

Corporate Tax Avoidance in an Emerging Market: The Critical Roles of Transfer Pricing and Earnings Management

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ABSTRACT: Manufacturing companies in Indonesia face pressure to increase profitability while meeting their tax obligations, which has led to the emergence of various strategies to minimize tax burdens within legal boundaries, such as transfer pricing and earnings management. This phenomenon is important to study because tax avoidance practices can impact government revenue. This study aims to analyze the influence of transfer pricing and earnings management on tax avoidance among manufacturing companies listed on the Indonesia Stock Exchange (IDX) during the 2020–2024 period. This study employs a quantitative approach using secondary data obtained from the companies' annual financial reports. The research sample consists of 25 companies with a total of 115 observations after outlier testing. The analysis method used is multiple linear regression with the aid of SPSS, which includes classical assumption tests, partial tests (t-tests), simultaneous tests (F-tests), and the coefficient of determination (R^2). The results indicate that transfer pricing does not have a significant partial effect on tax avoidance, whereas earnings management has a negative and significant effect on tax avoidance. Simultaneously, both independent variables were found to have a significant effect on tax avoidance.

KEYWORDS: transfer pricing, earnings management, tax avoidance, multiple linear regression

I. INTRODUCTION

Taxes represent one of the most important sources of government revenue and play a significant role in financing national development. In Indonesia, tax revenue contributes more than 70% of total state revenue, indicating that the sustainability of economic development largely depends on the effectiveness of tax collection. According to the Ministry of Finance, tax revenue in 2024 reached Rp1,932.4 trillion, exceeding the state budget target and demonstrating the government's efforts to improve fiscal performance. However, Indonesia's tax-to-Gross Domestic Product (GDP) ratio remains relatively low, indicating that there is still considerable untapped tax potential. Therefore, improving tax compliance remains an important challenge for the government.

From the perspective of companies, taxes are often viewed as a burden because they reduce net income and corporate profits. Consequently, companies frequently implement tax planning strategies to minimize tax expenses while remaining within legal boundaries. One of these strategies is tax avoidance, which refers to efforts to reduce tax liabilities by taking advantage of weaknesses or loopholes in tax regulations. Although tax avoidance is considered legal, aggressive tax avoidance practices may reduce government revenue and negatively affect fiscal sustainability.

Several factors may influence corporate tax avoidance practices, including transfer pricing and earnings management. Transfer pricing refers to the determination of transaction prices between related parties within the same corporate group. Through transfer pricing mechanisms, companies may shift profits to affiliated entities located in lower-tax jurisdictions, thereby reducing their overall tax burden. Meanwhile, earnings management refers to managerial actions intended to influence reported earnings through accounting policies or managerial discretion. Such practices may affect taxable income and ultimately influence the amount of taxes paid by companies.

The manufacturing sector is one of the major contributors to the Indonesian economy and plays an important role in industrial growth and export activities. Manufacturing companies listed on the Indonesia Stock Exchange (IDX) experienced considerable economic challenges during the 2020–2024 period due to the COVID-19 pandemic and the subsequent economic recovery. During this period, the government introduced several fiscal policies and tax incentives to support business activities. However, these conditions may also encourage companies to adopt various tax planning strategies, including transfer pricing and earnings management, in order to maintain profitability and financial performance.

Previous studies investigating the determinants of tax avoidance have produced inconsistent results. Sari and Wijaya (2020) found that transfer pricing positively affects tax avoidance, suggesting that related-party transactions increase opportunities for companies to reduce their tax burden. Similarly, Isnaini et al. (2024) reported that transfer pricing significantly influences tax

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avoidance practices. In contrast, Dewi and Hidayati (2024) found that transfer pricing does not significantly affect tax avoidance. Likewise, studies examining earnings management and tax avoidance have also reported mixed findings, indicating that the relationship between these variables remains inconclusive.

