The Influence of Profitability, Leverage and Firm Size on Company Decisions to Practice Transfer Pricing

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ABSTRACT

The research is based on the fact that there are still many cases of transfer pricing practices in various companies. The aim is to test whether the effect of transfer pricing is influenced by profitability, leverage and firm size. This type of research is quantitative using the explanatory method. The sampling technique used purposive sampling with a total sample of 41 companies. This type of research includes quantitative data analysis. Data analysis uses panel data regression. The results show that there is a positive effect of profitability and leverage on transfer pricing, while there is a negative effect of firm size on transfer pricing.

Keywords*:* Profitability, Leverage, Firm Size and Transfer Pricing.

INTRODUCTION

In the era of the global economy, business and investment are currently growing rapidly without knowing the boundaries of a country. Therefore, many companies are educating many subsidiaries in various countries in order to strengthen their global business to become more strategic and increase their market share [1, 2]. However, since the existence of policies related to GATT and WTO, business processes between countries have become easier [3, 4]. This makes many domestic companies begin to develop into multinationals with various activities involving subsidiary companies in other countries (Brilianty, 2015). In their activities, multinational companies often have business transactions between companies that are related or have special relationships [5].

The relationship between special taxpayers can occur due to the ownership of share capital of 25% by one or several entities (Law No. 36/2008). The existence of a special relationship can cause price/cost irregularities in a transaction [6, 7]. Pricing/cost irregularities in a multinational transaction due to a special relationship are known as transfer pricing practices. This practice is one of the problems in the field of taxation because it can lead to reduced / lost potential tax revenue. This is usually done to minimize the amount of tax paid by shifting tax obligations from countries with high tax rates to countries with lower rates through international transactions with affiliated companies[8, 9].

Some examples of transfer pricing cases include Starbucks in the UK. Starbucks recorded sales in 2011 of £398 million, but Starbucks did not pay corporate taxes. In addition, in 2018, Starbucks claimed to have suffered a loss of £112 million. In fact, based on reports in the US, Starbucks made a big profit in the UK from 2008-2010 of £1.2 billion, but on the grounds that Starbucks never paid taxes. Starbucks has been operating in the UK for 14 years, but the taxes paid are only £8.6 million. Another case is the tax paid by Google in the UK for only $6 million even though it scored $398 million in revenue in 2011. In addition, the same case occurred for Amazon in the UK, which paid only $1.5 million in taxes even though it scored $3.5 billion in sales in 2011 [10].

In Indonesia, a similar case occurred with Toyota Motor Manufacturing Indonesia (TMMIN) related to claims for refunds (restitution) filed for overpayment of taxes in 2005, 2007, and 2008. However, after the Director General of Taxes conducted an examination of TMMIN's annual SPT, several irregularities were found. . These irregularities were, for example, related to the 30% drop in profit from 1.5 trillion (2003) to 950 billion (2004), then in 2003 Astra sold most of its shares in TAM to TMC Japan on the grounds that there were debts that had to be paid immediately, so that when Currently TMC Japan owns 95% of TAM's shares. In addition, Astra and TMC Japan cooperated by establishing a sole agent company in the domestic market with Astra controlling 51% of the shares. As a result of the restructuring, the company's combined profits plummeted, at the same time sales and production turnover rose 40%. From the results of the tax audit, it was found that there were irregularities related to the alleged game of sales transaction prices and increased costs through improper royalty payments due to the delivery of 100 cars that were sent first to Singapore before going to the Philippines and Thailand [11]. In addition, PT Adaro Energy Tbk is also accused of tax avoidance by means of transfer pricing. An investigation conducted by the NGO International Global Witness found that Adaro sold coal to a subsidiary in Singapore at a low price, which then resold at a high price. This makes the potential for Indonesia's tax revenue to be reduced from the original $125 million [12, 13].

