



The Moderating Role of Corporate Governance in the Relationship Between Transfer Pricing and Tax Avoidance

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Abstract

This study investigates the relationship between transfer pricing (TP) and tax avoidance (TA), with corporate governance (CG) serving as a moderating variable. The research focuses on manufacturing firms listed on the Indonesia Stock Exchange (IDX) from 2017 to 2022. The sample comprises 180 observations derived from 30 multinational manufacturing companies, selected through a purposive sampling technique based on specific criteria. Panel data regression analysis was employed, utilizing models both with and without the moderating variable. The findings indicate that TP positively influences TA, suggesting that transfer pricing practices are associated with higher levels of tax avoidance. However, the study also reveals that strong CG can mitigate the positive impact of TP on TA, thereby underscoring the moderating role of effective governance mechanisms. These results highlight the importance of robust CG in reducing tax avoidance practices facilitated through transfer pricing. This study offers practical recommendations for strengthening corporate governance and implementing stricter regulatory oversight of transfer pricing activities. By enhancing governance frameworks, policymakers and companies can better address the ethical and financial implications of tax avoidance in multinational enterprises.

Keywords: transfer pricing, tax avoidance, corporate governance, multinational manufacturing company

Introduction

The study of tax avoidance (TA) has gained significant prominence in national and international political and public discourse over the past few decades. TA is often regarded as detrimental to the tax system, with adverse implications for a country's tax revenue (Chen et al., 2010). According to a 2021 OECD report, Indonesia's tax ratio was 10.1%, ranking third lowest among OECD member countries in terms of tax revenue (Nurhidayah & Rahmawati, 2022). Transfer pricing (TP)—where multinational corporations shift income to affiliates in low-tax jurisdictions—is widely cited as a major contributor to Indonesia's low tax revenue (Sitanggang & Firmansyah, 2021). This trend is closely tied to globalization, which facilitates the international expansion of multinational corporations, enabling them to transfer financial assets from developed to developing countries (Tomedi & Schreiber, 2014).

TP is particularly relevant in transactions involving overseas affiliates, especially in tax havens (Sikka & Willmott, 2010). It refers to the process by which management sets the price for goods and services exchanged within a company (Klassen et al., 2013). Through TP, corporate management influences both the taxes paid to governments and the dividends distributed to shareholders (Herianti & Chairina, 2019). Additionally, management may use TP to maximize incentives, such as bonuses, by increasing the company's revenue and output (Alkurdi & Mardini, 2020). However, TP can create agency problems, arising from misaligned interests between principals (shareholders) and agents (management). Information asymmetry exacerbates this issue, as management typically has access to more accurate and timely information than shareholders.

The Organization for Economic Cooperation and Development (OECD) recommends that related-party transactions adhere to the arm's length principle, which requires such transactions to be conducted as if the parties were unrelated (Amidu et al., 2019). However, TP schemes allow management to maximize utility by transacting with related parties, often obscuring specific transaction conditions. Only the name of the related party and the transaction amount are disclosed in holding group transactions, leaving the principal reliant on the agent for detailed TP data (Amidu et al., 2019; El-Helaly, 2018).

Previous research on the relationship between TP and TA has yielded mixed results. For instance, Amidu et al. (2019) provided empirical evidence that TP positively affects TA among financial and non-financial multinational firms in Ghana. Similarly, Irawan et al. (2020) found that TP positively impacts TA in manufacturing firms listed on the Indonesia Stock Exchange (IDX). Rossing et al. (2017) and Lin & Chang (2010) also demonstrated that multinational firms with subsidiaries in tax havens are more tax aggressive, conducting related-party transactions through TP schemes.

In contrast, Hendi & Hadianto (2021) reported that TP negatively affects TA in non-banking and financial sector firms on the IDX. Fasita et al. (2022) similarly found that TP negatively impacts TA among non-financial multinational businesses on the IDX. Christy et al. (2022) observed the same relationship in mining companies listed on the IDX. Meanwhile, Nugroho, (2022) found no significant impact of TP on TA in IDX-listed companies from 2015 to 2020. These inconsistent findings underscore the importance of reexamining the relationship between TP and TA, considering factors such as industry sector, firm characteristics, and the time period analyzed.

