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The Effect of Financial Distress and Transfer Pricing on Tax Avoidance in Multinational Companies Listed on Indonesia Stock Exchange (IDX) in 2020-2022 Period

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ABSTRACT

Due to the Covid-19 pandemic conditions from 2020 to 2022, many companies, including multinational corporations, experiencing financial difficulties tend to be more aggressive in tax avoidance to sustain the future viability of the company. On the other hand, companies also utilize transfer pricing mechanisms to avoid high tax payments. This research aims to examine the influence of financial distress and transfer pricing on tax avoidance in multinational companies listed on the Indonesia Stock Exchange (IDX) for the 2020-2022 period. Multiple regression analysis is used to analyze the data collected from a sample of 122 multinational companies listed on the IDX. The research results indicate that financial distress has a positive influence, while transfer pricing has a negative influence on tax avoidance in multinational companies listed on the IDX. Therefore, multinational companies in Indonesia need to consider these factors in managing their tax and financial risks. The implications of these research findings suggest that multinational companies in Indonesia need to consider these factors in managing their tax and financial risks.

Keywords: Covid-19 Pandemic, Financial Distress, Indonesia Stock Exchange, Multinational Company, Tax Avoidance, Transfer Pricing

INTRODUCTION

Business expansion, both domestically and internationally, is evolving alongside the phenomenon of globalization. With globalization, many companies are getting involved in trade expansion, leading to the emergence of multinational corporations. This phenomenon enables the formation of affiliate relationships among companies. In the effort to expand trade, companies tend to increase revenue while reducing tax burdens by exploiting gaps in tax regulations, such as transferring profits to jurisdictions with lower tax rates, often involving tax avoidance practices. The motive for tax avoidance serves as motivation for taxpayers, both individuals and companies, to reduce tax obligations and enhance corporate cash flow.

However, from the perspective of the country, tax avoidance can result in a loss of potential tax revenue (Eskandar & Ebrahimi, 2020), especially when companies use the practice of transferring income profits to jurisdictions with lower tax rates. Tax avoidance is a technique employed by taxpayers to minimize tax obligations by exploiting gaps in legislation (Sari, 2019). This differs from tax evasion, where techniques to reduce taxes are employed by violating tax regulations, typically involving dishonest actions in reporting income or inflating expenses under false pretenses. Essentially, several factors influence tax compliance, including the complexity of the tax system, tax rates, tax audits, and reward and penalty systems (Sepriana, 2021).

This situation becomes more complex with factors that contribute to tax avoidance. The first factor is financial distress, the condition of financial difficulty or liquidity issues experienced by a company that can potentially lead to the company’s bankruptcy (Hartoto, 2018). This situation reflects a significant financial challenge that can indicate risks to the company’s operational sustainability. Especially in the uncertain context of globalization and the impact of the Covid-19 pandemic, if a company faces financial problems, managers are likely to take proactive steps to reduce tax burdens as a strategy to maintain their operational continuity. Companies experiencing financial distress will take actions such as reducing production, halting factory operations, and/or resorting to managerial efforts to improve the company’s situation by engaging in risky tax avoidance practices (Valencia & Khairani, 2019). This situation reflects a significant financial challenge that can indicate risks to the company’s operational sustainability. This is in line with the research findings of Feizi et al. (2016), stating that when a company experiences financial distress, it tends to engage in tax avoidance practices.

Additionally, the second factor that triggers companies to engage in tax avoidance practices is transfer pricing, a condition that encourages a company as a taxpayer to set transfer prices, a scheme commonly found in multinational corporations. Transfer pricing, also known as transfer pricing, is a transaction conducted between related parties to determine a fair price as part of business and taxation activities. Transfer pricing is a tool used by multinational corporations to avoid high tax payments. The increasing number of multinational corporations indicates an increase in international investment and trade transactions, leading to an increase in manipulative transfer pricing practices and, consequently, an increase in tax avoidance (Irawan et al., 2020).

From the tax authorities’ perspective, internal transactions between related parties must be evaluated at market prices, known as the arm’s length principle, as stipulated by the Organization for Economic Co-operation and Development (OECD). Multinational corporations engage in transaction activities by employing transfer pricing practices as the international economy develops (Sebele-Mpofu et al., 2021). When transactions between companies involve the transfer prices of goods, services, intangible assets, or transactions with related parties, applying the arm’s length principle becomes necessary, making these transactions known as affiliate transactions or transactions influenced by special relationships. This is in line with Amidu et al. (2019) explaining that multinational corporations can set transfer prices in transactions between companies with special relationships in different countries with the goal of tax avoidance.

