

CHAPTER 1

INTRODUCTION

1.1 Background of the Study

The expansion of the global economy has influenced a great number of businesses to conduct their operations and expand their operations not only within their own country but also to other nations.

In Indonesia, multinational company contributes to the economic growth due to their high productivity (Sempurna, 2019). Their contributions enable Indonesia to conduct business with other nations and have increased the country's tax revenue. However, there are still a significant number of businesses that apply every tax avoidance through transfer pricing.

Transfer pricing is the transfer price of a goods or services from one division to another division in one company or to another company that has a special relationship (Firdaus, 2017). However, transfer pricing has been utilized to decrease the tax liability of company. It is conducted by diverting its profits to another sub-company or corporation with a particular relationship that is located in a lower tax rate country, thereby reducing the total tax burden of the company (Susanti and Firmanysah, 2018).

There are legal umbrella to minimize transfer pricing. They are Law Number 36 Year 2008 Article 2018 concerning Amendments Fourth on Law Number 7 Year 1983 concerning Income Tax Provisions, Regulation of Minister

of Finance No.22/PMK.03/2020 concerning the procedure for the implementation of transfer pricing (advance pricing agreement), and Regulation of the Director General of Taxes Number PER-32/PJ.2011 concerning the application of the Arm's Length Principle govern transfer pricing in Indonesia (ALP).

Despite the existence of such laws and regulations, corporations continue to apply transfer pricing. Advance Pricing Agreement is a way for decreasing the implementation of transfer pricing (APA). APA is an agreement between the taxpayer and the taxing authorities to determine the transfer price between businesses with special relationships (Oktaviani & Tambunan, 2020). APA is established so that tax authorities and taxpayers can determine a transfer price based on the Principle of Fairness and Business Practice, often known as the Arm's Length Principle (ALP). Arm's Length Principle is the principle that decides whether a transaction between two firms with a special relationship has the same price range as a transaction between two firms with a special relationship or no relationship (Delina et al., 2021).

Tax is presumed as the motivation to conduct transfer pricing. Individuals are required to pay taxes to their government so that the government can contribute back to its citizens. Despite the fact that taxation is a vital source of revenue for the government, businesses continue to employ transfer pricing in order to decrease their overall tax burden. By calculating the Effective Tax Rate (ETR), it can be determined whether taxes have any impact on a company's transfer pricing. ETR is typically used to determine the amount of tax a business will pay (Henig, 2016). In a company's financial statement, it is derived by

dividing income tax expense by earnings before income tax expense. The lower ETR reflects the greater likelihood that a corporation will apply transfer pricing in its business operations.

Profitability is another element that could influence the transfer pricing practices of businesses. Profitability is a ratio that measures the performance and efficacy of a company in creating profit (Indriaty & Thomas, 2019). Profitability can be recognized if the company are able to earn a return during their business by their ability in utilizing their assets. High profitability indicate that a company is able to properly manage its assets and profit from its operations. This might motivates businesses to make transfer pricing options that decrease the tax burden while preserving the high profit achieved (Bonita & Murtanto, 2021). By calculating the Return on Assets (ROA), profitability is measured based on the assets owned by the company. ROA is computed by dividing the financial statement's net income by its total assets. An increase in a company's net income results in a decrease in its tax expense, hence boosting the ROA. Higher ROA indicates greater profitability, hence increasing the likelihood that a business will apply transfer pricing.

The size of a corporation is another variable that may influence the transfer pricing. The size of a business can be determined by its resources, such as total assets, total sales, and stock market value (Wuryani, 2012). Total assets will be utilized to determine the size of a corporation in this study (Ln).

In this research, the author will study about the effects of taxes, profitability and company size on transfer pricing. This research will use ETR to measure taxes, the ROA to measure profitability, natural logarithm to measure company size and Related Party Transactions (RPT) to measure transfer pricing.

Table 1. 1 Taxes, Profitability, Company Size and Transfer Pricing In Year 2017-2019

Company	Year	ETR	ROA	Company Size	RPT
PT. Indofood Sukses Makmur Tbk (INDF)	2017	0.3282	0.0585	32.1076	18.4925
	2018	0.3337	0.0514	32.2009	17.1871
	2019	0.3254	0.0614	32.1974	20.2741
PT. Budi Starch & Sweetener Tbk (BUDI)	2017	0.2512	0.0155	28.7092	75.8211
	2018	0.2969	0.0149	28.8527	83.4023
	2019	0.2370	0.0213	28.7295	85.6783
PT. Nippon Indosari Corpindo Tbk (ROTI)	2017	0.2728	0.0297	29.1482	14.0054
	2018	0.3197	0.0289	29.1112	22.0075
	2019	0.3186	0.0505	29.1747	25.6920

Source: Prepared by the Writer (2021)

From the table shown above, we could see that the ETR of PT Indofood Sukses Makmur Tbk (INDF) during the year 2018 to 2019 declined from 0.3337 to 0.3254 by 14.8%. In 2019, income before tax increases due to higher sales generated during the year. This increase shows that INDF has been gaining a high income before tax which might drive the company to implement transfer pricing in order to reduce the amount of tax paid. This could be seen from the increase in the RPT by 17.96%, thus indicating that company having higher income tax is more likely to implement transfer pricing. This result supports the research done

by Sulistyowati & Kananto (2018) which stated that tax has positive effects towards transfer pricing.

