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Environmental Uncertainty in The Effect of Transfer Pricing on Tax Avoidance

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ABSTRACT: One of the tax avoidance schemes undertaken by companies, especially multinational companies, is transfer pricing. Transfer pricing decisions in tax avoidance can depend on environmental uncertainty. This research analyzes the effect of transfer pricing on tax avoidance and environmental uncertainty as moderating variables in multinational companies. Secondary data from annual reports or financial statements are used as sample data. The sample used is 195 from 39 firms that appropriate the criteria of 113 companies on the Indonesia Stock Exchange (BEI) during 2018-2022 in the non-cyclical consumer sector. The analysis of this research is a regression with a moderating variable. We argue that transfer pricing is undertaken to tax avoidance practices and the decision to avoid tax by transfer pricing is influenced by environmental uncertainty. This study's results show that transfer pricing affects tax avoidance positively. In addition, environmental uncertainty can moderate that influence. The value of transfer pricing is linearly related to the value of tax avoidance. That value is strengthened by environmental uncertainty.

KEYWORDS: Transfer Pricing, Environmental Uncertainty, Tax Avoidance, Moderation, Multinational Companies

I. INTRODUCTION

At the beginning of 2020, Indonesia was intensified by the introduction of Covid-19, which had never happened before and greatly hampered the activities of economic actors because the government made regulations to limit interactions between people as a result of the rapid spread of the virus. The economic growth rate at that time decreased by 2.07 % due to a sluggish economy (BPS, 2023). This reduction in growth rates has led the government to provide tax incentives to balance the economy through taxes which must be received as the largest income for ABPN. The Minister of Finance said tax incentives had been used to increase purchasing power, help liquidity and business continuity (Darono, 2021). One of these incentives is a reduction in the Corporate Income Tax rate from 25% to 22%. The diminishing of corporate income tax rates is effective in attracting foreign investors, but the results of this policy vary in each country (Coeurdacier & Rey, 2013; Álvarez-Martínez et al, 2018). In Indonesia, the economy will get better in 2021 with economic growth that year increasing by 3.69% and in 2022 increasing by 5.31%. (BPS, 2023).

Environmental uncertainty can be seen in increasing market competition, unpredictability of changes in consumer tastes, and other volatile conditions. (Annida & Firmansyah, 2022). The presence of COVID-19 disrupted company activities which caused many companies to experience losses so that the country's economic growth decreased, but with tax incentives, company activities began to improve. This tax policy is following the OECD publication which recommends paying attention to business operations, availability of job opportunities and household income as a response to the Covid pandemic, and survey results show that tax incentives are utilized by corporate taxpayers, especially from the trade sector, processing industry sector and construction sector (Darono, 2021).

Even so, the OECD states that the tax ratio of Indonesia has been low in the Asia Pacific region in recent years until 2021 (OECD, 2022). The low tax ratio can be caused by the influence of tax avoidance (Darussalam, 2020). Tax avoidance is a legal action but can be detrimental to the state because it can reduce the potential tax that can be received. Tax avoidance is the act of reducing a taxpayer's tax legally and not abusing the law due to loopholes in the tax law. (Suryantari & Mimba, 2022; Alfiyah et al, 2022).

In 2022, the Indonesian Government will stipulate regulations concerning the prevention of tax avoidance, namely Government Regulation Number 55 of 2022 concerning Adjustments to Regulations in the Income Tax Sector (PP 55/2022). The Ministry of

Finance's press release (2022) states that this regulation specifically regulates specific prevention instruments for certain tax avoidance schemes as well as the application of the principle of recognizing economic substance above its formal form. One of the rules for preventing tax avoidance in this regulation is company activities related to special relationships in transfer pricing activities.

Transfer pricing is the price determination for each good or service of a department that is transferred to another department of the same corporate or between or inter-related party companies (Wahyudi et al, 2021) and the practice of transferring profits of multinational companies (Amidu et al, 2019). Transfer pricing is still a concern of the Indonesian government as a tax avoidance scheme because many companies in Indonesia have special relationships. As much as 37% - 42% of GDP cases in Indonesia are reported as affiliate transactions in Corporate Tax Returns which can reduce taxes from shifting profits with an estimate of US$ 100 billion to US$ 240 billion per year according to the OECD (Putri, 2021). Transfer pricing is carried out by several companies by considering several things, one of which is environmental uncertainty so that it can have a good impact. Transfer pricing practices in Indonesian taxation are often realized by multinational companies to minimize tax payments (Fasita et al, 2022; Suryantari & Mimba, 2022).

