

Determinants of Transfer Pricing Aggressiveness in Indonesia

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ABSTRACT

The objective of this empirical research is to examine the major determinants of transfer pricing aggressiveness in Indonesia. This research used a sample of multinational companies listed in the Indonesian Stock Exchange (IDX) from the period of 2010 to 2012. The data analysis was based on the company's financial statements generated from the IDX. Transfer pricing aggressiveness was measured by TPRICE index, which consists of items that represent occurrences of non-arm's length transactions. Six determinants of transfer pricing aggressiveness were tested in this study, including firm size, profitability, leverage, intangible assets, multi-nationality and tax haven utilisation. To test the model, multiple regression analysis was applied. Based on the results, the authors discovered that firm size and leverage are positively associated with transfer pricing aggressiveness, while intangible assets and multi-nationality are negatively associated. This study also shows that profitability and tax haven utilisation are not related to transfer pricing aggressiveness.

Keywords: Transfer pricing, tax avoidance, arm's length principle, Indonesia

INTRODUCTION

Reese et al. (1989) defined a multinational enterprise (MNE) as either a public or private corporation that owns at least one foreign subsidiary or affiliate division. In the last few decades, many companies have expanded their operation to overseas markets as part of their business strategy to increase their size. A study conducted by the World Trade Organization (World Trade Organization, 2007) showed that half of the largest economies

received contribution from corporations, out of which approximately 70% of worldwide trade in the past 20 years was generated from Multinational Enterprises (MNEs). By operating in overseas markets, MNEs are able to un-tap opportunities that are

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not available in the local market due to differences in the competitive advantages among nations such as access to raw materials, access to customers, cost of production, technology advancement, infrastructure maturity etc. (Ernst & Young, 2011).

These MNEs reflect the increase in economic integration among nations (Rugraff & Hansen, 2011). Aligned with the activities by MNEs, the number of cross-border transactions between related parties increased in the form of trade of goods and services, transfer of intangible assets, flow of fund etc. (Conover & Nichols, 2000). The statistics indicate that 30% of current international transactions come from intra-group trade (United Nations, 2013). Cross-border transactions are not always driven by commercial reasons but are conducted instead for tax purposes (i.e. tax arbitrage due to different taxation regulation among nations), and this practice leads to popularity of transfer pricing practices (hereinafter referred to as 'TP').

The Organisation for Economic Cooperation and Development (2003) defined TP as the price at which to buy and sell goods and services between parties that are related. The transaction may be conducted by a person or an entity that has special relationship with the corporation. Hence, the intra-group transaction is purposely structured such that the profit is shifted and reported in the low-tax country as much as possible while the cost is recorded in the high-tax country. This practice is against the arm's length principle

(Bernard et al., 2006). The arm's length principle is a condition wherein terms of transactions to a related party are the same as those applied to an independent party.

Global taxes that are influenced by non-arm's length conditions are further facilitated by tax haven countries (Dharmapala, 2008). OECD (2006) conducted an extensive study that is revised regularly and reports 39 tax-haven countries. Those countries provide a favourable tax regime by charging foreign investors zero or low withholding-tax rates. They allow the shifting income from high-tax to low-tax jurisdiction countries and shifting expense in opposite directions (Hamilton et al., 2001). Those TP practices have led to TP aggressiveness, which causes tax avoidance, and is significantly lower in corporate tax payments for the group as a whole (Sukanto, 2013). In fact, Agus Martowardojo, former Indonesian Minister of Finance, was quoted in an MUC Consulting Group report (2013) as claiming that 4,000 multinational firms based in Indonesia had not paid corporate tax in seven consecutive years. Kontan newspaper pointed out in a report that potential losses of tax revenue in Indonesia during 2009 due to transfer pricing was approximately 1.3 trillion rupiah (Yani, 2010). All this indicates the existence of MNEs and signals that an increasing number of foreign operations have existed in Indonesia. The many issues that have arisen regarding tax avoidance through TP practices prompted this research, which has as its objective the examination of the major determinants of TP aggressiveness in Indonesia.

LITERATURE REVIEW

Transfer pricing is the price used to transfer either tangible or intangible assets among entities in a group. OECD (2013) defined transfer pricing (TP) as “shifting of risks and intangibles, the artificial splitting of ownership of assets between legal entities within a group, and transactions between such entities that would rarely take place between independents” (p.6). TP, thus, is the price used to transfer either tangible or intangible assets among entities in a group.

