CHAPTER I

INTRODUCTION

1.1 Background of Study

Tax plays a major role in a country's development and citizen's welfare. Thus, the tax is the main income of a country. In 2018, the target of revenue received by the country was Rp. 1.618,1 Trillion, while the actual revenue generated was Rp. 1.894,7 Trillion (Reily, 2018). The ability for the government to maximize the revenue could be restrained by the practice of transfer pricing which lead to tax avoidance. By taking advantage of the taxation rules and regulation loopholes, the companies able to minimize the amount of tax payable to be paid, especially for multinational company.

According to Asmara in CNBC Indonesia (2018), the revenue receives in Indonesia from 2014-2017 was in following:

1. 2014; Realization Rp. 985 trillion or 91,9% from the target Rp 1.072 trillion
2. 2015; Realization Rp. 1.055 trillion or 81,5% from the target Rp 1.294 trillion.
3. 2016; Realization Rp 1.283 trillion or 83,4% from the target Rp 1.539 trillion.
4. 2017 : Realization Rp 1.147 trillion or 89,4% from target Rp 1.283 trillion.

In addition, the revenue received by the county from 2014-2018 is shown as follows:

Table 1.1 Revenue Received by Indonesia

Year	Target	Realization
2014	Rp.1,072 trillion	Rp. 985 trillion
2015	Rp 1,294 trillion	Rp. 1,055 trillion
2016	Rp.1,539 trillion	Rp. 1,283 trillion
2017	Rp.1,283 trillion	Rp. 1,147 trillion
2018	Rp.1,618 Trillion	Rp. 1,894.7 trillion

Source: Prepared by Writer (2019)

From the table above, the target of revenue received by the country is increasing each year. However, the ability to achieve the target is only once, which is in 2018. One of the possibility factors is due to the legal practice of transfer pricing, in which entity taxpayer has opportunity to avoid paying higher tax. Transfer pricing highly refers to the prices of goods and services exchanged between entities within an enterprise. From the taxation point of view, transfer pricing takes advantage of different tax regimes in different countries (Barker, et al., 2017). For example, company A located at high tax country sells inventories at lower price instead of using market price to subsidiary (company B) located at low tax country. As a result, company A will produce lower revenue and paying lower tax. On the other hand, company B generates lower cost of goods sold (COGS), which ultimately increase the company's profit. In other words, company A's revenue is lower by the same amount of company B's cost savings. In overall, both companies can save on taxes by making company A less profitable and company B more profitable. Company A charges lower price and forward the saving into company B, increase its profit through lower COGS, thus company B will be taxed at lower rate. In addition, the company will have possibility to maximize the profit by avoiding paying higher tax.

When the profit of the country keeps on increasing, this will attract more investor to invest, especially in the Stock Market. Multinational company that conduct transfer pricing will argue that despite the firms pay small amount of income tax in certain country, however the payment of tax is still considered as contribution that can affect the economic well-being. Some economics might argue that the taxation can manipulate the operation of market and the tax avoidance is the response to excessive amount of tax, including large public sector (Economic Online, 2019). In other words, the application of transfer pricing has ultimately benefited the multinational company in generating profit. The number of transfer pricing case is shown as follows:

Table 1.2 Transfer Pricing cases in 2017

Reporting Jurisdiction	**2017 Start Inventory**	**Cases Started in 2017**	**Cases Closed in 2017**	**2017 End Inventory**
Argentina	3	1	0	4
Australia	33	8	14	27
Austria	100	37	26	111
Belgium	86	37	40	83
Brazil	7	2	1	8
Bulgaria	8	0	2	6
Canada	182	73	114	141
China	75	25	16	84
Hungary	13	2	3	12
India	620	121	95	646
Indonesia	**27**	**10**	**6**	**31**
Italy	292	148	48	392
Japan	108	24	26	106

Source: OECD (2019)
Prepared by: Writer

It can be concluded that the case of transfer pricing in Indonesia is considered as moderate. The number of cases recorded in OECD is average. In case of basic industry and chemical company, the practice of transfer pricing is common. There are numbers of factor which alter the structure of the company in order to reset the business strategies. One of the main factors is the increase of production cost and the decrease of sales revenue. During the production processes, the company will emit waste water, waste gas, and waste residue, which will ultimately produce high environmental protection cost and safety input cost. Thus, the cost controlling levels on the profitability of a company have greater impact, instead of selling prices. Furthermore, the possibility of reduction of state’s construction investments may cause demands and orders from customers to decrease. Therefore, cost controlling is the main factor of a company to overcome intense competition in the industry (Li & Paisey, 2019).

In Indonesia, the law of transfer pricing is regulated in Article 16 of Law number 36, year 2008, PER-43/PJ.2010 Jo PER-32/PJ/2011. However, the effectiveness of the Law is still questionable. According to Lumanauw in *BeritaSatu* (2016), around 2000 companies in Indonesia did not pay tax for 10 years and claimed that they were loss. Thus, firms are benefited in this situation as it offers the opportunity for companies to maximize the profit and minimize the tax payable.