Based on what has been explained, researchers are interested in researching the impact of transfer pricing on tax avoidance and the presence of environmental uncertainty on this relationship in multinational firm listed on the Indonesian Stock Exchange in the non-cyclical consumer sector. Non-cyclical consumer sector companies are industrial sector companies whose business growth follows population and income growth. This research uses several control variables such as liquidity, leverage, and profitability. Control variables were included to ensure that the analysis results were not biased due to financial performance (Alfiyah et al, 2022). This research aims to find out whether transfer pricing affects tax avoidance and whether environmental uncertainty can moderate this effect in Indonesia.

II. LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

Tax avoidance according to Erly Suandy (2017) is a tax imposition arrangement that is still following tax provisions. The act of avoidance is an act that uses loopholes from the lack of clarity in the law. Legal loopholes that taxpayers take advantage of can occur due to the absence of clear regulations regarding a scheme or transaction (Putranti, 2015). Purwanti et al (2023) stated that tax avoidance is considered legal but can reduce state income from the tax sector. Tax avoidance is a taxpayer's effort by not engineering transactions to avoid taxes so that they do not violate them. According to Putranti (2015), tax avoidance is generally done in 3 ways, namely delaying income to postpone tax payments, tax arbitrage by taking utilize of different tax rates and tax arbitrage by taking advantage of different tax treatments. The company has two goals to achieve from earnings management for tax avoidance, namely the company wants to postpone the actual tax paid and the company wants to pay taxes lower than what should be paid (Sulistyanto, 2018).

Raya and Setyowati (2023) state that agency theory is related to tax avoidance. Agency theory was proposed by Jensen & Meckling in 1976. This theory states that managers interact with shareholders which can cause conflict due to differences in interests and responsibilities. In a company, shareholders want profits from the company's business, while managers want to achieve company goals that are not only focused on profits. In particular, Jensen and Meckling in 1974 tried to describe an agency association as the commitment that asks a manager to perform certain services in their concerns. Sulistyanto (2018) states that agency theory creates sacrifices from agency relationships so that earnings management is carried out. One way of earnings management is used as tax avoidance.

At the end of 2022, the government issued Government Regulation Number 55 of 2022 (PP No. 55 of 2022) concerning Adjustments to Regulations in the Income Tax Sector. Article 32 of that regulation states the rules for preventing tax avoidance. This article regulates transactions with special relationships that are usually carried out by companies, namely transfer pricing. This article explains that transfer pricing can be carried out according to business practices. The prevalence of transfer pricing in tax regulations is measured using several methods that taxpayers can choose.

According to Purwanti (2023), Transfer Pricing is a price calculated between companies or between divisions of a company or party that has a special relationship as management control over the transfer of goods or services. Transfer prices occur due to transactions with related parties or special relationships and are often found in multinational companies, but it does not rule out the possibility that transfer prices can occur in companies that only have branches in the country or in one company (Holtzman & Nagel, 2014).

Erly Suandy (2017) states that transfer pricing is an effort to save tax expenses with multinational transfer tactics and prices relating to trade between divisions within one legal unit (entity) or between entities within an economic unit involving various sovereign territories of the country. Savings on the tax expense can be done by shifting profits to countries with low tax rates or to companies that have small cash flows. Transactions with related parties may affect the company's net profit because products or services acquired by related parties are subject to fees that most likely do not apply to non-related companies (Herianti & Chairina, 2019). In the Tax Law, Transfer Pricing is not prohibited as long as it is within the specified limits. This is explained in Article 18 paragraphs (3), (3a), and (4) of the Income Tax Law concerning determining the price of special company relationships. The application of transfer pricing is used by taxpayers to diminish the tax expense.