Transfer pricing is currently a crucial issue because it is difficult to determine the price considered as effective in transferring assets between entities in the same group (Holmstrom & Tirole, 1991). It would be easy if the related price were available as that could be used as a reference point. For instance, the price of commodities is obviously available in the market, but the price of proprietary goods and services or intangibles is not. As a result, it is easy to determine whether the transactions on commodities to related parties are arm's length, but this becomes a complicated task when it comes to the proprietary ones. The price charged to acquire those goods and services, however, can significantly influence global taxes.

Hypothesis Development

Firm size. Tax planning activities consume resources, such as human resource and money and time. Wahab and Holland (2012) stated that the fee from related tax activities is the second largest source of income for UK accounting firms. As it needs additional

efforts, a company needs to consider tax planning carefully, particularly the availability of resources. The economics of scale theory states that there is a competitive advantage as a result of an increase in a firm's size of operations that leads to a decrease in unit cost. By producing and selling more products, a company has the ability to invest in specialist expertise (Manktelow, 2014). Hiring specialists may seem expensive at the beginning; however, their presence enables a company to improve quality and increase efficiency in production with the same amount of input. Hence, this additional cost of employees can be offset.

From the financial point of view, operating a bigger size of company may indicate that more assets can be used by a company as collateral. Therefore, it offers an opportunity to acquire borrowings with a lower interest rate. In relation to tax avoidance, Siegfried (as cited in Rego, 2003, p. 810) pointed out that larger firms have the ability to recruit more employees, play a role in the political process and construct activities to optimise tax saving. Corporations are able to gain access to expertise particularly in tax planning, which aims to reduce corporate tax payment with a lower average cost as referred to in the economics of scales theory. As a result, larger firms are more aggressive in organising tax planning strategies than smaller firms (Siegfried, 1972; Stickney & McGee, 1982; Porcano, 1986; Conover & Nichols, 2000). Shackelford et al. (2007) also stated that larger firms are likely to shift their income for tax purposes. As

they grow bigger, they are more efficient in exploiting and arranging tax avoidance (Mills & Maydew, 1998). These advantages significantly increase the incentives for companies to reduce corporate tax liabilities by being more aggressive in applying TP practices. Hence, the following hypothesis is formed:

H1: Firm size is positively associated with transfer pricing aggressiveness

Profitability. Economies of scale also exist in companies that have larger pre-tax income. Firms with greater income before tax have more incentives to reduce their tax payment by shifting their income to a low-tax jurisdiction or by transferring tax deductible expenses to high-tax nations (Womack & Drucker, 2011; Duhigg & Kocieniewski, 2012). Rego (2003) argued that companies with greater pre-tax income have resources to participate in tax avoidance activities. Further, Rego explained that companies that gain more profit have a tendency to formulate transactions to avoid tax payment.

Wilkie (1988) and Wilkie and Limberg (1993) found that profitability is negatively associated with effective tax rates (ETR). ETR is used to measure group or overall corporate tax payment, which is calculated by dividing corporate tax payment with the total pre-tax income. Companies with the same amount of income may have different ETR. A lower ETR indicates the company is more effective in tax planning activities that aim to reduce corporate tax payments. Research into the relationship

between profitability and ETR has shown that profitable companies have more ability to pay less than the overall corporate taxes. In other words, the more profitable the company, the lower is its overall corporate tax payment.

Wilkie (1988) also conducted research that showed that companies with more profit have higher capability to apply the tax preference theory. Tax preference refers to components such as debt financing and intangible assets that allow pre-tax income that is different from taxable income. Companies that make a higher profit are more likely to have more preferences or items to engage in tax planning activities to reduce corporate tax payments. Thus, our next hypothesis is:

H2: Profitability is positively associated with transfer pricing aggressiveness

Leverage. Leverage is used to show how much debt is used in order to finance a firm's assets. Basically, capital is structured either according to debt or equity. The total of both types of capital of a company reflects its total financing capacity. Debt is considered lower than equity due to tax benefits and limited obligation to lenders. Debt is claimed as a tax deductible item. The payment of interest to a lender is part of the expenditure allowed in an income statement, while payment of dividend to equity holders is part of retained earnings. Hence, debt gives more benefit in terms of tax purposes for the borrower. Debt can be taken advantage of as a tax-deductible item

in a financial statement, specifically in the expenses section in an income statement.

