The Role of Tunneling in Doing Transfer Pricing

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ABSTRACT

Transfer pricing practices carried out by companies by shifting profits from countries with high tax rates to countries with low tax rates, so as to minimize the tax burden in an effort to maximize company profits. In fact, tax revenue on income from multinational companies is a very significant part of tax revenues in the total tax revenues in the countries where these multinational companies operate. This study aims to determine the effect of profitability and taxes on transfer pricing with tunneling as a moderation variable. The study used secondary data as many manufacturing companies listed on the Indonesian Stock Exchange in 2019-2022. Sample selection using purposive sampling method which resulted in 40 manufacturing companies. This study used linear regression analysis with SPSS tools. The results of this study show that profitability and taxes have a significant positive effect on transfer pricing. Furthermore, tunneling is able to moderate the effect of profitability and taxes on transfer pricing.

Introduction

Transfer pricing is a transaction of goods and services at unreasonable prices between several departments in a group of companies, either by increasing or decreasing mostly carried out by multinational companies (Suyana, 2012). Trade in the world is more than 60% generated from transactions related to multinational companies using transfer pricing schemes (Darussalam, et al, 2013). The scheme carried out by multinational companies in the practice of transfer pricing is by shifting their profits from countries with high tax rates to countries with low or zero tax rates, so as to reduce the tax burden in an effort to maximize company profits. In fact, tax revenue on income from multinational companies is a very significant part of tax revenues in the total tax revenues in the countries where these multinational companies operate.

Transfer pricing is the determination of prices related to the delivery of goods, services or the transfer of technology between companies that have a special relationship along with a systematic price manipulation engineering with the intention of artificial profit reduction, which is made as if the company is experiencing losses so as to avoid taxes or duties in a country. There are a number of factors that cause a company to decide to carry out transfer pricing activities (Suandy, 2011).

Taxes become so important for the State because the largest source of state revenue comes from Taxes (Hambani &; Warizal, 2017). Tax is a mandatory contribution for
individuals to the state that has met certain requirements like taxpayers, where contributions are fairly used for the welfare of the wider community (Ratnawati, 2012). Tax revenue always increases compared to non-tax revenue (Setiawan & Y. Rohmatiani, 2019). Thus, Companies feel that being tucked into taxes will harm their companies, so many things are done by a company in order to minimize tax payments to a country, so they will avoid paying taxes. One way that a company does is by carrying out transfer pricing activities (Indariaswari, 2017).

To prevent the transfer of taxable profits, tax authorities in various countries make regulations on strict transfer pricing provisions, such as the application of sanctions or penalties, careful research of several cost elements, documentation requirements, and tax audits that can lead to transfer pricing corrections. The existence of such corrections can cause conflicts, if done without facts, approaches and methods that apply in international taxation. Thus, this transfer pricing problem does not only involve between taxpayers and tax authorities of a country, but also involves between two or more tax authorities in different countries. Therefore, the importance of a provision on transfer pricing in a country to determine which countries are entitled to tax profits generated by companies that carry out their business in more than one country. In addition, transfer pricing provisions are also a legal guide for multinational companies in carrying out their transfer pricing policies.

The occurrence of transfer pricing is due to low profitability and high taxes and even the role of tunneling that strengthens transfer pricing. The purpose of this study was to determine the effect of profitability and taxes on transfer pricing with tunneling as a moderation variable. The novelty of the study is to add the tunneling variable as a moderation variable, because previous research has not used tunneling as a moderation variable. The research data uses manufacturing companies because there is often transfer pricing between companies.

Literature Review

Profitability

Profitability is a ratio that measures the effectiveness of the entire management expressed by a measure of the level of profit associated with sales and investment (Fahmi, 2012). Profitability is defined as a company's ability to benefit from its business (Sunyoto, 2013). A profitability ratio is a ratio designed to measure a company’s ability to generate profits from sales, assets or equity. The ability to make a profit from sales may vary between companies in different businesses (Husnan and Pudjiastuti, 2015).

Tax

Tax is a contribution to the state treasury based on the law (which is forced) by not getting lead services, which can be directly shown and used to pay general expenses (Agoes, Sukrisno, & Trisnawati, 2013). Taxes are the main component of state
revenue, therefore taxes must be increased so that national development can be carried out (Nursheha & Trisni, 2014). The Tax Law (Law No. 36 of 2008) states that the tax burden is a mandatory contribution to the state owed by an individual or entity that is coercive based on the law, with no direct compensation and used for state purposes for the greatest prosperity of the people.

