

Transfer Pricing and Its Relationship with Effective Tax Rate, Profitability and Foreign Ownership

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Abstract

This study aims to investigate the influence of effective tax rate and profitability on transfer pricing moderated by foreign ownership of consumer non-cyclical enterprises listed on the Indonesia Stock Exchange. Transfer pricing has become an intriguing subject due to firms' desire to reduce tax expenses to generate higher profits. The hypothesis was tested using Moderated Regression Analysis (MRA), which found that the effective tax rate has no significant effect on transfer pricing, however, profitability influences companies' decision to perform transfer pricing. It has been proved that foreign ownership has a moderating effect on the effective tax rate, profitability, and the transfer pricing interaction.

Keywords: Effective Tax Rate; Foreign Ownership; Profitability; Transfer Pricing

INTRODUCTION

Transfer pricing is an essential topic in the business sector, both nationally and globally, because it may impact the price or cost imposed on transactions between two companies or subsidiaries in several different countries (Marliana et al., 2022). This is possible because transfer pricing allows commodities such as goods, services, labor, and intellectual property to be traded from one business unit to another, even across borders (Rifqiyati et al., 2021). With the World Trade Organization's capabilities, globalization has further optimized these worldwide transactions (Lingga, 2012). Transfer pricing has expanded into a mechanism that allows businesses to manage profits in order to meet their obligation to pay taxes in the most profitable way possible (Adilah et al., 2022).

Countries with low tax rates are very attractive to multinational companies (Hasibuan et al., 2022). By shifting its transactions to the country, the company can reduce the tax obligations it needs to bear so that costs can be kept as low as possible, minimizing corporate income tax and profit is generated as much as possible (Lestari et al., 2021;

Lingga, 2012). This transfer pricing strategy can maintain the company's competitiveness to compete globally and maintain its sustainability (Setyorini & Nurhayati, 2022). However, from the government's point of view, such actions can reduce potential state revenue from the taxation sector (Fadillah & Lingga, 2021). Therefore, multinational companies are often targeted by government agencies in charge of taxation (in Indonesia, it is the authority of the Directorate General of Taxes, Ministry of Finance) in meeting tax revenue targets (Wahyudi et al., 2021).

The decision to conduct transfer pricing is not only influenced by management's interest in beautifying the financial statements by displaying optimal profit. Research conducted by Fitri et al. (2019) and Hasibuan et al. (2022) proved that the level of foreign ownership has a significant effect on the company's decision to conduct transfer pricing. When foreigners sit as controlling shareholders, the control to maximize personal profits by distributing profits to countries with low tax rates will be more dominant and the company's motive to do transfer pricing will increase (Fitri et al., 2019).

Previous research that explores the influence of various factors on the company's decision to conduct transfer pricing has been widely conducted. However, there is no consistency in the results of research on these factors so it still leaves a gap for further research to fill. Research conducted by Lestari et al. (2021) and Yumna et al. (2021) found that the company's motivation to do transfer pricing in the context of tax management has a significant effect. Meanwhile, research conducted by Setyorini & Nurhayati (2022) and Wiharja & Sutandi (2023) found opposite results. Similarly, the profitability and foreign ownership factors have not obtained uniform research results in explaining their influence on transfer pricing conducted by the company.

This study differs from previous studies in the placement of the foreign ownership variable as a moderator between the transfer pricing relationship with the factors that influence it. Foreign ownership is placed as a moderating variable because there is still an inconsistent relationship between foreign ownership and transfer pricing (Baron & Kenny, 1986; Wahyudi et al., 2021), as shown by the research results of Adilah et al. (2022); Fitri et al. (2019); Hasibuan et al. (2022). In addition, research that uses foreign ownership factors in explaining the enabling factors for transfer pricing is still limited.

Therefore, this study aims to add the horizon of knowledge and insight to understand the factors that cause companies to practice transfer pricing. What makes this research even more interesting is that the year of observation coincides with the momentum of national economic recovery after the Covid-19 pandemic which, as we understand, has devastated the economy in Indonesia. The consumer non-cyclical sector was chosen as the object of research because companies that produce basic goods for the community are incorporated in this industrial sector and the demand for these products tends to be more stable so that they are more resilient in the face of economic turmoil.