Firms with high leverage are likely to take opportunity of tax avoidance by structuring its debt (Grubert et al., 1991; Newberry & Chaliwal, 2001; Dyreng et al., 2008). This is done by acquiring debt from group members located in low-tax regions (Hines, 1996; Rego, 2003; Dyreng et al., 2008) and incurring the interest in high-tax areas. Hence, companies in high-tax jurisdictions can have additional expenses to deduct from their tax payment. Mills and Newberry (2004) showed that companies with a high leverage report lower ETR. A previous study conducted by Bernard et al. (2006) also stated that firms with debt higher than equity are more aggressive in planning their tax system. Further, it is common that multinational companies transfer debt/equity between group members (Richardson et al., 2013).

Thin capitalisation rules exist as a tax-avoidance rule to restrict interest deduction when the debt-to-equity ratio is considered excessive. OECD (2013) stated that these rules may enable the limiting of transfer of debt done by related parties; however, companies are able to organise a scheme of debt transference through an independent third party. Hence, there is still a possibility of using debt in reducing overall tax payment.

The shifting of profit through a debt scheme is also motivated by tax arbitrage opportunities. Tax arbitrage is a strategy to exploit different tax rate rules of different countries. Corporations

with high-tax jurisdiction acquire debt from group members located in low-tax regions (Hines, 1996; Rego, 2003; Dyreng et al., 2008) to have tax-deduction items (i.e. interest expense) to include in their income statement. A hypothesis regarding firm leverage impact on transfer pricing aggressiveness was therefore developed as follows:

H3: Firm leverage is positively associated with transfer pricing aggressiveness

Intangible assets. OECD member countries and other countries that adopt the arm's-length principle believe that the principle provides broad parity on how taxes should be applied when MNE groups and independent parties transact. The arm's-length principle treats firms in MNE groups (related parties) and independent enterprises equally to prevent neither of them from being advantaged or disadvantaged for tax purposes. The arm's-length principle works effectively in various cases, such as in commodities. The prices of commodities, as an indicator to determine arm's-length transactions, are readily available in the market. They enable purchase and sell activities such as conditions and circumstances to be compared between independent and dependent parties. There are also other methods from the financial perspective that are used to make relevant comparison of transactions such as net profit, gross profit and mark-ups on cost. There are, however, many cases where

applying the arm's-length principle is difficult and complicated, such as unique intangibles.

Issues regarding the arm's-length principle arise when companies under the same group transfer their intangible assets, such as royalties (Gravelle, 2010). Intangibles are acknowledged as highly flexible and less fixed to a particular time and place. Transfer of intangible assets incurs significant risks of transfer pricing aggressiveness due to variability in interpreting valuations and difficulties in determining accurately under which intangible assets the transactions occur (Grubert, 2003). Such activities may be different from those engaged in by independent enterprises. As a result, there is no clear evidence on how the transaction of intangibles should be undertaken. Hence, they can be transferred between nations as a way to reduce corporate tax payments by shifting income internationally (Hanlon et al., 2007; Shackelford et al., 2007; Dyreng et al., 2008).

Intangibles, for instance, new invention of foods, are difficult to be valued and compared because of market price unavailability. Subjective reviews also may be involved in deciding the most appropriate terms of transactions and can lead to difficulties in determining whether the conditions of transactions are arm's-length. As a result, the characteristics of those intangibles' may open great opportunities to transfer pricing aggressiveness through transfer intangibles between entities in a group with different corporate tax rates (Shackelford et al., 2007). Our hypothesis

regarding intangible assets is presented as below:

H4: Intangible assets are positively associated with transfer pricing aggressiveness

Multinationality. Companies that operate overseas have significantly more opportunity and incentive in shifting their profit and escaping tax through cross-border transactions (Slemrod, 2001; Rego, 2003). Slemrod (2001) also claims that multinational companies are facilitated by various tax avoidance mechanisms and approached to reduce their tax liabilities significantly.