Decisions regarding transfer pricing in a company can also be influenced by environmental uncertainty. Smolarski (2019) said that setting transfer prices in companies must also consider unexpected events due to environmental uncertainty. According to Irmayani (2022), environmental uncertainty requires managers to study the elements of environmental uncertainty and take steps to adapt to existing changes. Elements of environmental uncertainty include uncertainty and complexity. Uncertainty is the condition of company leaders who do not have enough information regarding the company's environmental conditions, while complexity is the diversity or number of external elements that influence the organization. The changing environment creates planning activities to properly cope with the turbulent environment, including tax-related planning (Huang et al, 2017)

A. Transfer Pricing and Tax Avoidance

Determination of transfer prices that appear to be reasonable is difficult to detect because they still comply with applicable regulations. Manager utilizes a transfer pricing policy mechanism to diminish the company's tax expense through transactions between related parties that get tax holiday facilities, shifting profits to a company incurring losses, or transactions with related parties in tax-free areas or low taxes. (Herianti & Chairina, 2019).

In research by Herianti & Chairina (2019), Pratomo & Triswidyaria (2021), Aristyatama & Bandiyono (2021), Utami & Irawan (2021), Turwanto & Alfan (2022) and Wulandari et al (2023) which was conducted with Indonesian research objects stated that transfer pricing influences tax avoidance positively. The results of this research are similar to research by Amidu et al, (2019) with the research object in Ghana. However, research by Pamungkas & Setyawan (2022) and Fasita et al (2022) states that transfer pricing influences tax avoidance negatively. These studies explain that companies can shift profits by determining transfer prices to avoid taxes. Companies with high profits or effective tax rates can use transfer pricing with related companies so they can reduce the tax expense. For that reason, the first hypothesis of this research

H1: Transfer Pricing affects tax avoidance

B. Environmental Uncertainty as Moderating in Transfer Pricing on Tax Avoidance

Environmental uncertainty makes the government often improve policies under environmental changes which can have an impact on a company's strategic decision-making so that management makes policies more carefully (Mawaddah & Darsono, 2022). By agency theory, management has the responsibility of managing the company for shareholders under any circumstances (Purnomo & Eriandani, 2023). Management will strive to make decisions that can benefit the company while maintaining good relationships with stakeholders. Raya and Setyowati (2023) say that the relationship between agency theory and tax avoidance is likely to occur in three companies, namely the desires of shareholders driving tax avoidance behavior, and tax avoidance including opportunistic actions from managers as agents. Tax avoidance practices are driven by the desires of shareholders and managers.

Tight competition with environmental uncertainty which results in market changes makes company management increasingly complex, while shareholders always want something to gain from the company, so this encourages management to avoid taxes so that profits are maximized due to minimal costs incurred for taxes (Purnomo & Eriandani, 2023; Mawaddah & Darsono, 2022; Putri & Syafruddin, 2021). Environmental uncertainty's influence on tax avoidance has been studied. According to Huang et al (2017) that high environmental uncertainty makes tax avoidance activities carried out also high. Purnomo & Eriandani (2023), Raya & Setyowati (2023) and Putri & Syafruddin (2021) state that environmental uncertainty has a positive effect on tax avoidance while Mawaddah & Darsono (2022) states that it has a negative effect. Annida & Firmansyah (2022) state that environmental uncertainty is not related to tax avoidance.

One type of tax avoidance can be done through transfer pricing. Amidu et al, (2019) said managers can choose certain transfer pricing methods compared to others by looking at the company's external and internal factors. Apart from that, transfer pricing practices can be carried out by carrying out transfer pricing with companies that are tax-free or have low tax rates. Pricing mechanisms that can maintain flexibility at the business unit level, managerial level and company level are used to deal with uncertainty and problems in transfer pricing behavior (Smolarski et al, 2019). Therefore, the second hypothesis of this research is:

H2: Environmental uncertainty moderates the effect of transfer pricing on tax avoidance

III. RESEARCH METHODS

This is quantitative research with annual reports or financial statements of sample companies as secondary data sources. Data processing was analyzed using statistical tools in the form of Eviews version 12. Data analysis was carried out using a descriptive approach. This research uses panel data. The study population is companies registered on the Indonesian Stock Exchange in the primary consumer goods sector or consumer non-cyclicals according to IDX Yearly Statistics 2018-2022. Companies in this sector were chosen because non-cyclical consumer sector companies are companies whose businesses follow developments in population conditions. There will be 113 companies in the non-cyclical consumer sector in 2022. The research sample is multinational corporations listed on the Indonesian Stock Exchange in the non-cyclical consumer sector with certain criteria. The specified criteria are to publish financial statements or annual reports for 2018-2022 in rupiah currency and not experience acquisitions or mergers.

