice (Y)

Dependent variables are the main variables that are the factors that apply in the investigation (Sekaran & Bougie, 2017). the company's decision to practice transfer pricing into dependent variables noted as Y variables.

2. Independent Variables – Profitability (X1), Company Size (X2) and Tunneling Incentive (X3)

Independent variables are variables that affect bound variables, either positively or negatively. That is, if there are free variables, bound variables are also present, and with each unit of increase in free variables, there is also an increase or decrease in bound variables. In other words, bound variable variances are determined by free variables (Sekaran & Bougie, 2017). In this study, there are three independent variables used, the first is profitability which is noted as variable X1, second is the Company Size noted as X2 and the third is Tunneling Incentive which is notated as X3.

Overasionalization of variables is an effort to reduce the abstract level of construction so that it can be measured by defining variables operationally based on observed characteristics that allow researchers to carefully measure one object or phenomenon (Nuryaman & Christina, 2015). Explanation of each variable is as follows:

3.1. Transfer pricing

Transfer pricing is the determination of prices or rewards in connection with the delivery of goods, services, or transfer of technology between companies that have a special relationship (Gunandi in Suwandy, 2011). Dependent variables in this study are transfer pricing, transfer pricing can be measured using a proxy ratio of related party transactions (RPT) receivables on total receivables (Nancy Kiswanto, 2014).

$$\text{Transfer Pricing} = \frac{\text{Account Receivable Related Party Transaction X 100\%}}{\text{Toal Account Receivable}}$$

(Nancy Kiswanto, 2014)

3.3. Profitability

Profitability is the company's ability to earn profit in relation to sales, total assets, and own capital (Agus Sartono, 2010).

According to Brigham and Huston (2010), there are various ratios that can be used to measure profitability, one of which is ROA. The ratio to return on total assets can also be called Return on Asset (ROA) which is the ratio of profit to total assets as a whole. This ratio is a measure to assess the percentage of the company's return rate of each asset owned or used. According to Sutrisno (2012), the formula for calculating this ratio is:

$$\text{Return on Assets (ROA)} = \frac{\text{EBIT}}{\text{Total Assets}}$$

(Sutrisno, 2012)

3.3. Company size

The size of the company is the size of the size of a company that is shown or in value by total assets, total sales, total profit, tax expense and others (Brigham & Huston, 2010).

The company size variable in this study was measured by using total assets because the value of assets is relatively more stable compared to sales (Murdoko & Sularto, 2007).

This variable measurement uses the company size ratio as follows:

$$\text{Company Size} = \text{Ln (Total Asset)}$$

(Hantono, 2016)

3.4. Tunneling Incentive

Tunneling is the behavior of management or majority shareholders who transfer the company's wealth for their own benefit, but the cost is charged to minority shareholders (Mutamimah, 2008). The criteria of ownership structure are concentrated based on PSAK No. 15 which measures the significant influence of shareholders by foreign parties by using presentse share ownership of 20% or more.

$$\text{TUN} = \frac{\text{Largest Total Share Ownership}}{\text{Number of Shares Outstanding}}$$

(Laksmita, 2017)

4. Results and Discussion

4.1. Results

The study was analyzed using descriptive statistical analysis and panel data regression analysis. Descriptive statistical test results show a statistical summary that includes mean, median, maximum, minimum, standard deviation, skewness and kurtosis, from profitability, company size, tunneling incentive, and transfer pricing data.

Mean of Profitability data is 0.176362, Median of Profitability data is 0.115800, Maximum value of Profitability data is 0.884900, Minimum value of Profitability data is 0.008400. By deviation standards can see the level of data dissemination (variance) Profitability deviates from the average of 0.168316. Profitability Skewness is 1.755618 and the kurtosis of profitability data in this period is 5.754334.

Mean of Company Size data is 16.42588, Median of Company Size data is 14.88300, Maximum value of Company Size data is 29.17500, Minimum value of Company Size data is 6.613000. With the standard deviation can see the level of data dissemination (variance) Company Size deviates from the average of 4.649256. The Company Size skewness was 1.112061 and the kurtosis of the Company Size data in this period was 4.901838.

Mean of Tunneling Incentive data is 0.588813, Median of Tunneling Incentive data is 0.555300, Maximum value of Tunneling Incentive data is 0.956500, Minimum value of Tunneling Incentive data is 0.257700. By deviation standards can see tunneling incentive data deployment rate deviates from the average of 0.205707. Skewness Tunneling Incentive is 0.096493 and the kurtosis of tunneling incentive data in this period is 1.786758.

Mean of Transfer Pricing data is 0.284378, Median of Transfer Pricing data is 0.122100, Maximum value of Transfer Pricing data is 0.978900, Minimum value of Transfer Pricing data is 0.000000. With the standard deviation can see the level of data dissemination (variance) Transfer Pricing deviates from the average of 0.331376. Skewness of Transfer Pricing is 1.028108 and kurtosis of Transfer Pricing data in this period is 2.539871.

In this study, multiple regression analysis was intended to determine the influence between Profitability, Company Size, and Tunneling Incentive, on Transfer Pricing. The purpose is to predict or estimate the value of dependent variables in causal relationships to the value of other variables. The models of multiple linear regression equations formed are as follows:

$$\mathbf{Y = 0.345487 - 0.358647\ X1 + 0.002305\ X2 - 0.060668X3}$$

From the analysis, it was seen that Profitability, Company Size, and Tunneling Incentive had an influence on Transfer Pricing by 0.054870 or 5.49%, while the remaining 94.51% was influenced by other factors not observed in this study.

4.2. Partial hypothesis testing of profitability variables (X1)

H0: $\beta 1 = 0$; Profitability has no significant effect on Transfer Pricing;
H1: $\beta 1 \neq 0$; Profitability has a significant impact on Transfer Pricing.

Based on the test criteria that have been determined obtained that the value of tcount variable Profitability is in the rejection area H0 (-2.161575 < -1.977). This indicates that H0 is rejected and H1 is accepted, meaning Profitability has a significant negative effect on Transfer Pricing.

4.3. Partial hypothesis testing of enterprise size variables (X2)

H0: $\beta 1 = 0$; The Size of the Company has no significant effect on Transfer Pricing;
H1: $\beta 1 \neq 0$; The Size of the Company has a significant effect on Transfer Pricing.

Based on the test criteria that have been determined obtained that the variable tcount value of the Company Size is in the acceptance area H0 (0.880296 < 1977).

This indicates that H0 is rejected and H1 is accepted, meaning the Company Size has no significant effect on Transfer Pricing.

4.4. Partial hypothesis testing of tunneling incentive (X3)

H0: $\beta 1 = 0$; Tunneling Incentive has no significant effect on Transfer Pricing;
H1: $\beta 1 \neq 0$; Tunneling Incentive has a significant effect on Transfer Pricing.

Based on the test criteria that have been determined obtained that the tcount value of tunneling incentive variable is in the acceptance area H0 (-0260872 > -1977).

This indicates that H0 was accepted and H1 was rejected, meaning tunneling incentives had no significant effect on Transfer Pricing.

5. Conclusion

Based on the results of the analysis and discussion conducted in the previous chapter on "The Effect of Profitability, Company Size, and Tunneling Incentive on the Company's Decision to Conduct Transfer Pricing Practices", it can be concluded that:

1. Profitability affects the company's decision in transfer pricing;
2. The size of the company has no effect on the decision of the company in conducting transfer pricing;
3. Tunneling incentive has no effect on the decision of the company in making transfer pricing.

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