

The Effect of Transfer Pricing and Profitability on Tax Avoidance Empirical Study in Industrial Sector Companies

421

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ABSTRACT

This study aims to evaluate the influence of transfer pricing and profitability on tax avoidance in industrial sector companies listed on the Indonesia Stock Exchange (IDX) during the period 2019-2023. The analytical methods employed include descriptive statistical analysis, classical assumption tests, multiple linear regression analysis, t-tests, and the determination coefficient test using SPSS software with a 5% significance level. The sample used in this study consists of 139 observations. The results indicate that transfer pricing has a significant effect on tax avoidance, while profitability does not have a significant impact on tax avoidance. These findings suggest that companies tend to use transfer pricing strategies to minimize tax burdens and increase after-tax profits. Conversely, changes in profitability levels cannot be considered a reliable indicator to predict changes in corporate tax avoidance behavior. Thus, this study highlights the importance of transfer pricing as a key factor in corporate tax avoidance strategies, while profitability does not show a significant relationship with tax avoidance. These findings contribute to the literature on tax avoidance and can serve as a reference for policymakers in understanding the dynamics of tax avoidance in the industrial sector.

Keywords: Transfer Pricing, Profitability, Tax Avoidance

ABSTRAK

Penelitian ini bertujuan untuk mengevaluasi pengaruh transfer pricing dan profitabilitas terhadap tax avoidance pada perusahaan sektor industri yang terdaftar di Bursa Efek Indonesia (BEI) selama periode 2019-2023. Metode analisis yang digunakan meliputi analisis statistik deskriptif, uji asumsi klasik, analisis regresi linear berganda, uji t, dan uji koefisien determinasi dengan bantuan program SPSS dan tingkat signifikansi 5%. Sampel yang digunakan dalam penelitian ini berjumlah 139 observasi. Hasil penelitian menunjukkan bahwa transfer pricing memiliki pengaruh signifikan terhadap tax avoidance, sedangkan profitabilitas tidak memiliki pengaruh signifikan terhadap tax avoidance. Temuan ini mengindikasikan bahwa perusahaan cenderung menggunakan strategi transfer pricing untuk meminimalkan beban pajak dan meningkatkan laba setelah pajak. Sebaliknya, perubahan dalam tingkat profitabilitas tidak dapat dijadikan indikator yang andal untuk memprediksi perubahan dalam perilaku penghindaran pajak perusahaan. Dengan demikian, penelitian ini menyoroti pentingnya transfer pricing sebagai faktor kunci dalam strategi penghindaran pajak perusahaan, sementara profitabilitas tidak menunjukkan hubungan yang signifikan dengan tax avoidance. Temuan ini memberikan kontribusi terhadap literatur mengenai tax avoidance dan dapat menjadi acuan bagi para pembuat kebijakan dalam memahami dinamika penghindaran pajak di sektor industri.

Kata kunci: Transfer Pricing, Profitabilitas, Tax Avoidance

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INTRODUCTION

The Indonesian government certainly needs a source of funds for operational expenses and national development, taxes are one of the components. According to Haztania & Lestari (2023), taxes are contributions that must be fulfilled by both individuals or an agency, their nature is mandatory as explained by statutory regulations. These taxes are used for the state's sake and its people's prosperity. The existence of taxes is very necessary; this is because, with taxes, a country can run its activities. This is what requires the preparation of appropriate tax regulations. In 2022, tax revenues reached IDR 1,716.8 trillion, exceeding the target of IDR 1,485 trillion. Sri Mulyani Indrawati recorded a growth of 34.3%, reflecting a positive economic recovery. Economic growth from the tax sector also reached 34.3% compared to the previous year, showing a positive trend. This indicates optimism about economic recovery after the Covid-19 pandemic, even though there was a low revenue base in 2021 (news.ddtc.co.id). Minister of Finance Sri Mulyani Indrawati said that various efforts have been made by the state through the Directorate General of Taxes to optimize income tax revenues from taxpayers, but the results are still not optimal because there are still many potential taxpayers who do not pay taxes or even avoid them (kemenkeu.go.id). The portrait of this condition highlights the practice of tax avoidance carried out by taxpayers. According to the Indonesian Forum for Budget Transparency (FITRA), around 80 percent of tax avoidance perpetrators are corporate taxpayers, while the rest are individual taxpayers (suara.com). According to Pohan (2018), tax avoidance is carried out legally and safely for taxpayers, by exploiting weaknesses in tax laws and regulations to reduce the amount of tax to be paid.

