TRANSFER PRICING PRACTICES: TAXES AND TUNNELING INCENTIVES

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Abstract

The purpose of this study is to examine the motives of companies to conduct transfer pricing practices that are triggered due to tax and tunneling incentives. This research is a descriptive verification study using multiple linear regression analysis tools assisted by the SPSS test tool. The research sampling technique used purposive sampling, where the number of research samples were 21 manufacturing companies in the food and beverage sector from 53 listed companies. The results found that tax affects the practice of transfer pricing, while tunneling incentives do not affect the practice of transfer pricing. Companies are more likely to transfer profits to companies through manipulation of transfer prices and tunneling incentives tend to do earnings management by transfer pricing.

Keywords: Tax, Tunneling Incentive Transfer pricing

1. Introduction

This study discusses transfer pricing practices that are influenced by taxation and tunneling incentives. Transfer pricing is a set of rules used by organizations to allocate shared income between responsibility centers (Atkinson et. Al., 2012). This means that the practice of transfer pricing was initially used by companies to assess performance between company divisions or between members within a decentralized company. However, along with the times, this transfer pricing practice is used to manage other things in such a way that is in the form of efforts to minimize the tax burden borne by the company (Hartati, 2014).

The practice of transfer pricing is due to increased cross-border transactions at multinational companies and the presence of the WTO (World Trade Organization) which facilitates transnational trade (Lingga, 2012). Multinational companies establish subsidiaries, branches and business representatives in various countries with the aim of strengthening and facilitating strategic alliances and metamorphosing the export and import market share of their products in various countries (Sumarsan, 2013).

One of the motives of companies in implementing transfer pricing is Tax, which tax is the largest source of state revenue. However, the practice of transfer pricing can cause the potential of state revenue to be smaller, even it can eliminate state revenue, so that it can have an impact on government efforts to develop the country (Maftuchan, 2013). Transfer pricing is not a new problem in taxation, especially in the case of international transactions that occur in multinational companies.

The government's view on transfer pricing believes it will have an impact on the reduction and even disappearance of a country's tax revenue potential, this is due to the large number of multinational companies shifting their tax obligations from countries that have high tax rates to countries with low tax rates (Santoso, 2004). The implementation of transfer pricing policy becomes an international tax issue, because the transfer pricing policy has shifted its function to reduce the tax burden by multinational companies (Klassen et al, 2013). However, the results of research conducted by Mispiyati (2015) did not find results that taxes affect transfer pricing decisions but there are other factors that can influence transfer pricing decisions, namely tax management with a cash effective tax rate.

In addition to taxation as a motive for transfer pricing decisions, there are also other motives, namely tunneling incentives. Tunneling incentive is a behavior of the majority shareholders who transfer the assets and profits of the company for their own benefit, but minority shareholders share in the costs they incur. One form of tunneling is the role of controlling shareholders in transferring company resources through special relationship transactions (Hartati et al., 2014). The controlling shareholder carries out tunneling activities aiming to temporarily transfer his assets to members or subsidiaries with transfer pricing in order to reduce the costs which can later reduce the company's profit. Research on tunneling incentives has been carried out by Yuniasih et al. (2012), and Mutamimah (2009) who found tunneling incentives had a positive effect on manufacturing company decisions in transfer pricing. Examples of tunneling are not distributing dividends, selling assets or securities of the companies they control to other companies they have at prices below market prices, and selecting family members who do not meet the qualifications to occupy important positions in the company (Zhuang, et. Al. , 2001).

2. Literature Review

2.1. Transfer pricing

According to Ralph S. Polimeni, "transfer pricing is the dollar base used to quantify the transfer of goods or services from one responsibility center to another responsibility center" (Lubis, 2009: 174). In addition, according to Cooper, the term transfer pricing is also often connoted as something that is not good (abuse of transfer pricing), namely the transfer of taxable income (taxation income) from a multinational corporation to countries with low tax rates in order to reduce total tax burden of the national group of companies (Cooper, 2004). In general, the purpose of transfer pricing is:

1. Can obtain relevant price information.
2. Facilitate price management and avoid price competition.
3. Can help manage cash flow subsidiary / branch company.
4. Minimizing the burden of taxation, import duties and shipping costs.
5. Motivate managers in achieving goals.

In addition, the purpose of transfer pricing is to first outsmart the profit amount so that tax payments and dividend payments are low. Second, inflating profits to polish (window-dressing) financial statements (Suryana, 2012). Transfer pricing is calculated by using the ratio of the ratio between the sales ratio of related party transactions and the total commodity sales to measure the transfer price strategy (Agnes, et.al, 2010).

