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Transfer Pricing of Manufacturing Companies in Indonesia

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ABSTRACT

This study aims to analyze the effect of the variables of Tax, Mechanism of Bonuses, Foreign Ownership, and Company Size on Transfer Pricing Transactions in manufacturing companies. The population of this study is manufacturing companies listed on the Indonesia Stock Exchange from 2014-2016. The samples were selected using purposive sampling method and obtained 20 companies or 60 units of analysis which were the object of observation. The technique of data analysis in this research is Partial Regression Analysis with the help of software SmartPLS version 3.0. The results of this study indicate that foreign ownership has a significant affects on transfer pricing transaction. Tax variables, bonus mechanisms, and company size have no significant effect on transfer pricing transactions. As many as four hypotheses submitted only one received, namely foreign ownership has a significant effect on transfer pricing transaction. The conclusions in this study indicate that the higher foreign ownership will affect the transfer pricing transaction. The higher the value of the tax variable, the bonus mechanism, and the size of company does not affect the transfer pricing transaction with the manufacturing companies.

INTRODUCTION

Study of Setiawan (2013) mentions the state losses 1,300 trillion per year for potential tax revenue. Even, Supriadi (2014) said the potential loss of state tax revenue is around 2,000 trillion rupiah per year. The loss of potential tax is due to the practice of transfer pricing done by the company. The practice of transfer pricing is an international tax issue for managing taxes (Muhammadi et al., 2016). Some cases occur in domestic and foreign companies. In Indonesia, PT Toyota Manufacturing Indonesia, which is the largest automotive factory from Japan, also practices transfer pricing to reduce costs. The Directorate General of Taxes accused PT Toyota Motor Manufacturing Indonesia avoided tax payments of Rp 1.2 trillion with transfer pricing. Even this case has remained in the Tax Court since the last trial in 2013 (Sugiharto, 2014).

Transfer pricing transaction in management accounting is defined as the price charged for a component by the seller's division to the buyer's division in the same company (Hansen & Mowen, 2016). Determination of the transfer price becomes unnatural because the determination is determined by the controlling company (Holtzman & Nagel, 2014). Multinational companies manipulate the determination of transfer pricing with the ultimate goal of maximizing global earnings and minimizing their global taxes by placing their affiliates in countries with very low or zero taxes (Amidu et al., 2011).

Transfer pricing is influenced not only by tax reasons, but also by non-tax reasons such as bonus mechanisms, foreign ownership, and company size. Studies conducted by Bernard et al. (2006), Fong et al.(2008), Hartati et al.(2015), and Noviastikaet al. (2016) state that tax and bonus mechanisms affect on transfer pricing transactions. Lin & Chang (2010) state that tax has no effect on transfer pricing. Irpan (2011) in his research finds a bonus mechanism has effect on earnings management. Research of Mispiyanti (2015) states that tax and bonus mechanisms have no effect on transfer pricing. Research of Nugraha (2016) finds that bonus mechanism has no effect on transfer pricing transactions. Research conducted by Kiswanto & Purwaningsih (2014) finds that foreign ownership has an effect and company size has no effect on transfer pricing transactions. Research conducted by Nurjanah et al. (2016) states that company size affects on transfer pricing transactions and foreign ownership does not affect on transfer pricing.

This research is intended to re-examine the effect

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of taxes, bonus mechanisms, foreign ownership, and company size on transfer pricing transactions. The population taken in this study are manufacturing companies listed on the Indonesia Stock Exchange in 2014-2016. Measurement of related party transactions of sales & expense (RPTSE) becomes a measurement in calculating the amount of transfer pricing which is one of the measurement tools that have not been used by previous researchers. Manufacturing companies are chosen because this type of company is the largest company in donating taxes. Besides, transfer pricing is also more often found in companies that are included in the type of Foreign Investors (PMA). Manufacturing companies are one of the companies most commonly found by foreign investors.

The theories underlying this research are agency theory and positive accounting theory. Agency theory is a developed theory by Jensen & Meckling (1976) that is describing the agency relationship as a relationship that occurs on the contract between management (agent) and shareholders (principals). Both parties are bound together and agree to work together, the principal employs a person or other party (agent) to carry out services and give authority to make decisions. Watts & Zimmerman (1990) stated that Positive Accounting Theory is able to explain why accounting policies become a problem for companies and interested parties with financial statements, and to predict accounting policies to be chosen by companies under certain conditions.