One of the phenomena related to tax avoidance is that according to the Tax Justice Network report, Indonesia loses around 4.86 billion US dollars per year due to tax avoidance. Most of it, around 4.78 billion US dollars, comes from corporate tax avoidance practices. The rest, around 78.83 million US dollars, comes from individual taxpayers (kompas.com). From the news quote above, in an effort to minimize taxes, companies use various strategies. First, tax avoidance is done legally by following existing regulations. Second, tax evasion, violates tax provisions to reduce tax debt. This reflects the complexity of dealing with tax issues and their impact on state revenues (Suandy, 2011). According to research conducted by Burhannudin (2020), transfer pricing is used by multinational companies to avoid taxes by selling products and services below market prices and then transferring profits to subsidiaries in countries with lower tax rates. This allows them to minimize the tax burden they have to pay. The variables that can influence the occurrence of tax avoidance include profitability Napitupulu (2020), transfer pricing Rathke et al. (2021), corporate social responsibility Juliana & Stiawan (2022), tax haven (Temouri et al., 2022), company characteristics Sutanto & Lasar (2023), company size Nani (2021), earnings management (Sari & Ajengtiyas, 2021).

In this study, the author uses transfer pricing and profitability as independent variables (variables that affect the dependent variable). In Law No. 36 of 2008, there are regulations that deal with transfer pricing issues, namely in Article 18 paragraph of the Income Tax Law which states that the Directorate General of Taxes is authorized to re-determine the amount of Taxable Income (PKP) for taxpayers who have special relationships with other taxpayers in accordance with the fairness and customs of the business that is not influenced by special relationships. Based on Law No. 36 of 2008 Article 18 paragraph, a special relationship can occur when a Taxpayer has direct or indirect capital participation of at least 25% in two or more Taxpayers. According to Sari (2004), it highlights those special relationships between companies can result in price, cost, and reward distortions in business transactions, shifting income and tax burdens from one taxpayer to another to reduce the amount of tax to be paid. One example of transfer pricing practices is carried out by PT Adaro Energy Tbk through its subsidiary in Singapore, Coaltrade Services International. The effort was said to have been carried out from 2009 to 2017. Adaro is suspected of having arranged it in such a way that they could pay US\$ 125 million in taxes or equivalent to Rp 1.75 trillion (exchange rate of Rp 14 thousand) lower than what should have been paid in Indonesia (detikfinance.com). In addition to transfer pricing

which is used as motivation in tax avoidance, other factors are also influenced by profitability. Companies that have more profits tend to be involved in transactions or schemes to avoid corporate taxes (Cahyadi & Kurniawan, 2018). Company profit is obtained from the difference between incoming assets (revenue and profit) and outgoing assets (expenses and losses). The profitability ratio can be used to measure a company's ability to make a profit.

Profitability is a performance indicator carried out by management in managing company assets as indicated by the profits generated; the higher the profitability of a company, the higher the possibility of profit shifting; in other words, the greater the suspicion that the company is committing tax avoidance. The company will transfer profits to affiliated companies located abroad with lower tax rates where the company is located. This profit or profit shift aims to reduce the tax burden borne by the company because the amount of tax depends on the profit obtained by the company (Setiawan, 2014). This study was conducted based on inconsistencies in the results of previous studies regarding the effect of transfer pricing and profitability on tax avoidance. From the results of research conducted by Sari & Kurniatio (2022) and Isnaini & Handayani (2024), it was stated that transfer pricing has an effect on tax avoidance. However, the results are different from the research conducted by Napitupulu et al. (2020) and Istiqomah & Cahyono (2024), which stated that transfer pricing has no effect on tax avoidance. This means that tax avoidance will not be affected even if the company carries out transfer pricing for tax avoidance.

