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ANALYSIS OF THE ROLE OF TRANSFER PRICING AND EARNING MANAGEMENT IN TAX AVOIDANCE IN INDONESIAN COMPANIES

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Abstract

Indonesia is a country that cannot be separated from the problem of tax avoidance. Each country has different corporate income tax rates, for example, Indonesian and Japanese tax rates, where the Indonesian tax rate charged to entities is 25% and the Japanese tax rate charged to entities is 23%. It can be seen that Japan's tax rate is lower than Indonesia, therefore there are many companies that want to do tax avoidance.

This research is basic research to solve the problem theoretically and is expected to support further theory development. This study examines the effect of independent variables consisting of transfer pricing and earnings management on tax avoidance as the dependent variable. The control variables used in this study are profitability, leverage, tangibility, liquidity, age, and company size. This study uses data from non-financial sector companies that have been audited and published on the official website of the Indonesia Stock Exchange (IDX). Time data collection methods used in this study arecross-sectionall and time series.

The research data sample was obtained through a purposive sampling method, meaning that data collection was carried out by selecting research samples based on certain criteria and considerations. This study measures the level of influence of the choice variable on tax avoidance which is the dependent variable. Transfer pricing and earnings management are independent variables in this study.

Keywords:

Tax Avoidance, Transfer Pricing, Earning Management, Accounting, and Economics.

Introduction

Taxes are part of income and wealth, which are levied to pay for public costs and implement fiscal policies to maintain economic, social, and political interests through government official and administrative rules and levers. Some experts argue that taxes are the amount of money that the government gets from private individuals, companies, and public institutions for the general strengthening of government and public provision according to rules and regulations (Jamei, 2017).

In tax avoidance, several factors influence tax avoidance, one of which is transfer pricing, transfer pricing is a part or factor that supports tax avoidance practices (Chandra & Cintya, 2021). Transfer pricing is usedas a buying and selling transaction between several parties by setting a special price on goodsor services. Parties involved in transfer pricing practices may consist of subsidiaries, siblings, and other related parties with different domicile locations. Multinational companies generally have subsidiaries or related entities located in tax haven countries to enable transfer pricing practices to avoid taxes.

This transfer pricing manipulation occurs when a company attempts to buy or sell to an affiliated entity at a price below or above the price of goods or services because the two companies are in different tax variables. This effect is frequently observed in developing countries as a result of their lack of human resources to deal with the complex nature of transactions conducted within affiliated entities and inadequate policies to eliminate the practice. Also, transfer pricing tends to reduce the rights of domestic shareholders and employees due to under-reported profits (Hendi & Hadianto, 2021).

The second tax avoidance technique is to use the benefits of accounting policies. A company can set policies that lead to financial reports which are called earning management practices. Earning management is the manager's actions to increase or decrease the profit on the company's financial statements related to profits earned in a period and is carried out to gain profits for the company, and to impress stakeholders on the company's performance. Whereas Sulistiyanto (2016) defines earnings management as an action taken by a company by misusing the components of financial statements through the accounting methods used by the person who records transactions and prepares financial reports.

So far, previous studies have only examined any companies wanting on earnings management and the effect of earnings management on tax evasion. No research integrates the three variables related to party transactions, real earnings management, and tax avoidance in one study. The sample for this research is a manufacturing company listed on the Indonesia Stock Exchange (IDX) during 2017 – 2021. The manufacturing company used as a sample is that there is a tendency for real earnings management only to occur in manufacturing companies.

Indonesia is a country that cannot be separated from the issue of tax avoidance. The Tax Justice Network in 2020 reported that Indonesia is estimated to experience losses of US$4,86 billion per year, due to tax avoidance practices by companies (NewsSetup, 2020).

Each country has different colpotomy tax rates, for example, Indonesian and Japanese tax rates, where the Indonesian tax rate charged to entities is 25%, and the Japanese tax this study aims 23%. It can be seen that Japan's tax rate is lower than Indonesia, therefore many companies want to tax avoidance.

Research on international tax avoidance practices shows that Indonesian companies avoid international taxes through transfer pricing manipulation, thin capitalists, tax utilization, intangible payments, income shifts, and affiliated financing structures. Moreover, most of these studies reveal that transfer pricing manipulation is the main avoidance mechanism used by these companies to achieve their goals of global profit maximization and tax minimization.