Tax variable in the study arises because researchers assume that principals or shareholders who have a desire for high corporate earnings thereby having a good reputation and certainly providing benefits for them will pressure agents or directors to do the things that shareholders want. Each party has their own interests. Various methods are carried out one of which is transfer pricing mechanism. Transfer Pricing is used as a mechanism of income transfer to reduce the tax burden of the multinational corporation (Rossing & Rohde, 2014). Manipulation of multinational corporate transfer prices considers the tax laws and regulations of the host country for price manipulation by transferring to countries with lower tax burdens at low prices, and transferring abroad to maximize group profits (Lin & Chang, 2010). Therefore, the fiscal authority views the purpose of transfer pricing is to avoid tax. Research conducted by (Hartati Winda et al., 2015) and Indrasti (2016) find that tax affects on transfer pricing transaction.

H_1: Taxes affect on transfer pricing transactions

The variable of bonus mechanism in this study is based on the hypothesis of bonus plan which states that company managers with bonus plans tend to improve their performance in order to get a bonus increase on the performance that has been achieved. Determination of bonuses based on the achievement of net income makes managers try with a variety of strategies to increase the amount of net income that can be generated. Management tends to utilize transfer pricing transactions to maximize the bonuses they receive if bonuses are based on earnings (Lo, Wong, & Firth, 2010). Studies of Hartati et al. (2015), Nurjanah et al.(2016), and Irpan (2011) find that bonus mechanisms affect on transfer pricing transactions.

H_2: Bonus mechanism affects on transfer pricing transaction

The variable of foreign ownership in this study is also based on problems that could arise due to differences in interests between principals or shareholders and agents or directors. The presence of foreign ownership has function to increase pressure on management to serve the interests of shareholders (Hamdan, 2018). In this variable, the source of the problem that occurs between the shareholders is more specialized where the shareholders can be categorized as controlling shareholders or non-controlling shareholders. Controlling shareholders carry out the practice of transfer pricing as an effort of expropriation. Studies conducted by Noviastika et al. (2016), Kiswanto & Purwaningsih (2014), Refgia (2017) and Mispiyanti (2015) find that foreign ownership affects on transfer pricing transactions.

H_3: Foreign ownership affects on transfer pricing transaction

The variable of company size is based on the hypothesis of political cost proposed in positive accounting theory. This hypothesis says that a company that has a large size means it has a large political cost. Much less transfer pricing depends on the size of a company (Refgia, 2017). Large-scale companies have high standards in its performance. Transfer pricing is done to manage earnings so that the company's credibility is maintained in the eyes of shareholders and creditors. Research conducted by (Nurjanah et al., 2016) and Prasetyo (2011) find that company size influences tax avoidance, one of which is transfer pricing.

H_4: Company size affects on transfer pricing transaction

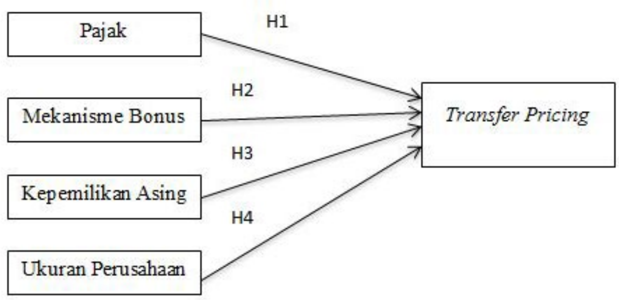

Figure 1. Research Model

RESEARCH MODEL

This research was an empirical study conducted on the manufacturing companies listed on the Indonesia Stock Exchange (BEI) in 2014-2016 using secondary data of the financial statements that were officially published on www.idx.co.id. Data collection technique of this research was a documentation technique. This research used a quantitative approach with a hypothesis testing research design. The sampling method used

Table 1. Sampling Procedure

No	Criteria	Number
1.	Manufacturing companies listed on the Indonesia Stock Exchange (IDX) in 2014	156
2.	The data of manufacturing companies in the form of financial reports or annual reports available on the IDX and have complete	(12)
3.	Publication of financial statements using the rupiah currency	(19)
4.	Manufacturing companies that present the size of the relationship related to sales and equity	(17)
5.	Companies do not experience a loss or have a positive earning	(52)
6.	Manufacturing companies which its outstanding shares are owned by foreign companies with ownership presentations of 20% or more	(36)
	Total sample companies	20