LITERATURE REVIEW

Transfer pricing in the view of positive accounting theory puts company management and shareholders are rational and try to maximize their profits by considering the principle of costs and benefits (Setijaningsih, 2012; Watts & Zimmerman, 1978). This theory can be

a postulate to explain that companies optimize profit achievement by reducing costs as much as possible, one of which is to carry out transfer pricing strategies by moving their transactions to countries with lower tax rates. (Lestari et al., 2021; Lingga, 2012). This theory can also explain how the company's accounting behavior will adapt to the environment and respond to the applicable regulations in the country so that the company finally make the decision to do transfer pricing.

State revenue from the taxation sector takes up the largest portion of state revenue. Optimal tax revenue can be used to finance state development and the delivery of public services (Agustina, 2019). However, from the company's point of view, the tax expense is not a pleasant thing. For profit-oriented companies, a high tax expense is a stumbling block in achieving profit optimization. Therefore, companies will choose to take actions that can benefit them. Companies will be increasingly motivated to conduct transfer pricing and shift their transactions to countries with lower tax rates (Hasibuan et al., 2022). Effective Tax Rate (ETR) gives an idea of how much the tax expense is carried by the company when compared to the profit it generates (Yumna et al., 2020). The lower the ETR value, the greater the tax avoidance carried out by consumer non-cyclical companies in Indonesia through the transfer pricing mechanism. Based on the explanation above, the hypothesis formulated is as follows:

H1: Effective Tax Rate has a significant effect on Transfer Pricing

For profit-oriented companies, the main thing that triggers them to do transfer pricing is so that profits can be generated as much as possible. This has been reinforced by positive accounting theory which states that both management and shareholders are rational so that they will choose options that can provide greater benefits than the costs that need to be incurred (Setijaningsih, 2012). Based on research conducted by Apriani et al. (2020), it is proven that profitability affects the company's decision to conduct transfer pricing. Therefore, the hypothesis formulated is as follows:

H2: Profitability has a significant effect on Transfer Pricing

Companies with a majority of foreign ownership can affect the management of tax risks in business practices. Transfer pricing practices can be useful as a means of minimizing tax risks to maximize profit achievement. With the information it obtains from the operations of companies located in different countries, foreign ownership can use differences in tax rates in these countries to reduce tax expense and maximize profits (Fitri et al., 2019). Research conducted by Fitri et al. (2019) and Hasibuan et al. (2022) showed that foreign ownership has a significant effect on the company's decision to do transfer pricing. However, different results are known from research Adilah et al. (2022) and Marlina et al. (2022). This is what encourages the placement of foreign ownership variables as a moderator between the relationship of independent variables that affect transfer pricing practices. Therefore, the hypothesis is as follows:

H3: Foreign Ownership moderates the relationship between Effective Tax Rate (ETR) and Transfer Pricing decision.

H4: Foreign Ownership moderates the relationship between profitability and transfer pricing decisions.

Based on the hypothesis that has been formulated above, the following figure is the theoretical model of this study.

