The Effect of Tax Planning, Profitability, Tunnelling Incentive and Capital Intensity Towards Transfer Pricing Indication

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ABSTRACT
This investigation aims to examine transfer pricing signals that may be impacted by tax strategizing, profitability, tunneling motivations, and capital intensity. The study utilized a sample of 25 mining firms listed in Indonesia between 2015 and 2019. This study employed a quantitative methodology utilizing panel data and multiple linear regression models. The present study has determined that transfer pricing is not influenced by tax planning, profitability, and capital intensity, while tunneling incentives significantly impact transfer pricing.

Keywords: Transfer Pricing, Tax Planning, Profitability, Tunnelling Incentive and Capital Intensity.

1. INTRODUCTION

Several variables can cause the inability of tax authorities to achieve tax revenue targets. Transfer pricing is one of the factors that the company carries out. The tax burden is considered to hinder company performance. Hence the management seeks to reduce tax payments by avoiding tax through transfer pricing (Nurazi, Santi, Usman, 2015). The corporate line and the global economy are vulnerable to transfer pricing actions. Transfer pricing transactions are carried out so companies can determine their income to directly or indirectly affect a country's tax revenue level (Kananto, 2019). Tax rates are a common problem due to globalization, and the disparity in tax rates causes companies to decide to use transfer pricing measures (Abbas, 2020). Khasanah (2020) explained that transfer pricing activities are permitted if they are still within the corridor of the applicable tax regulations.

Khasanah (2020) conducted a study on transfer pricing within the scope of manufacturing companies where the bonus mechanism does not affect transfer pricing practice decisions. However, intangible assets and inventory intensity ratio hurt transferring pricing. Furthermore, Abbas (2020) concludes that the Effective Tax Rate significantly affects transfer pricing. In contrast, Tunneling Incentive has different results. This variable does not affect transfer pricing. Exchange Rate has a negative influence on transfer pricing decisions. This argument is supported by several previous studies, such as Merliyana (2020); Krisdianto (2019); Clausing (2003), and Lo (2010). The analysis Merle (2019) examines the indications of transfer pricing using 40 companies registered in the French CAC where the effective tax rate (ETR) reduces the intensity of transfer pricing in French companies.

Profit is the company's ability to benefit from the activities carried out by the company (Zulaikha, 2014). Companies with high-profit yields tend to look for ways to reduce tax obligations (Rego, 2003). From a transfer pricing perspective, firms may adjust their
prices to reduce their taxable income with high corporate tax rates, and conversely, they will adjust prices to increase profits where tax rates are low. A high ratio of profitability can indicate efficiency in a company's management. Profitability is the variable studied here, which is one of the tax burdens because high profits will also have high taxes. Therefore, the company may be trying to avoid tax obligations.

Capital Intensity is the following variable studied in this study: a company's investment in fixed assets, where a company can use fixed assets to gain profit. Investments made by a company in fixed assets will create a depreciation expense. Research on this variable of tax aggressiveness has been carried out by Andhari and Sukartha (2017). The company invests in fixed assets, creating a depreciation expense. This burden will undoubtedly reduce the company's profit to reduce the obligation to pay taxes.

2. LITERATURE REVIEW

This theory describes the interaction or relationship between shareholders (principals) and management (agents). One possibility is a conflict of interest because the agent does not consistently act following the principal's interests, thus triggering agency costs. Managers with effective and efficient authority gain corporate profits and sustainability (Jensen & Meckling, 1976). Irfan (2002) said that as a manager who manages the company's operational activities, he manages more information than shareholders. Therefore, the manager must convey information about the company's financial and non-financial conditions to the principal. This information can be done through financial statements.

Transfer pricing describes the tax scheme used in planning in preparing a tax reduction that must be paid by a company (Khasanah, 2020). Choi (2020) suggests that source countries of Foreign Direct Investment (FDI) will be willing to set higher tax rates to tolerate some profit shifting to some countries. Differences in tariffs can cause difficulties for multinational companies, which will become a source of problems with additional foreign investment, the most prominent of which is transfer pricing (Fitri, 2019). Schuster (2015) defines transfer pricing as the internal price of a product that has two main functions, namely profit allocation (to assess the profitability of a division and measure performance) and coordination (to reach decisions that favor the interests of the company as a whole).

