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CAN INDEPENDENT COMMISSIONER DECREASE THE POSITIVE ASSOCIATION BETWEEN TRANSFER PRICING AND TAX AVOIDANCE?

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Abstract
Indonesia's tax ratio has not increased proportionally to projected tax revenues. A low tax ratio indicates tax avoidance. One type of tax avoidance strategy is transfer pricing. The presence of independent commissioners is expected to suppress transfer pricing practices as a forum for tax avoidance by management. This research examines the contribution of transfer pricing to tax avoidance practices. The study also investigates the moderation role of independent commissioners on managers' tax avoidance actions. The sample selection was carried out purposely on multinational manufacturing companies listed from 2019 to 2022 on the Indonesia Stock Exchange, resulting in 12 multinational manufacturing companies as samples. This research utilizes quantitative methods through panel data regression analysis. The test result finds that transfer pricing positively influences tax avoidance. However, the independent commissioner succeeds in weakening the positive influence of transfer pricing on tax avoidance. This indicates that independent commissioners have difficulty influencing management or operational-related decisions. This research implies that the Directorate General should focus on companies with high related party transactions to indicate that the company is likely to commit tax avoidance. This focus on supervision is considered to be able to increase Indonesia's tax revenue and ratio.
Keywords: Corporate governance, Tax planning, Transfer pricing

INTRODUCTION

At the 2023 G20 meeting held in Indonesia, Indonesia's tax proportion ranked third lowest among all members, at 10.39%. This fact indicates that there is still great potential in tax revenue that has not been included in the tax object in Indonesia and that has not been fully collected because of tax avoidance. In addition, when related to Gross Domestic Product (GDP), a high tax proportion indicates an improvement in the quality of tax collection.

In the state revenue budget structure, taxes are essential to the state budget (Falbo & Firmansyah, 2019). Taxes have the most significant proportion and are the primary source of state revenue. This is shown in the 2023 State Budget structure, that the tax revenue target is IDR 2,012.2 trillion from the total State Revenue Budget of IDR 2,463 trillion (Kemenkeu, 2024). Collecting tax revenue is certainly not an easy thing to do for the Directorate General of Taxes (DJP). It can be seen from a shortfall where the achievement of tax revenue does not reach the planned target. Tax revenue reached its target only in 2008, IDR 571 trillion from the target of IDR 535 trillion or 106.7%.

This shortfall indicates that Indonesia's taxpayers might not comply with tax law. Indonesia's taxpayers, especially companies, will likely focus on profit maximization, so they will find a way to maximize their profit. Managers as agents are interested in having good performance and getting incentives, so they exploit asymmetric information between them and the principal by performing tax avoidance to maximize the company's profit. This operational decision does not share the principal's best interest because tax avoidance can disrupt the company's sustainability. This tax avoidance also gives Indonesia one of the lowest tax proportions compared to other countries. Conversely, a shortfall in tax revenue and a low tax proportion indicate that tax collection is not optimal, one of which may be caused by tax avoidance practices.

One type of tax avoidance strategy is transfer pricing. Multinational companies can move or lower their profits when they manipulate transfer prices. It is known as transfer pricing

(Sitanggang & Firmansyah, 2021). The general purpose of a transfer pricing strategy is to take advantage of differences in tax jurisdictions between countries to avoid paying taxes. One of the issues related to transfer pricing in Indonesia involves PT Adaro Energy, which is engaged in the coal mining industry. Adaro is assumed to be trying to minimize its tax burden by shifting its revenues and profits to other countries. It was achieved by supplying cheap coal to Adaro's affiliate in Singapore. Global Witness detected that the level of tax remittances to the Indonesian state was 125 million dollars less than it should have been. In addition, Global Witness revealed how Adaro could lower its annual tax costs by $14 million thanks to tax havens. Based on these criteria, this study concludes that tax avoidance and transfer pricing should be investigated further.

To investigate further, We performed a mapping research study on tax avoidance. Previous studies have examined tax avoidance with transfer pricing (Amidu et al., 2019; Fasita et al., 2022; Ghasani et al., 2021; Irawan et al., 2020; Napitupulu et al., 2020; Naruli et al., 2022; Putri & Mulyani, 2020; Richardson et al., 2013; Taylor & Richardson, 2012; Utami & Irawan, 2022; Yohana et al., 2022). This study examines the results of studies on tax avoidance because tax avoidance includes activities that legally reduce tax payments.