Tax avoidance in this research is the dependent variable. The measurement of tax avoidance is proxied using Book-tax Difference (BTD). BTD can describe taxable income, but taxable income cannot be publicly observed (Lou et al, 2023). The BTD formula is accounting profit before tax subtraction tax profit compared to total assets.

This research measures transfer pricing using research scores from examining the information of annual reports or financial statements as was done in the research of Amidu et al (2019) and Fasita et al (2022). Each of the criteria above is given a value of 1 if it is met and a value of 0 if it is not met. The total score if everything is fulfilled is 5. Measurement is carried out by calculating the comparison of the information that is fulfilled with the total score. This information concerns matters such as the following:

- having a parent company, a subsidiary company in a tax haven country,
- transactions with related parties in tax haven countries for the period under study,
- have a parent company or subsidiary company in a country other than a tax haven country
- transact with related parties domiciled in states that have different tax rates for the research financial year
- payments related to intangible assets between related parties for the period under study.

Environmental uncertainty in this study is a moderating variable. Environmental uncertainty is proxied by sales volatility as in Huang et al (2017) and Annida & Firmansyah (2022). The sales volatility formula uses the covariance of sales.

The research uses control variables, namely liquidity, leverage, and profitability. Company liquidity is assessed by current assets over current liabilities and is estimated to be positively related to tax avoidance (Amidu et al, 2019). Leverage is a debt ratio calculated by comparing total long-term debt with total assets (Amidu et al, 2019). Profitability is a financial report analysis ratio that provides a summary of the company's operational activities and one type of this ratio is Return On Assets (ROA). Return On Assets is an indicator that indicates the company's financial performance to gain profits by looking at the value of net profit and total assets.

In this study, data were analyzed by testing multiple regression with interaction tests (MRA). This analysis is to test the existence of moderating variables in the influence of the independent variable on the dependent variable. The application of MRA checks three regressions for the similarity of regression coefficients (Sharma, 1981). Therefore, the regression models of this study are

Model 1 (Md1)

$$TA\_it=\alpha+ \beta1TP\_it+\beta2CR\_it+\beta3LEV\_it+\beta4ROA\_it+\varepsilon1 \quad (1)$$

Model 2 (Md2)

$$TA\_it=\alpha+ \beta1TP\_it+\beta2VP\_it+\beta3CR\_it+\beta4LEV\_it+\beta5ROA\_it+\varepsilon2 \quad (2)$$

Model 3 (Md3)

$$TA\_it=\alpha+ \beta1TP\_it+\beta2VP\_it+\beta3TP*VP\_it+\beta4CR\_it+\beta5LEV\_it+\beta6ROA\_it+\varepsilon3 \quad (3)$$

Information:

TA = Tax Avoidance
TP = Transfer Pricing
VP = Environmental Uncertainty (sales volatility)
CR = Liquidity
LEV = Leverage
ROA = Profitability
α = Constant
$\beta1$-$\beta6$ = Regression coefficient
ε = Standard error

IV. RESULTS

A. Descriptive Statistical Analysis and Hypothesis Testing

Descriptive statistical analysis is presented in Table 1. Tax avoidance (TA) as proxied by BTD has an average of -0.017035. The negative value on average indicates that the majority of non-cyclical consumer MNCs do not avoid tax because they have pre-tax profits that are smaller than their tax profits. This can also be seen from the median value which is still negative and greater than the average value of -0.008492 with a small standard deviation of 0.071811.

Table 1. Descriptive Statistics on Research Data

Variables	Means	Median	Maximum	Minimum	Std. Dev
TA	-0.017035	-0.008492	0.302313	-0.569248	0.071811
TP	0.585641	0.6	1	0	0.293923
VP	0.112511	0.074804	1.055915	0.000293	0.135814
CR	2.190548	1.503147	9.954171	0.060138	1.881167
LEV	0.523532	0.497117	2.311944	0.037812	0.309247
ROA	0.056690	0.049626	0.446758	-0.582526	0.117187

Source: Processed data, Eviews 12

The average value of transfer pricing (TP) is 0.585641 with a maximum value of 1 and a minimum value of 0 and a median value of 0.6. In this study, several non-cyclical consumer multinational companies carried out transfer pricing because the average and median values were more than half the maximum value, but the standard deviation was higher than tax avoidance and sales volatility, which meant that there was a high deviation in scores between the companies making the transfer and does not carry out transfer pricing. Environmental uncertainty, which is proxied by sales volatility (VP), in this study does not affect company activities because the average value is small and the median value is far from the maximum value.