LITERATURE REVIEW

Transfer Pricing

Transfer Pricing is an effort to allocate wealth by an affiliated inter-country company by setting unreasonable transaction prices in order to reduce taxable revenues.

$$\text{Transfer Pricing} = \frac{\text{A/R Related Party Transaction}}{\text{Total Account Receivable}} \times 100\%$$

Profitability

Profitability is the company's ability to manage assets to generate profits within a certain period (Munawir, 2014).

$$\text{ROA} = \frac{\text{EBIT}}{\text{Total Asset}} \times 100\%$$

Leverage

Leverage is the company's ability to meet short/long term debt. Leverage also describes the extent to which the company's debt is compared to the company's capital [14].

$$\mathrm{DER} = \frac{\text{Total Debt}}{\text{Total Equtiy}} \times 100\%$$

Firm Size

Firm size is a small scale of a company that can be seen from total assets, sales, profits, and so on [15].

$$\text{Firm Size} = \mathrm{Ln}\ (\text{Total Asset})$$

Framework

The Influence of Profitability on Transfer Pricing

Profitability as measured by ROA shows the company's financial performance in maaging assets to generate profits. The high ROA shows the amount of profit achieved by the company, it has an impact on the high tax burden of the company. The high tax burden makes companies tend to take action to reduce taxes. The high tax burden of a company is influenced by the high profit earned by the company. The higher the profitability, the higher the alleged attempt by the company to practice transfer pricing [16].

The Influence of Leverage on Transfer Pricing

Leverage is the company's ability to meet short/long term debt. Leverage also describes how much debt the company has. The high debt of the company has an impact on the high interest expense on debt which is often used as a deduction from pre-tax profit. Companies also often manage debt by utilizing transfer pricing by acquiring debt from subsidiaries/branches of affiliated companies that have low tax rates [17].

The Influence of Firm Size on Transfer Pricing

Transfer pricing practices can also be determined by the scale of a company. Companies with high asset values are likely to have good long-term performance prospects. This makes large-scale companies get more attention from the public/government so that companies tend to be more careful in financial reporting, especially when they want to practice transfer pricing [17]. In addition, small-scale companies are suspected to show good performance tend to practice transfer pricing. Therefore, the larger the scale of a company, the lower the possibility of transfer pricing practices [18].

Below will be presented a picture of the framework of thought as a form of research flow of thought, namely as follows:

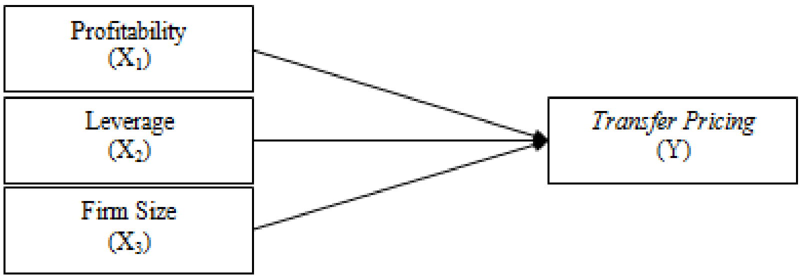

Figure 1.1 Framework

Research Hypothesis

H_1 : There is a positive effect of profitability on transfer pricing.
H_2 : There is a positive effect of leverage on transfer pricing.
H_3 : There is a negative effect of firm size on transfer pricing.

RESEARCH METHODOLOGY

This type of research is quantitative using the explanatory method. The sampling technique using purposive sampling obtained a sample of 41 manufacturing companies listed on the IDX for the 2016-2020 period. Types and sources of data are secondary. The data collection technique uses documentation studies in the form of financial reports from the IDX website. The independent variables are profitability, leverage, and firm size, while the dependent variable is the prevention of transfer pricing fraud. Data analysis using panel data regression.

RESULTS AND DISCUSSION

Results

Table 1

Panel Data Regression Analysis

Information	Coefficient
Constant	14.425
Profitability	0.257
Leverage	0.084
Firm Size	-0.615
Source : Eviews output Result	
$Y=14.425+0.257X_1+0.084X_2-0.0615X_3$	

Based on table 1, it is known that profitability and leverage have a positive influence on transfer pricing, while company size has a negative influence on transfer pricing.