Taxation is considered one of the primary sources of state revenue, such as in Indonesia, where taxes are the primary source of state revenue (Irianto, 2010). Tax planning is a method of tax regulation in the business of individual taxpayers and business organizations by using loopholes that can be taken by corporations while remaining within the provisions of tax control so that business actors can pay taxes with the minimum amount possible (Pohan, 2014) According to Zain (2003) tax planning can be defined as structured behavior with an emphasis on controlling every transaction that generates taxes in it to control each transaction to minimize the amount of tax paid through tax avoidance as long as it remains within the scope of tax laws. In general, tax planning is the practice of structuring companies and taxpayer transactions in such a way as to minimize tax debt.

Companies that carry out tax planning must deepen tax regulations and always pay close attention to all renewals and adjustments to tax regulations so that tax planning can run well and avoid mistakes that refer to tax evasion (Mardiasmo, 1992). Nazihah, Azwardi, and Fuadah (2019) analyzed the effect of taxes, tunneling incentives, bonus mechanisms, and firm size on transfer pricing from 2013 until 2017. The results of the regression panel data show that taxes, bonus mechanisms, and firm size significantly affect transfer pricing.

Profit maximization is a fundamental goal for a company in running its business and to be able to face competition from companies that have operations in similar industries. It is the main prerequisite for the long-term survival of a company (Gitman & Zutter, 2012).
Profitability is a measure of company performance and is essential information in financial statements that can be used to make decisions from each stakeholder. Financial ratios assess decision-making and even regulate performance (Barnes, 1987). Ratios provide a standard method for measuring a company's activities and help determine its performance in terms of its strengths and weaknesses. Borio, Gambacorta, and Hofmann (2017) define profitability as the capability of a business, defined as profit over a certain period. Hanafi (2012) says that the profitability ratio shows the company's capacity to benefit from the sale of assets and share capital. The most studied ratios in the calculation of this variable are Profit Margin, Return on Assets, and Return on Equity.

Tunneling is an activity to transfer resources outside the company to achieve the profits of the controlling shareholder (Johnson et al., 2000). According to Mutaminah (2008), there are two types of ownership, majority and minority. Ownership structure can describe the type of agency conflict that takes place in a company. According to Mitton (2002), the emergence of issues to agency among majority and minority shareholders is caused by the emergence of factors. First, the largest shareholders serve in the company's management as directors and members of the board of commissioners, and they are more likely to influence minority shareholders. Second, because share ownership is cross, pyramidal, and classy, the voting rights of the majority shareholder exceed the cash flow limit (Claessens, 2000). According to Law no. 36 of 2008, taxpayers who deposit at least 25% have control over the company whose capital is paid up, so they are categorized as majority shareholders.

The controlling majority shareholder will transfer capital to themselves at the expense of the minority shareholder's rights, resulting in a decrease in wealth transfer because the majority shareholder's ownership percentage will decrease (Sansing, 1999). Based on PSAK No. 15, companies with at least 20% of the capital or more of their resources are considered to have a significant direct or indirect impact.

Capital intensity determines how companies invest in fixed assets and inventory (Siregar, 2016). The explanation of capital intensity shows that the company efficiently utilizes its assets to generate sales. All assets are depreciated, then depreciation expense reduces the company's tax liability (Pilanoria, 2016). Muzakki (2015) explains that fixed assets can be used to reduce corporate taxes through the depreciation of fixed assets every year, which creates a burden so that the depreciation expense can reduce tax.

Capital intensity is one of the company's characteristics that can directly affect the company's tax rate (Dwiyantri, 2019). Nugraha (2019) said that capital intensity is a form of investment activity by companies whose investment activities are in fixed assets so that the company's efficiency level can be seen through the use of these assets in generating income through high capital intensity in the company. This research is also supported by Commanor and Wilson (1967), who argue that the capital intensity ratio is information that stakeholders, namely investors, can use because it can describe the efficiency of capital a company has invested.

3. RESEARCH METHOD

The data type used in this study is quantitative, and the data source is secondary. The quantitative research method is a type of research whose specifications are systematic, planned, and structured from the start to the creation of the research design.

3.1. Data Collection Techniques

Data collection by researchers was carried out using secondary data collected from online and offline sources—the financial report data of 25 mining companies from 2015 until 2019.