The inconsistency of previous empirical findings indicates the existence of a research gap regarding the influence of transfer pricing and earnings management on tax avoidance. Furthermore, limited studies have examined these relationships in Indonesian manufacturing companies during the post-pandemic period. The economic recovery period may create different managerial incentives regarding financial reporting and tax planning practices, thereby providing a unique research setting.

Therefore, this study aims to examine the effect of transfer pricing and earnings management on tax avoidance in manufacturing companies listed on the Indonesia Stock Exchange during the 2020–2024 period. This study is expected to contribute to the literature by providing updated empirical evidence regarding corporate tax avoidance practices in Indonesia, particularly during the post-pandemic economic recovery period.

II. LITERATURE REVIEW

A. Agency Theory

Agency theory explains the contractual relationship between a company's owners (principals) and management (agents), who are authorized to manage the company and make operational decisions. In this relationship, owners expect management to act to maximize the company's value and shareholder welfare. However, in practice, this relationship does not always run smoothly due to conflicts of interest and information asymmetry between the two parties. Management has broader access to the company's internal information than the owners, which potentially allows them to exploit this situation for personal gain (Jensen & Meckling, 1976).

This conflict of interest can lead to opportunistic behavior, such as the manipulation of financial statements or decision-making that does not fully reflect the company's economic condition. In the context of taxation, agency conflicts can encourage management to implement various strategies to reduce the tax burden, including through transfer pricing and earnings management. Shareholders generally focus on increasing the company's long-term value, while management tends to focus on achieving short-term targets, such as bonuses and compensation. This difference in orientation forms the basis for the emergence of aggressive earnings management practices and tax strategies.

B. Transfer Pricing

Transfer pricing is a mechanism for determining the price of transactions involving goods, services, or intangible assets that occur between parties with a special relationship within a business group. These transactions generally occur between a parent company and its subsidiaries, or between affiliated entities located in different jurisdictions. Conceptually, transfer pricing practices are permitted as long as they comply with the arm's-length principle, which means that the prices used must be equivalent to those prevailing in transactions between independent parties (OECD, 2022).

However, in practice, transfer pricing is often used as a means of shifting profits, particularly to countries with lower tax rates. By setting prices for transactions between entities, companies can manage the distribution of profits so that their tax burden is reduced (Sianturi & Sanulika, 2023). This situation has led to transfer pricing being viewed as a strategy often associated with tax avoidance. In addition, special relationships between entities also give companies the flexibility to set prices that do not always reflect actual market conditions (Juliana & Stiawan, 2022).

In the regulatory context, the Indonesian government has regulated transfer pricing practices through various tax regulations that are in line with international standards, including OECD guidelines. Monitoring these practices is crucial to ensure that transactions between related parties are conducted on an arm's-length basis and do not undermine government revenue. Therefore, transfer pricing is a relevant variable in research on tax avoidance, particularly for companies with complex corporate group structures.

C. Earnings Management

Earnings management refers to actions taken by management to influence the earnings reported in financial statements, so that those earnings do not fully reflect the company's actual economic condition. This practice can be carried out through various methods, including accrual-based earnings management and real earnings management. Common forms of earnings management include accelerating revenue recognition, deferring expense recognition, and changing the accounting methods used (Alfarizi et al., 2021).

In many cases, earnings management is carried out to achieve specific objectives, such as meeting investor expectations, maintaining earnings stability, or securing performance-based compensation. In addition, this practice can also be used for tax purposes, namely by reducing taxable income so that the tax liability to be paid is lower (Hendi & Handianto, 2021). This indicates that earnings management not only affects the quality of financial statements but is also closely related to a company's tax strategy.

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From the perspective of agency theory, earnings management is a form of opportunistic behavior that arises from conflicts of interest between managers and company owners. Managers tend to exploit the flexibility in accounting standards to maximize their personal interests, particularly in the short term. Therefore, earnings management is a key factor that can influence tax avoidance practices within a company.