Earnings management stated that system tools such as changes in accounting procedures, maximizing income, and income smoothing are tools used by managers in managing earnings, but in the literature, on income management, it is determined that to manage earnings, companies need to structure the transaction to give rise to the difference between taxable profit and accounting income (Yopie & Erika, 2021).

Based on the formulation of the problem that has been prepared, this study aims to obtain knowledge from facts and valid data regarding the effect of earnings management and transfer pricing on tax avoidance.

Literature Review

Tax avoidance is a way for companies to reduce the tax burden, but this is contrary to the principles of government taxation so different interests arise between companies and the government where companies always by their tax burden as low as possible, while the government always tries to increase State tax revenue to the maximum extent possible for each targeted period according to the State Budget (APBN) (Ampriyanti & Merkusiwati, 2016).

Tax avoidance can be defined as a profit strategy that is not prohibited by tax laws. One transaction plan may reduce the present value of tax payments, but if these savings lead to higher non-tax costs in other areas of the organization, the transaction is not an efficient tax plan. In making tax avoidance decisions, managers consider the consequences of tax avoidance actions first (Carrolline et al., 2021).

The tax collection system in Indonesia has undergone a change from the official assessment system to a self-assessment system since the 1983 tax reform paying self-report the amount of tax to be paid. Awareness, knowledge, attitude of taxpayers, and taxpayer compliance are important factors of system implementation. The self-assessment system in the taxation law is regulated in Article 12 of the KUP Law that every taxpayer is obliged to pay the tax owed by the provisions of the tax laws and regulations, without relying on a tax assessment letter (SKP) (Wicaksono & Lestari, 2017)

The purpose of improving the tax law is in the framework of extensification and intensification of tax imposition which is carried out by seeking potential tax objects to raise funds and encourage economic recovery. Government policies related to the financial sector must also pay attention to macroeconomic factors. The government must see the macro impact on fulfilling long-term financing, both for private investment and fulfillment of the state budget, through the issuance of state bonds.

Tax avoidance in companies that occur outside of illegal activities and tax evasion. Illegal tax avoidance practices can expose companies to legal problems. In terms of decision-making determined by management, it must consider the impact of legal issues on illegal tax avoidance practices. The context of tax avoidance can be said to be part of tax planning which aims to reduce or minimize tax obligations so that companies gain profits.

Transfer pricing represents the price for each service or product that is transferred from one division to another within the scope of the same entity or related entity. Globalization is growing with the benefits of foreign direct investment have necessitated cross-border and international trade between business firms (Abdallah and Maghradi, 2009; Chang and Lin, 2010).

Previous literature indicates that tax avoidance behavior serves as a motivation for earnings management (Graham et al., 2012; Wang and Chen, 2012). Studies on earnings management have stated that tools such as changes in accounting procedures, revenue maximization, and income smoothing are the main instruments used by managers in managing earnings (Healy, 1985). However, the literature on revenue management stipulates that to manage earnings, companies structure their transactions in such a way as to give rise to differences in taxable profit and accounting income (Hanlon and Heitzman, 2010).

Earnings management is very important for companies because it is done in a relevant and reliable way. The company's internal personnel use earnings management to manipulate and compile financial reports. Manipulating profits is an act that violates the rules of a company's financial statements that deliberately generate irrelevant profits. Stated that the company believes that earnings management is considered a source of various financial scandals, which raises public concerns about the quality of financial information (Dewi & Lisa, 2021).

The empirical study of tax avoidance is an interesting study to study. Previous researchers likeAmidu et al, (2019), Lakhal et al, (2017), Zeng, (2018), Cabello et al, (2019), Wang, (2022), Mashiri, (2018), Tomukorpi, (2020), Efendi, (2022), Warih, (2019), Jamei, (2017), Taufik & Novita, (2022), Ampirawati, (2022), And Salhi et al, (2020) have researched this main topic.

Research Methods

This research is basic research to solving problems theoretically and is expected to support further theory development (Sukmadinata, 2012). This study examines the effect of independent variables consisting of transfer pricing and earnings management on tax avoidance as the dependent variable the control variables used in this study are firm size, profitability, leverage, tangibility, liquidity, age, and firm size.

