

CHAPTER II

THEORETICAL FOUNDATION

2.1 Tax Avoidance

Multinational companies will carry out various tactics to ease the tax burden that will be paid by the company, one of which is transfer pricing. Transfer pricing in taxation is included in the category of tax avoidance which is often applied by multinational companies. One of the originators of tax avoidance, namely Slemrod (2004) and Slemrod and Yitzhaki (2002) is that aggressive tax reporting includes all transactions with the main objective of reducing tax obligations without involving a real response by the company and is part of tax avoidance. Intuitively, aggressiveness is thought to drive tax laws. Hanlon & Heitzman (2010) define tax avoidance as a tax reduction that is done openly. Dyreng et al. (2010) define tax avoidance as an effort carried out by companies that aim to reduce the amount of tax burden borne by the company. Tax avoidance describes a continuation of the company's tax planning strategy. According to Roy Rohatgi in Darussalam and Septriadi (2005), in many countries, tax avoidance is divided into permitted and not permitted tax avoidance.

Tax avoidance is considered by the company as an arrangement in lowering or eliminating the corporate tax burden by considering the consequences of the tax it

causes (Agusti, 2013). Tax avoidance carried out by multinational companies is usually calculated through the company's leadership based on the policies taken not accidentally (Budiman and Setiono, 2012). This statement is in line with Annisa (2012) who states that tax avoidance is carried out by companies through management policies as an effort to reduce the company's tax burden.

Previous research has tried to link transfer pricing with tax avoidance as stated by Lingga (2013) that transfer pricing is believed to have the impact of reducing or eliminating the potential tax revenue of a country because multinational companies tend to transfer their tax obligations from countries with high tax rates to other countries. countries with low tax rates. This has encouraged the practice of transfer pricing to avoid taxes.

According to Lingga (2013), Indonesia's tax rate with other countries can be used by taxpayers to avoid taxes by increasing or lowering transfer prices to move profits to countries with low tax rates. Transfer pricing guidelines can also be applied to taxpayer transactions that have a special relationship or related parties in Indonesia who can take advantage of the difference in rates due to:

1. Treatment of the imposition of final or non-final Income Tax on certain business sectors;
2. Treatment of the imposition of Sales Tax on Luxury Goods; or
3. Transactions made with taxpayers of oil and gas cooperation contract contractors.

2.2 Transfer Pricing

The OECD states that what is meant by transfer pricing is the price determined in transactions between related parties or group members in a multinational company. The determination of the transaction price usually deviates from the fair price in the market. Fair price deviations occur because companies are free to adopt whatever principles are good for their corporations (Tiwa, Saerang, & Tirayoh, 2017). Suandy (2008: 65) says the definition of transfer pricing can be divided into two, namely, first, the definition is neutral which assumes transfer pricing is purely a business tactic without any tax burden reduction motive. Second, the definition is pejorative which assumes transfer pricing as an effort to avoid tax by reducing the tax burden.

Halim Rachmat (2019) stated that the practice of transfer pricing is believed to reduce the potential of a country's tax revenue due to the tendency of companies to shift their tax obligations to countries with low tax rates. Likewise, Clausing (2003) who discusses tax motivations said that the transfer pricing mechanism by multinational companies will increase the company's tax motivation so that it can affect income shifting behavior in the United States.

2.2.1 Deferred Tax

Assessment of accrual accounting policies and estimates allows companies to generate deferred tax burdens, such as shifting revenues and expenses (Timuriana et al., 2015). The basis of different calculations between companies and taxation will give rise to a tax-deferred burden. According to Yulianti (2004, 109) tax burden arises due to the temporary difference between accounting profit (i.e. profit used

for additional company and external operations) and fiscal profit (profit charged as the basis for tax calculation).

In multinational companies, the tax burden borne by the company can affect the emergence of transfer pricing decisions. As Graham et al. (2017) explain, the tax burden is the main burden used as input in decision-making by companies. The difference in the tax burden in the two countries can be input in making transfer pricing decisions to ease the corporate tax burden.

Previous research was conducted by Yuniasih, N. W., N. K. Rasmini, and M. G. Wirakusuma. (2012) mentioned that taxes have a positive effect on the company's decision to make transfer pricing. Mispiyanti (2015) said that empirical testing results showed that the tax burden had no significant effect on the transfer pricing decisions of manufacturing companies listed on the Indonesia Stock Exchange. However, by Susanti & Firmansyah (2018) the tax burden is negatively related to transfer price decisions. The lower the company's tax burden, the higher the possibility of profit transfers made to the company. On the other hand, the higher the company's tax burden, the less likely the company is to transfer profits to the company. From the discussion above, we can formulate the following hypothesis.

H_{1a}: Tax burden affects transfer pricing decisions

2.2.2 Tunneling Incentive

According to Brundy (2014) tunneling is a shift of resources out of the company to the controlling shareholder. Meanwhile, from Johnson et al. (2000) tunneling is the activity of transferring assets and profits out of the company for the benefit of the controlling shareholder of the company. Mutamimah (2009) states that

tunneling is the behavior of management or majority shareholders who transfer company assets and profits for their interests, but the costs are borne by minority shareholders.

Some researchers use different proxies to represent tunneling activities, such as tunneling being proxied by other receivable balances which mostly arise as a result of transactions with related parties conducted by Jiang et al. (2005). There is also Brown et al. (2012) where tunneling is proxied through transaction balances with related parties. According to Brundy (2014) things that can cause tunneling are categorized into two, namely first, shifting company resources through transactions between companies and shareholders. Usually, this is done by the controlling shareholder. Second, the controlling shareholder can indirectly increase the number of shares owned by issuing dilutive shares or other financial transactions that have an impact on the loss of non-controlling shareholders.

Previous research conducted by Yuniasih, Rasmini, and Wirakusuma (2012), Marfuah and Azizah (2014), and Mispityanti (2015) showed that tunneling activity had a positive effect on transfer pricing decisions. Under these conditions, it shows that there are many multinational companies conducting tunneling in Indonesia. Based on Lo, Wong, and Firth (2010), tunneling activities carried out by SOEs in China have a negative impact on the shift in company profits through transfer pricing practices. Based on the discussion above, we can formulate the following hypothesis.

H_{1b}: Tunneling incentive affects transfer pricing decisions

2.2.3 Bonus Mechanism

According to Suryatiningsih et al. (2009), the bonus mechanism is an indicator of calculating the number of bonuses obtained through the GMS to directors who have performed well for a year. The bonus comes from the company owner or shareholders. Purwanti (2010) says a bonus is an award that is obtained by the board of directors if the company makes a profit based on the GMS. Bonuses can influence management to make sales and always make a profit. Nurjanah et al (2016) stated that the management's desire to be given a bonus by the owner of the company will take advantage of transfer pricing so that the company can maximize its profits. Referring to the opinion of Horngren (2008: 428), which states that bonus compensation is seen by team varies in various divisions within an organization.

In connection with previous research by Mispuyanti (2015) said that bonuses and transfer pricing are not related. Research conducted by Susanti & Firmansyah (2018) also says that transfer pricing decisions that are often made by companies have no relationship with management's desire to get bonuses. However, using the Net Profit Trend Index proxy, Nurjanah, Isnawati, and Sondakh (2016) found that the bonuses received by management influenced their actions to transfer pricing. Based on the discussion above, we can formulate the following hypothesis.

H_{1c}: Bonuses affect transfer pricing decisions.