III. RESEARCH HYPOTHESES

D. *The Effect of Transfer Pricing on Tax Avoidance*

Transfer pricing is the process of setting prices for transactions between parties with a special relationship within a business group. From the perspective of agency theory, management, as the agent, tends to maximize corporate profits, in part by reducing the tax burden. This can be achieved by shifting profits to entities located in countries with lower tax rates. This practice results in lower reported profits, thereby minimizing the company's tax liability.

Research conducted by Chrisandy & Simbolon (2022) shows that transfer pricing has a positive effect on tax avoidance. However, a study by Noviyanti Dewi & Wahyu Nurul Hidayati (2024) found that transfer pricing has no effect on tax avoidance. The discrepancy in these findings suggests that the relationship between transfer pricing and tax avoidance remains inconsistent, warranting further investigation.

H₁: Transfer pricing affects tax avoidance.

E. *The Effect of Earnings Management on Tax Avoidance*

Earnings management refers to actions taken by management to adjust reported earnings in accordance with specific objectives. In agency theory, this practice arises due to information asymmetry between management and owners, thereby providing management with the opportunity to manipulate financial statements. One of the objectives of earnings management is to reduce a company's tax burden, as higher earnings result in higher taxes payable.

Research Wang & Chen (2012) shows that earnings management has a positive and significant effect on tax avoidance. This is consistent with the study by Zubaidah & Satyawan (2017) which states that earnings management practices can be used as a strategy to reduce a company's tax burden.

H₂: Earnings management affects tax avoidance.

F. *The Effects of Transfer Pricing and Earnings Management on Tax Avoidance*

Companies can employ various strategies to reduce their tax burden, including transfer pricing and earnings management. Simultaneously, these two practices can complement each other in minimizing tax liabilities. Transfer pricing allows companies to shift profits between entities, while earnings management is carried out through the manipulation of financial statements.

A study by Anggraini & Pramono (2022) shows that transfer pricing and earnings management simultaneously have a significant effect on tax avoidance. This indicates that both variables can enhance the effectiveness of a company's tax avoidance strategies.

H₃: Transfer pricing and earnings management simultaneously have a significant impact on tax avoidance.

IV. RESEARCH METHOD

This study employs a quantitative approach using secondary data obtained from manufacturing companies listed on the Indonesia Stock Exchange during 2020–2024. The sampling technique used is purposive sampling. Data were analyzed using multiple linear regression with SPSS.

A. TABLE RESEARCH SAMPLE

The sampling technique used was purposive sampling a method based on specific criteria selecting companies that were consistently listed during the study period, published complete financial reports, and had data that met the study's requirements. Based on these criteria, 25 companies were selected as the research sample. With an observation period of five years, the initial number of observations was 125 data points. However, after conducting an outlier test to remove extreme data that could potentially distort the analysis results, the sample size used in this study was reduced to 115 observations. The following are the results of the sample processing in this study:

No	Sampling Criteria	Total
1	Manufacturing companies listed on the IDX during 2020–2024	198
2	Companies experiencing losses during 2020–2024	(126)
3	Companies with incomplete variable information	(33)
4	Companies that did not publish complete annual reports	(14)
Final sample companies		25
Observation year		5

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Initial observations	125
Outliers	(10)
Final observations	115

V. RESULTS AND DISCUSSION

A. Descriptive Statistics

The descriptive statistics indicate that the average value of transfer pricing is 0.2950, earnings management is -0.0746, and tax avoidance is 0.2103. The results suggest variations in corporate practices regarding transfer pricing, earnings management, and tax avoidance among manufacturing companies.

	N	Minimum	Maximum	Mean	Std. Deviation
Transfer Pricing	115	0.00	0.92	0.2950	0.29235
Manajamen Laba	115	-1.13	0.90	-0.0746	0.55142
Tax Avoidance	115	0.00	0.39	0.2103	0.09405
Valid N (listwise)	115				

B. Classical Assumption Tests

The results of the classical assumption tests indicate that the regression model satisfies the normality, multicollinearity, heteroscedasticity, and autocorrelation assumptions. Therefore, the regression model is considered appropriate for hypothesis testing.