**Tunneling**

Tunneling is the transfer of resources out of a company for the benefit of controlling shareholders (Johnson et al., 2000). Tunneling is the activity of transferring assets and profits out of the company for the benefit of the company's controlling shareholders (Johnson et al., 2000) Wafiroh and Hapsari (2015) said that tunneling can be done by selling company products to companies that have relationships with managers at lower prices compared to market prices, maintaining their positions or job titles even though they are no longer competent or qualified in running its business or selling company assets to companies that have relationships with managers (affiliated parties) (Wafiroh and Hapsari, 2015).

**Transfer Pricing**

The notion of transfer pricing can be divided into two types, namely broad understanding and narrow understanding. Broadly speaking, transfer pricing is the value of goods or services that are moved from one accountability center to another. While transfer pricing in a narrow sense is the value of goods and services transferred between two or more profit centers (Riyadi, 2017). Transfer pricing is defined as the price charged when one part of a company provides goods or goods to another part of the same company (Garriison, et al, 2007).

**Research Hypothesis**

**The Effect of Profitability on Transfer Pricing.**

Profitability is one of the performance indicators applied by management in managing company wealth which is expressed as profit generated or can be said to be the company's ability to manage profits. If the company's profitability is high, then the transfer pricing index will be lower, but if the company's profitability is low, then the transfer pricing index will be higher in the future (Ginting et al., 2020). The company is low, so the transfer pricing index will be higher in the future (Ginting et al., 2020). The company generates large profits to attract investors related to the profits earned. Management uses a transfer pricing strategy to increase profits so that agents can get additional incentives in the form of bonuses (Adelia & Santioso, 2021). Based on research conducted by Roslita (2020), T. tri Rahayu et al. (2020), Sari & Mubarok (2018), stated that there is an influence of profitability on transfer pricing. Based on the description above, the hypothesis of this study is as follows.

**H1: Profitability has a positive effect on transfer pricing.**

The effect of taxes on transfer pricing.
Transfer pricing practices carried out by companies are by shifting their profits from countries with high tax rates to countries with low tax rates (Darussalam, 2013). Thus the company's obligation to pay taxes will be smaller than it should be. This can be detrimental to the state, therefore tax authorities in various countries make strict provisions on transfer pricing, such as the application of sanctions or penalties, careful research of several cost elements, documentation requirements, and tax audits that can cause transfer pricing corrections (Darussalam, et al, 2013). Thus, transfer pricing not only involves between taxpayers and the tax authorities of a country, but also involves between two or more tax authorities in different countries. This is supported by the results of research by Noviastika (2016), Refgia (2017), Purwanto and Tumewu (2018), and Agustina (2019) which states that taxes have an influence or influence on transfer pricing. Based on the description above, the hypothesis of this study is as follows.

**H2: Taxes affect transfer pricing.**

The effect of profitability on transfer pricing with tunneling as a moderation variable.

Profitability is an indicator of management performance to manage company assets by generating high profits (Malik, 2020). Companies with a high level of profitability mean that the company generates high profits as well. As a result, major shareholders will carry out more tunneling activities aimed at transferring company assets or profits to subsidiaries through transfer prices to reduce the cost of reducing those profits. The higher the controlling rights held by major shareholders, the greater the tendency of major shareholders to enter into transactions with parties who take advantage of themselves. Meanwhile, listed companies must distribute dividends to minority shareholders (Malik, 2020). Companies with ownership concentrated in one party tend to tunnel within the company through transfer pricing agreements. In addition, the higher the company's profitability, the higher the tunneling carried out by the majority shareholder, so the higher the transfer pricing between the company and related parties (Malik, 2020). Based on the description above, the hypothesis of this study is as follows.

**H3: Tunneling is able to moderate the effect of profitability on transfer pricing**

The effect of taxes on transfer pricing with tunneling as a moderation variable.

Taxes are people's contributions to the state treasury based on the law so that they can be imposed by not getting direct remuneration (Nugraha, 2016). Differences in tax burdens in multinational businesses are common, so countries with less developed companies often charge lower tax rates, while countries with developed companies actually impose high tax rates (Marfuah & Azizah, 2014). As a result, major shareholders will carry out more tunneling activities aimed at transferring company assets or profits to subsidiaries through transfer prices to reduce the cost of reducing...
those profits. High tax payments make companies avoid taxes, namely by transferring pricing. In transfer pricing activities, multinational companies with several branches in various countries tend to shift their tax obligations from countries that have high tax rates to countries that apply low tax rates (Refgia, 2017). The higher a country's tax rate, the more likely the company is to transfer pricing. The results of research by Saraswati & Sujana (2017), Kiswanto & Purwaningsih (2014), and Yuniasih, et al (2012) stated that taxes have a positive effect on transfer pricing.