According to a study by Amidu et al. (2019), Naruli et al. (2022), Putri & Mulyani (2020), Richardson et al. (2013), Taylor & Richardson (2012), Utami & Irawan (2022), Yohana et al. (2022), transfer pricing positively impacts tax avoidance. In contrast, according to the study results by Fasita et al. (2022) and Irawan et al. (2020), transfer pricing negatively impacts tax avoidance. In addition, according to a study by Ghasani et al. (2021) and Napitupulu et al. (2020), transfer pricing does not affect tax avoidance. Due to this inconsistency in study findings and the case of transfer pricing practices, the impact of transfer pricing on tax avoidance needs to be reinvestigated.

Internal business issues such as governance and ownership structure can impact tax avoidance practices. Effective governance can mitigate agency problems associated with tax avoidance (Yohana et al., 2022). One aspect that supports this effectiveness is the role of independent commissioners. An independent commissioner is neutral and has no individual interest in the company, so their supervision can support the reduction of tax avoidance. The study by Apriyanti et al. 202 stated that an increase would follow an increase in the ratio of Independent Commissioners in a company in the possibility of disclosing related party transactions. However, other studies have found no correlation between the ratio of independent commissioners of a company and this opportunity (Stefani & Paramitha, 2022). In addition, studies state that independent commissioner can weaken tax avoidance practices (Subagiastra et al., 2017). This finding supports the effectiveness of independent commissioners in reducing tax avoidance practices and may supervise managers in decision-making. Based on these criteria and previous research, this study identifies independent commissioners as a moderating variable in the association between transfer pricing and tax avoidance.

The previous studies investigating the association between transfer pricing and tax avoidance are still rare, with a sample representing multinational manufacturing companies listed from 2019 to 2022 on the Indonesia Stock Exchange (IDX). Thus, this study is expected to be able to add the literature related to this topic in Indonesia's context. Furthermore, with further investigations into the effect of independent commissioners on tax avoidance practices in this study, it is expected that the Directorate General of Taxes can optimize Indonesian tax receipts by reducing tax avoidance practices.

LITERATURE REVIEW

Agency theory is based on an agreement whereby one or more individuals (owners) hire others (agents) to assign or manage the owners' resources on their behalf (Jensen & Meckling, 1976). The owner of the resources, i.e., the company owner (principal), gives the manager, who acts as the agent, the power to make business choices. However, problems arise when agents do not always behave according to best practices to support the company's interests, so problems occur and lead to agency conflicts (Jensen & Meckling, 1976).

This agency theory can be related to tax avoidance, where managers can manipulate company profits, resulting in improper tax reporting. Managers do this to create a good performance picture and obtain incentives. This interest is, of course, contradictory when compared to the owner's interests. The company's owner does not expect improper tax reporting through tax avoidance because it is risky for the business, and the reported profit is not from the operations that can increase the owner's wealth in the long term. This manipulation can invite agency costs due to information asymmetry between company owners and management.

Tax avoidance can be elaborated as various actions that aim to legitimately lower tax liabilities (Lipatov, 2012). Tax avoidance is an attempt to avoid paying taxes legally by exploiting legal gaps caused by incomplete and inaccurate laws (Mocanu et al., 2021). According to Mardiasmo (2023), tax avoidance is an attempt to reduce tax expenses by not violating the law. Based on this interpretation, tax avoidance is allowed under the relevant tax regulations.

Transfer pricing is the price paid by the divisions of the seller and buyer who are engaged in transactions with the same company (Hansen et al., 2007). According to Darussalam et al. (2013), transfer pricing, in a neutral sense, is a policy related to prices that apply in transactions conducted by related parties. Transfer pricing is also often associated with manipulation by a company by transferring taxable income to a company that is part of the same multinational organization but based in a low-tax rate region (Darussalam et al., 2013). In line with this definition, Transfer pricing refers to the practice where companies based in high-tax rate regions can transfer their profits to low-tax rate regions, thereby reducing their tax liability. Transfer pricing is done by selling products or services at lower prices to subsidiaries based in low-tax regions. It aims to lower the income of companies operating in high-tax areas while increasing the income and profits of companies affiliated with low-tax countries. This whole transaction leads to income tax avoidance (Barker et al., 2016).

Multinationals have a greater chance of avoiding taxes through transactions that transfer taxable income to low-tax regions (Wang et al., 2020). Management can use transfer pricing as a tax avoidance method by transferring income to countries with lower tax rates. Compared with principals, agents' action in tax avoidance is to utilize the accuracy of the information, which can disrupt the company's sustainability if there are legal problems or the company's good name is affected. This action can be supported by company conditions where the company has branches in countries with low tax rates. Based on research by Amidu et al. (2019), Naruli et al. (2022), Putri & Mulyani (2020), Richardson et al. (2013), Taylor & Richardson (2012), Utami & Irawan (2022), Yohana et al. (2022), Wulandari et al. (2023), it is known that transfer pricing has a positive effect on tax avoidance. These findings are still supported by a study by Pratomo & Triswidyaria (2021) and Wulandari et al. (2023) of companies in Indonesia that concluded that transfer pricing affects tax avoidance. Companies that carry out transfer pricing activities are indicated to be committing tax avoidance.