C. Multiple Regression Analysis

The regression equation is as follows:

$$Y = 0.205 + 0.002X_1 - 0.054X_2$$

The regression coefficient of transfer pricing is positive but statistically insignificant. Meanwhile, earnings management has a significant effect on tax avoidance.

D. Hypothesis Testing

a. Effect of Transfer Pricing on Tax Avoidance

The results indicate that transfer pricing does not significantly affect tax avoidance. This finding suggests that related-party transactions conducted by manufacturing companies are not necessarily intended to reduce tax burdens. The implementation of transfer pricing regulations and tax supervision may limit the use of transfer pricing as a tax avoidance strategy. This result is inconsistent with the findings of Sari and Wijaya (2020) and Isnaini et al. (2024), which reported a significant effect of transfer pricing on tax avoidance. However, the findings support studies that concluded that transfer pricing does not significantly influence tax avoidance.

b. Effect of Earnings Management on Tax Avoidance

The results show that earnings management significantly affects tax avoidance. This finding indicates that managers may utilize accounting discretion to influence reported earnings and taxable income. Consequently, earnings management becomes one of the mechanisms used to manage corporate tax obligations. This finding supports agency theory, which explains that managers may act in their own interests through accounting policies. The results are also consistent with previous studies that found earnings management significantly influences tax avoidance.

c. Simultaneous Effect of Transfer Pricing and Earnings Management on Tax Avoidance

The simultaneous test shows that transfer pricing and earnings management jointly affect tax avoidance. This result indicates that both variables contribute to explaining variations in tax avoidance practices among manufacturing companies. The coefficient of determination indicates that transfer pricing and earnings management explain a portion of tax avoidance, while the remaining variation is influenced by other factors not included in this study, such as profitability, leverage, firm size, and corporate governance.

Code	Hypothesis	Result	Conclusion
H ₁	Effect of Transfer Pricing on Tax Avoidance	The transfer pricing variable was found to have no significant effect on tax avoidance	Rejected
H ₂	Effect of Earnings Management on Tax Avoidance	Earnings management affects tax avoidance the earnings management variable has no significant effect on tax avoidance	Accepted
H ₃	Simultaneous Effect of Transfer Pricing and Earnings	Transfer pricing and earnings management simultaneously have a significant effect on tax avoidance the transfer pricing and	Accepted

	Management on Tax Avoidance	earnings management variables together have a significant effect on tax avoidance	
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E. Discussion

The results show that transfer pricing does not significantly affect tax avoidance. This finding indicates that related-party transactions are not necessarily used as a strategy to minimize corporate tax burdens. The result differs from previous studies that found a significant relationship between transfer pricing and tax avoidance. Earnings management significantly affects tax avoidance. This finding suggests that managers may use accounting discretion to influence reported earnings and taxable income. The result supports agency theory and previous studies indicating that earnings management contributes to tax avoidance practices. Simultaneously, transfer pricing and earnings management affect tax avoidance. This finding indicates that both variables jointly contribute to explaining tax avoidance practices in manufacturing companies listed on the Indonesia Stock Exchange during 2020–2024.

CONCLUSIONS

Based on the results of this study on the effects of transfer pricing and earnings management on tax avoidance among manufacturing companies listed on the Indonesia Stock Exchange during the 2020–2024 period, it can be concluded that, in isolation, transfer pricing does not have a significant effect on tax avoidance. Meanwhile, earnings management has a significant effect on tax avoidance. However, when considered simultaneously, transfer pricing and earnings management were found to have a significant effect on tax avoidance.

The results of this study indicate that tax avoidance practices in companies are not influenced by a single factor alone but rather result from a combination of several interrelated policies. Therefore, companies tend to employ various strategies simultaneously in managing their tax obligations.

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