**H4: Tunneling is able to moderate the effect of taxes on transfer pricing**

**Method**

The population of this study uses manufacturing companies listed on the Indonesia Stock Exchange for the 2019-2022 period. Researchers choose manufacturing companies because manufacturing companies include companies that run transfer pricing. Sample selection using nonprobability sampling method with purposeful sampling technique. The sample selection criteria are 1). Manufacturing companies listed on the Indonesia Stock Exchange for the period 2019-2022, 2). Manufacturing companies that present financial statements in rupiah, 3). Manufacturing companies that did not suffer losses in 2019-2022, 4). Manufacturing companies that present complete financial statements for the period 2019-2022, 5). Manufacturing companies not controlled by foreign companies with a percentage of share ownership of less or more than 20%, because one of the indications is tunneling, 6). Manufacturing companies that have subsidiaries abroad. The measurement of tax variables is measured by the Effective Tax Rate (ETR) with the following formula.

\[
ETR = \frac{Tax \ Expense - Differed \ Tax}{Profit \ Before \ Tax}
\]

The variable profitability is measured by ROA with the following formula.

\[
ROA = \frac{Net \ Profit}{Total \ Assets}
\]

The tunneling variable is measured by the number of largest share holdings divided by the number of outstanding shares with the following formula.

\[
TNC = \frac{Largest \ Number \ of \ Share \ Holdings}{Number \ of \ Shares \ Outstanding}
\]

Transfer pricing is measured by related party receivables divided by the company's total receivables with the following formula:
This research data analysis technique uses linear regression analysis using the SPSS tool. The stages of analysis of this study are classical assumption analysis, t test and RMA test to test moderation variables.

Result and Discussion

This research data uses 40 manufacturing companies and the observation period of 2019-2022 (4 years) is $40 \times 4 = 160$ samples from the results of data collection using the purposive sampling method.

<table>
<thead>
<tr>
<th>Table 1 Descriptive Statistics</th>
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<tbody>
<tr>
<td></td>
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<tr>
<td>Profitability</td>
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<tr>
<td>Tax</td>
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<tr>
<td>Tunelling</td>
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<tr>
<td>Transfer Pricing</td>
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<td>Valid N (listwise)</td>
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</tbody>
</table>

Based on table 1 above, it is known that the amount of data ($n$) is 160. The following is a descriptive statistical explanation, namely the minimum, maximum and mean values of each variable, namely 1) Transfer Pricing variables have a minimum value of 0.00; maximum value of 0.97; average of 0.176, 2) The profitability variable has a minimum value of 0.00; maximum value of 1.31; The average is 0.0776. 3) Variable Tax has a minimum value of 0.07; maximum value of 10.67; The average is 0.9539. 4) Tunelling variable minimum value of 0.01; maximum value of 4.00; The average value was 0.1769.

Classical Assumption Tests include the Normality Test with the Kolmogorov Sminarnov (K-S) value of 0.673 and the Asymp value. Sig of 0.574 which is greater than 0.05. This means that the residuals in the study are normally distributed. Multicollinearity test results of tolerance and VIF values of all variables show a tolerance value greater than 0.1 and a VIF value less than 10 which means the regression equation model is free from multicollinearity. Heteroscedasticity test results, the significance value of all variables is greater than 0.05, which means that there is no influence between the independent variables on the absolute residual. Thus, the model made does not contain symptoms of heteroscedasticity. The results of the autocorrelation test showed that the Durbin-Watson value ($d$) was 1.753 with a
significance level of 0.05 (95%), with a total sample (n) of 137 and k as many as the number of variables (k) as much as 4, then obtained the table value \( d_l = 1.6613 \); \( du = 1.749 \). Thus showing the value of \( d_l < d < du \), which is \( 1.6762 < 1.753 < 1.749 \) which means it is free from autocorrelation.

### Table 2 MRA Test Results

<table>
<thead>
<tr>
<th>Coefficients</th>
<th>B</th>
<th>Std. Error</th>
<th>Beta</th>
<th>t</th>
<th>Sig./p-Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Constant)</td>
<td>2.153</td>
<td>.539</td>
<td></td>
<td>3.992</td>
<td>.000</td>
</tr>
<tr>
<td>Profitability</td>
<td>.025</td>
<td>.169</td>
<td>.019</td>
<td>4.146</td>
<td>.005</td>
</tr>
<tr>
<td>Pajak</td>
<td>.342</td>
<td>.193</td>
<td>.288</td>
<td>3.777</td>
<td>.007</td>
</tr>
<tr>
<td>Profitability* Tunneling</td>
<td>.013</td>
<td>.062</td>
<td>.028</td>
<td>3.211</td>
<td>.003</td>
</tr>
<tr>
<td>Tax* Tunneling</td>
<td>.258</td>
<td>.222</td>
<td>.191</td>
<td>2.162</td>
<td>.004</td>
</tr>
</tbody>
</table>