Tax non-compliance is done by exploiting the differences in tax rules between countries and the changes in tax distribution from what is intended or suggested by tax law (Conover & Nichols, 2000; Rego, 2003; Hanlon et al., 2007). Hanlon et al. (2007) also stated that successful non-compliance by one corporation will trigger other entities to do the same as a means of avoiding additional payment. Some observers believe that multinational corporations have greater opportunity to relocate their profits from one jurisdiction to another than companies operating domestically i.e. only in one location (Rego, 2003).

Rego (2003) found that multinational enterprises have lower worldwide ETRs than do domestic-only companies. The discovery indicates that companies with extensive foreign operations do transfer

pricing more aggressively by shifting income from high-tax locations to low-tax locations; this allows multinational firms to pay less corporate tax than do companies that operate in the same location. This led to the next hypothesis regarding multinationality i.e:

H5: Multinationality is positively associated with transfer pricing aggressiveness

Tax haven utilisation. Tax haven is a jurisdiction that applies favourable tax regimes to both its residents and non-residents. OECD (1998) defined a set of criteria to identify tax-haven countries, including zero or low taxes, absence of effective exchange of information and absence of transparency. These criteria are advantages and reasons why non-residents are able to escape tax payments in their country of residence.

Tax havens open opportunities for entities to operate in high-tax territories to indulge in tax avoidance activities by shifting their profits to zero or nominal tax territories (Desai & Dharmapala, 2006; Slemrod & Wilson, 2009). Tax havens apply strict confidentiality rules and have laws and administrative practices to avoid sharing information between tax authorities on taxpayers benefiting from those countries. Hence, other countries do not have access to information regarding what their residents do in tax havens. Tax havens give advantages to taxpayers by keeping their income unreported in the source country. They hide

information regarding source of income invested in their jurisdictions.

Tax havens facilitate tax planning activities, which aim to reduce corporate tax payments significantly, through transfer pricing practices (Grubert et al., 1991; Hines & Rice, 1994). They allow transfer of goods or services from countries with high tax rates to those with low tax rates at the lowest transfer price and transfer goods or services out of those countries at the highest transfer price. For instance, company A, which runs a business in country A with a 25% corporate tax rate, has a subsidiary B in a tax-haven country. It sells product X that costs IDR95,000 to its customer in country A for IDR175,000 per piece. A tax-avoidance activity would be to sell product X to subsidiary B for IDR100,000 each, then have subsidiary B sell to customers in country A for IDR175,000 each. Hence, the taxable income of company A in country A is only IDR5,000 instead of IDR80,000, without considering other costs or expenses.

Prior research conducted by Dyreng and Lindsay (as cited by Mills, 2012) shows that firms incorporated in tax havens have lower ETR due to an increase in incentives to reduce overall corporate tax payment. It is done by establishing operations in or sourcing intangibles to low-tax jurisdictions and allocating the income or expense to camouflage firm performance as a whole.

Harris et al. (1993) found that multinational companies in the US have lower corporate tax liabilities with the existence of tax havens. This is indirectly used as proof that firms with tax-haven subsidiaries lead

to transfer pricing aggressiveness (Slemrod et al., 2009). Furthermore, tax-haven incorporated entities play a significant role for the whole corporate group. They are able to influence the corporate group as a whole, including business, treasury and service functions. Hence, the presence of tax-haven incorporated firms will affect accountability and transparency of the entire corporate group (Desai et al., 2007). A hypothesis regarding tax haven utilisation, thus, is as follows:

H6: Tax-haven utilisation is positively associated with transfer pricing aggressiveness

METHODOLOGY

There were 447 publicly-listed Indonesian entities for the year 2012. However,

the sample used was 93 multinational companies due to the exclusion of financial firms (62), insurance companies (11), companies without overseas subsidiaries, which were considered non-multinational companies (251) and companies that did not report earnings in 2010-2012 (30). In total, there were 279 financial reports to be analysed. This number was derived from multiplying 93 companies by three, as the financial reports of three years, 2010-2012, were used.