The second factor that could affect transfer pricing is profitability which is measured by Return on Assets (ROA). Based on the table shown above, PT Budi Starch & Sweetener Tbk (BUDI) experienced an increase in the ROA from 0.0149 in 2018 to 0.0213 in 2019. The increase in ROA is caused by the increase in net income during the year 2019 by 21.17%, which is driven by an increase in the net sales by 13.5% and a decrease in the operating expense by 4.5%. Due to the increasing amount of ROA, the RPT in the company also increases in 2019 by 2.65% than 2018. This indicates that the higher profit earned by a company causes higher probability to practice transfer pricing. This result supports the research done by Ria et al. (2020) that stated profitability has a positive significant effect towards transfer pricing.

The last factor that could affect transfer pricing is company size that is measured by total assets (Ln). According to the table shown above, PT Nippon Indosari Corpindo Tbk (ROTI) has an increase in their company size from 29.1112 in 2018 to 29.1747 in 2019, due to the increase in the property, plant and equipment by 14.32%. Large quantities of assets indicate that the company will incur more depreciation and service and maintenance costs, resulting in a drop in profit. The table also indicates that RPT will increase by 16.74 percent in 2019. When a business has excessive expenses, it will attempt to reduce them in order to retain and increase profit, hence increasing the likelihood that it may apply

transfer pricing practice. This result supports the research of Afifah et al. (2019) that stated company size has a positive significant effect towards transfer pricing.

The writer chooses consumer goods companies recorded in Indonesian Stock Exchange (IDX) as the object of the research. Consumer goods companies are categorized in the manufacturing sector. Manufacturing industries has been one of the main tax contributors for the economy in Indonesia with the percentage of 32% in 2017, 30% in 2018 and 29.7% in 2019 according to APBN. The writer chooses this company because the writer wishes to know how is the practice of transfer pricing being implemented in these types of companies and what are the motives behind the practice.

The author chose to conduct this study regarding transfer pricing because it is an interesting activity especially in Indonesia. The author would like to analyze whether tax, profitability and company size influence transfer pricing decision. Based on the explanation above, the author would like to conduct this research with the title: **“The Effect of Tax, Profitability and Company Size towards Transfer Pricing on Consumer Goods Companies Listed on the Indonesian Stock Exchange.”**

1.2 Problem Limitation

Due to the limitations of time and resources, this research is subject to several limitations as follows:

- a. This research only focuses on the effects of taxes on transfer pricing in consumer goods companies listed in Indonesia Stock Exchange 2017-2019.
- b. This research only focuses on the effects of profitability towards transfer pricing in consumer goods companies listed in Indonesia Stock Exchange 2017-2019.
- c. This research only focuses on the effects of company on transfer pricing in consumer goods companies listed in Indonesia Stock Exchange 2017-2019.
- d. This research is limited to only researching the consumer goods companies listed in the Indonesian Stock Exchange.
- e. The data utilized in in this research is restricted to the year 2017-2019.

1.3 Problem Formulation

According to the issued being mentioned before, the problem formulation for this research is as follows:

- a. Does tax has any effect towards transfer pricing in consumer goods companies listed in Indonesia Stock Exchange?
- b. Does profitability has any effect towards transfer pricing in consumer goods companies listed in Indonesia Stock Exchange?
- c. Does company size has any effect towards transfer pricing in consumer goods companies listed in Indonesia Stock Exchange?

- d. Does tax, profitability and company size has any effect towards transfer pricing in consumer goods companies listed in Indonesia Stock Exchange?

1.4 Objective of the Research

The objective of this research that the author wishes to gain is as follows:

- a. To figure out whether tax has any effect towards transfer pricing in consumer goods companies listed on the Indonesia Stock Exchange.
- b. To figure out whether profitability has any effect towards transfer pricing in consumer goods companies listed on the Indonesia Stock Exchange.
- c. To figure out whether company size has any effect towards transfer pricing in consumer goods companies listed on the Indonesia Stock Exchange.
- d. To figure out whether tax, profitability and company size has any effect towards transfer pricing in consumer goods companies listed on the Indonesia Stock Exchange.

1.5 Benefit of the Research

With the completion of this research, the author expects to provide the following benefits:

1.5.1 Theoretical Benefit

This research is conducted despite the fact that it provides knowledge primarily to the company's management in order for them to have more references for developing and updating the existing management in the company, particularly in consumer goods companies, so that they are aware of the advantages and disadvantages of transfer pricing in the company.

1.5.2. Practical Benefit

1. For Author

This research is conducted to give benefits for the author to expand the author's knowledge about transfer pricing in consumer goods companies that are listed in Indonesian Stock Exchange.

2. For Consumer Goods Companies

This research is undertaken to inform organizations about the impact of tax, profitability, and company size on transfer pricing, and to aid them in predicting the risk associated with implementing transfer pricing within the organization.

3. For Future Researchers

This research could act as a future references for future researchers who are going to conduct a study on a similar topic.