* Dependent Variable: Transfer_Pricing

Source: Output SPSS 24 (2023)

Table 2 shows that profitability has a positive effect on transfer pricing with a t-count of 4.146 greater than t-table 1.97743 and a significance value of 0.005 smaller than 0.05. Tax has a positive effect on transfer pricing with a t-count of 3.777 greater than t-table 1.97743 and a significance value of 0.007 less than 0.05. Tunneling is able to moderate the effect of profitability on transfer pricing with a t-count of 3.211 greater than t-table 1.97743 and a significance value of 0.003 smaller than 0.05. Tunneling is able to moderate the effect of taxes on transfer pricing with a t-count of 2.162 greater than t-table 1.97743 and a significance value of 0.004 smaller than 0.05.

### Discussion

**The effect of profitability on transfer pricing**

Based on the results of the t test that profitability affects transfer pricing, so the hypothesis in this study is accepted. Profitability is a company's ability to get profits, profits are obtained by the company from sales and investments made by the company, profitability can also describe the performance of management in managing the company. An increase in a company's profit can cause the amount of tax to be paid by the company to be higher as well, so there is a possibility for companies to do ways to reduce the amount of tax paid using transfer pricing. Transfer pricing practices that are usually carried out by companies are by adjusting transfer prices for transactions made between companies that have special relationships. This transfer price adjustment is made to be able to adjust the profit obtained, so that the tax rate paid by the company is lower. The more profitable the company, it will provide a positive signal for investors to get profits. There is a tendency for management to use transfer
pricing transactions to maximize the bonuses they will receive if the bonuses are based on company profits. So it can be concluded that managers will tend to take actions that regulate net income by using transfer pricing practices to maximize the bonuses they will receive. The results of this study are in accordance with research conducted by Junaidi and Yuniarti (2020).

The effect of taxes on transfer pricing

Based on the results of the t test that taxes affect transfer pricing, so the hypothesis in this study is accepted. There are many things that companies do to minimize their tax payments to a country. One way is to carry out transfer pricing actions. Transfer pricing transactions are often used by the company to minimize the tax burden that should be paid. In transfer pricing activities, multinational companies prefer countries that have small tax levies rather than countries with large taxes, by reducing selling prices between companies. This means that high tax levies will make companies carry out transfer pricing in order to get a low tax burden. Based on the findings of researchers, it appears that the average manufacturing company listed on the Indonesia Stock Exchange (IDX) carries out tax payments with a fairly low percentage compared to the company’s profit obtained before tax deductions, this is evidenced by the results of research that has been described earlier. So it can be concluded that the higher the tax burden that must be paid by the manufacturing company, the higher the company will also carry out transfer pricing. Conversely, the smaller the tax burden that must be paid by the company, the smaller the company will carry out transfer pricing. The results of this study are in accordance with research conducted by Refgie (2017) and Purwanto et al. (2018).

The effect of profitability on transfer pricing with tunneling as a moderation variable.

Based on the results of the t test that tunneling is able to moderate the effect of profitability on transfer pricing, so the hypothesis in this study is accepted. That is, the greater the shares owned by the controlling shareholder, the greater the opportunity for a company to transfer pricing. The more profitable the company, it will provide a positive signal for investors to get profits. Because if a subsidiary company purchases to the parent company using a price that is not in accordance with the fair price (more expensive), it will automatically provide benefits for the parent company.

The effect of taxes on transfer pricing with tunneling as a moderation variable.

Based on the results of the t test that tunneling is able to moderate the effect of taxes on transfer pricing, so the hypothesis in this study is accepted. The practice of tunneling is the activity of transferring assets in profits out of the company for the benefit of the controlling shareholder of the company. The role of tunneling in conducting transfer pricing is the tax motivation in transfer pricing in multinational companies is carried out in a way that moves income to the country with the lowest or
minimum tax burden where the country has a group of companies or divisions of companies operating. In transfer pricing practice, multinational companies tend to shift their tax obligations from countries that have high tax rates to countries that apply low tax rates by reducing the selling price between companies in one group. Therefore, the large tax burden triggers companies to carry out transfer pricing in the hope of reducing expenses.

Conclusion

The results of this research can be shown that profitability has a positive effect on transfer pricing. Taxes have a positive effect on transfer pricing. Tunneling is able to moderate the effect of profitability on transfer pricing. Tunneling is able to moderate the effect of taxes on transfer pricing. The limitation of this study is that the data used is still small, namely 40 manufacturing companies. The next means of research is to change the sampling criteria that are looser, so that more samples are used. In addition, further research tested the bonus variable as an independent variable because transfer pricing practices may have management importance to get bonuses.

References


