

CHAPTER I

INTRODUCTION

1.1 Background

The economic sector has become the most important part of this modern world, especially in the industrial sector. In general, industries in Indonesia are run by two categories of companies, namely domestic companies and multinational companies as stated by Sinthayani & Panji Sedana (2015). Multinational companies are companies that have a strong influence on the market which generally have several branches in various industrialized countries and usually already have an office to operate the company, according to John H. Dunning (1993) is "an enterprise that engagements in foreign direct investment (FDI) and owns or, in a certain way, controls value-added activities in more than one country."

Multinational companies compete with each other in producing goods at affordable or even low prices. This results in a high level of public consumption. Increased consumption levels will increase demand for goods so that companies can develop their companies and open subsidiaries. This is in line with the opinion of Jiwandhana & Triaryati (2016) which says, the era of the free market will certainly result in making competition between companies even tighter, especially if these companies are listed on the same stock exchange.

The problem faced by many companies is the difference in tax rates in each country. The main problem that arises from the difference in tax rates is the emergence of transfer pricing decisions. According to Refgia (2017), transfer pricing is the price determined in transactions between divisional members within a multinational company with a specified transfer price scheme that can deviate from the market price and match between divisions. Jian Li and Alan Paisley (2006) in their book entitled "Transfer Pricing Audit in China" defines transfer pricing as a term used to describe a process and determination of the price for assets or services delivered between parties who have a special relationship with the company. multinational where the transaction goes through two tax authorities.

One of the causes of the loss of potential tax revenue and low tax ratio is the emergence of transfer pricing decisions in multinational companies. This transfer pricing practice is alleged to have caused losses in the taxation sector to reach billions and even trillions of rupiah, as stated by Maliki (2015). The Indonesian Tax Authority through Liputan6 (2016) states that 2000 multinational companies do business in Indonesia that do not fulfill their tax obligations for up to 10 years on the grounds of loss. However, despite experiencing losses, the company's operations are still ongoing, so further handling is needed.

There are many cases of the use of transfer pricing by multinational companies in Indonesia. One of the cases is the case of PT. Asian Agri Group in 2016. According to radarkota.com, the modus operandi is to sell Asian Agri's Crude Palm Oil products to affiliated companies abroad at prices below market prices and then resell them to real buyers. at a high price to reduce the tax burden in the country

can. In addition, it appears that some of the foreign companies that are partners with Asian Agri are fictitious companies. Upon the disclosure of the case, the Asian Agri Group was found guilty and had to pay a fine for its crime (Tian, 2016). Large companies and have subsidiaries in various countries tend to be involved in corporate tax avoidance schemes such as the one conducted by PT. Asian Agri Group. The use of transfer pricing is a tax avoidance scheme.

There are three triggers for multinational companies to make transfer pricing decisions, namely the tax burden, tunneling, and the provision of management bonuses. The tax burden is the main burden used by the company as an input to make a decision (Graham et al., 2017). Tunneling is an act of diverting company resources carried out for the benefit of the majority shareholder, whereas as a result of the transfer there is a burden that must be borne by minority shareholders (Johnson et al., 2000). According to Chan, Moand, and Tang (2016), tunneling can occur due to the ownership of the majority shareholder as the controller and the lack of management within the company. Several hypotheses were proposed, one of which by Watts and Zimmerman (1979) in the agency problem is the bonus hypothesis. When receiving the bonus based on the amount of income, it will be a consideration by management to increase sales so that they get a bonus.

Previous research was conducted by Susanti & Firmansyah (2018) with the title Determinants of Transfer Pricing Decisions in Indonesian manufacturing companies. The results show that first, the tax burden is negatively related to the transfer price decision. Second, tunneling is negatively related to transfer pricing

decisions. Lastly, bonuses are not tied to transfer pricing decisions. However, there are some limitations in this paper, namely:

1. The results of this study focus on company data that has a calculation of the gross profit ratio of transactions to related parties compared to data for the gross profit ratio of transactions to third parties.
2. The period used in this research is the years 2011-2015 which requires a review of transfer pricing practices.

Previous research conducted by Marfuah & Azizah (2014) which examined the effect of taxes, tunneling incentives, and exchange rates on the company's transfer pricing decisions, showed that the results of logistic regression analysis concluded that the higher the tax rate imposed, the lower the company's transfer pricing decisions or vice versa. The limitation of this study is that this study uses samples from manufacturing companies without distinguishing between industrial sectors, which include the basic and chemical industry sectors, the various industrial sectors, and the consumer goods industrial sector.