In this study, the relationship between variables is presented using the multiple regression model. This was modified from the regression model created by Richardson et al. (2013).

$$TPRICE_{it} = \alpha_{it} + \beta_1 SIZE_{it} + \beta_2 PROFIT_{it} + \beta_3 LEV_{it} + \beta_4 INTANG_{it} + \beta_5 MULTI_{it} + \beta_6 THAV_{it} + \beta_7 -15INDSEC_{it} + \epsilon_{it}$$

Table 1
Dependent Variables and Measurements

Category	Variable	Measurement
Dependent variable	TPRICE	Transfer pricing index, ranging 0-100% from each company's mean of criteria as follows: <ol style="list-style-type: none"> 1. The existence of interest-free loans between related entities 2. The existence of debt forgiveness between related entities 3. The existence of impaired loans between related entities 4. The provision of non-monetary consideration without commercial justification 5. The absence of formal documentation to support selection of appropriate arm's-length methodologies or the formal documentation regarding related parties transactions 6. The disposal of capital assets to related entities without commercial justification 7. The absence of arm's-length justification for transactions between related entities 8. The transfer of losses between related entities without commercial justification

(i=listed multinational companies on the Indonesian Stock Exchange (excluding financial institutions, banks and insurance and securities companies; ϵ =error).

Variables and Measurements

TPPRICE represents the dependent variable. It consists of eight dichotomous items that can be found in notes to financial statement, particularly in the receivables, loans and related party transactions sections. These items aim to measure the occurrence

of non-arm’s-length transactions that lead to the percentage of transfer pricing aggressiveness.

This research used ‘sum-score’ approach, which has been successfully applied in other research, particularly in the development of corporate governance indices (Brown & Caylor, 2006; Bebchuk et al., 2009) and accounting disclosure indices (Salter & Niswander, 1995; Zarzeski, 1996; Lanis & Richardson, 2012). The higher the percentage of the overall result, the higher the level of transfer pricing aggressiveness.

Table 2
Independent Variables and Measurements

Category	Variable	Measurement
Independent variables	1. Firm size (SIZE)	Natural logarithm of total assets
	2. Profitability (PROFIT)	Natural logarithm of pre-tax income
	3. Leverage (LEV)	Long-term debt divided by total assets
	4. Intangible assets (INTANG)	A dummy variable (1 if the company has payment of royalties with related parties, otherwise 0)
	5. Multi- nationality (MULTI)	Total number of company's foreign subsidiaries divided by total number of company's subsidiaries
	6. Tax Haven Utilisation (THAV)	A dummy variable (1 for the entity with at least one subsidiary company incorporated in an OECD (2006) listed tax haven, otherwise 0)

There were six independent variables in this research, including firm size (SIZE), profitability (PROFIT), firm leverage (LEV), intangible assets (INTANG), multi-nationality (MULTI) and tax-haven utilisation (THAV), and each variable measurement is reflected in Table 2.

FINDINGS AND DISCUSSION

This research included all the multinational companies listed on the Indonesia Stock Exchange for the year 2010 to the year 2012 based on the criteria discussed in Part 3. Table 3 below shows the multiple regression results.

Table 3
Regression Results

Variables	Expected Sign	Coef	Sig	VIF
Constant		0.036		
SIZE	+	0.014	0.092*	1.737
PROFIT	+	-0.004	0.347	1.67
LEV	+	0.19	0.007***	1.195
INTANG	+	-0.084	0.014**	1.085
MULTI	+	-0.1	0.025**	1.151
THAV	+	0.033	0.133	1.184
R sq.			0.113	
Adj. R sq.			0.094	
F-stat			0	

***significant at $\alpha=0.01$ **significant at $\alpha=0.05$ *significant at $\alpha=0.10$

The regression showed the acceptance of the first hypothesis at 10% significance level with a coefficient of 0.014. As shown above, there was a significant positive relationship between firm size (SIZE) and transfer pricing aggressiveness (TPRICE). The result was supported by the theories expressed in Part 2, which stated that bigger companies are more aggressive in conducting tax planning to minimise the payment of corporate tax. This finding was also consistent with findings Shackelford et al. (2007), who claimed that larger firms have a tendency to shift income for tax purposes through transfer pricing practices. As larger firms have more resources and opportunities, they have bigger incentives to construct tax planning. The advantages owned by bigger corporations refer to the economics of scale theory; this was also the conclusion reached by Conover and Nichols (2000), Porcano (1986) and Stickney and McGee (1982) in their research. They concluded that these advantages pushed

bigger companies to utilise the opportunity to reduce corporate tax payment.