This study uses data from the company’s non-financial sector that has been audited and published through the Indonesia Stock Exchange (IDX) official website. The data collection time method used in this study is cross-sectional and time series. Sample research data is obtained through the purposive sampling method, which means data collection is done by selecting research samples based on certain criteria and considerations.

Tax avoidance is broadly defined as an explicit tax reduction (Hanlon and Heitzman, 2010). Yorke et al. (2016), and Taylor and Richardson (2012), also define tax avoidance as the difference between the statutory tax rate (STR) and the effective tax rate (ETR).

Effective Tax Rate (ETR) is used to measure the level of a company's ability to carry out tax avoidance. The tax avoidance variable in this study is measured using the ETR because it has the advantages of easy access to data and, the impossibility of changing data, and the ETR inherently reflects differences in permanent book taxes and all other legal adjustments (Frank et al., 2009).

$$\textit{Effective Tax Rate}\ \textbf{(ETR)} = \frac{\text{Beban pajak penghasilan perusahaan}}{\text{Laba sebelum pajak}}$$

Transfer pricing according to Nurhayati (2013) is an unfair pricing mechanism for goods or services delivery transactions by related parties. Transfer pricing measurements in this study follow previous research from Amidu et al (2019), namely the transfer pricing index of companies based on the sum of the five different transfer pricing items divided by the five companies.

The assessment is carried out by giving a score to each transfer pricing criterion, a score of 1 if the company meets the transfer pricing criteria, and 0 if not. The overall score determines the level of transfer pricing, where the higher (lower) the score obtained, the higher (lower)

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the level of transfer pricing aggressiveness or the level of possibility of transfer pricing.

$$\text{Transfer pricing} = \frac{\text{Total score obtained}}{5}$$

The five (5) criteria consist of (1) having a subsidiary or sibling company located in a tax haven; (2) transacting with subsidiaries or sibling companies in tax havens in the current year; (3) having a parent company, subsidiary or sibling company located in a country with a different tax rate other than a tax haven; (4) transacting with related parties located in countries with different tax rates and; (5) pay royalties on intangible assets to related parties in the current year.

Earning management is defined as the active manipulation of accounting information to create a changing impression of a company's financial performance, as measured by income. Measuring earnings management for financial firms, studies (proxies for earnings) management using discretionary loan loss reserves (DLLP) are in line.

The stages of measuring earning management start from:

1) Calculating the total value of accruals (accruals):

$$TAC_{it} = \left(\Delta CA_{it} - \Delta Cash_{it}\right) - \left(\Delta CL_{it} - \Delta LTD_{it} - \Delta ITP_{it}\right) - DPA_{it}$$

Where; TACit is the company i's total accruals in period t; ΔCAit is the current assets of the company i in period t minus t-1; ΔCash is the cash balance of company i in period t minus t-1; ΔCLit is the current liabilities of the company i in period t minus t-1; ΔLTDit is the long-term liabilities of the company i in period t minus t-1; ΔITPit is company i's income tax payable in period t minus t-1; and DPAit is the depreciation and amortization expense of company i in period t minus t-1

Determine the value of discretionary accruals and non-discretionary accruals:

$$\frac{TAC_{it}}{TA_{it-1}} = \alpha_0\left[\frac{1}{TA_{it-1}}\right] + \beta_1\left[\frac{\Delta REV_{it} - \Delta REC_{it}}{TA_{it-1}}\right] + \beta_2\left[\frac{PPE_{it}}{TA_{it-1}}\right] + \varepsilon_{it}$$

Where; TACit is the company i's total accruals in period t; TAit−1 is the total assets of the company i in period t-1; ΔREVit is company i's sales in period t minus t-1; ΔRECit is the receivables of the company i in period t minus t-1; PPEit is the gross value of fixed assets of the company i in period t minus t-1 and ϵit is an error. The non-discretionary NACit is removed from the above equation and leaves the remaining part which is a discretionary DCAit (TACit - NACit). Discretionary DCAit is the residual absolute value of the estimation model. Source: Amidu et al. (2019)

Results and Discussion

This study uses secondary data types, data obtained based on information contained in the financial reports of the non-financial sector which are listed on the Indonesia Stock Exchange during the 2017-2021 period. The Statistical Package for the Social Science Program (SPSS Program) and the Eviews Program are used in processing and testing data to obtain test results for this empirical study.