2.2. The effect of tax on transfer pricing

Indonesia realizes that multinational companies are seen as having advantages in economic development, but from the other side multinational companies have negative impacts from the tax side, because they are able to carry out transfer pricing engineering to transfer Indonesia's tax potential to other countries for various reasons. There are two things that are of concern in the case of transfer pricing that can indicate tax evasion, namely affiliation (associated enterprises) or special relationship (arm's length principle) (Mispiyati, 2015).

Thus the company can carry out internal transactions in a company that is conditioned so that subsidiaries in Indonesia suffer losses, while the group of companies both inside and outside the country benefit, so in this case the company can reduce the tax burden in Indonesia (Rahayu, 2010). This condition supports the opinion of Gusnardi (2009), Bernard, et. al. (2006), Swenson (2001), Yani (2001), and also supported by Yuniasih, et. al. (2012) which states that by minimizing the corporate tax burden by transfer pricing thereby increasing profits. To measure tax in this study using the effective tax rate (ETR). Effective tax rate (ETR) is a comparison of the value of the tax rate that is the company's obligation. ETR is taken from the financial statements issued by the company so that ETR is obtained from the calculation of tax rates on companies (Yuniasih, et. Al., 2011; Marfuah & Azizah, 2014; Mispiyanti, 2015).

Taxes are the motivation of multinational companies to behave in transfer pricing, meaning that multinational companies carry tax burden transfers from countries with higher tax rates to countries with more taxable tax rates, so this behavior will minimize the corporate tax burden globally. In addition, according to Sikka & Willmott (2010), Davies, at. al. (2014), Barker, at. al. (2017) which states that the practice of determining transfer pricing is very responsive to opportunities in determining value in ways that are important for increasing personal profit, by avoiding public tax payments, and proves that transfer pricing has become a vehicle where many corporations divert their income to low tax jurisdiction even to areas where the tax rate is zero percent.

Based on the description above, it can be stressed that the decision of the company to practice transfer pricing is one of them motivated by taxation, where tax is the final result of multiplication of tax rates and calculation of the total profit and loss that is deceived in such a way through transfer pricing which is used to transfer the actual potential tax imposition with various excuses, reasons, and justifications for the engineering so that the total profit and loss obtained is lower than it should be charged in accordance with general tax provisions.

2.3. The Effect of Tunneling incentives on Transfer pricing

Tunneling is the behavior of the largest shareholders who collaborate with management to transfer assets and profits of the company in their own interests, while the burden of losses is borne by minority shareholders (Zhang, 2004). This type of tunneling can be seen in the form of actions such as loan guarantees, selling prices below market prices, manipulating dividend payments. (Aharony et. al., 2010). The structure of share ownership is concentrated in controlling rights and the authority of cash flow held by certain parties, such as family, or management, so that the increase in power of cash flow held by majority shareholders will have an impact on incentive increases (Mispiyati, 2015). This supports the statement of Jian & Wong (2008) which states that when a company has an excess of financial resources, controlling shareholders will move the resources for their interests rather than distributing them as dividends. The way that majority shareholders often do expropriation is through related party transactions.

Related party transactions are most likely used as tunneling, because the price of transactions with related parties may differ from independent party transactions. These related party transactions can be in the form of sales or purchases that are used to transfer cash or other current assets out of the company through pricing that is inappropriate or reasonable for the interests of the controlling shareholder. The related party transactions can be in the form of sales or purchases that are used to transfer cash or other current assets out of the company through price fixing not in the market for the benefit of the controlling shareholder. Then the controlling shareholder will gain power and incentives in the company. Thus, Jian & Wong (2008) states that when companies have excess financial resources, controlling shareholders will move resources for their own interests or tunneling rather than distributing them as dividends. Yuniasih et. al., (2012) states that tunneling incentives affect the decision making of manufacturing companies in transfer pricing. Tunneling incentives are measured by the percentage of shares owned by an institution of more than 20% as the largest controlling shareholder (Yuniasih et. al., 2012; Marfuah & Azizah, 2014; Misiyanti, 2015).

3. Research Methods

The object of research or variables in this study consists of transfer pricing, taxes, and tunneling incentives which will be tested using descriptive verification methods. Research that aims to describe each variable and verify or look for influence between research variables. Data analysis uses regression analysis with SPSS tools. Testing of this study uses data from food and beverage sector manufacturing companies listed on the Indonesia Stock Exchange by determining the sample using purposive sampling. The number of samples of this study were 21 of 53 companies with 2013-2018 observation years

4. Results and Discussion

The results of the study found that tax affects the practice of transfer pricing while Tunneling Incentive does not affect the practice of transfer pricing, as shown in table 1.

