Impact of Income Tax, Tax Haven Utilization, and Foreign Ownership on Transfer Pricing Practices

Ni Putu Mila Purwitasari[1]
Ni Ketut Lely Aryani Merkusiwati[2]
[1,2]Fakultas Ekonomi dan Bisnis Universitas Udayana, Indonesia
**Correspondences*: mila.purwitasari20@student.unud.ac.id

ABSTRACT

Transfer pricing is a significant concern in accounting and taxation because it is viewed as a strategic tool that can enable companies to gain a competitive advantage. This study aims to provide empirical evidence on the impact of income tax, tax haven utilization, and foreign ownership on transfer pricing practices. The research focuses on manufacturing companies listed on the Indonesia Stock Exchange from 2020 to 2022. A purposive sampling technique was employed to select the sample, resulting in the collection of 96 observational data points. The data were analyzed using multiple linear regression. The findings indicate that income tax exerts a positive influence on transfer pricing, whereas tax haven utilization and foreign ownership do not have a significant impact on transfer pricing practices.

Keywords: Transfer Pricing; Income Tax; Tax Haven Utilization; Foreign Ownership

Pengaruh Pajak Penghasilan, Pemanfaatan Tax Haven, dan Kepemilikan Asing pada Transfer Pricing

ABSTRAK

Transfer pricing menjadi perhatian dalam akuntansi dan perpajakan karena dianggap sebagai alat strategis yang dapat memudahkan perusahaan mencapai keunggulan kompetitif. Penelitian ini bertujuan memperoleh bukti empiris perihal pengaruh pajak penghasilan, pemanfaatan tax haven, dan kepemilikan asing pada transfer pricing. Perusahaan manufaktur yang tercatat di Bursa Efek Indonesia tahun 2020-2022 digunakan sebagai populasi penelitian. Sampel penelitian diambil dengan teknik purposive sampling dan diperoleh 96 data amatan. Analisis regresi linier berganda digunakan sebagai teknik analisis data dalam penelitian ini. Temuan analisis mendapati bahwa pajak penghasilan berpengaruh positif pada transfer pricing, sementara pemanfaatan tax haven dan kepemilikan asing tidak menunjukkan adanya pengaruh signifikan pada transfer pricing.

Kata Kunci: Transfer Pricing; Pajak Penghasilan; Pemanfaatan Tax Haven; Kepemilikan Asing

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INTRODUCTION

Economic growth in the era of globalization has significantly accelerated the expansion of cross-border economies, thereby fostering the rise of multinational companies. These companies engage in international transactions that often lead to transfer pricing practices. According to Director General of Taxes Regulation PER-32/PJ/2011, transfer pricing refers to the pricing of transactions between related parties. Such transactions may involve a company's financial operations, as well as the exchange of products, services, or intangible assets. This concept is further clarified in Article 18, Paragraph (4) of Law No. 36 of 2008, which states that a special relationship exists between corporate taxpayers when one entity owns 25 percent or more of another entity's shares.

Transfer pricing is legally permissible as long as it complies with the relevant regulations (Putri et al., 2022). Companies must apply the arm's length principle when engaging in transfer pricing (Amidu et al., 2019). However, the practice of transfer pricing has garnered a negative connotation due to instances of abuse, where income is shifted from a business in a high-tax country to a related business in a low-tax country (Setiawan, 2014). Such dishonest or illegal practices, including deliberate manipulation of transfer prices to evade taxes, can significantly diminish state revenue (Kalra & Afzal, 2023). According to the Tax Justice Network's 2020 report, The State of Tax Justice 2020: Tax Justice in the Time of COVID-19, Indonesia loses an estimated $4.86 billion per year (approximately IDR 68.7 trillion) due to tax avoidance, a substantial portion of which is attributed to transfer pricing. The increasing prevalence of transfer pricing is underscored by the Director of International Taxation, John Hutagaol, who noted that digital evolution and globalization have amplified the volume and value of cross-border transactions. Currently, 60 percent of global transactions, often involving transfer pricing practices, are conducted by multinational enterprises (MNEs) (pajak.go.id, 2020).

In response to these developments, the Ministry of Finance issued Regulation No. 213/PMK.03/2016, mandating the preparation of Transfer Pricing Documentation (TP Doc) for such transactions. Maryanti & Munandar (2024) noted that the tax ratio—a key indicator of whether the regulation would lead to increased tax revenue—showed improvement after its implementation. Indonesia's tax ratio rose from 8.33 percent in 2020 to 9.11 percent in 2021, reflecting economic recovery after the COVID-19 pandemic, and continued to increase to 10.41 percent in 2022. Despite this growth, Indonesia's tax ratio remains relatively low compared to other countries in the Asia-Pacific region and international standards. Therefore, even with these regulatory measures, further efforts are needed to enhance tax revenue and achieve the desired tax ratio.