In this research, three control variables can describe company performance. The highest average, median, minimum, maximum and standard deviation of these variables occurs in company liquidity (CR) and the lowest in company profitability (ROA). This shows that the companies studied have different levels of liquidity, but the level of company profitability (ROA) is not much different between MNC companies in this sector. Most of the companies in this study have low CR, ROA and leverage (LEV) because the average is far from the maximum value and the median value is lower than the average value.

Table 2. Results of Hypothesis Testing

	MD 1		**Md 2**		**MD 3**	
Variable	Coef	Prob	Coef	Prob	Koef	Prob
C	-0.1210	0.0001	-0.12438	0.0001	-45186.60	0.0038
TP	0.0868	0.0481	0.07654	0.0785	29009.34	0.7342
VP			0.06208	0.0224	-105683.6	0.0130
TP_VP					0.266282	0.0003
CR	0.0030	0.5135	0.00371	0.4127	1066.571	0.6082
LEV	0.0206	0.4495	0.02194	0.4143	-0.052029	0.3601

ROA	0.6300	0.0000	0.63335	0.0000	0.490066	0.0000
Adjusted R-squared		0.615178		0.625819		0.654399
Prob (F. Stat)		0.00000		0.00000		0.00000

Source: Processed data, Eviews 12

Hypothesis testing for this research consists of three models. Md1 for test results of the effect of transfer pricing on tax avoidance, Md2 for test results of the effect of transfer pricing and environmental uncertainty on tax avoidance and Md3 for test results of environmental uncertainty as a moderating effect of transfer pricing on tax avoidance. The results of hypothesis testing are shown in Table 2. The significance level in this test is 5% (0.05), which means the risk of error in decision-making is 5%. The T-test in Table 2 shows the transfer pricing (TP) probability values of 0.0481 (Md1), 0.0785 (Md2) and 0.7342 (Md3). The TP probability value on Md1 is lower than 5% but on Md2 and Md3 it is higher than 5%. This means that transfer pricing has an effect on tax avoidance on Md1 and has no effect on Md2 and Md3.

Environmental uncertainty (VP) in Table 2 has a probability value of 0.0224 for Md2 and 0.0130 for Md3. The probability value is less than 5% in Md2 and Md3, and the interaction test between transfer pricing and environmental uncertainty in Md3 also has a probability value lower than 5%, namely 0.0003. This means that environmental uncertainty affects tax avoidance in model 2 and model 3. Furthermore, environmental uncertainty can moderate the effect of transfer pricing on tax avoidance. Apart from that, among the control variables used, only profitability (ROA) affects tax avoidance because the probability value is less than 5%.

The F test in this study shows a probability of less than a significance value of 5%, namely 0.000000 in all models. This means that all test variables have a simultaneous effect on tax avoidance. This research has a determination value of 0.615178 on Md1, 0.625819 on Md2, and 0.654399 on Md3 so that the relationship between the test variables simultaneously in model 1 is 61.52%, in model 2 it is 62.58% and in model 3 it is 65.43%.

B. Discussion

1. The Effect of Transfer Pricing on Tax Avoidance

According to the output of the Md1 test, H1 is accepted, meaning that transfer pricing affects tax avoidance. Transfer pricing on tax avoidance in this study has a positive effect because the transfer pricing coefficient is positive. The positive influence illustrates the existence of a straight relationship between transfer pricing and tax avoidance. When transfer pricing is high, tax avoidance in the company is high or vice versa. Multinational companies use transfer pricing for tax avoidance (Amidu et al, 2019). The findings of this research are in line with research by Wulandari et al (2023), Pratomo & Triswidyaria (2021), Aristyatama & Bandiyono (2021), Utami & Irawan (2021), Turwanto & Alfan (2022), Herianti & Chairina (2019) and Amidu et al, (2019) but contrasts with research from Pamungkas & Setyawan (2022) and Fasita et al (2022).