The application of transfer pricing regarding tax avoidance has been done by many popular corporations, such as Starbucks. The UK Starbucks used several tricks to manipulate the profit by transferring them to other country. The first trick is by conducting offshore licensing. The UK Starbucks claimed that the company did not own the intellectual property rights for the recipes, logo, and design. The intellectual property rights were owned by the Netherlands Starbucks called Starbucks Coffee EMEA BV. Therefore, the UK Starbucks claimed that the company had to pay a large amount of licensee fee to the Netherlands Starbucks every year. While actually, what the company done was transferring the income to lower tax country. The second tactic was related to the purchases of Coffee Bean. The UK Starbucks purchased coffee bean from the Swiss Starbucks, where the sales of coffee bean was categorized as the sales of commodity that was only taxed for 2% (Jafri & Mustakasari, 2018).

In Indonesia, transfer pricing towards tax avoidance was done by PT. Asian Agri. The company sold the crude palm oil to the affiliated companies located in the overseas with lower price, then resell it again with higher price to customers. The practice of transfer pricing produced financial loss amounted Rp. 1.3 trillion to the country (Huda, Nugrehi, and Kamarudin, 2017).

The tax avoidance through transfer pricing had also been done by the Apple. Basically, the U.S. corporation developed a patent domestically and licensed this patent to their subsidiary located in Ireland. The royalty charged for the U.S. Company is very low, therefore, most of the company's income resided in Ireland. Furthermore, Ireland has a corporate income tax rate of only 12.5% rate. The apple owned 3 subsidiaries with Wholly Owned Subsidiaries status (AOI, AOE, and ASI). The ASI was registered in Ireland. Even though ASI was established since 1980, however the company began to hire employees in 2012. The ASI had two functions. First, was to contact with several industries in China to produce the Apple products. Second, was to market the Apple product through subsidiaries, especially to Europe and Asia. Therefore, even though the ASI was located in Ireland, however the product was produced in China and never in Ireland (Rosid, 2016).

According to the previous study conducted by Paskalis A. Panjalusman, Erik Nugraha, Audita Setiawan on June-December 2018, transfer pricing did not affect the tax avoidance for multinational company listed on Indonesian Stock Exchange from 2014-2018, because during those time, the government had set new policies, such as tax amnesty. Therefore, the multinational company's productivity was decreased and the practice of transfer pricing could not be proven. While according to the research done by Annisa Lutfia and Dudi Pratomo in 2018, the transfer pricing by manufacturing company listed on Indonesian Stock Exchange from 2012-2016 did influence the practice of tax avoidance. The transfer pricing is conducted in order to minimize the tax payable legally, reach the company's target and to motivate the management.

In addition, there are high possibility that the practices of transfer pricing will grow, since based on the table of phenomenon, the number of transfer pricing case in Indonesia is increasing In other words, the application of transfer pricing has been proven to be very effective in supporting the company to generate profit. On the other hand, transfer pricing has been conducted by large companies in many ways. While according to previous researches above, the influence of transfer pricing towards tax avoidance are still inconsistent. Thus, writer shall conduct descriptive quantitative research on determining the **"Analysis on the influence of transfer pricing towards tax avoidance at Basic Industry and Chemical Company listed on Indonesian Stock Exchange".**

1.2 Problem Limitation

1. The research object is Basic Industry and Chemical Company listed on Indonesian Stock Exchange.
2. The independent variable is transfer pricing. While dependent variable if tax avoidance
3. The research period is from 2014 until 2018.

1.3 Problem Formulation

Does transfer pricing significantly influences tax avoidance at Basic Industry and Chemical Company listed on Indonesian Stock Exchange from 2014-2018?

1.4 Objective of The Research

The general purpose of this research is to explore the influence of transfer pricing towards tax avoidance at Basic Industry and Chemical Company listed on Indonesian Stock Exchange from 2014-2018. The specific objective of this research is to investigate whether transfer pricing can influence tax avoidance at Basic Industry and Chemical Company listed on Indonesian Stock Exchange from 2014-2018.

1.5 Benefit of The Research

Writer believes that this research could broaden one's horizon about transfer pricing and its impact to tax avoidance at Basic Industry and Chemical Company listed on Indonesian Stock Exchange from 2014-2018. Moreover, this research contains theoretical benefit and practical benefit for readers.

1.5.1 Theoretical Benefit

Theoretical benefit is highly related to the academic context. This research will provide knowledge on the influence of transfer pricing towards tax avoidance at Basic Industry and Chemical Company listed on Indonesian Stock Exchange from 2014-2018. Furthermore, this research will enrich the understanding of writer and serves as a contribution for other researchers or writers in the future.

1.5.2 Practical Benefit

Practical Benefit is highly related to the functional context (for the company). This research aims to give insights for firms' management regarding the application of transfer pricing towards tax avoidance.