This study investigates the relationship between TP and TA using the Book-Tax Difference (BTD) and the Cash Effective Tax Rate (CETR) as measures of TA. The hypotheses tested in this study are as follows:

H1a: Transfer pricing positively impacts Book-Tax Difference.

H1b: Transfer pricing positively impacts Cash Effective Tax Rate.

The inconsistency in the findings of prior studies suggests the potential influence of other factors on the relationship between transfer pricing (TP) and tax avoidance (TA). One such factor is the objectives of various stakeholders, which play a critical role in effective corporate tax planning (Lietz, 2013). According to stakeholder theory, good corporate governance (CG) mechanisms can help align the interests of all stakeholders, not just shareholders. While economic efficiency emphasizes prioritizing shareholder welfare and optimizing financial returns, CG from a stakeholder perspective advocates broader accountability to other parties, such as employees and the environment.

Empirical studies support the role of CG in mitigating tax avoidance. [Noviari & Suaryana \(2019\)](#) found that TA decreases with the implementation of good corporate governance (GCG). Similarly, [Nugroho et al., \(2020\)](#) provided evidence that CG weakens the influence of TA. [Wahyudi et al., \(2021\)](#) further demonstrated that CG moderates the relationship between tax aggressiveness and financial reporting aggressiveness, indicating that improved CG implementation can reduce tax aggression, particularly in TP schemes. Based on these findings, the study proposes the following hypotheses:

H2a: Corporate Governance weakens the influence of Transfer Pricing on Book-Tax Difference.

H2b: Corporate Governance weakens the influence of Transfer Pricing on Cash Effective Tax Rate.

This study aims to examine the influence of transfer pricing on tax avoidance, both directly and through corporate governance as a moderating variable. The conceptual framework of this study is grounded in agency theory and stakeholder theory. Transfer pricing, conducted through inter-company and intra-company mechanisms, is often indicative of tax avoidance practices. These practices may involve manipulating transfer prices to benefit parent companies, subsidiaries, or affiliates located domestically or abroad. The presence of a parent company or subsidiary in a tax haven, often referred to as a shell company, further highlights the potential for TP to shift profits from high-tax to low-tax jurisdictions.

To address the inconsistencies in previous research findings, this study incorporates CG as a moderating variable. CG serves as a corporate control mechanism to protect stakeholders from fraudulent practices, including TP schemes orchestrated by managers. Effective CG helps mitigate agency conflicts between principals (shareholders) and agents (managers). According to stakeholder theory, managers are expected to make decisions that align with the interests of all stakeholders, rather than focusing solely on shareholders. The study's conceptual framework, as illustrated in Figure 1, reflects these theoretical foundations and relationships.