3.2 Operational Definitions of Variables

Table 1: Variable Measurement

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Variable Measurement
Transfer Pricing Related Party Transaction = \frac{\text{Receivables from Related Parties}}{\text{Total Accounts Receivable}}

Tax Planning Effective Tax Rate = \frac{\text{Profit before tax}}{\text{Profit after tax}}

Profitability Return on Asset = \frac{\text{Total Asset}}{\text{Total Accounts Receivable}}

Tunneling Incentive Tunneling Incentive = \frac{\text{Receivables from Related Parties}}{\text{Total Asset}}

Capital Intensity Capital Intensity = \frac{\text{Net Fixed Assets}}{\text{Total Asset}}

3.2. Sample Collection Techniques
The population in this study were all manufacturing companies in the mining sector listed on the Indonesian stock exchange. The selection of the research sample was based on the purposive sampling technique. The criteria used to select the sample are as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>No Of Companies</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mining companies listed on IDX from 2015-2019</td>
<td>25</td>
</tr>
<tr>
<td>Complete data available in the financial reports for 2015 – 2019.</td>
<td>-</td>
</tr>
<tr>
<td>Number of research samples</td>
<td>25</td>
</tr>
<tr>
<td>Total sample data for research five years</td>
<td>125</td>
</tr>
</tbody>
</table>

3.3. Data Analysis Techniques
Multiple linear regression was chosen because the independent variables used were more than 2 variables. Below is the linear regression equation in this study:

\[ Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + e \]

Where:
- \( Y \) = Transfer Pricing
- \( \alpha \) = Constant
- \( \beta_1 \) = Coefficients
- \( X_1 \) = Tax Planning
- \( X_2 \) = Profitability
- \( X_3 \) = Tunnelling Incentive
- \( X_4 \) = Capital Intensity
- \( e \) = error

4. RESULTS AND DISCUSSIONS

4.1. Results

<table>
<thead>
<tr>
<th>Variables</th>
<th>Coefficient</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax Planning</td>
<td>0.045</td>
<td>0.121</td>
</tr>
<tr>
<td>Profitability</td>
<td>0.008</td>
<td>0.664</td>
</tr>
<tr>
<td>Tunneling Incentive</td>
<td>0.089</td>
<td>0.000</td>
</tr>
<tr>
<td>Capital Intensity</td>
<td>0.014</td>
<td>0.608</td>
</tr>
<tr>
<td>R-square</td>
<td>0.527</td>
<td></td>
</tr>
<tr>
<td>Prob(F-statistic)</td>
<td>0.000</td>
<td></td>
</tr>
<tr>
<td>Observations</td>
<td>125</td>
<td></td>
</tr>
</tbody>
</table>

Source: Proceed by E-views, 2022

4.2. Discussion
Tax Planning affects transfer pricing indications. The output results show that the significant number is 0.121. This value shows that it is greater than the significance level of 0.05 (0.121 > 0.05). It is concluded that tax planning has no significant effect on transfer pricing, and it can be concluded that H1 is rejected.

Profitability affects indications of transfer pricing. The output results show that the significant number is 0.664. That is, it can be shown that the value is greater than the significance level of 0.05 (0.664 > 0.05), and it can be concluded that profitability has no significant effect on transfer pricing. It can be concluded that H2 is rejected.

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Tunneling Incentive affects transfer pricing indications. The test output shows that the significant number is 0.000. This value shows that it is smaller than the significance level of 0.05 (0.000 < 0.05). It is concluded that the tunneling incentive variable has a significant positive effect on transfer pricing, so H2 is accepted. The positive effect is known through the t-test, which produces a value of 9.630, where this value has a positive value.

Capital Intensity affects transfer pricing indications. The output results show that the significant number is 0.608. It means that the value shows that it is greater than the significance level of 0.05 (0.608 < 0.05), so it means that capital intensity does not significantly affect transfer pricing. It is stated that H4 is rejected.

5. CONCLUSIONS

Tax planning does not affect transfer pricing because existing data shows results above the significance level of 0.05 or 5%. Profitability does not affect transferring pricing because the statistical calculations are above the significant level (0.05 or 5%), 0.664. The company's tunneling incentive has a significant effect because existing data shows the test results are below the significance value of 0.000 or p-value < 0.05. Capital Intensity on the company does not have a significant effect because the existing p-value shows the test results above the significance value of 0.608. Simultaneously, the research concludes that tax planning, profitability, tunneling incentive, and capital intensity significantly affect transfer pricing indications.

This research has several limitations. The selection of independent variables is limited to tax planning, profitability, tunneling incentive, and capital intensity. The value of R2 in the statistical test can increase more than the research by analyzing other variables that can affect transfer pricing. For future researchers, it is better to increase the samples, which are limited to mining companies and companies engaged in manufacturing, plantations, finance, and other sectors.

REFERENCES


Schuster, Peter. 2015. Transfer Prices and Management Accounting. Springer.