Source: data processed, 2018

Table 2. Operational Definition of Variables

Variables	Definition	Measurements/Indicators
Transfer Pricing	Transfer pricing is the price that occurs on a product or service as a result of transfers that occur between divisions within a company that have a related relationship (Nurjanah et al., 2016).	$TP = \frac{\text{RPTsales} + \text{RPTexpense}}{\text{Equity}}$
Taxes	Taxes are mandatory contributions to the state owed by individuals or entities that are coercive and are used for state purposes for the greatest prosperity of the people. Taxes are calculated by tax expense divided by taxable profit (Hanlon & Heitzman, 2010)	$ETR = \frac{\text{Tax expense i,t}}{Pretax\ Income\ i,t}$
Bonus Mechanism	Bonus mechanism is one of the motives for accounting calculations which has purpose to determine the amount of bonuses received by company directors (Irpan, 2011)	$ILB = \frac{\text{net profir t}}{net\ profit\ t-1}\ x100\%$
Foreign Ownership	Foreign shareholders are shareholders of foreign controlling companies that own company shares of 20% or more (Nurjanah et al., 2016)	$KEPMAS = \frac{\text{Total foreign share ownership}}{Total\ outstanding\ share} x100\%$
Firm Size	Firm size is a large or small size of a company (Refgia, 2017)	Size= Ln Total Asset

Source: data processed, 2018

was purposive sampling method and resulted 60 units of analysis. The sampling procedure is presented in table 1.

Based on the table, the sample in this study were 20 companies so there were 60 units of analysis during the period of 2014-2016. This study used five variables consisting of one dependent variable, namely transfer pricing and four independent variables including tax, bonus mechanism, foreign ownership, and company size. The operational definitions of the research variables are presented in Table 2.

Data analysis techniques to examine the hypothesis of this study are descriptive statistics and partial regression analysis with a significance level of 5%. The analytical tools used are using IBM SPSS Statistics 21 for descriptive statistical analysis and using SmartPLS 3.0 to test the inner model.

RESULTS AND DESCRIPTIONS

Descriptive statistics produce data about the description of endogenous and exogenous variables consisting of minimum, maximum, mean and standard deviation values. Endogenous variable in this study is transfer pricing which is measured by using a measure of the magnitude of the transaction value related to sales and equity. Exogenous variables in the study are tax, bonus mechanisms, foreign ownership, and company size measured by using effective tax rate (ETR) measure, net profit trend index, percentage of foreign ownership, and the natural logarithm of total assets. The following are the results of the descriptive statistics of this study:

The result of descriptive statistical test with the amount of data processed as many as 60 data from 2014-2016 in the table shows the transfer pricing variable with

Table 3. The Results of Descriptive Statistical Analysis

	N	Minimum	Maximum	Mean	Std. Deviation
Transfer_Pricing	60	.001	15.195	1.27735	2.977544
Taxes	60	-5.548	.514	.15349	.752576
Bonus_Mechanism	60	.263	4.141	1.16866	.698090
Foreign_Ownership	60	.251	.930	.58311	.213742
Firm_Size	60	11.804	19.383	14.61991	1.862064
Valid N (listwise)	60				

Source: Output of secondary data processed 2018 indicator of related party transaction of sales and expense (RPTSE) has the lowest value of 0.001 owned by PT Lionmesh Prima Tbk. This indicates that the company does the lowest related relationship transactions among other companies. Meanwhile, the company that does the highest transfer pricing in this study is PT Wilmar Cahaya Indonesia Tbk with a value of 15.195, which means the company was more maximizing transfer pricing transactions. The variable of transfer pricing on the RPTSE indicator has a mean value of 1.27735, which means that the average transfer price carried out by the sample companies is 1.277735 from the sales and equity transactions. This indicates that most of the sample companies do not maximize the transactions of transfer pricing. The standard deviation value of 2.977544 which is more than the average value indicates that the indicator data deviation is relatively large so the data range of transfer pricing in the RPTSE indicator is said to be less good.

The tax variable is measured by the effective tax rate (ETR) indicator, which is by reducing tax burden and deferred tax divided by taxable income. The smaller ETR results show the greater the tax avoidance. Based on the table of ETR, it shows the lowest value of -5.548 and the highest value of 0.514 with a standard deviation of 0.752576. The lowest value is owned by PT Indo Acidatama Tbk, which means the company is the biggest in terms of tax avoidance and shows that the company maximizes the transactions of transfer pricing as the company's efforts to minimize the amount of tax. The highest value is owned by the company of PT Indo Acidatama Tbk. The company does the lowest tax avoidance even without avoiding it because it has deferred tax from the previous year which can cover the tax burden that must be paid. The standard deviation of the ETR indicator is greater than the average value that is 0.15349 indicating that the deviation of data is less good. The mean value of the sample company indicates that most companies do not avoid tax through the practice of transfer pricing.