Another factor that influences tax avoidance is profitability. Based on research conducted by Adelia and Asalam (2023), it shows that profitability has a positive effect on tax avoidance. Meanwhile, research conducted by Anggiyanti & Sormin (2024); Rathke et al. (2020) shows that profitability has a significant negative effect on tax avoidance. However, the results are different from the research conducted by Ariska et al. (2020) profitability has no effect on tax avoidance. This is because not all companies transfer profits to affiliated companies abroad. Based on the background and identification of the problems above, the purpose of this study is to determine and provide empirical evidence regarding the effect of transfer pricing and profitability on tax avoidance in manufacturing companies listed on the Indonesia Stock Exchange (IDX) in 2019-2023. With this research, researchers hope to be able to provide useful contributions and can provide benefits to interested parties. In theory, the benefits of the results of this study are that they can provide a deeper understanding of the relationship between tax avoidance, especially the variables of transfer pricing and profitability. In practice, the results of this study are expected to be able to provide information to investors, both external and internal, as a consideration before making an investment or not making the wrong decision.

LITERATURE REVIEW

The legitimacy theory was first proposed by Dowling & Pfeffer (1975), he stated that legitimacy can be said to be a benefit or potential source for a company to be able to survive and survive. The legitimacy theory is rooted in the idea of a social agreement between corporations and society. The survival and growth of a company depends on its ability to convey the desired goals to distribute benefits in the economic, social, or political fields to the community where it obtains its power (Shocker & Sethi, 1973). The legitimacy theory is stated by providing a description that there is a difference between the values according to the company and those in society, therefore the company will be in a threatened position if there is a difference or known as a legitimacy gap. This theory is based on the idea that if society has realized that the company operates in harmony with society itself, the presence of the company will be able to continue. Insensitivity to the possible impacts that can occur on company activities is said to be able to cause a legitimacy gap (Lindawati & Puspita, 2015).

According to Gupta and Newberry (1997), transfer pricing practices can affect public perceptions of corporate ethics and accountability. They found that transfer pricing

manipulation can damage public trust in companies, threatening their legitimacy in the eyes of the public. Meanwhile, the relationship between high profitability and aggressive tax avoidance practices. They found that companies with high profitability tend to be more likely to engage in controversial tax avoidance, which can damage their legitimacy in the eyes of the public and government (Hanlon & Slemrod, 2009). The concept of legitimacy shows that companies try to be responsible for maintaining their image and reputation in front of the public. Companies maintain good cooperative relationships between companies and stakeholders such as investors, creditors, the public, and the government so that they have a good impact on the sustainability of the company. Companies that maintain good relationships with stakeholders and maintain their reputation will certainly avoid actions such as tax avoidance that will tarnish the company's good image. An entity must be in line with the values and norms that exist and apply in society, so that it will not pose a threat to the legitimacy of society (Nurulita and Yulianto, 2023).

According to Suandy (2011), transfer pricing can be divided into two, namely a neutral understanding and a pejorative understanding. The neutral understanding assumes that transfer pricing is purely a business strategy and tactic without the motive of reducing the tax burden. While the pejorative understanding assumes transfer pricing as an effort to save tax burdens with tactics, including shifting profits to countries with low tax rates. Transfer pricing is a transaction of exchanging products or services that occurs between two different entities in a corporate group. The exchange of products between the sales division and the purchasing division in the same entity cannot be said to be transfer pricing because technically it is still in the same reporting entity. According to Gunadi (2013), transfer pricing is the price of the transfer of goods or services by name and in any form between companies that have a special relationship (associates) whether domestically or abroad (Tampubolon and Al Farizi, 2018).

The profitability of a company can be assessed in various ways depending on the profit and assets or capital that will be compared with each other. According to Kasmir (2019), the profitability ratio is a ratio to assess the company's ability to seek profit or profit in a certain period. This ratio also provides a measure of the level of effectiveness of a company's management as indicated by the profit generated from sales or from investment income. According to Susilowati & Fadhillah (2019), profitability is the company's ability to earn profit in relation to sales, total assets or equity. In general, companies prefer the income they receive to be used as the main source of financing for investment. If the source is from the company, then another alternative used is to issue debt, then issue new shares as another alternative for financing.

Tax avoidance practices are efforts made by taxpayers so that taxes owed can be minimized. Tax avoidance practices emphasize efforts that can be made but do not violate the provisions or regulations of applicable tax laws. The purpose of establishing laws in collecting taxes is to obtain state income from large tax revenues. However, there are various loopholes in tax laws that make tax avoidance practices often carried out by Taxpayers. Tax avoidance practices do not violate the contents of the law (The letter of law), but do not support the purpose of establishing the tax law (pajak.go.id). According to Pohan (2018), tax avoidance is an effort to avoid taxes that is carried out legally and safely for taxpayers because it does not conflict with tax provisions, where the methods and techniques used tend to exploit weaknesses (grey areas) contained in the tax laws and regulations themselves to reduce the amount of tax owed.