Table 2

Partial Hypothesis Testing

Information	T Value	Prob Value	Result
Profitability	3.166>1.972	0.0019<0.05	H1 Accepted
leverage	2.876>.972	0.006<0.05	H2 Accepted
Firm Size	3.394>.972	0.006<0.05	H3 Accepted

Based on table 2, it is known that partially there is a positive effect of profitability, leverage and firm size on transfer pricing.

Table 3

Simultaneous Hypothesis Testing

Information	F Value	Prob Value	Result
Profitability, leverage, Firm Size	2.911>2.649	0.001<0.05	H4 Accepted

Based on table 3, it is known that there is a simultaneous effect of profitability, leverage and firm size on transfer pricing.

Table 4

Coefficient of Determination

Information	Value	Percentage
R- Squared	0.4373	43.73%

Based on table 4, it is known that the magnitude of the influence of profitability, leverage and company size on transfer pricing is 43.73%.

Discussion

The Influence of Profitability on Transfer Pricing

The results showed that there was a positive effect of profitability on transfer pricing. It can be explained that profitability as measured by ROA shows the company's financial performance in managing assets to generate profits. The high ROA shows the amount of profit achieved by the company, it has an impact on the high tax burden of the company. The high tax burden makes companies tend to take action to reduce taxes (Dewinta and Setiawan 2016; Hidayat, 2018). The high tax burden of a company is influenced by the high profit earned by the company. The higher the profitability, the higher the alleged attempts by the company to practice transfer pricing (Cahyadi and Noviari, 2018). This result is supported by Sari and Mubarok (2018), Richardson (2013), and Cahyadi and Noviari (2018) which state that transfer pricing affected by profitability.

The Influence of Leverage on Transfer Pricing

The results of the study show that there is a positive influence of leverage on transfer pricing. It can be explained that leverage is a ratio that describes the company's ability to meet short/long term debt. Leverage also describes how much debt the company has. The high debt of the company has an impact on the high interest expense on debt which is often used as a deduction from pre-tax profit (Rezky and Fachrizal, 2018). Companies also often manage debt by utilizing transfer pricing by acquiring debt from subsidiaries/branches of affiliated companies that have low tax rates (Dyreng, Hanlon, and Maydev, 2008). This result is supported by Roslita (2020), and Cledy and Amin (2020) stating that transfer pricing is influenced by leverage.

The Influence of Firm Size on Transfer Pricing

The results showed that there was a negative effect of firm size on transfer pricing. It can be explained that the practice of transfer pricing can also be determined by the scale of a company. Companies with high asset values are likely to have good long-term performance prospects. This makes large-scale companies get more attention from the public/government so that companies tend to be more careful in financial reporting, especially when they want to practice transfer pricing (Pujiningsih, 2011). In addition, small-scale companies are suspected to show good performance tend to practice transfer pricing (Refgia, 2017). Therefore, the larger the scale of a company, the lower the possibility of transfer pricing practices (Kusumasari et al, 2018). This result is supported by Kiswanto and Purwaningsih (2014), Cledy and Amin (2020), and Kusumasari et al (2018) which state that transfer pricing is influenced by firm size.

CONCLUSIONS AND SUGGESTIONS

Conclusions

1. There is a positive effect of profitability on transfer pricing.
2. There is a positive effect of leverage on transfer pricing.
3. There is a negative effect of firm size on transfer pricing.

Suggestions

1. The government can be wiser in asserting and clarifying regulations regarding transfer pricing through the application of the principle of fairness in special relationship transactions so that companies can apply fair prices in order to reduce abuse of transfer pricing practices so that state tax revenues will also be higher.
2. Further research is recommended to add other variables that may affect the company's decision to transfer pricing such as tax variables, bonus mechanisms, exchange rates and tunneling incentives.
3. Future research is expected to extend the research period so that it can produce better research results and conclusions.

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