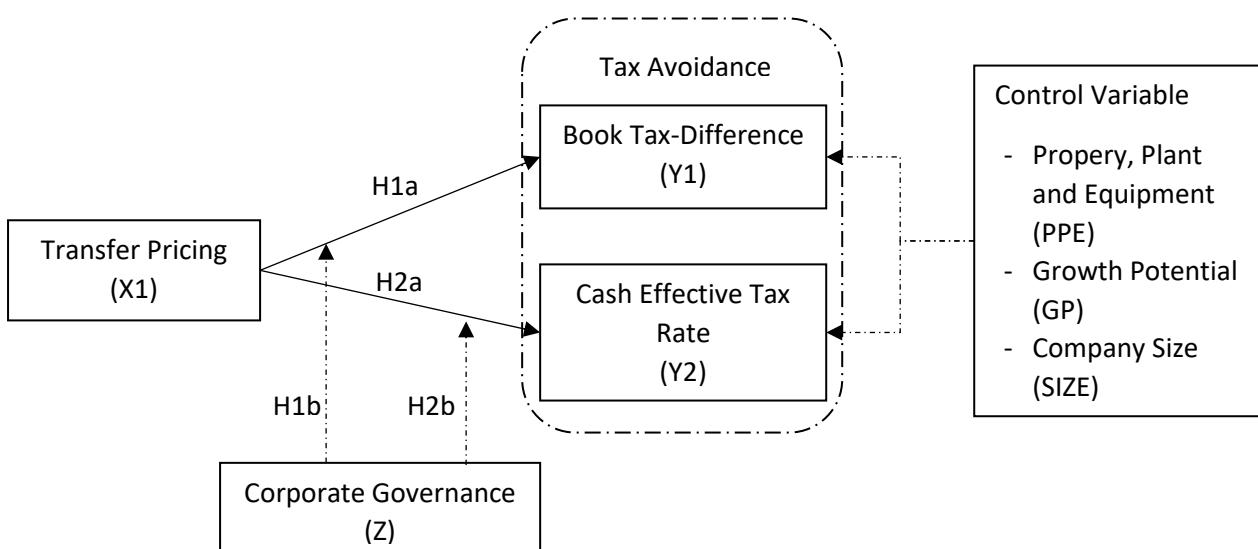


Figure 1. Research Model

Research Method

This research adopts a quantitative methodology to investigate the relationship between tax avoidance (TA) as the independent variable and transfer pricing (TP) as the dependent variable, with corporate governance (CG) included as a moderating factor. The study utilizes panel data, combining time-series and cross-sectional dimensions, and relies on secondary data obtained from the annual financial reports of companies listed on the Indonesia Stock Exchange (IDX). These reports were sourced from the IDX’s official website, www.idx.co.id, covering the period from 2017 to 2022.

The population of this study consists of multinational manufacturing companies listed on the IDX. These firms were chosen because they have a greater likelihood of shifting income from high-tax jurisdictions to low-tax jurisdictions. Furthermore, multinational manufacturing companies exhibit a high propensity for tax avoidance, often reflected in an Effective Tax Rate (ETR) below 35% and a Cash Effective Tax Rate (CETR) below 40% (Astuti & Aryani, 2017). As of December 31, 2022, the IDX listed 229 manufacturing companies.

The sample for this study was determined using purposive sampling, guided by specific judgment-based criteria. The criteria include: (1) multinational manufacturing firms listed on the IDX that have not been delisted for five consecutive years (2017–2022), (2) firms that have published annual reports consistently during the observation period, and (3) firms with a CETR value of less than one to ensure reliable model estimation. Based on these criteria, 30 multinational manufacturing firms were selected as the study sample, resulting in 180 research observations over the six-year period from 2017 to 2022. Details of the sample selection process are presented in Table 1.

Table 1. Sample Selection

Criteria	Amount
Manufacturing companies listed on the IDX for the 2022 period	229
Sample selection process:	
IPO companies and listed manufacturing companies that are not multinational companies during 2017 – 2022	(142)
Companies that do not publish consecutive financial reports, Companies with incomplete data, and Companies with negative pre-tax profits during 2017 – 2022	(50)
Companies with a CETR value of more than 1	(7)
Number of companies used in the study (n)	30
Observation Period (2017-2022)	6
Number of Observation data	180

Source: Processed Data, 2023

Book-tax Difference (BTD) and Cash Effective Tax Rate (CETR) are used to quantify TA. The reason for using BTD and CETR is that these measures are often used as proxies for TA in various tax studies (Hanlon & Heitzman, 2010). BTD is used as a measure because the difference between accounting profit and fiscal profit reflects TA (Comprix et al., 2011). The BTD equation that we use:

$$Book\ Tax\ Difference\ (BTD) = \frac{Earnings\ Before\ Tax - Earnings\ After\ Tax}{Total\ Assets} \dots\dots\dots (1)$$

Then, CETR is used as a measure of TA because it can show how much cash is spent by the company to pay taxes (Lennox et al., 2013). The CETR equation we use:

$$\text{Cash Effective Tax Rate (CETR)} = \frac{\text{Cash Tax Paid}_{i,t}}{\text{Pretax Income}_{i,t}} \dots\dots\dots (2)$$

The use of BTD and CTR is of course strongly influenced by the tax rate. However, the reduction in the tax rate from 25% in 2017 to 22% in 2022 in Indonesia certainly does not solely reduce TA activities. This is because tax avoidance behavior is also influenced by various factors beyond tax rates, including economic conditions, demographics, individual behavior, and tax regulations and policies (Haque et al., 2023).