One of the key factors influencing transfer pricing is income tax. Income tax refers to the tax levied by the government on income earned within a financial year. Discrepancies in income tax rates across countries can pose significant challenges, particularly for companies with subsidiaries in high-tax jurisdictions, as they face an increased tax burden (Devi & Noviari, 2022). As the income tax burden rises, companies are more likely to engage in transfer pricing to reduce their tax liabilities (Gracia & Sandra, 2022). Although numerous studies have examined the relationship between taxes and transfer pricing, the findings remain

inconclusive. For instance, research by Jayanti & Supadmi (2023), Marfuah et al. (2019), Putri et al. (2022), and Yulia et al. (2019) suggests that taxes positively influence transfer pricing. In contrast, studies by Devi & Noviari (2022) and Hikmatin & Suryarini (2019) indicate that taxes do not have a significant impact on transfer pricing.

Another influential factor in transfer pricing is the utilization of tax havens. Tax havens are countries that offer favorable financial and taxation policies for businesses (Anh et al., 2018). These jurisdictions typically have low or even nonexistent tax rates, making them attractive for companies seeking to minimize their tax obligations. By leveraging the differences in taxation systems and regulations in tax haven countries, companies can shift profits to reduce their income tax burden. Studies examining the relationship between tax haven utilization and transfer pricing, such as those by Anh et al. (2018), Bhudiyantia & Suryarini (2022) dan Devi & Noviari (2022), have found that tax haven utilization positively affects transfer pricing, suggesting that tax havens encourage companies to engage in such practices. However, other research, including studies by Agata et al. (2021) and Syahputri & Rachmawati (2021), found no significant relationship between tax haven utilization and transfer pricing.

Foreign ownership is another factor that influences transfer pricing. Foreign ownership refers to the stake held by foreign individuals or institutions in a company's shares in Indonesia (Rohaeni *et al*., 2021). When foreign shareholders own 20 percent or more of a company's shares, they are considered foreign controlling shareholders, significantly impacting business management decisions, including pricing policies and transfer pricing strategies (PSAK No. 15). The greater the foreign shareholding, the more control these shareholders exert over company decisions that may benefit them, including those related to transfer pricing (Sulistyowati & Kananto, 2018). This view is supported by studies such as those by (Sulistyowati & Kananto, 2018), which found a positive relationship between foreign ownership and transfer pricing. Conversely, research by Bhudiyantia & Suryarini (2022) and Yulia et al. (2019) suggests that foreign ownership does not significantly affect transfer pricing.

The inconsistency in the results of prior studies makes transfer pricing a compelling issue, serving as the primary motivation for this study to re-examine the topic using a more recent observation period. The objective of this research is to provide empirical evidence on the influence of income tax, tax haven utilization, and foreign ownership on transfer pricing in Indonesia.

The study population consists of manufacturing companies in Indonesia listed on the Indonesia Stock Exchange (IDX) during the 2020–2022 period. Manufacturing companies are selected due to their high potential for engaging in transfer pricing, as they often operate across multiple countries with varying tax rates. These companies frequently have relationships with subsidiaries or branch offices, involving the transfer of supplies necessary for their operations, which increases the likelihood of transfer pricing practices.

Agency theory elucidates the contractual relationship between a principal and an agent, where the agent is tasked with performing work on behalf of the principal (Jensen & Meckling, 1976). One of the core assumptions of agency theory

is that individuals act in their own self-interest, which raises concerns that agents may engage in profit-maximizing behaviors, such as manipulating financial statements, potentially reducing the returns earned by the principal. Positive accounting theory further explores how accounting expertise and the selection of appropriate accounting policies can be used to navigate specific future conditions. A key hypothesis within this theory, the political cost hypothesis, suggests that companies with high profitability are inclined to reduce their reported profits by deferring revenue recognition to future periods to avoid political costs (Watts & Zimmerman, 1986). Political costs, such as tax burdens imposed by government regulations, increase with rising profits. As profits grow, the corresponding income tax liability also increases (Pitaloka & Merkusiwati, 2019). High tax burdens, as noted by Nofryanti & Arsjah (2019), motivate companies to engage in transfer pricing. Empirical studies, including those by Azzura & Pratama (2019), Jayanti & Supadmi (2023), Marfuah et al. (2019), Nurwati et al. (2021), Putri et al. (2022), Sulistyowati & Kananto (2018), Wijaya & Widianingsih (2020), and Yulia et al. (2019), have shown that taxes positively influence transfer pricing practices. Based on this explanation, the first hypothesis of this research is:
H_1: Income tax has a positive effect on transfer pricing.