METHOD

This study was conducted on industrial sector companies listed on the Jakarta Stock Exchange (IDX) during the 2019-2023 period, with a sample of 50 companies selected using a purposive sampling method based on the industrial sector index (IDXINDUST). According to Rinaldi & Cheisviyanny (2015), the measurement of tax avoidance uses the effective tax rate or Cash Effective Tax Rate (CETR). The higher the CETR, the lower the level of corporate tax avoidance (Susanti, 2018). Transfer pricing is the determination

of prices for goods, services, or technology between companies that have special relationships (Suandy, 2011; Gunadi, 2013). The dependent variable in this study is transfer pricing, measured by the ratio of related party transactions to total receivables (Ardyaksa & Kiswanto, 2014). Brigham & Huston (2010) explain that one of the ratios for measuring profitability is Return on Assets (ROA), which shows the percentage of company profits from total assets (Sutrisno, 2012). The hypothesis was tested using the multiple linear regression analysis method, which analyzes the relationship between two or more independent variables with one dependent variable to show the direction of the relationship (Sugiyono, 2013).

RESULT

In this study, the population used is the industrial sector companies with the index code (IDXINDUST) consisting of 50 companies on the Indonesia Stock Exchange (IDX) in 2019 - 2023. The sample was selected using the purposive sampling method. After the sample selection was carried out according to the predetermined criteria, 40 companies were obtained that met the sample criteria. Outliers are cases or data that have unique characteristics that look very different from other observations and appear in the form of extreme values for either a single variable or a combination. Detection of outlier data in this study has been carried out using the SPSS 25 application, by converting data values into standardized scores or what are commonly called z-scores. According to Ghazali (2018) for small sample cases (less than 80), the standard score with a value ≥ 2.5 is declared an outlier. Table 1 presents the observation sampling process.

Table 1. Observation Sampling Results

Criteria	Total
Industrial sector companies with index codes listed on the Indonesia Stock Exchange 2019 – 2021	50
Financial reports of companies that do not have complete information regarding Transfer Pricing and Profitability, and starting from 2019 to 2023	10
Companies that meet the criteria	40
Total data 2019 – 2023: 40 companies x 5 years	200
Outlier Data	(61)
Number of Observation Samples	139

Based on the results of descriptive statistics, it is known that the data from this study are limited only to industrial sector companies listed on the IDX 2019 - 2023. The total sample processed in this study was 40 companies with 139 observations. In these descriptive statistics describes the description of each variable seen from the number of observations, minimum value, maximum value, mean and standard deviation. The results of descriptive analysis using IBM SPSS Statistics 25. The results of descriptive statistical data are presented in Table 2.

Table 2. Descriptive Statistical Test Results

Variable	N	Min	Max	Mean	Std. Dev
Transfer Pricing	139	0.00	0.14	0.0514	0.03425
Profitability	139	0.00	0.44	0.1949	0.10725
Tax Avoidance	139	-0.08	0.79	0.1763	0.21177
Valid N (list wise)	139				

Based on Table 2, the results of the descriptive statistical test above can be explained that the observation data for Tax Avoidance has a minimum value of -0.08. The maximum value in the observation data is 0.79 while the average value is 0.17 with a standard deviation of 0.21. The observation data for Transfer Pricing has a minimum value of 0.00. The maximum value in the observation data is 0.14 while the average value is 0.05 with a standard deviation of 0.03. The observation data for Profitability has a

minimum value of 0.00. The maximum value in the observation data is 0.44 while the average value is 0.19 with a standard deviation of 0.10.

Before conducting hypothesis testing using multiple regression, in this study, a test was first conducted on whether there was a deviation from the classical assumption or not. This classical assumption test must be carried out so that the level of accuracy of the multiple linear regression model to be used can be known. The classical assumption test in this study consists of Kolmogorov-Smirnov to test the normality of the data statistically. The following are the results of the classical assumption test that has been carried out. The data normality test is carried out to see whether the data can be distributed properly normally or not. In this study, normality testing is carried out based on graphical tests and analysis. Ghozali (2018) explains that the normality test aims to test whether in the regression model, the independent variables and the dependent variables both have a normal distribution or not. The level of significance used is $\alpha = 0.05$. A good regression model is a normal or near-normal data distribution.