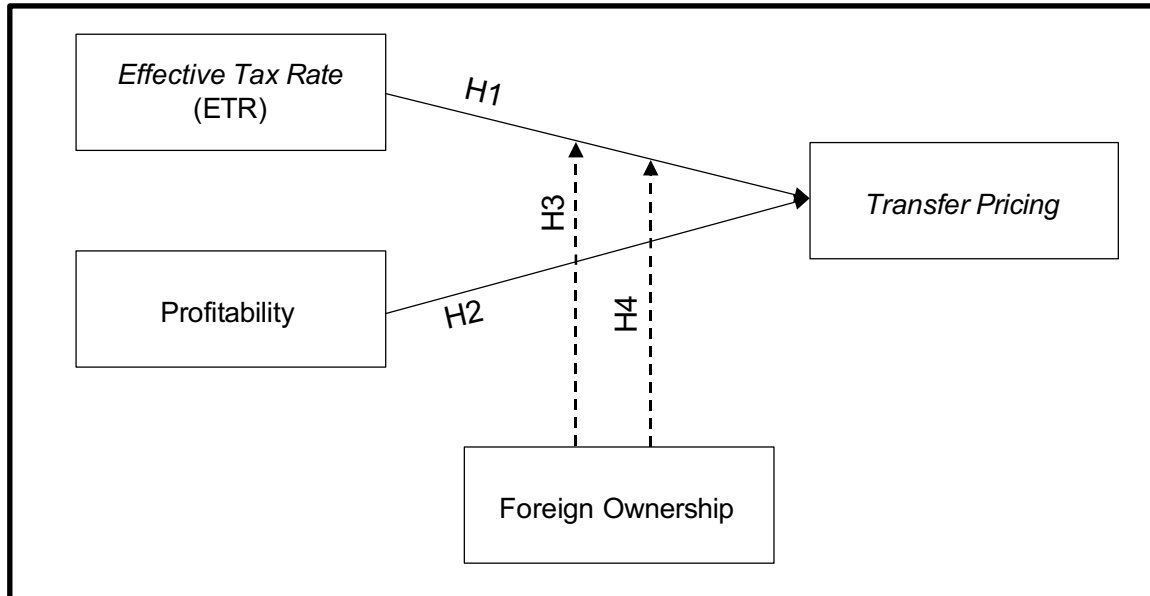


Figure 1. Research Model

Source: Hasibuan et al. (2022), modified.

RESEARCH METHODS

This study uses the Moderated Regression Analysis (MRA) method to test the relationship between the independent variable and the dependent variable involving moderating variables. This study uses secondary data, which are audited company financial statements obtained through the Indonesia Stock Exchange website and securities ownership data through the Indonesia Central Securities Depository (KSEI) website. The population in this study are non-cyclical consumer sector companies listed on the Indonesia Stock Exchange (IDX) in 2021-2022 where this period coincides with the momentum of national economic recovery after Covid-19. The sample determination was carried out using a purposive sampling method with the following criteria:

Table 1. Sample Criteria

Criteria	Sample Quantity
Consumer Non-Cyclicals sector companies listed on the Indonesia Stock Exchange (IDX) for the period 2021-2022	125
<u>Reduced into:</u>	

(1) Companies that debuted on the IDX in 2022 and thereafter	<i>Indrawaty, et al.</i> 27
(2) Companies that do not publish financial statements on the IDX consistently during 2021-2022	5
(3) Companies that experience losses during 2021-2022	12
(4) Companies with no foreign ownership during 2021-2022	26
(5) Companies with incomplete data	18
Year of Observation	2
Number of samples observed	74

Source: Author's estimation (2023)

The variables in this study and the measurement instruments used are described in table 2 as follows.

Table 2. Research Variables

Variables	Measurement Instrument	References	Data Source
Transfer Pricing (TP)	$TP = \frac{\text{Total Receivables from Related Parties}}{\text{Total Receivables}}$	Hasibuan et al., 2022; Yumna et al., 2021	Company Financial Statements
Effective Tax Rate (ETR)	$ETR = \frac{\text{Income Tax Expense}}{\text{Earnings before tax}}$	Hasibuan et al., 2022; Yumna et al., 2021	Company Financial Statements
Profitability (PFT)	$ROA = \frac{\text{Net Income}}{\text{Total Asset}}$	Apriani et al., 2020	Company Financial Statements
Foreign Ownership (KA)	$KA = \frac{\text{Num. of foreign - owned shares}}{\text{Number of outstanding shares}}$	Hasibuan et al., 2022	Securities Ownership Data

The equation used for hypothesis testing in this study is as follows:

$$TP = \alpha_1 + \beta_1 ETR + \beta_2 PFT + \varepsilon_1 \quad (1)$$

$$TP = \alpha_2 + \beta_1 ETR + \beta_2 PFT + \beta_3 KA + \beta_4 ETR * KA + \beta_5 PFT * KA + \varepsilon_2 \quad (2)$$

RESULTS AND DISCUSSION

Descriptive statistical analysis is carried out to summarize and explain the important things that are seen from the observed data (Devore et al., 2014). The results of descriptive statistical analysis are shown in table 3 below.