TP is measured using Related Party Transaction (RPT) adapted from Kim & Yoo, (2017) research. The RPT equation we use:

$$\text{Related Party Transaction (RTC)} = \frac{\text{Purchase from Related Parties}}{\text{Total Sales}} \dots\dots\dots (3)$$

Related-party transactions (RPT) serve as a critical measure of transfer pricing (TP), providing insights into how companies interact with related entities and the implications for their tax liabilities (Aryotama & Firmansyah, 2020). By disclosing RPTs, companies and tax authorities can work toward ensuring that transfer pricing practices adhere to fair and transparent tax principles.

In this study, corporate governance (CG) is measured based on the Financial Services Authority circular letter No. 32/SEOJK.04/2015 and OJK Regulation No. 33/POJK.04/2014 on public company governance. These regulations define 25 items grouped under eight principles of good governance. Each principle is assigned a value of 1 if it has been implemented, and 0 if it has not. The CG score is then calculated by dividing the total number of implemented principles by the total number of existing principles, multiplying the result by 100% (Dara et al., 2019). The CG equation used in this study is as follows:

$$\text{Corporate Governance (CG)} = \frac{\text{Total Number of Recommendations Implemented}}{\text{Total Number of Recommendations}} \times 100\% \dots\dots\dots (4)$$

This study incorporates control variables, including Property, Plant, and Equipment (PPE), Growth Potential (GP), and Company Size, to ensure that the relationship between independent and dependent variables is not influenced by extraneous factors. The inclusion of these control variables provides a more comprehensive and accurate understanding of the factors affecting corporate tax decisions. By accounting for PPE, GP, and Company Size, this research offers deeper insights into the dynamics between transfer pricing and tax avoidance, contributing to more informed tax policy and corporate governance practices.

For hypothesis testing, this study employs two analytical techniques: panel data regression and moderated regression analysis (MRA). Panel data regression is used to assess the direct effects of independent and control variables on dependent variables, while MRA examines the presence and significance of a moderating variable in these relationships. Based on the research objectives, the study applies panel data regression and MRA methodologies using multiple regression equations.

To evaluate tax avoidance, two empirical models of the regression equation are proposed, with the Book-Tax Difference (BTD) serving as the measure of tax avoidance. The first model, designed to test hypothesis H1a, is specified as follows:

$$BTD = \alpha + \beta_1 TP + \beta_2 PPE + \beta_3 GP + \beta_4 SIZE + \varepsilon \dots\dots\dots (5)$$

To analyze hypotheses H2a, model 2 is used as follows:

$$BTD = \alpha + \beta_{11} TP + \beta_{12} CG + \beta_{13} CG \times TP + \beta_{14} PPE + \beta_{15} GP + \beta_{16} SIZE + \varepsilon \dots\dots (6)$$

Likewise, for the regression model using CETR in measuring tax avoidance, there are also 2 models, namely: To analyze hypotheses H1b, model 1 is used as follows:

$$CETR = \alpha + \beta_1 TP + \beta_3 PPE + \beta_5 GP + \beta_6 SIZE + \varepsilon \dots\dots\dots (7)$$

To analyze hypotheses H2b, model 2 is used as follows:

$$CETR = \alpha + \beta_{11} TP + \beta_{12} CG + \beta_{13} CG \times TP + \beta_{14} PPE + \beta_{15} GP + \beta_{16} SIZE + \varepsilon \dots (8)$$

Where:

- BTD : Book Tax-Different sebagai proksi tax avoidance
- CETR : Cash Effective Tax Rate sebagai proksi tax avoidance
- TP : Transfer Pricing
- TA : Tax Avoidance
- CG : Corporate Governance
- PPE : Property, Plant and Equipment
- GP : Growth Potential
- SIZE : Company Size
- α : Konstanta
- $\beta_1 - \beta_{16}$: Koefisien Regresi
- ε : Error

Result and Discussion

The results of the tax avoidance (TA) analysis in this study are measured using Book-Tax Difference (BTD) and Cash Effective Tax Rate (CETR). Based on the descriptive statistics (Table 2), the MARK firm (2017) recorded the lowest BTD value (-0.240), while the LPIN firm (2017) exhibited the highest value (0.683). According to (Ibrahim et al., 2021), a positive BTD value indicates a higher propensity for businesses to engage in TA. The average BTD value across the sample is 0.009, with a standard deviation of 0.070.

In terms of CETR, the values range from a minimum of 0.014 (observed in KINO, 2021) to a maximum of 0.874. The average CETR is 0.259, with a standard deviation of 0.125. Considering Indonesia's corporate tax rate of 25%, the sample's average CETR value aligns closely with the practical tax rate limit. A lower CETR value suggests a higher likelihood of aggressive TA practices among businesses.

Transfer pricing (TP) is calculated by dividing the total number of transactions involving related parties (purchases and sales) by the total number of sales. As shown in Table 2, TP values range from a minimum of 0.002 to a maximum of 2.317, with an average of 0.292 and a standard deviation of 0.346.

Table 2. Descriptive Statistics Results

Variabel	Min.	Max.	Average	D.S
BTD	-0.240	0.683	0.009	0.070
CETR	0.014	0.874	0.259	0.125
TP	0.002	2.317	0.292	0.346
CG	0.680	1.000	0.876	0.110
PPE	0.013	0.781	0.345	0.185
GP	-0.592	2.298	0.085	0.263
Size	26.151	33.537	29.607	1.688

Source: Processed Data, 2023

Corporate governance (CG) scores range from a minimum of 0.680 to a maximum of 1.000, reflecting the extent to which firms comply with the principles outlined in the Financial Services Authority (OJK) regulation POJK No. 32/SEOJK.04/2015. On average,

87.6% of the sample firms adhered to excellent corporate governance practices, indicating substantial compliance with the principles, aspects, and recommendations mandated by the regulation. This suggests that the majority of firms in the sample have implemented good corporate governance effectively.

This study incorporates control variables—Property, Plant, and Equipment (PPE), Growth Potential (GP), and Company Size—predicted to influence tax avoidance (TA). The descriptive statistics reveal that PPE ranges from a minimum value of 0.013 to a maximum value of 0.781, with an average value of 0.345 and a standard deviation of 0.185. GP values range from -0.592 to 2.298, with an average of 0.085 and a standard deviation of 0.263. Company Size exhibits an average value of 29.607, with a standard deviation of 1.688, indicating slight variation between the lowest and highest values over the observation period.

To select the appropriate panel data regression model, three estimation models were considered: the Common Effect Model (CEM), Fixed Effect Model (FEM), and Random Effect Model (REM). The Chow test, Hausman test, and Lagrange Multiplier test were employed to determine the most suitable model (Table 3).

For the Book-Tax Difference (BTD) model, used as a proxy for TA, the Chow test results indicate a Cross-section Chi-Square probability of 0.000, which is less than the 0.05 significance level. This result rejects the null hypothesis (H0) and accepts the alternative hypothesis (H1), confirming FEM as the more appropriate estimation model. Similarly, for the Cash Effective Tax Rate (CETR) model as a proxy for TA, the Cross-section Chi-Square probabilities for moderation testing are 0.0102 and 0.0149, respectively. These probabilities are also below the 0.05 threshold, rejecting H0 and supporting FEM as the optimal model for estimation (see Table 3).