Agency theory also posits that company management, acting as agents, may exploit the authority granted by principals to manage company assets. Given that agents typically have more access to information than principals, they may prioritize their own goals and welfare over those of the principals. In line with the political cost hypothesis of positive accounting theory, as political costs increase, managers are more likely to adopt accounting policies that shift profits to countries with lower tax rates (Irawan & Ulinnuha, 2022). The presence of tax havens provides a mechanism for companies to reduce their tax liabilities by transferring taxable income from high-tax countries to those with low or no taxes (Makni et al., 2020). Companies operating in high-tax countries often utilize subsidiaries or related parties in tax haven jurisdictions to shift income through transfer pricing practices, thereby minimizing their overall tax burden. Research by Almutairi et al. (2023), Anh et al. (2018), Bhudiyantia & Suryarini (2022), Devi & Noviari (2022), Hadmoko & Irawan (2022), Irawan & Ulinnuha (2022), Kristanto & Sumaryati (2023), Ningtyas & Mutmainah (2022), and Pertiwi (2019) has demonstrated that tax haven utilization positively impacts transfer pricing. Based on this explanation, the second hypothesis of this research is:
H_2: Tax haven utilization has a positive effect on transfer pricing.

Agency theory posits that agency conflict arises due to information asymmetry, where disparities in access to information create tensions between controlling and non-controlling shareholders. Controlling shareholders may exploit their control rights to maximize personal wealth through practices such as expropriation, which involves transferring or distributing wealth at the expense of non-controlling shareholders. For instance, foreign controlling shareholders might sell products from the companies they control to their own private companies at below-market prices, thereby benefiting themselves while harming non-controlling shareholders (Refgia, 2017). The presence of foreign controlling shareholders within a company can influence corporate decision-making and policy, including decisions related to transfer pricing. This relationship is

supported by studies conducted by Fitri et al. (2019), Hikmatin & Suryarini (2019), Prananda & Triyanto (2020), Pratama (2020), Putri (2023), Rohaeni et al. (2021), Saputra et al. (2020), and Supriyati et al. (2021), which collectively indicate that foreign ownership positively impacts transfer pricing. Based on this explanation, the third hypothesis of this research is:
H_3: Foreign ownership has a positive effect on transfer pricing.

RESEARCH METHODS

The data collection method employed in this research is the non-participant observation approach. The study population comprises 198 manufacturing companies listed on the Indonesia Stock Exchange (IDX) between 2020 and 2022. A purposive sampling technique was used to select the sample, ensuring that the data collected met the specific criteria required for the research. The criteria for selecting the sample included manufacturing sector companies listed on the IDX that publish annual reports, report positive earnings, have at least 20 percent foreign share ownership, and engage in transactions with related parties consistently from 2020 to 2022. Based on these criteria, 32 companies were selected, resulting in 96 units of analysis over the three-year observation period.

Transfer pricing in this study is measured using a formula based on the research conducted by Devi & Noviari (2022), Lo et al. (2010), and Putri et al. (2022). This ratio enables the identification of the magnitude and direction of income-shifting behavior by comparing profit ratios between transactions with related and unrelated parties. The measurement is formulated as follows.

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

The income tax variable in this study is measured using the Current Effective Tax Rate (CETR). CETR is an effective metric for reflecting the methods employed by business management to defer tax burdens and serves as a tool to characterize a company's tax avoidance activities. The measurement approach for the income tax variable in this study is based on the research conducted by Cahyadi & Noviari (2018), Devi & Noviari (2022), and Nazihah et al. (2019), and is formulated as follows.

$$\text{Current ETR} = \frac{\text{Current Tax Expense}}{\text{Profit Before Tax}} \quad \ldots\ldots\ldots\ldots\ldots (2)$$

The tax haven variable in this study is measured using a dummy variable, based on the methodology established by Anh et al. (2018) and Devi & Noviari (2022). A value of 1 is assigned if a company has at least one subsidiary located in a tax haven country, as listed on the Corporate Tax Haven Index (CTHI), and a value of 0 is assigned if it does not.