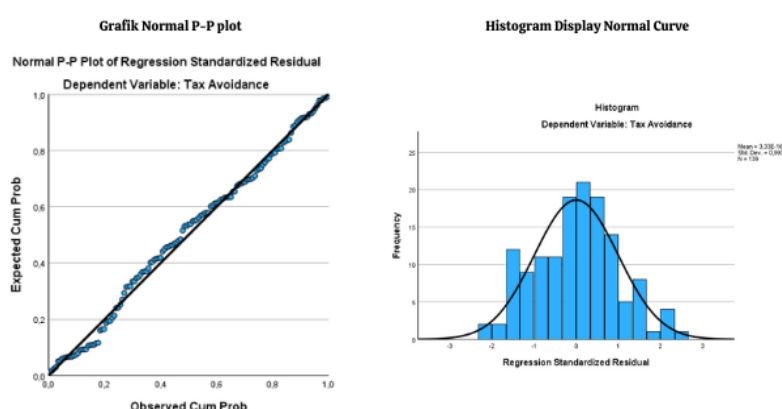


Figure 1. Normal P-P plot graph and Normal Curve Histogram Display

From Figure 1, it can be seen that the data in this study are spread around the diagonal line or the histogram graph shows a normal distribution pattern and the bell shape is in the middle, so the regression model meets the normality assumption. The normality test is carried out to see whether in the regression model the dependent variable and the independent variable both have a normal distribution or not. A good regression model is a regression that is normally distributed.

Table 3. Kolmogorov-Smirnov test

		Un-std. Residual	
N		139	
Normal Parameters	Mean	0.0000000	
	Std. Deviation	0.10311506	
Most Extreme Differences	Absolute	0.066	
	Positive	0.066	
	Negative	-0.049	
Test Statistic		0.066	
Asymp. Sig. (2-tailed)		0.200 ^d	
Monte Carlo Sig. (2-tailed)	Sig.	0.153	
	99% Confidence Interval	Lower Bound	0.144
		Upper Bound	,163

Population data is said to be normal if the Asymp. Sig (2-tailed) coefficient is greater than 0.05. Based on the normality test above using the Kolmogorov-Smirnov Test (Table 3), the table shows that in this study the data is normally distributed, because the probability value is greater than 0.05, namely 0.200. Ghozali (2018) stated that the results of the linear regression test are in the form of coefficients for each independent variable. This coefficient is obtained by predicting the value of the dependent variable with an

equation. This multiple linear regression analysis is used to test the influence between the independent variable and the dependent variable (Table 4).

Table 4. Multiple Linear Analysis Results

Model	Un-std. Coefficients		Std. Coefficients	t	Sig.
	B	Std Error	Beta		
(Constant)	0.177	0.019		9.220	0.001
Transfer Pricing	0.134	0.043	0.264	3.110	0.002
Profitability	-0.118	0.266	-0.038	-0.444	0.658

From the data results above, the following regression equation can be made:

$$TA = 0,177+ 0.134 TP - 0.118 P+ error$$

The constant of 0.177 states that if the independent variable is stated as constant, the Tax Avoidance value is 0.177. The Transfer Pricing regression coefficient of 0.134 states that every 1 unit increase in Transfer Pricing is followed by a decrease in Tax Avoidance of 0.134. Conversely, if the Transfer Pricing decreases by 1, it will increase Tax Avoidance by 0.134. The Profitability regression coefficient of -0.118 states that every 1 unit increase in profitability is followed by a decrease in Tax Avoidance of 0.118. Conversely, if the decrease in profitability is 1, it will increase Tax Avoidance by 0.118.