Table 3. Regression Model Selection Test Results

Testing	Select Test		
	Common Effect Model (CEM)	Fixed Effect Model (FEM)	Random Effect Model (REM)
Chow Test:			
BTD model as a proxy for TA		√	
CETR model as a proxy for TA		√	
Hausman Test:			
BTD model as a proxy for TA		√	
CETR model as a proxy for TA			√
Lagrange Multiplier Test			√

Source: Processed Data, 2023

The Hausman test results for both direct testing and testing with moderation on the Book-Tax Difference (BTD) model, used as a proxy for tax avoidance (TA), yielded probability values of 0.0002 and 0.0011, respectively. Since these values are below the significance threshold of 0.05, the null hypothesis (H0) is rejected, and the alternative hypothesis (Ha) is accepted. Consequently, the Fixed Effect Model (FEM) is identified as

the most appropriate estimation model for the equation using BTD as a proxy for TA. Given these results, conducting the Lagrange Multiplier test is unnecessary, as the Chow and Hausman tests confirm the suitability of FEM.

In contrast, for the Cash Effective Tax Rate (CETR) model, also used as a proxy for TA, the Hausman test results for direct and moderated testing yielded probability values of 0.1252 and 0.1394, respectively, both exceeding the 0.05 threshold. These results indicate that H_0 is accepted and H_a is rejected, identifying the Random Effect Model (REM) as the more appropriate estimation model. To confirm this result, the Lagrange Multiplier test was conducted. The test findings, including the cross-section probability for both direct and moderated testing, produced probability values greater than 0.05. As a result, H_0 is accepted, and H_a is rejected, confirming that the Common Effect Model (CEM) is the most suitable estimation model for the CETR equation.

The F-test results, which assess the combined influence of independent variables on the dependent variable, indicate that all direct and moderated test probability values in the BTD and CETR models are less than 0.05. These findings demonstrate that transfer pricing (TP) as an independent variable, corporate governance (CG) as a moderating variable, and the control variables collectively impact TA, as measured by both BTD and CETR (Table 4).

Table 4. F Test

	F-Test	Prob (F-Statistic)
Dependent Variable: BTD		
Live Testing	9.594	0.000
Moderated Testing	8.825	0.000
Dependent Variable: CETR		
Live Testing	2.294	0.0196
Moderated Testing	2.760	0.0021

Source: Processed Data, 2023

The partial significance test (t-test) aims to determine how much each independent variable influences the dependent variable (Table 5).

Table 5. t-Statistic test

Variabel	BTD		CETR	
	Panel (1)	Panel (2)	Panel (3)	Panel (4)
TP	0.120093**	-0.488563	-0.055189*	-0.704048**
(t-statistics)	(2.25)	(-0.98)	(-1.68)	(-2.35)
CG		-0.099466		-0.183963
(t-statistics)		(-0.75)		(-1.49)
CG_TP		0.656527		0.725750**
(t-statistics)		(1.23)		(2.21)
PPE	0.109405	0.119698	-0.110786	-0.086837
(t-statistics)	(1.02)	(1.10)	(-1.64)	(-1.23)
GP	-4257.558**	-4216.538**	-4731.406	-5804.170
(t-statistics)	(-2.19)	(-2.11)	(-1.13)	(-1.41)
SIZE	7585.051**	7807.733**	-1247.763*	-1179.360
(t-statistics)	(2.55)	(2.54)	(-1.80)	(-1.61)

Source: Processed Data, 2023

Based on the t-test, the equations for BTD and CTER are as follows:

Equation 1:

$$BTD = 2.036461 + 0.120093 TP + 0.109405 PPE - 4257.558 GP + 7807.733 SIZE + \epsilon$$

Equation 2:

$$BTD = -2.029836 - 0.488563 TP - 0.099466 CG + 0.656527 CG_TP + 0.119698 PPE - 4216.538 GP + 7807.733 SIZE + \epsilon$$

Equation 3:

$$CETR = 7.341575 - 0.055189 TP - 0.110786 PPE - 4731.406 GP - 1247.763 SIZE + \epsilon$$

Equation 4:

$$CETR = 8.376502 - 0.704048 TP - 0.183963 CG + 0.72575 CG_TP - 0.086837 PPE - 5804.170 GP - 1179.360 SIZE + \epsilon$$

Furthermore, hypothesis testing is carried out using panel data regression model estimation techniques (shown in Table 6). This test is divided into two parts, namely: 1). The first hypothesis test is related to the relationship between TP and BTD and CETR as a proxy for TA, and 2). The second hypothesis test is related to the relationship between TP and TA with CG as a moderating variable.