Descriptive statistics are part of the data testing process which processes research samples into the tabular form so that information can be more easily understood and interpreted. The table below is the results of descriptive statistical tests through a statistics program:

Table 1. Descriptive Statistical Test Results for Research Variables

	N	*Minimum*	*Maximum*	*Means*	*std. Deviation*
CTAs	409	-.05146465	1.60963147	.24724192	.15487642
TP	410	.0	.8	.245	.2331
EM	410	-35918020	94671000	65274069	13639841
ROA	410	.00108299	2.32287288	.10657906	.14704894
Lev	410	.00108299	2.32287288	.10657906	.14704894
AGE	410	15.0	116.0	44,344	19.9247
SIZE (Rp. 1,000,000)	410	25.79571050	33.53723001	29.34538052	1.59739861
TANG	410	.00017099	1.80384157	.33674231	.25974649
GP	410	-995230	584390	81128078	7416139
LIQ	410	.13000673	17.95408778	2.54599524	1.99815885
Valid N (listwise)	409				

Source: Secondary data processed (2022)

Tax avoidance has a minimum value of -0.05146465 obtained from Duta Pertiwi Nusantara Tbk, the company is considered to have committed tax avoidance because the ETR value is smaller than the STR value in Indonesia, which is 25%. The maximum tax avoidance value was obtained from PT Austindo Nusantara Jaya Tbk of 1.60963147. Where PT Austindo Nusantara Jaya Tbk is stated to have a higher ETR than Indonesia's STR, so it can be seen that the company does not carry out tax avoidance. The average value of tax avoidance is 0.24724192 explaining that the average listed on the Indonesian Stock Exchange is involved in tax avoidance practices. The standard deviation value of tax avoidance is 0.15487642.

Transfer pricing gets a minimum value of 0,00, this explains that there are companies that do not meet any indication of transfer pricing practices. The maximum value of transfer pricing is known to be 0.8 because there are companies that meet the four indications of transfer pricing transactions. Adaro Energy Tbk is an example of a company that fulfills the four transfer pricing indications. Adaro Energy Tbk has subsidiaries located in Mauritius and Singapore. Mauritius is a tax haven in the world, while Singapore is a country with a lower corporate tax rate compared to Indonesia. Transfer pricing has an average value of 0.245, this explains that the average company listed on the Indonesian Stock Exchange can carry out a transfer pricing scheme.

Earning management obtains a minimum and maximum value of -35918020 and 94671000 respectively based on the results of descriptive statistical tests. The minimum and maximum earning management values are represented by Pan Brothers Tbk. Companies listed on the Indonesia Stock Exchange on average do not manipulate earnings, this is explained by the average earning management value of 65274069 with a standard deviation of 13639841.

Profitability (ROA) based on the results of descriptive statistical tests is known to have a minimum value of 0.00108299 and a maximum value of 2.32287288. The average profitability value is 0.10657906 which explains that most public companies in Indonesia have a low level of profitability in the 2017-2021 period. The standard deviation value of profitability is 0.14707894.

Leverage has the lowest value of 0.00108299 and the highest value of 2.32287288. The average value of leverage is 0.10657906 which explains that the average public company in Indonesia still pays attention to the level of corporate leverage. Leverage based on the results of descriptive statistical tests has a standard deviation value of 0.14704894.

Age has the lowest score and the highest score is 15 years (Midi Utama Indonesia Tbk) and 116 years (PP London Sumatra Indonesia Tbk). It can be seen that companies listed on the Indonesia Stock Exchange are companies that have been running for more than 10 years. The average age listed on the Indonesia Stock Exchange is 44.344 and the standard deviation is 19.9247.

Conclusions

This study measures the level of influence of the choice variable on tax avoidance which is the dependent variable. Transfer pricing and earning management are independent variables in this study. The research sample is non-banking and other financial sector companies listed on the Indonesia Stock Exchange for the 2017-2021 period.

Transfer pricing and Earning management have proven to have a significant effect on tax avoidance. This provides a gap for tax avoidance with transfer pricing schemes. A fiscal correction policy is one of the tools to neutralize the level of profit manipulation by companies.

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