H_1: Transfer pricing has a positive effect on tax avoidance

Agency theory shows that agents do not always act in the principal's best interests. It can be seen from the manager's action on avoiding tax by using transfer pricing and asymmetric information between agents and principals to increase company profit in the expectation of reaching incentives. As a result, this action can weaken the financial statements' credibility, affecting the principal's equity and the company's sustainability. To reduce this action, the asymmetric information between agents and principals should be mitigated by supervising managers in decision-making (Jensen & Meckling, 1976). An independent commissioner is an individual who serves as a member of the board of a company but does not belong as part of the daily operational management of the company (Puspitaningrum & Atmini, 2012). Independent commissioners are individuals who act as management supervisors in implementing corporate governance. An independent commissioner is a way to review and balance the commissioners' performance and increase their effectiveness (Widhiadnyana & Dwi Ratnadi, 2019). According to Hasnati (2014), the objective of the independent commissioner is to create a more objective and independent situation in overseeing corporate management. They are tasked with maintaining a balance between the interests of the corporate controllers and enforcing the rights of minority shareholders. Under this understanding, an independent commissioner can act as a consultant when companies make decisions and reduce management manipulation, including tax avoidance.

The role of the independent commissioner is to oversee and advise decisions taken by the company's management. Their presence is important because it can prevent fraudulent practices that management may commit. One example of common fraud is tax avoidance through transfer pricing. With the strict supervision of the Independent Commissioner, such practices can be identified and prevented, thus ensuring compliance with applicable tax regulations. The independent commissioner is expected to reduce the use of transfer pricing as one of the tax avoidance methods. Based on research results by Subagiastra et al. (2017) suggested that independent commissioners can weaken tax avoidance practices. Thus, an independent commissioner's existence is expected to be able to supervise managers in decision-making, especially on tax decisions, to reduce tax avoidance practices and ensure agents act in the principal best interest.

H_2: Independent commissioner weakens the positive effect of transfer pricing on tax avoidance

METHODS

The study applies a quantitative approach using data from the financial statements of multinational manufacturing companies ranging from 2019 to 2022 in the IDX, with a population of 166 companies. In sample selection, purposive sampling is used to collect samples that meet predetermined standards. Here are the results of the sample selection, along with the standard used through purposive sampling:

Table 1
Research Sample

Criteria	**Amount**
Manufacturing companies listed on the IDX	166
The number of listed companies after January 1, 2019	-18
Incomplete Financial Report 2019-2022	-5
Foreign ownership of the company below 50%	-115
The company does not disclose receivables to related parties	-4
The company incurred losses between 2019-2022	-11
The company received a tax refund	-1
The number of company data can be used in this study	**12**
Total research data	**48**

In this study, tax avoidance is used as the dependent variable. To represent tax avoidance, the Effective Tax Rate (ETR) is used, which is in line with the study by Wahab & Holland (2012), Desai & Dharmapala (2006), Dyreng et al. (2008), Hanlon (2005), Hanlon & Heitzman (2010), Rego (2003). The use of ETR is also based on the ability of ETR to explain tax avoidance stemming from temporary consequences as well as fluctuations in the overall tax burden as it considers current and deferred taxes (Hanlon & Heitzman, 2010). To calculate the tax rate, ETR uses financial accounts to compare income tax expense with the pre-tax income of the company, so the proxy tax avoidance in this study can be elaborated with the following formula:

$$\mathrm{ETR} = \frac{\text{Tax Expense}}{\text{Pretax Income}} \mathrm{x} - 1$$

Furthermore, transfer pricing is included in this study as an independent variable. Transfer pricing describes pricing in transactions between related parties (Darussalam et al., 2013). Transfer pricing is calculated by the ratio of related party receivables to total company receivables as Merle et al. (2019):

$$\mathrm{TP} = \frac{\text{Amount of Receivables to Related Parties}}{\text{Amount of Receivables}}$$

This study also uses Independent Commissioners as a moderating variable. Independent Commissioners have a function to reduce tax avoidance practices through transfer pricing because they have no connection with company management. Independent commissioners are measured by the formula employed by Pratama (2020):

$$\mathrm{IndCom} = \frac{\text{Amount of Independent Commissioner}}{\text{Amount of Company Commissioner}}$$