Table 3. Descriptive Statistical Analysis

Variables	Minimum	Maximum	Average	Standard Deviation
ETR	0.0174	0.6309	0.227804	0.0772623
PFT	0.0046	0.3431	0.102973	0.0714172
KA	0.0100	0.9600	0.261892	0.2536024
TP	0.0005	0.9393	0.269943	0.3041534

Source: Own Author Estimation (2023)

The dependent variable used in this study is Transfer Pricing (Y) which is known to have a minimum value of 0.0005, a maximum value of 0.9393, and a mean value of 0.269943. Meanwhile, there are two independent variables in this study, namely Effective Tax Rate and Profitability. Effective Tax Rate (X_1) has a minimum value of 0.0174, a maximum value of 0.6309, and a mean value of 0.227804. Profitability (X_2) has a minimum value of 0.0046, a maximum value of 0.3431, and a mean value of 0.102973. This study also uses a moderating variable, namely Foreign Ownership (Z) with a minimum value of 0.0100, a maximum value of 0.9600, and a mean value of 0.261892.

Classical Assumption Test

Before conducting regression analysis, the research data needs to be tested for classical assumptions in order to produce a regression model that meets the BLUE (Best Linear Unbiased Estimator) criteria. A regression model that fits the BLUE criteria is a regression model that can be used as an estimator that is unbiased, consistent, normally distributed, and also efficient.

The classic assumption tests used in this study include Normality Test, Heteroscedasticity Test, and Multicollinearity Test. The results of these tests are presented in table 4.

Table 4. The Results of Classical Assumption Tests

Variables	Normality Test	Multicollinearity Test		Heteroscedasticity Test
	KS Test	Tolerance	VIF	Glejser Test
ETR		0.819	1.221	0.042
PFT	0.082	0.717	1.395	0.026
KA		0.860	1.162	0.286
ETR_trans				0.893
PFT_trans				0.080
KA_trans				0.536

Source: Own Author Estimation (2023)

The normality test is carried out as an initial screening of the data to be processed so that it can be seen whether the data is normally distributed or not. This is important to ensure that the residuals will be normally distributed and independent so that the statistical test results will not be degraded (Ghozali, 2018). This study uses Kolmogorov-Smirnov Statistical Test to run normality testing. If the Asymp. Sig > 0.05 then the data is assumed to be normally distributed. If the value of Asymp. Sig < 0.05, it is concluded that the data is not normally distributed. In the initial run of normality test, the Asymp. Sig value was found to be 0.020, which is less than 0.05. Therefore, it can be concluded that the data distribution is not normal. To overcome this problem, the outlier data will be removed from the observation and the test will be conducted again. After removing 15 outlier data and conducting the Kolmogorov-Smirnov test again, the data is obtained as in table 4. The normality test results have shown that the data is normally distributed.

Next, multicollinearity test was conducted to determine whether the regression model found a correlation between independent variables. A good regression model should not have multicollinearity (Ghozali, 2018). To find out whether multicollinearity occurs in the research data, it can be seen in the tolerance value and the variance inflation factor (VIF) value. If the tolerance value 0.10 or equal to the VIF value 10, it is said that multicollinearity occurs in the regression model. The results of multicollinearity testing in table 4 shows that the tolerance value of each independent variable is 0.10 and the VIF value is 10. Thus, it can be concluded that there is no multicollinearity in this research data.

Lastly, the heteroscedasticity test is conducted to test whether in the regression model there is an inequality of variance from the residuals of one observation to another. (Ghozali, 2018). A good regression model is one that is homoscedasticity or does not occur heteroscedasticity. The Glejser test was used to test for heteroscedasticity in this study. Data is said not to occur heteroscedasticity if after the Glejser Test, the significant value > 0.05. If the significant value of the independent variable < 0.05, it is assumed that heteroscedasticity occurs in the research data (Ghozali, 2018). In the initial run of heteroscedasticity test, the result shows that the significant value of the Effective Tax Rate and Profitability variables is < 0.05, so it is known that heteroscedasticity occurs in this regression model. To overcome this, data transformation is carried out using the Weighted Least Squares method in order to neutralize the unbiased nature and consistency of the regression model (Hanifah et al., 2015). After data transformation

using the Weighted Least Squares method, the significant values for the Effective Tax Rate (ETF_trans) and Profitability (PFT_trans) variables have reached > 0.05 . This means that the transformation method successfully overcomes the symptoms of heteroscedasticity in this research data so that it is homoscedasticity. Because this research data has passed all classical assumption tests, it can be concluded that this data has met the BLUE (Best Linear Unbiased Estimator) criteria and can proceed to hypothesis testing using the Moderated Regression Analysis (MRA) method.