Profitability variable (PROFIT) has -0.004 of correlation coefficient and 0.347 of p-value. It indicates an insignificant outcome as well as a negative association with TPRICE. There is no significant relationship between profitability and transfer pricing aggressiveness. The finding is not aligned with the studies of Rego (2003), Womack and Drucker (2011), and Duhigg and Kocieniewski (2012), which prove that firms with higher pre-tax income have more incentives to formulate transactions to shift their income or to transfer expenses to reduce tax payment. The result contradicts the expected outcome, and implies that profitability is irrelevant in affecting transfer pricing aggressiveness in Indonesia to reduce corporate tax payment.

Firm leverage (LEV) has a significant as well as positive relationship with transfer pricing aggressiveness (TPRICE). It is highly significant under $\alpha=0.01$. Further,

the correlation coefficient was in positive sign (0.190). The result confirmed that the higher the leverage of a firm, the more aggressive a company was in doing transfer pricing activities. This is consistent with previous research conducted by Bernard et al. (2006), which concludes that firm leverage did have a significant effect on transfer pricing aggressiveness. This is also in line with the earlier studies of Grubert & Harry (1995), Newberry & Chaliwal (2001) and Dyreng et al. (2008) that firms that are highly-leveraged have more opportunity to avoid corporate tax payment through debt structuring between group members. It enables companies to deduct their profits through the payment of interest as a result of intra-group loans. Therefore, pre-tax income becomes smaller; consequently, the payment of corporate tax liability is reduced. The finding of a positive relationship between firm leverage and transfer pricing aggressiveness is also supported by the discovery of Mills and Newberry (2004) that concluded that lower ETR is owned by companies with higher leverage. Lower ETR (reduction of total tax burden of overall group tax payment) indicates that companies have achieved tax savings.

Intangible assets that are represented by royalty have a significant effect at $\alpha=0.05$ to TPRICE as dependent variables; nevertheless, the coefficient of -0.084 indicates a negative relationship that is different from the expected sign. It is not possible to prove that the existence of royalties in companies can increase the level of transfer pricing aggressiveness. Instead,

companies with royalty payments decrease the practice of transfer pricing. This result is inconsistent with the studies of Shackelford et al. (2007) and Hanlon et al. (2007) that states that intangibles are difficult to be valued and compared. This opens great opportunities for transfer between firms within a group for tax purposes. One explanation might be due to tight regulations that particularly regulate transaction of royalties in Indonesia. The Regulation of the Director General of Taxation No. PER-32/PJ/2011 issued on November 11, 2011 as an amendment to PER 43/PJ/2010 requires certain conditions that indicate arm's-length intra-firm royalty payment assessed through specific tests called a three-step process. Firstly, there should be proof of intangible property (IP) ownership against the IP existence. Secondly, there should be tangible benefits generated by the payee towards the receipt of royalty payments. Thirdly, an arm's-length test should be passed in assessing the payment. The first two requirements need to be met before proceeding to the third step (Phan & Gupta, 2012). Other regulations exist to avoid corporate tax payment through intra-firm royalty payments. The Regulation of the Director General of Taxation No. Per-61/PJ. /2009 regulates the procedure and implementation of tax treaties. It ensures the prevention of misappropriation of tax treaties. Bilateral tax treaties between Indonesia and other countries are made not only to avoid double taxation but also to reach the agreement of arm's-length transfer prices (OECD, 2008). A section in

the tax treaty discusses royalty transactions in detail. It specifies the definition of royalty, how taxes are charged on royalty and at what rate, and so forth, so the presence of a tax treaty helps to prevent transfer pricing practices that aim to avoid corporate tax payment. Therefore, due to the tight regulation on royalty in Indonesia, the existence of royalties in multinational companies listed in the IDX does not increase the transfer pricing aggressiveness. Therefore, the finding that of a negative relationship between intangible assets and aggressiveness of transfer pricing is reasonable.