Table 6. Conclusion Hypothesis Test

	Hypothesis	t	Prob.	Hasil
H1a	TP has a positive effect on BTD	2.25	0.0266	Accepted
H1b	TP has a negative effect on CETR	-1.68	0.0949	Accepted
H2a	CG weakens the relationship between TP and BTD	1.23	0.2211	Rejected
H2b	CG weakens the relationship between TP and CETR	2.21	0.0285	Accepted

Source: Data processed, 2023

Table 6 presents the regression results indicating that transfer pricing (TP) positively impacts Book-Tax Difference (BTD), with a t-value of 2.25 and a significance level of 0.0266, which is below the 0.05 threshold. These findings suggest that increased TP activities by multinational firms are associated with higher BTD values, signifying greater tax avoidance (TA). Additionally, TP negatively impacts the Cash Effective Tax Rate (CETR), with a t-value of -1.68 and a significance level of 0.0949, below the 0.1 threshold. This further supports the notion that TP activities facilitate TA.

Multinational corporations frequently use TP mechanisms to shift profits earned in high-tax jurisdictions to related entities in low-tax jurisdictions, thereby reducing their overall tax liabilities. TP involves setting prices for transactions between related parties or affiliated firms. Prior studies (Amidu et al., 2019; Irawan et al., 2020; Kim & Yoo, 2017; Park, 2018; Rossing et al., 2017) have consistently demonstrated that multinational corporations manipulate TP to evade taxes, aligning with the findings of this study.

This observation also supports the foundational premise of agency theory, which posits that individuals act as self-interested agents seeking to maximize personal financial gain. Conflicts of interest between shareholders and management often compel managers to make tax decisions that serve their objectives at the expense of stakeholders. As noted by (Jung et al., 2009), income shifting through related-party transactions is often driven by corporate management's desire to minimize tax liabilities.

Transactions with related parties can significantly affect a company's net income and financial prospects, as goods and services exchanged within a business group are

subject to terms that may not apply to external transactions. However, only the related party's name and transaction amount are typically disclosed in financial reports, leaving out specific details (Kumar et al., 2021). Companies with higher tax burdens can exploit such transactions to shift taxable income to affiliates in lower-tax jurisdictions, thereby reducing the overall tax burden at the group level.

The study also examines the moderating role of corporate governance (CG) on the relationship between TP and TA. The regression results reveal that CG does not significantly impact the relationship between TP and BTD, with a t-value of 1.23 and a significance level of 0.2211, exceeding the 0.1 threshold. However, CG significantly reduces the association between TP and CETR, with a t-value of 2.21 and a significance level of 0.0285, which is below the 0.05 threshold. These findings suggest that firms with stronger CG mechanisms tend to engage in less aggressive TA practices. Furthermore, the interaction between CG and TP positively impacts CETR, indicating that improved CG implementation shifts the regression coefficient of TP from a negative to a positive influence on CETR.

These findings are consistent with previous studies, such as Nugroho et al., (2020), which identified CG as a corporate mechanism capable of weakening the relationship between TP and TA. Moreover, the results align with agency theory, emphasizing that good corporate governance reduces agency conflicts between shareholders and management, thereby safeguarding shareholder interests. The findings also support stakeholder theory, which posits that CG should address the interests of all stakeholders, including those beyond shareholders.