Hypothesis Testing

The Moderated Regression Analysis (MRA) method is used to test the hypothesis and draw research conclusions. The significance value used in this study is < 0.05 , so if the significance value of the independent variable on the dependent variable is < 0.05 , the hypothesis is accepted. The results of the hypothesis testing are presented in table 5.

Table 5. The Results of Hypothesis Testing

Variable	Multiple Linear Regression			Moderated Regression Analysis		
	B	t	Sig.	B	t	Sig.
ETR_trans	0.090	0.859	0.394	1.843	9.234	<0.001
PFT_trans	-5524.752	-2.707	0.009	1856.184	1.570	0.122
KA_trans	-	-	-	1.678	10.560	<0.001
trans_ETR_KA	-	-	-	-0.002	-13.424	<0.001
trans_PFT_KA	-	-	-	-294.366	-3.563	<0.001
R square	0.160	-	-	0.809	-	-
Adj. R square	0.130	-	-	0.791	-	-

Source: Own Author Estimation (2023)

From table 5, it is known that Effective Tax Rate variable has a significance value > 0.05 (i.e., 0.394), which means that Effective Tax Rate does not affect the company's decision to do Transfer Pricing. Thus, H1 is rejected. Furthermore, Profitability variable has a significance value < 0.05 (i.e., 0.009) which means that Profitability has a significant effect on the company's decision to conduct Transfer Pricing. Therefore, it can be concluded that H2 is accepted.

The Coefficient of Determination test aims to explain how far the regression model's ability to explain variations in the independent variable (Ghozali, 2018). It is known that the R square value of multiple linear regression is 0.160, which means that the contribution of the Effective Tax Rate and Profitability variables to Transfer Pricing is 16% and the rest is influenced by other factors not observed in this study.

From table 5 above, it is known that the significance value of the interaction variable between Effective Tax Rate and Foreign Ownership is <0.001 (<0.005), which means that the Foreign Ownership variable is able to moderate the effect of Effective Tax Rate variable on Transfer Pricing variable. Thus, H3 is accepted. In addition, it is also known that the significance value of the interaction variable between Profitability and Foreign Ownership is <0.001 (<0.005), which means that the Foreign Ownership variable is able to moderate the effect of Profitability variable on Transfer Pricing. Therefore, H4 is accepted.

The Coefficient of Determination Test in Moderated Regression Analysis shows the interaction of Foreign Ownership as a moderating variable with the independent variables. It is known that the R square value is 0.809, drastically increased from the result of the Coefficient of Determination Test of previous regression model. This value means that the contribution of Effective Tax Rate and Profitability variables to Transfer Pricing after moderated by Foreign Ownership variable is 80.9%.

Discussion

From the results of statistical testing that has been done, it is known that only H1 is rejected. This indicates that the motivation of companies to conduct transfer pricing is not influenced by the desire to reduce the tax burden. However, profit optimization is one of the factors that influence the company's decision to conduct transfer pricing. This is also reinforced by the role of Foreign Ownership which is able to moderate the relationship between the Effective Tax Rate variable and Profitability variable on transfer pricing.

The Effect of Effective Tax Rate on Transfer Pricing

The first hypothesis testing result shows that the effective tax rate does not affect the company's decision to do transfer pricing. Although according to positive accounting theory it is said that management and shareholders will try to maximize profits by analyzing costs and benefits, it can be assumed that the method chosen is not through transfer pricing for tax expense reduction. Companies can perform business operations efficiently to reduce operational expenses or can take advantage of various tax relief or amnesty programs provided by the Government to reduce the income tax burden.