The variable of bonus mechanism in this study is measured by the index of net profit trends, namely the percentage of achievement of the net profit in the year t to the net profit in t-1. The table shows that the lowest value is 0.263 and the maximum value is 4.141 with a standard deviation of 0.698090. The lowest value of the bonus received by the directors is owned by PT Lionmesh Prima Tbk which shows that the company gives the lowest bonus amount among the other sample companies. Then the highest value is owned by PT Japfa Comfeed Indonesia Tbk which means the company gives the biggest bonus among the other sample companies. The standard deviation of the indicator of the net profit trend index is smaller than the mean value that is 1.16866 indicating that the data deviation is good. In addition, seen from the mean value of the net profit trend index indicator indicates that the average sample companies do not provide a large bonus to management.

The variable of foreign ownership in this study is measured by the percentage of foreign share ownership in the structure of share ownership. The table shows that the lowest value is 0.251 and the highest value is 0.930 with a standard deviation of 0.213742. The lowest value is owned by PT Nippon Indosari Corpindo Tbk which shows that the number of foreign share ownership who control the company is the lowest among the other sample companies. The highest value owned by PT Darya-Varia Laboratoria Tbk means that the number of foreign shareholders who control the company is the highest among the other sample companies. The standard deviation of the indicator of the percentage of foreign share ownership is smaller than the average value of 0.58311, indicating that the data deviation is good. The mean value shows that the ownership of controlling foreign shares invested in the sample companies is in the average range of 58.311%.

The variable of company size is measured by the indicator of natural logarithm of total assets. The table shows the lowest value of 11.804 and the highest value of 19.383 with a standard deviation of 1.862064. The lowest value owned by PT Lionmesh Prima Tbk shows that the company is the lowest among other companies in the amount of assets or wealth owned. The highest value owned by PT Astra International Tbk shows that the company is the highest among other companies in the amount of assets or wealth owned. The standard deviation of the indicators of total assets natural logarithm is smaller than the mean value of 14.61991, indicating that the data deviation is good. The mean value of 14.61991 indicates that the sample companies in this study are, on average, classified as medium or not giant companies.

The value of the coefficient of determination can be showed on the value of the Adjusted R-square value. The value of the Adjusted R-square is 0.099. This means variables of taxes, bonus mechanisms, foreign ownership, and company size can explain transfer pricing of 9.9% and the remaining 90.9% is explained by other factors outside the independent variables in this study. The results of hypothesis testing can be seen in Table 4.

The effect of tax on transfer pricing transactions

Tax has a negative and insignificant effect on transfer pricing. This means that tax avoidance efforts

Table 4. Results of Hypothesis Testing

	Hypothesis	Original Sample	Sig.	P Value	Results
H_1	Tax have an effect on transfer pricing	-0.005	0.05	0.972	Rejected
H_2	Bonus mechanism has an effect on transfer pricing	0.192	0.05	0.294	Rejected
H_3	Foreign ownership has an effect on transfer pricing	0.332	0.05	0.009	Accepted
H_4	Company size has an effect on transfer pricing	0.038	0.05	0.599	Rejected

Source: Output of secondary data processed 2018 have no relevance to the implementation of transfer pricing in companies, in other words large or small tax paid does not affect the companies in conducting the transactions of transfer pricing. The companies continue to do transfer pricing transactions regardless of the small or large of the effort carried out in minimizing the tax burden. This is reinforced by the existence of a sample company which at one time was the lowest company in paying taxes but in another year it was the highest company in paying taxes. The company is PT Indo Acidatama Tbk.

The result of the study is not in accordance with agency theory in which conflicts occur because of differences in interests, namely the interests of shareholders who want maximum profit and managements want adequate compensation for their performance. All parties have personal interests and feel they need to be prioritized, this is thought to cause conflict. However, according to the result of the study, the companies and the shareholders can cooperate with each other in fulfilling desires without ignoring the interests of other parties. The companies can try to minimize the tax burden without having to do unlawful ways by carrying out tax smuggling or tax evasion that is not justified through a transfer pricing scheme that aims to reduce the tax burden in order to generate high final earnings. The companies may try to minimize or avoid the tax burdens in ways that are not illegal and permissible such as avoiding tax sanctions and penalties, choosing business forms and investments with the lightest tax burden, utilizing tax facilities, avoiding non-deductible costs in taxation and in correction of transfer pricing.

This study is in line with the study of Mispiyanti (2015) which results that the tax does not have a significant effect on transfer pricing. According to Suandy (2011) in Mispiyanti (2015) in its development, the company's efforts to minimize the tax burden that must be paid can be done through tax management.