In addition, this study uses control variables, leverage, and firm size. Leverage measures the debt used to finance the company (Waworuntu & Hadisaputra, 2016). According to Richardson et al. (2013), leverage is calculated by dividing total debt by total company assets.

$$\mathrm{LEV} = \frac{\text{Total Debt}}{\text{Total Assets}}$$

Firm size is a control variable because the company's resources will increase as it grows. Along with the increase in these resources, the course gives management more opportunities for tax avoidance. In this study, the size of the company is projected by the natural logarithm (ln) of the total company assets with full unit value in line with Santoso & Junaeni (2022) and Taylor & Richardson (2012).

$$\mathrm{SIZE} = \ln(\text{Total Assets})$$

The data in this study were then analyzed through panel data regression. Panel data regression is done with the help of EViews software. First, descriptive analysis was conducted to explain each variable's maximum, average, and minimum values. Furthermore, analysis was carried out through the Chow, Hausman, and Lagrange Multiplier tests to ensure a suitable regression model was applied between common, fixed, or random effects. The form of multiple linear regression used can be elaborated as follows:

$$\mathrm{TAXAVOID}_{i,t} = \alpha + \beta_1 \mathrm{TP}_{i,t} + \beta_2 \mathrm{LEV}_{i,t} + \beta_3 \mathrm{SIZE}_{i,t} + \beta_4 \mathrm{ComInd}_{i,t} + \beta_5 \mathrm{TP}_{i,t} * \mathrm{KI}_{i,t} + \varepsilon_{i,t}$$

Where: TAXAVOID is for tax avoidance, TP is for transfer pricing, LEV is for leverage, SIZE is for firm size, and ComInd is for independent commissioner.

Next, a classical assumption test is performed to test the accuracy of regression equations in estimates. Finally, a hypothetical test is carried out to evaluate the hypotheses that have been compiled using double regression analysis of panel data.

RESULTS AND DISCUSSIONS

Descriptive statistical analysis in this study is used to explain the variables' maximum, average, and minimum values. Table 2 below displays a recapitulation of the descriptive statistics of all variables.

Table 2 Statistics Descriptive

Variable	Mean	Med.	Max.	Min.	Std. Dev.
TAXAVOID	0,0266	0,2686	0,8141	0,1133	0,0262

TP	0,0002	0,0915	0,3586	0,0993	0,0002
LEV	0,1670	0,5225	0,8400	0,1701	0,1670
SIZE	28,2012	29,9982	33,6551	1,7303	28,2012
ComInd	0,3000	0,4297	0,8333	0,1383	0,3000
TP*ComInd	0,0000	0,0394	0,1434	0,0421	0,0000

Based on the distribution of 48 pieces of data used as research material, the average ETR is 0.27, whereas SKBM had the highest ETR in 2019 at 0.81, while FASW had the lowest ETR in 2020 at 0.03. The average TP is 0.092, where TBMS has the highest TP in 2019 of 0.36 and value, while NIKL has the lowest TP in 2022 of 0.0003. The average LEV is 0.52; SKBM has the highest LEV in 2022 at 0.84; INTP has the lowest LEV in 2019 at 0.16. The average SIZE is 29.99, ASII has the highest SIZE in 2022, 33.65, and SKBM has the highest SIZE in 2020, 28.20. The average KI is 0.42, UNVR has the highest KI in 2020 at 83%, and ASII has the lowest KI in 2020 at 30%. The average TP*KI is 0.03. TBMS has the highest TP*KI in 2019 at 0.14, while NIKL has the lowest TP*KI in 2022 at 0.00008.

Furthermore, the best are fixed effect models after performing the Chow and Hausman Test. In this study, no Lagrange Multiplier test is needed. This consideration is based on the results of the Chow and Hausman tests, which describe that the best model is the fixed effect. The results testing the hypothesis are shown in Table 3 below.

Table 3 Test Results Hypothesis

Var.	Coeff.	t-Stat	Prob.	
C	-1.594	-0,527	0,6016	
TP	2,138	2,072	0,0466	**
LEV	-0,940	-5,318	0,0000	***
SIZE	0,071	0,706	0,4849	
ComInd	0,394	1,451	0,1588	
TP*ComInd	-4,201	-1,756	0,0889	*
R^2			0.756	
Adj. R^2			0.630	
F-stat.			6,023	
Prob(F-stat.)			0,000	

Based on the test results in Table 3, it is known that the R-squared is 0.756, which indicates that the variables used can explain the dependent variable by 75.6%, while variables outside this model explain the remaining 24.4%. Furthermore, the F-statistic probability value is 0.000. The probability value is below the significance value of 0.05, so the model is appropriate for measuring tax avoidance (ETR). The linear equation can be presented as:

TAXAVOID = -1.594 + 2.138*TP - 0.940*LEV + 0.071*SIZE + 0.394*KI - 4.201*TP_KI.