Regarding foreign ownership, high levels of foreign share ownership can lead to the foreign shareholders becoming controlling shareholders within the company. The measurement of the foreign ownership variable is based on the research conducted by Hikmatin & Suryarini (2019) and Pratama (2020). The measurement is formulated as follows.

$$\text{Foreign ownership} = \frac{Total\ Foreign\ Share\ Ownership}{Total\ Outstanding\ Share} \quad \ldots\ldots\ldots\ldots\ldots (3)$$

The analysis in this research was conducted using multiple linear regression, with the following regression model:

$Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + e$ .... (4)

Where:

Y	= Transfer Pricing
α	= Constants
$\beta_1, \beta_2, \beta_3$	= Regression Coefficient
X_1	= Income Tax
X_2	= Tax Haven Utilization
X_3	= Foreign Ownership
e	= Error

RESULT AND DISCUSSION

The results of the descriptive statistical analysis, based on 96 data points from 2020 to 2022, are presented in Table 1.

Table 1. Descriptive Statistics Test Results

	N	Minimum	Maximum	Mean	Std. Deviation
Transfer Pricing (Y)	96	0.001	8.348	0.637	1.595
Income Tax (X_1)	96	0.019	0.913	0.232	0.113
Tax Haven Utilization (X_2)	96	0	1	0.35	0.481
Foreign Ownership (X_3)	96	0.206	0.997	0.592	0.269
Valid N (listwise)	96				

Source: Research Data, 2024

Table 1 presents the descriptive statistics for the study variables. The transfer pricing variable (Y) has a minimum value of 0.001 and a maximum value of 8.348, with an average of 0.637 and a standard deviation of 1.595. The income tax variable (X1) shows a minimum value of 0.019 and a maximum of 0.913, with an average of 0.232 and a standard deviation of 0.113. The tax haven utilization variable (X2), measured by a dummy variable, ranges from 0 to 1, with an average value of 0.35 and a standard deviation of 0.481. Lastly, the foreign ownership variable (X3) has a minimum value of 0.206 and a maximum of 0.997, with an average of 0.592 and a standard deviation of 0.269.

Table 2. Normality Test Results

	Unstandardized Residual
N	96
Test Statistic	0.084
Asymp. Sig. (2-tailed)	0.088

Source: Research Data, 2024

The normality test was conducted using the Kolmogorov-Smirnov test, with the results presented in Table 2. According to Table 2, the Asymp. Sig. (2-tailed) value is 0.088, which exceeds the significance threshold of $\alpha = 0.05$. These results indicate that the data are normally distributed.

Table 3. Multicolinearity Test Results

Variable	Collinearity Statistics	
	Tolerance	VIF
Income Tax (X_1)	0.964	1.038
Tax Haven Utilization (X_2)	0.929	1.077
Foreign Ownership (X_3)	0.958	1.044

Source: Research Data, 2024

The multicollinearity test was conducted using tolerance and Variance Inflation Factor (VIF) values. As shown in Table 3, each independent variable has a tolerance value greater than 0.1 and a VIF value less than 10, indicating that there is no multicollinearity among the independent variables.

Table 4. Autocorrelation Test Results

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	0.306	0.094	0.064	1.832	0.729

Source: Research Data, 2024

Table 4 reports a Durbin-Watson value of 0.729. Since this value falls between -2 and +2, it suggests that there is no autocorrelation in the data, according to the decision-making criteria outlined by Santoso (2010).

Table 5. Heteroscedasticity Test Results

Variable	Sig.
Income Tax (X_1)	0.504
Tax Haven Utilization (X_2)	0.140
Foreign Ownership (X_3)	0.602

Source: Research Data, 2024

Table 5 indicates that each independent variable has a significance value greater than 0.05, suggesting that the regression model in this research does not exhibit heteroscedasticity.

Multiple linear regression analysis was employed to assess the direction of the relationship between the dependent variable, transfer pricing (Y), and the independent variables, namely income tax (X1), tax haven utilization (X2), and foreign ownership (X3). The multiple linear regression equation, as derived from Table 6, is formulated as follows.

$Y = 4{,}527 + 0{,}894X_1 + 0{,}480X_2 + 0{,}058X_3 + e$ .... (5)

Table 6. Multiple Linear Regression Results

Model	*Unstandardized Coefficients*		*Standardized Coefficients*		
	B	*Std. Error*	*Beta*	t	Sig.
(Constant)	4.527	0.544		7.821	0.000
Income Tax (X_1)	0.894	0.297	0.304	3.009	0.003
Tax Haven Utilization (X_2)	0.480	0.406	0.122	1.182	0.240
Foreign Ownership (X_3)	0.058	0.371	0.016	0.156	0.876
Adjusted R Square	0.064				
F-test	3.168				
Sig. F	0.028[b]				

Source: Research Data, 2024

Table 6 shows that the significance level of the F-test is 0.028, which is less than the threshold of 0.05, indicating that the model is suitable for use as a regression model. The coefficient of determination, represented by the Adjusted R Square value, is 0.064. This suggests that 6.4 percent of the variance in transfer pricing can be explained by the income tax, tax haven utilization, and foreign ownership variables, while the remaining 93.6 percent is attributable to other factors not included in this study.