The Effect of Bonus Mechanism on Transfer Pricing Transactions

The bonus mechanism has a positive but not significant effect on transfer pricing. Seen from the direction of a positive relationship, it is concluded that the higher the value of the bonus given to the directors, the greater the amount of transfer pricing transactions undertaken by the company. However, giving bonuses to the board of directors in the company do not relate to the implementation of transfer pricing transactions.

The result of the study contradicts with the positive accounting theory which proposes a hypothesis regarding bonus plans. The hypothesis of bonus plan states that managers with bonus plans want high profits in each period. If their rewards depend on the bonuses reported on net income, then the possibility is they can get an increase in bonuses in that period by reporting the highest net income possible. However, in fact, according to the result of research that receiving bonuses does not have relationship with the practice of transfer pricing. Transfer pricing transactions that are expected to make efficient costs and create high final profits as well as become the basis for calculating bonuses are apparently not entirely correct. Looking at the data in the sample companies, transfer pricing transactions tend to be static in each company and each year. Still, the net earnings generated tend to fluctuate or change. This indicates that the amount of net earnings is not only influenced by transfer pricing transactions. Because, the main purpose of transfer pricing transactions is efficiency.

The result of this study is in line with Indrasti (2016) which states that the bonus mechanism has no effect on transfer pricing. The research states that bonuses promised by company owners to directors which are able to improve the company's financial performance do not make directors motivated to do transfer pricing activities.

The Effect of Foreign Ownership on Transfer Pricing Transactions

Foreign ownership has a positive and significant effect on transfer pricing. This means that controlling share ownership owned by foreign influences the company's decision to do transfer pricing. The greater the shares controlled by foreigners, the more chance the company will have in maximizing transfer pricing transactions.

The result of the study is in line with agency theory where conflicts occur because several parties have interests that are prioritized over other interests. Differences in access to information bridge the occurrence of conflict between controlling shareholders and non-controlling shareholders. Controlling shareholders have greater access to information and influence company decisions. The controlling shareholders, especially from foreign parties, provide greater opportunities in the company's decision to do transfer pricing transactions. The controlling shareholders from foreign countries are better able to provide proposals or input to the companies regarding matters that occur outside the company, especially abroad regarding the rules or regulations applicable to the scheme of transfer pricing. This is what can be thought of by management in making decisions on the practice of transfer pricing.

The result of this study is in line with Refgia (2017) which states that the greater the level of foreign ownership in a company, the greater the influence of foreign shareholders in determining various decisions in the company including the the policy of pricing determination.

The Effect of Company Size on Transfer Pricing Transactions

Company size has a positive and insignificant effect on transfer pricing. This means that the greater an asset that is owned, it will also increase the amount of the transfer price transaction by the company. However, company size has no relevance to the company's decision in the practice of transfer pricing.

The result of the study is not in line with the positive accounting theory that proposes a political cost hypothesis. The political cost hypothesis introduces a political dimension to the selection of accounting policies. Very large companies may be subject to higher performance standards, with respect for environmental responsibility. If large companies also have foreign competition, it might lead to decreased profitability. One of the ways to do this is to adopt an accounting policy of income decreasing in order to convince the government that profits are declining. Transfer pricing transactions become the choice of how accounting policies can make revenue decrease with various mechanisms that are felt to achieve company goals.

The result of this study indicates that companies classified as large companies have no effect on the practice of transfer pricing. In fact, the greater the size of a company will make the company itself more careful because it becomes the attention of various parties. If the company does matters that are not in accordance with applicable law or norms, it will make the company lose trust and appreciation from various parties. The ability to achieve high profits, the political costs can be enlarged. The companies can face political costs at certain times.

The result of this study is in line with Refgia (2017) that a company which size is relatively larger will be seen by its performance by the public so that the directors or managers of the company will be more careful and transparent in reporting their financial condition.

CONCLUSIONS

The conclusion of this research is that foreign ownership affects on the transfer pricing transaction while taxes, bonus mechanisms, and company size do not affect on transfer pricing transactions

This research still has several limitations. Most of the hypotheses are not accepted and it is probable that further research can examine better. Suggestions for further research are to be able to add other variables that affect transfer pricing like tariff and / or increase the time span of the study and use other proxy alternatives such as sales, cash ETR and the amount of compensation in measuring variables of company size, taxes, and bonus mechanism in order to get better results. The amount of transfer pricing transactions that are considered to be carried out by many manufacturing companies as seen from the size of the company shows no effect. Further research can try to examine companies engaged in other fields besides manufacturing, namely service companies in the telecommunications subsector.

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