The effect of transfer pricing on tax avoidance

Based on the hypothesis testing result, transfer pricing positively affects tax avoidance, so H_1 is accepted. This result is in line with research by Amidu et al. (2019), Naruli et al. (2022), Putri & Mulyani (2020), Richardson et al. (2013), Taylor & Richardson (2012), Utami & Irawan (2022), Yohana et al. (2022), Wulandari et al. (2023). However, these results differ from studies by Fasita et al. (2022) and Irawan et al. (2020), which found that transfer pricing negatively affects tax avoidance. If agency theory is associated with tax avoidance, in which managers control corporate earnings, they do this to provide a positive performance image and receive incentives. The company's owner does not anticipate inaccurate tax reporting through tax avoidance since it is hazardous for the firm, and the reported profit is not from operations that will improve the owner's wealth in the long run. This manipulation may result in agency costs owing to information asymmetry between firm owners and management.

This research indicates that multinational manufacturing companies can avoid tax using transfer pricing practices. It occurs because of the nature of multinational manufacturing companies, which have branches in many different countries that might have lower tax rates from one branch to another. Multinational companies have a higher probability of avoiding taxes by transferring taxable income to low-tax areas (Wang et al., 2020). As a result, managers exploit this circumstance to avoid tax payments by utilizing transfer pricing practices to maintain good performance and get incentives. This finding also explains that agency theory can be reflected in the multinational manufacturing sector within 2019 - 2022. While having advantages in information accuracy, managers strive to maintain their performance and incentives by utilizing information about branches with low tax rates from transferring pricing to avoid tax.

The independent commissioner's moderation role in the association transfer pricing and tax avoidance.

Based on the test results in Table 3, independent commissioners weaken the positive influence of transfer pricing on tax avoidance, so H_2 is accepted. Agency theory suggests that agents do not always behave in the best interests of their principals. Regarding managers' activities in avoiding taxes using transfer pricing, managers utilize asymmetric knowledge with principals to increase company profits in the hope of receiving rewards. This action could harm the interests of shareholders as principals. This study shows that the placement of independent commissioners in multinational companies can prevent tax avoidance activities by carrying out transfer pricing. Based on the findings in this research, independent commissioners in multinational companies can work objectively and independently to supervise company management. These activities aim to maintain a balance between the company's controlling interests and upholding the rights of minority shareholders. Apart from that, this research also shows that independent commissioners successfully monitor tax avoidance activities by carrying out transfer pricing, which might endanger the company's condition in the future.

Independent commissioners can identify and prevent managerial practices potentially related to non-compliance with applicable tax regulations. The result of this study also confirms the finding of Subagiastra et al. (2017) suggested that independent commissioner can weaken tax avoidance practices with transfer pricing activities. The higher the percentage of independent commissioners in multinational companies in the manufacturing sector, the stronger the activities of independent commissioners in preventing tax avoidance practices with transfer pricing activities. Even though they work for multinational companies, independent commissioners strive to ensure company compliance with tax regulations and align the company's interests, especially those of minority shareholders.

CONCLUSIONS

Based on the test, transfer pricing positively influences tax avoidance. This result illustrates that multinational manufacturing companies in Indonesia tend to use transfer pricing as a tax avoidance technique. Furthermore, independent commissioners proved to weaken the positive effect of transfer pricing on tax avoidance. Independent commissioners can fully influence management in making operational decisions to obey tax regulations in Indonesia. In addition, independent commissioners strive to continue to protect minority shareholders by reducing tax avoidance with transfer pricing activities that may not be in line with them.

This research has limitations, such as the sample of companies used in this study is a multinational manufacturing company listed on the Indonesia Stock Exchange for a limited period, only 4 (four) years (2019 - 2022). In addition, 6 (six) criteria reduce the number of samples in determining the sample. Related to these limitations, future research can expand the scope of companies, not only the manufacturing sector, and increase the range of sample years to expand data coverage. Furthermore, based on this research's findings, future research can represent tax avoidance with Abnormal Book Tax-Difference (ABTD) or Cash Effective Tax Rate (CETR). The results of this study can be utilized by the Directorate General of Taxes (DJP) in making decisions regarding the focus of supervision. Supervision can be focused on companies with high related party transactions to indicate that the company is likely to commit tax avoidance. The results also can help prepare tax regulations to increase multinational companies' compliance with tax law.

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