According to Table 6, the income tax variable has a significance level of 0.003, which is below 0.05, and the direction of the regression coefficient is positive, with a value of 0.894. This indicates that income tax has a positive effect on transfer pricing, leading to the acceptance of Hypothesis 1 (H_1). This result suggests that as the income tax burden increases, companies are more likely to engage in transfer pricing. This finding aligns with agency theory, which posits that individuals act in their own self-interest. Agents, entrusted with authority by principals, may engage in opportunistic behaviors, such as implementing transfer pricing strategies. The results also support the political cost hypothesis, which suggests that highly profitable companies may seek to reduce their reported profits to avoid political costs, such as taxes. This motivates management to adopt accounting policies aimed at lowering corporate income tax through transfer pricing. A lower CETR value indicates higher tax avoidance activities, such as transfer pricing. These findings are consistent with the research of Azzura & Pratama (2019), Jayanti & Supadmi (2023), Marfuah *et al*. (2019), Nurwati *et al*. (2021), Putri *et al*. (2022), Sulistyowati & Kananto (2018), Wijaya & Widianingsih (2020), and Yulia *et al*. (2019), all of which demonstrate that income tax positively influences transfer pricing.

The tax haven utilization variable has a significance level of 0.240, which exceeds 0.05, and the regression coefficient is positive with a value of 0.480. This indicates that tax haven utilization does not significantly affect transfer pricing, resulting in the rejection of Hypothesis 2 (H_2). The existence of tax haven countries does not appear to influence companies' transfer pricing decisions. This could be attributed to the presence of tax treaties or Double Tax Avoidance Agreements (DTAAs) Agata et al. (2021) and Syahputri & Rachmawati (2021). These treaties are designed to eliminate double taxation from cross-border transactions and facilitate information exchange to prevent tax evasion. Many tax havens now adhere to such treaties, which likely diminishes their appeal as tools for tax avoidance, including through transfer pricing schemes. The findings of this research do not support the application of agency theory or positive accounting theory in this context. These results are consistent with studies by Agata et al. (2021), Kusbandiyah et al. (2024), and Syahputri & Rachmawati (2021), which also found no significant effect of tax haven utilization on transfer pricing.

The foreign ownership variable has a significance level of 0.876, which is greater than 0.05, and the regression coefficient is positive at 0.058. This indicates that foreign ownership does not significantly affect transfer pricing, leading to the rejection of Hypothesis 3 (H_3). The findings suggest that transfer pricing is undertaken by companies regardless of the proportion of foreign controlling shareholding. In this study, a foreign shareholding percentage of 20 percent or more does not significantly influence the determination of transfer pricing, likely

because transfer pricing decisions are made collectively by the company's board of directors. Consequently, these findings do not support agency theory. The study indicates that the extent of foreign ownership does not strengthen the position of foreign shareholders nor influence the company's decision to engage in transfer pricing, as managerial decisions are based on the board of directors' agreement, rather than the personal welfare ambitions of foreign shareholders (Bhudiyantia & Suryarini, 2022). These results are consistent with the findings of Bhudiyantia & Suryarini (2022), Evi & Sasongko (2023), Prabaningrum et al. (2021), and Yulia et al. (2019), which also found no significant influence of foreign ownership on transfer pricing.

CONCLUSION

Based on the discussion of the research results, it can be concluded that income tax has a positive effect on transfer pricing. This indicates that as the amount of income tax paid increases, the likelihood of a company engaging in transfer pricing also increases. In contrast, tax haven utilization does not significantly influence transfer pricing, meaning that the presence of tax havens does not affect an entity's decision to engage in transfer pricing. Similarly, foreign ownership does not have a significant impact on transfer pricing, suggesting that a company will implement transfer pricing regardless of the proportion of foreign controlling share ownership.

A limitation of this study is that the independent variables explain only 6.4 percent of the variation in the dependent variable, leaving 93.6 percent attributable to other factors not included in the study. Future researchers are encouraged to explore additional variables beyond those examined here and to extend the research period and geographic scope to enhance the robustness of the findings.

For policymakers, it is recommended that the government intensify its oversight of corporate tax reporting and transfer pricing practices in Indonesia to prevent unethical transfer pricing strategies that could harm the state. For companies, it is crucial to consider the risks associated with their policies, to cultivate a strong ethical awareness in business practices, and to ensure that their activities comply with existing regulations.

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