Table 1. Results of statistics test

Variabel	**R Square**	**B Value**	**Signification Value**	**Signification Standard (alpha**	**Decission**
Tax → Transfer Pricing	0.304	-0.536	0.038	0.05	Efect
Tunneling Incentive →Transfer Pricing		-0.542	0.086	0.05	No Effect

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This study explains that the influence of taxes on transfer pricing decisions because of the decrease in the amount of tax will indicate an increase in corporate behavior making transfer pricing decisions, but conversely if the tax has increased, it can be indicated that companies have low behavior on the practice of transfer pricing decisions.

This condition is the same as the result of the effect of tunneling incentives on the transfer pricing decision. The interpretation of the regression equation can be seen from the tunneling incentive coefficient value of -0.542, which states that if tunneling incentive has increased by one unit, it will not increase the transfer pricing decision by -0.542. Conversely, if tunneling incentive decreases by one unit, it will not reduce the decision of the transfer pricing practice by -0.542, because the tunneling incentive variable has no effect on the transfer pricing decision.

4.1. The Effect of Tax on Transfer Pricing Decisions

Transfer pricing is the determination of prices or rewards in connection with the delivery of goods, services, or technology transfer between companies that have a special relationship (Lubis, 2009: 174). The results showed that tax has an influence on the transfer pricing decision. The results of this study are in line with research conducted by Sari & Mubarok (2018), Agnes et. al. (2010), and Marfuah & Azizah (2014) who found that taxes negatively affect transfer pricing.

The results in this study identify that the smaller or lower taxes paid by looking at the effective tax rate obtained by the company, the greater the company is indicated to do the practice of transfer pricing with parties who have special relationships at home and abroad. With the occurrence of this phenomenon, there will be more possibilities for companies that practice transfer pricing, which in turn will reduce taxes to be received in a country, resulting in lower tax payments globally. In addition the transfer pricing practice is used to increase the profits of registered companies when corporate income tax rates decrease, which will increase corporate profits in the future through potential investors if management compensation is determined by reference to looking at corporate profits.

In other words, the practice of transfer pricing is carried out to outsmart the profit in terms of inflating profits to window-dressing financial statements, so that the State has lost trillions of rupiah due to foreign transfer pricing practices in Indonesia. This condition is in line with the statement stating that transfer pricing is a systematic manipulation of engineering with the intention of reducing artificial profits, making it appear as if the company is losing money, which is aimed at the company to avoid taxes or import duties in a country (Lubis, 2009: 174).

The results of this study are not in line with the results of research conducted by Noviastika, et. al. (2016), Deanti (2017), Yuniasih (2012), Klassen, et. al. (2013), and Marfuah, et. al. (2014) who found a positive effect of tax on corporate transfer pricing decisions. This condition can be indicated because the previous researchers used the operationalization of the transfer pricing measurement by giving a value of 1 to have a special relationship and 0 to those who did not have a special relationship, and the analysis technique used was also different namely logistic regression analysis. In the measurement of transfer pricing conducted, the majority of all companies listed on the Indonesian stock exchange have a special relationship with several companies, rarely companies listed on the Indonesian stock exchange that do not have a special relationship, therefore there is no variation to explain transfer pricing.

4.2. The Effect of Tunneling Incentive on Transfer Pricing Decisions

According to Hartati et. al. (2014) which states that tunneling incentive is a behavior of the majority shareholders who transfer the assets and profits of the company for their own benefit, but the minority shareholders also bear the costs they charge. The results of this study indicate that tunneling incentives have no effect on transfer pricing decisions. The results of this study are not in line with Noviastika, et. al. (2016), Deanti (2017), Yuniasih (2012) who found a positive effect of tunneling incentives to the indication of transfer pricing practices. However, the results of this study are in line with research by Wafiroh & Hapsari (2015), Melani (2016), Nugraha (2016) who found tunneling incentives have a positive and significant effect on transfer pricing practices, this is indicated because tunneling incentives are proxied by controlling share ownership, or controlling that the existence of a controlling shareholder does not affect the management in transfer pricing.

5. Conclusion

This study was conducted to examine the effect of taxation, tunneling incentives, on transfer pricing decisions on industrial consumer goods companies listed on the IDX. The results of the study found that tax affects the transfer pricing decision, this shows that registered tax companies enjoy a decrease in corporate tax rates, where companies are more likely to transfer profits to listed companies through manipulation of transfer prices. Tunneling incentives have no effect on transfer pricing decisions, it was found that tunneling incentives tend to compensate for each other in such a way that there is no earnings management to transfer pricing that can be seen.

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