Effective CG mechanisms, as recommended by OJK Regulation No. 33/POJK.04/2014, include optimizing whistleblowing systems, enforcing insider trading policies, and implementing codes of ethics for directors and commissioners. These measures aim to guide corporate management and protect stakeholders from fraudulent activities, including covert TP practices. Such practices make it challenging for shareholders to assess managers' performance accurately and impose significant costs on tax authorities in their efforts to gather information about related-party transactions.

The study also examines control variables such as Growth Potential (GP) and Company Size (SIZE). GP, measured as the ratio of a company's income to its total assets, negatively impacts TA. This finding suggests that firms with higher growth potential are less likely to engage in TA, supporting prior research by Amidu et al., (2019). Conversely, SIZE, which reflects the scale of a firm's operations, positively impacts TA. Larger firms are more likely to avoid taxes due to their complex operations and greater opportunities to exploit tax planning strategies. This aligns with findings by Asih & Darmawati, (2021), who noted that larger firms have greater resources to implement sophisticated tax avoidance measures, enabling them to reduce their tax liabilities effectively.

Conclusion

This study examined the direct and indirect effects of transfer pricing (TP) on tax avoidance (TA), with corporate governance (CG) serving as a moderating variable. Secondary data from multinational manufacturing firms listed on the Indonesia Stock Exchange (IDX) between 2017 and 2022 was utilized. A purposive sampling technique was applied, guided by specific criteria, resulting in 180 observations. The panel data regression analysis was conducted using EViews version 12.

The findings indicate that TP facilitates TA by enabling multinational corporations to shift a portion of their income from the country of origin to affiliates located in jurisdictions with lower tax rates. These transactions with related parties are a primary mechanism for implementing such practices. However, CG mitigates the impact of TP on TA by guiding management in adhering to applicable laws and protecting the interests of stakeholders. CG achieves this through the principles, tenets, and recommendations outlined in OJK regulations.

From the perspective of agency theory, the relationship between TP and TA arises because related-party transactions are often inadequately disclosed in financial statements. This creates information asymmetry, where principals, such as shareholders and tax authorities, incur significant costs to uncover the true extent of TP practices and assess management's performance. By applying agency and stakeholder theories, CG can reduce this information gap, safeguarding the rights and values of firms through the implementation of OJK-recommended CG practices.

The findings offer two significant contributions to government policymaking. First, they highlight the prevalent use of TP among Indonesian public companies, particularly multinational manufacturing firms, as a mechanism for tax avoidance. However, the implementation of good corporate governance (GCG), based on the 2015 OJK recommendations, demonstrates the potential to weaken the relationship between TP and TA. Therefore, the government is encouraged to strengthen the enforcement of governance regulations for public companies in Indonesia. Additionally, oversight of taxpayers must be enhanced to address the increasing complexity of firm transactions and the emergence of new loopholes for tax avoidance, particularly as globalization and technological advancements reshape the business landscape.

Second, the findings emphasize the need for tax authorities to continuously update tax regulations to address and monitor taxpayers benefiting from special treatment. Increasing tax education and optimizing digital-based tax services are essential to ensure that taxpayers remain aware of their obligations. These measures can help minimize tax avoidance practices and maximize state revenue from the tax sector.

This study provides evidence that TP influences management's engagement in TA. Investors are advised to exercise caution when selecting firms for investment, paying close attention to the risks posed by TA as reflected in financial statements. Investors should also consider the adoption of CG practices recommended by OJK to mitigate these risks.

Nevertheless, this study has limitations, particularly in measuring TA. It relies on Book-Tax Difference (BTD) and Cash Effective Tax Rate (CETR) as proxies. While BTD captures the difference between book income and taxable income, it does not distinguish whether the discrepancy is intentional or unintentional. Future research could address this limitation by incorporating Abnormal Book-Tax Difference (ABTD) and Normal Book-Tax Difference (NBDT) as proxies. These measures can provide a clearer distinction between deliberate and inadvertent discrepancies, offering a more accurate understanding of the firm's intent or motive to reduce its tax burden through accounting practices. Using ABTD and NBDT will enhance insights into firms' tax avoidance strategies and improve the robustness of TA measurements.

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