Hypothesis testing aims to determine the effect of an independent variable on a dependent variable with a measurement scale. Testing is carried out using the t-test (partial) and determination test (R2). The Determination Coefficient (Adjusted R2) aims to determine the proportion or percentage of the total variation of the related variable explained by the independent variable (Ghozali, 2018). The value of the determination coefficient is between zero and one. A value close to one means that the independent variable provides almost all the information needed to predict the variation of the independent variable. Each additional variable, then (R2) will definitely increase regardless of whether the variable has a significant effect on the independent variable. The value used in this study is the Adjusted R2 value because this value can increase or decrease if one independent variable is added to the model being tested. The Adjusted R2 value can be seen in Table 5:

Table 5. Coefficient of Determination Test (R²)

R	R Square	Adj. R Square	Std. Error
0.275	0.076	0.062	0.10387

Based on the table above, it can be seen that the Adjusted R2 value is 0.076. This can be interpreted that the independent variables Transfer Pricing and Profitability can explain the dependent variable Tax Avoidance by 7.6%, while the rest is explained by other factors not studied. The t-statistic test basically shows how far the influence of one independent variable individually in explaining the dependent variable (Ghozali, 2018). The t-test in this study aims to test whether or not the relationship between the independent variables of the Transfer Pricing and Profitability variables with the dependent variable, namely Tax Avoidance, is significant. The results of the t-test in this study can be seen in Table 6.

Table 6. Simultaneous Test Results (Uji t)

Model	Un-std. Coefficients		Std. Coefficients	t	Sig.
	B	Std Error	Beta		
(Constant)	0.177	0.019		9.220	0.001
Transfer Pricing	0.134	0.043	0.264	3.110	0.002
Profitability	-0.118	0.266	-0.038	-0.444	0.658

Based on the Significance value of variable X1 with a significance level of 95% ($\alpha = 0.05$). The significance number (P Value) is $0.02 < 0.05$. Based on this comparison, H1 is accepted or means that variable X1 has a significant influence on variable (Y). Based on the Significance value of variable X2 with a significance level of 95% ($\alpha = 0.05$). The significance number (P Value) is $0.658 > 0.05$. Based on this comparison, H2 is rejected or means that variable X2 does not have a significant effect on variable (Y). Based on the research data that has been presented, the research results will be discussed according to the problems raised. In this study, it has been proven that the test results carried out on the Transfer Pricing variable can be seen that the significance value is 0.02 which is smaller than the probability value of 0.05 or $0.02 < 0.05$. This indicates that hypothesis one (H1) for Transfer Pricing is accepted, so it can be concluded that Transfer Pricing has a significant positive effect on Tax Avoidance. The results of this study indicate that one of the transfer pricing practices carried out by companies is to carry out tax avoidance, namely to minimize their company's global tax obligations. When the tax rate is high, the tax burden will also increase, so that some of the burden will be transferred. The test results carried out on the Profitability variable can be seen that the significance value is 0.658 which is greater than the probability value of 0.05 or $0.658 > 0.05$. This can be interpreted that Profitability has an insignificant effect on Tax Avoidance so that H2 is rejected. In conclusion, that corporate profitability, measured by ROA (Return on Assets), does not have a significant influence on tax avoidance practices. In other words, changes in the level of profitability cannot be used as a reliable indicator to predict changes in corporate tax avoidance behavior based on the data that has been analyzed.

CONCLUSION

Based on the results of the research and analysis conducted, the results of the research from the formulation of the proposed problem can be concluded that the results of the test conducted on the Transfer Pricing variable can be seen that the significance value is 0.02 which is smaller than the probability value of 0.05 or $0.02 < 0.05$. This indicates that hypothesis one (H1) for Transfer Pricing is accepted, so it can be concluded that Transfer Pricing has a significant effect on Tax Avoidance. This shows that the transfer pricing practices carried out by the company indicate a tax avoidance motive. The results of the test conducted on the Profitability variable can be seen that the significance value is 0.658 which is greater than the probability value of 0.05 or $0.658 > 0.05$. This shows that Profitability has an insignificant effect on Tax Avoidance in a negative direction so that H2 is rejected. In other words, changes in the level of profitability cannot be used as a reliable indicator to predict changes in the company's tax avoidance behavior based on the data that has been analyzed. Further research on factors influencing tax avoidance is expected to provide better and quality results, by considering suggestions for the Indonesian government in order to increase state revenue from the tax sector, especially corporate or individual income tax, to further improve its control function so that taxpayer compliance increases. Then for multinational companies, especially the industrial sector, to further improve the quality of their financial reports, especially by implementing better tax planning so as not to practice tax avoidance that violates tax regulations.

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