In addition, another study conducted by Ramadhan & Kustiani (2017) with the title Determinants of Transfer Pricing Aggressiveness shows that the first result is that multinational variables have a significant positive effect on transfer pricing aggressiveness. Second, the variable utilization of tax heaven country has a significant positive effect on the aggressiveness of transfer pricing. Third, the firm size variable has no effect on the aggressiveness of transfer pricing. Fourth, the profitability variable has no effect on the aggressiveness of transfer pricing. Fifth, the leverage variable has no effect on the aggressiveness of transfer pricing. Sixth,

the intangible asset variable has no effect on the aggressiveness of transfer pricing. Seventh, the variable of compensation for losses and differences in compensation for losses has a significant positive effect on the aggressiveness of transfer pricing. There are several suggestions in this study for further research that are in line with the objectives of this study. First, further research can include other variables that can also affect the aggressiveness of transfer pricing. Second, further research can be carried out using panel data to further increase the sample so that the research results can be more reliable.

Based on this background, this study will retest manufacturing companies that go public that are listed on the Indonesia Stock Exchange. The study focused on samples from manufacturing companies engaged in the basic industrial and chemical sectors and the consumer goods industry sector only. The difference between this study and previous studies is the range of years used, namely 2018 to 2020. The use of a 3-year sample is enough to describe the condition of manufacturing companies in Indonesia that practice transfer pricing. Variables used are the same, namely dependent variables are transfer pricing, independent variables are tax burdens, tunneling, and bonuses, and control variables are debt ratio, related party transaction, and firm size. However, there is a new variable addition of foreign ownership (with 20% or more ownership) in its calculations. Based on the description above, this study will take the title "THE EMERGENCE OF TRANSFER PRICING DECISIONS IN INDONESIAN MANUFACTURING COMPANIES".

1.2 Problem Formulation

According to Simamora in Mangoting (2000:70), transfer pricing is defined as the value or special selling price used in inter-divisional exchanges to record the income of the selling division and the costs of the buying division. The Organization for Economic Co-operation and Development (OECD) defines transfer pricing as an action taken in a transaction with a related party to get the desired price in a manufacturing company so that the transfer price is different from the fair price in the market as long as the conditions are favorable to the company.

Based on the background above transfer pricing is a tax avoidance problem that occurs in multinational companies, one of which is multinational companies in Indonesia. This paper will examine the factors that influence the emergence of transfer pricing decisions, namely:

1. Does the tax burden affect transfer pricing decisions?
2. Does tunneling affect transfer pricing decisions?
3. Do bonuses affect transfer pricing decisions?

1.3 Writing Purpose

This paper aims to test the determinants of the emergence of transfer pricing decisions in manufacturing companies in Indonesia, namely:

1. To empirically prove the influence of tax burden on transfer pricing decisions.
2. To empirically prove the influence of tunneling on transfer pricing decisions.

3. To empirically prove the influence of bonuses on transfer pricing decisions.

1.4 Scope of Writing

This writing limits the scope of writing only to manufacturing companies in Indonesia that are listed on the IDX. The sample testing period is taken from 2018 to 2020 with a total of 50 companies every year. The reason for this scope restriction is that the author wants to focus on testing the determinants of the emergence of transfer pricing in manufacturing companies in Indonesia with sufficient range and sample data to describe the condition of the company.

1.5 Benefits of Writing

The academic benefit of this writing is to increase knowledge for readers about the factors that make multinational companies make transfer pricing decisions. Some of these factors are tax burden, tunneling, and bonus management. Readers can see the influence of these factors so that transfer pricing decisions arise by companies to avoid taxes. Academics can be a reference for writing in the future.

The practical benefit of this writing is that it can provide an overview to the government about the influence of tax burdens, tunneling, and bonuses as determinants of transfer pricing decisions to minimize companies doing tax avoidance with transfer pricing schemes in Indonesia.

1.6 Systematics of KTTA Writing

CHAPTER I INTRODUCTION

This chapter explains what will be discussed in the Final Project Writing Work, which consists of the background, problem formulation, writing objectives, scope of the problem, writing benefits, writing methods, and writing systematics.

CHAPTER II THEORETICAL FOUNDATION

This chapter describes the theoretical framework that is general and special, used for the preparation of written works consisting of various sources, such as journals, the income of experts, books, etc. related to writing, namely transfer pricing.

CHAPTER III METHODS AND DISCUSSIONS

This chapter will give an overview of multinational companies. How these multinational companies do tax avoidance through transfer pricing, as well as examples of multinational companies that have practiced transfer pricing, especially in Indonesia.

In addition, this chapter will contain the way the author tests the determinants of the emergence of transfer pricing decisions. There are three factors taken by the author, namely reducing the tax burden, the influence of tunneling, and the influence of bonuses.

CHAPTER IV CONCLUSION

This chapter will explain the conclusions on the influence of transfer pricing decision determining factors based on the sample test conducted by the author and contain suggestions and limitations about the writing of this paper.