Based on descriptive statistics, research shows that many multinational companies do not avoid tax so these companies carry out low transfer pricing. This is in accordance with Fasita et al (2022) who stated that multinational companies seemingly do not want to be seen by the Indonesian tax authorities by carrying out aggressive transfer pricing activities in tax avoidance. The tax authorities have long made various regulations as for the prevention of tax avoidance through transfer pricing and this is clearly emphasized again in article 32 of PP 55/2022. Apart from that, the Indonesian government issued regulations that provide tax incentives during the pandemic and are still in effect, for example, the use of a tax rate of 22% instead of 25%. Strict regulations and reduced tariffs mean that multinational companies in Indonesia are not motivated to carry out transfer pricing as tax avoidance. Transfer pricing for tax avoidance is carried out from countries that have high to low rates and the reduction in tax rates in Indonesia means that tax avoidance is no longer the main goal of earnings management (Wulandari et al, 2023).

2. Environmental Uncertainty on the Effect of Transfer Pricing on Tax Avoidance

Based on the Md3 test results, H2 is accepted, which means that environmental uncertainty can moderate the effect of transfer pricing on tax avoidance. Environmental uncertainty can be measured by sales volatility because environmental uncertainty can cause changes in sales (Huang et al, 2017). The research results show that environmental uncertainty affects tax avoidance positively such as Purnomo & Eriandani (2023), Raya & Setyowati (2023) and Putri & Syafruddin (2021). Besides that, the interaction of transfer pricing and environmental uncertainty influences tax avoidance. These results indicate that managers' decisions in carrying out transfer pricing for tax avoidance depend on environmental uncertainty. This research can enrich the tax accounting literature by providing empirical evidence to support agency theory in tax avoidance practices. This research is in line with the statement that in agency theory, managers must be able to be responsible to shareholders in managing the company in any situation (Purnomo & Eriandani, 2023) and shareholders encourage managers as in agency theory and shareholders encourage managers to avoid taxes to gain profits (Raya and Setyowati, 2023.

The results of this study show that the interaction coefficient value between transfer pricing and environmental uncertainty is positive. This means that environmental uncertainty strengthens the influence of transfer pricing on tax avoidance. Environmental uncertainty which is detrimental to the company makes the company undertake transfer pricing to practice tax avoidance, but when environmental uncertainty is not detrimental to the company the company does not avoid tax by transfer pricing. This result is similar to the statement by Smolarski et al (2019) that environmental uncertainty will influence managers in deciding on transfer pricing mechanisms. In this research, environmental uncertainty does not make managers avoid tax by transfer pricing. Indonesia is indeed experiencing an economic downturn due to the pandemic but the provision of tax incentives is being used well by companies in Indonesia (Darono, 2021). Therefore, the Company does not carry out transfer pricing because of the benefits of tax incentives provided in their operations so that tax avoidance does not occur.

V. CONCLUSION AND SUGGESTION

Tax avoidance is still a major concern in Indonesia. Indonesia's tax ratio is still one of the lowest in the Asia Pacific region, both before and after the environmental uncertainty in Indonesia, namely COVID-19 and the provision of tax incentives during COVID-19, which will continue until COVID-19 ends. The results of this research show that transfer pricing influences tax avoidance positively. In this study, tax avoidance was not widely carried out by multinational companies because the average BTD calculation was negative so the transfer pricing carried out was low. This research also shows that environmental uncertainty can moderate these effects. The existence of environmental uncertainty causes managers to consider transfer pricing actions in tax avoidance practices.

This research can be used as management evaluation material in making decisions that impact commercial and tax financial reports. Investors also need to pay attention to earnings management in companies that are facing an uncertain business environment. Apart from that, the tax authorities need to supervise special relationships, especially in multinational companies and must be careful in making regulations when something unpredictable happens so that the tax potential in Indonesia is not reduced.

This research has several limitations. The sample used in this research is only limited to one sector, this is intended to focus more on the phenomena that occur because the sample used can balance the country's economic conditions, but it is better for further research to add the types of sectors or make comparisons between sectors. Then the measurement of tax avoidance only uses BTD so it is hoped that further research can add other measurements as a comparison.

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