The decision not to do transfer pricing can also be influenced by the consideration that transfer pricing to reduce the tax burden can threaten the company's reputation because it is considered disobedient to the regulations (Simorangkir et al., 2018). As a result, the legitimacy of the company may decrease, thus affecting the sustainability of the company. Not to mention the economic conditions during the COVID-19 pandemic which, directly or indirectly, had an unfavorable effect on the company's business. Therefore, in the post-Covid-19 pandemic period, the company is at a critical point so the company needs to be careful in making decisions so that the company's reputation can be maintained and can continue to survive in the following period. The positive side of the company's decision not to do transfer pricing is that the government can intensify tax revenue from the company's business operations so that it can finance the National Economic Recovery (PEN) program. It is hoped that this can improve Indonesia's

economic growth, which had declined during the pandemic.

The results of this study are in line with research conducted by Wiharja & Sutandi (2023) and Setyorini & Nurhayati (2022). Both studies argue that companies do not have to use transfer pricing mechanisms to reduce tax expenses but can use other methods, for example through tax planning (Wiharja & Sutandi, 2023) or tax avoidance schemes (Sintiana & Purnomo, 2023).

The Effect of Profitability on Transfer Pricing

Positive accounting theory suggests that company management and shareholders are rational individuals so they try to maximize profits (Setijaningsih, 2012; Watts & Zimmerman, 1978). This theory is in line with the results of the second hypothesis testing which shows that profitability has a significant effect on the company's decision to do transfer pricing. With transfer pricing, companies can purchase raw materials from subsidiaries that have a lower selling price than the market price. In addition, transfer pricing can also be used by the company to increase goal congruency between managers and the board of directors which leads to an increase in the company's profitability (Blocher et al., 2010).

The results obtained in this study are consistent with the research of Apriani et al. (2020) which also proved that company profitability affects transfer pricing. Companies with a high level of pre-tax income do not use this to reduce the tax expense, but by transferring their income to subsidiaries (Rustian & Syafri, 2023).

Moderating Effect of Foreign Ownership on Transfer Pricing

The third hypothesis testing result shows that the interaction of the Foreign Ownership variable can moderate the relationship between effective tax rate and transfer pricing. This means that the higher the level of Foreign Ownership, the higher the transfer pricing transactions in the company. This is due to the influence of foreign investors who encourage management to move the company's business transactions to countries with lower tax rates to maximize profits (Rustian & Syafri, 2023).

Besides moderating the relationship between effective tax rate and transfer pricing, Foreign Ownership also moderates the relationship between profitability and transfer pricing decisions. This is based on the consideration that Foreign Ownership can encourage companies to simplify the company's operational costs by conducting transactions with subsidiaries so that the profit level can be increased and can also reduce income tax expenses. Research conducted by Fitri et al. (2019) and Hasibuan et al. (2022) also proves that there is a significant influence between Foreign Ownership on the company's decision to do transfer pricing.

CONCLUSION

Based on a series of statistical tests that have been conducted, it is known that the effective tax rate is not a motivation for companies to conduct transfer pricing practices. Companies can take maximum advantage of various tax relief programs, even tax write-offs, provided by the government. To increase the company's profit, making purchase

transactions to subsidiaries can be one of the options. By doing this, the company can help the government in achieving the state revenue target from the taxation sector, especially during the National Economic Recovery period. This action provides similar benefits for the company because with a high level of tax compliance, the public considers that the company has good values in running a business and public trust can increase. With a positive corporate image, the company can maintain its legitimacy in the community to preserve business continuity.

However, the government needs to increase attention against companies that have a majority shareholding structure held by foreign investors. According to the results of this study, foreign ownership in the company may affect the company's decision to conduct transfer pricing to minimize income tax burden and increase profits. The government can also intensify education to the public regarding the importance of investing, especially investing in companies in the industry of basic needs of the community, so that little by little local investors can dominate share ownership in the company.

Some limitations in this study, such as the short observation time, can be an opportunity for further research. In addition, future research can also include other industrial sectors as a complement, such as the health and pharmaceutical sectors, so that the generalizability of the research results will increase.

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