Multi-nationality was significantly negative in affecting transfer pricing aggressiveness. As a result, the fifth hypothesis is rejected at a significant level of 0.05 with a coefficient of -0.100. The outcome indicates that the more foreign subsidiaries companies have, the fewer transfer pricing activities they perform. This contradicts results by Hanlon et al. (2007), Conover and Nichols (2000) and Slemrod (2001), who found that companies with foreign operations have more chances and courage to escape taxes. This is done by exploiting tax rules differences between countries through various transfer pricing practices. These findings are not applicable in Indonesia as there are almost no transactions between companies and their foreign subsidiaries used in the sample based on the notes to the companies' financial statements. This might be because foreign subsidiaries that are formed by Indonesian listed companies may act as

dormant companies and the existence of assets owned by foreign dormant companies is not disclosed in detail in the financial statement of parent companies. According to a glossary published by OECD (2008), a dormant entity is a "legally alive and has legal personality, but does not carry on any activity and has neither employment nor turnover" (p.73). As a result, there were almost no transactions recorded between companies and their foreign subsidiaries referred to in the notes to the companies' financial statements. However, dormant entities have a potential risk of transfer pricing misappropriation, such as activities of dormant companies with intercompany creditors and net assets/investments (OECD, 2012). This is because there are several cases where dormant companies are purposely established only to hold an asset or intellectual property without having to comply with transfer pricing requirements (Department for Business Enterprise & Regulatory Reform, 2009).

Tax-haven utilisation showed a positive relationship with a coefficient correlation of 0.033. The result aligned with the expected sign as stated in the hypothesis that the existence of tax-haven countries positively impacts the aggressiveness of transfer pricing practices. However, the variable was not significant either at $\alpha=5\%$ and $\alpha=10\%$. This indicates that tax-haven utilisation was not significant to transfer pricing aggressiveness. This may prove the findings of Richardson et al. (2013). Their study found that tax-haven utilisation was in line with transfer pricing aggressiveness

but the result was insignificant. Therefore, the existence of tax-haven countries does not really affect the tax planning to avoid payment of corporate tax.

CONCLUSION

Transfer pricing aggressiveness reflects the activities that are purposely structured to avoid corporate tax payment. This research was conducted to examine major determinants of transfer pricing aggressiveness in Indonesia, particularly the factors that support multinational companies to conduct those practices. Six determinants were tested in this study, including firm size, profitability, leverage, intangible assets, multi-nationality and tax haven utilisation. This research found that firm size (SIZE) and leverage (LEV) were major determinants of TP aggressiveness in Indonesia. On the other hand, profitability (PROFIT) and tax haven utilisation (THAV) were not found as determinants, whereas intangible assets and multi-nationality were negatively significant in relationship to TP aggressiveness.

There was a positive significant relationship between firm size (SIZE) and transfer pricing aggressiveness (TPRICE) that was measured by using total assets. This finding implies that total assets of companies affect the aggressiveness of transfer pricing. The result was aligned with the expected hypotheses, which predicted a positive significant relationship between the variables. It was also in line with the greater opportunities and incentives that bigger companies have that can lead to transfer

pricing aggressiveness. There was also a positive significant relationship between company leverage (LEV) and TPRICE which is measured using total long-term debt divided by total assets. The result indicated that the higher the leverage, the more aggressive companies are in doing transfer pricing.

The result of this study contradicts the expected hypothesis on positive significant relationship. There was a significant negative relationship between INTANG and TPRICE that was examined through the existence of royalties. The outcome implies that the existence of royalties lessens the transfer pricing aggressiveness. The expected hypothesis is not applicable in Indonesia, which may be due to tight regulation and specific procedures to be fulfilled to prove arm's-length royalty transactions. There was also a significant negative relationship between MULTI and TPRICE that was quantified by dividing total foreign subsidiary with total subsidiaries. The result reflected that the higher the percentage of foreign subsidiaries that companies owned, the lower was the aggressiveness of transfer pricing activities. The outcome may be due to foreign subsidiaries that act as dormant entities. They do not carry on businesses but are allowed to hold assets or intellectual property.

The outcome of this study indicated that there was no significant relationship as predicted hypothesis. PROFIT, which is presented by total pre-tax income, and TPRICE were not significantly related. This means that the profitability of a company

does not really give impact to transfer pricing activities. THAV, which is measured by the existence of subsidiaries listed under tax-haven countries published by OECD in 2006, and TPRICE were insignificantly related. It indicated that the presence of subsidiaries located in tax-haven countries did not affect the aggressiveness of transfer pricing.

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