LITERATURE REVIEW

Agency Theory

Agency theory defines the relationship between agents and principals and is characterized by conflicts arising from the desire to fulfill each of their respective interests (Putra et al., 2019). According to Hoesada (2022), agency theory in current business activities is no longer managed by the entity's owners. Instead, the management of the company is delegated to other parties (agents). In the context of this research, agency theory explains the differences between the company's owners and management in handling operational activities. Agents typically possess more comprehensive knowledge of the company's information compared to the owners, leading to an imbalance of information (asymmetrical information) (Julianty et al., 2023). When multinational corporations face financial distress, agents tend to prioritize their own interests. Management (agents) will strive to maintain a positive image by making efforts to improve performance, even when the company is in financial difficulty. Agents make these efforts to ensure the company remains standing, attracting investors, and seeking lower profits by accumulating expenses, such as depreciation, which can be used to reduce taxable income. The larger the depreciation expenses deducted, the lower the taxable income, ultimately reducing the company's tax liability. This can lead to a risk where agent decisions are not entirely in the best interest of the company but rather serve personal interests. On the other hand, concerning transfer pricing (TPRICE), it is one way to decrease the amount of tax payable, thereby reducing the country's tax revenue. This reduction is achieved through the technique of manipulating transfer prices in transactions between related companies in countries with lower tax rates as a form of tax avoidance (Utami & Irawan, 2022). In this study, the decisions made by companies in practicing tax avoidance (TA), both with financial distress and transfer pricing schemes, are determined by the decision-making of company management (agents) to salvage the company.

Tax Avoidance

Tax Avoidance (TA) is an activity carried out with the goal of reducing income before tax (Utami & Irawan, 2022). In practicing tax avoidance, taxpayers employ strategies to minimize tax burdens by exploiting loopholes in the tax regulations (Nugroho et al., 2022). From an agency theory perspective, tax management has two types: legal, referred to as TA, and illegal, involving taxpayers providing false information or concealing the true tax situation to reduce their tax obligations. This includes dishonest tax reporting, which is an illegal act under tax laws (tax evasion). Tax avoidance is generally a legal technique involving income manipulation in accordance with tax laws to minimize the tax payable, while tax evasion involves illegal manipulation to minimize tax liability (Firdayanti & Kiswanto, 2020).

According to Kurniasih et al. (2013), some common tax avoidance activities involve transferring the subject or object of taxation to low-tax countries for a specific type of income (substantive tax planning), maintaining the economic substance of transactions to incur the lowest tax burden (formal tax planning), and anti-avoidance provisions through transfer pricing, thin capitalization, treaty shopping, and controlled foreign corporation transactions.

As every taxpayer seeks to minimize business expenses to reduce tax burdens, companies experiencing financial distress tend to engage in tax avoidance to improve their situation. In the context of international taxation, the existence of multinational corporations can erode tax revenues due to the tendency of these corporations to transfer income to jurisdictions with lower tax rates, a practice known as tax avoidance.

Financial Distress

Financial distress is a situation experienced by a company where it cannot meet its financial obligations due to a lack of funds, potentially hindering business operations and indicating potential bankruptcy signs (Anugerah et al., 2022). In agency theory, managers make efforts to avoid a negative image by acting in order to maintain the company's condition. Reducing tax burdens helps the company improve its image to parties such as creditors and investors, as it enhances the availability of funds to meet company obligations. However, if the threat of bankruptcy becomes significant, the company tends to make efforts to maintain its sustainability, avoiding a negative image, and also involves external parties. This prompts managers to create decisions by manipulating the company's financial reports to increase operational income by engaging in tax avoidance as a way to reduce tax burdens (Swandewi & Noviari, 2020). Poor company performance can lead to financial distress, influenced by several external and internal factors that impact stability. Analyzing a company's condition through its financial reports is crucial for assessing its ability to meet short-term obligations and predicting the risk of bankruptcy. Extended financial distress can lead to the failure to pay debts and eventual bankruptcy. Research by Feizi et al. (2016) suggests that intensified financial distress in a company can drive it to engage in tax avoidance. Saputra et al. (2017) also states that financial distress has a positive effect on tax avoidance. Therefore, the result for the first hypothesis is:

H1: Financial distress has a positive effect on tax avoidance.

Transfer Pricing

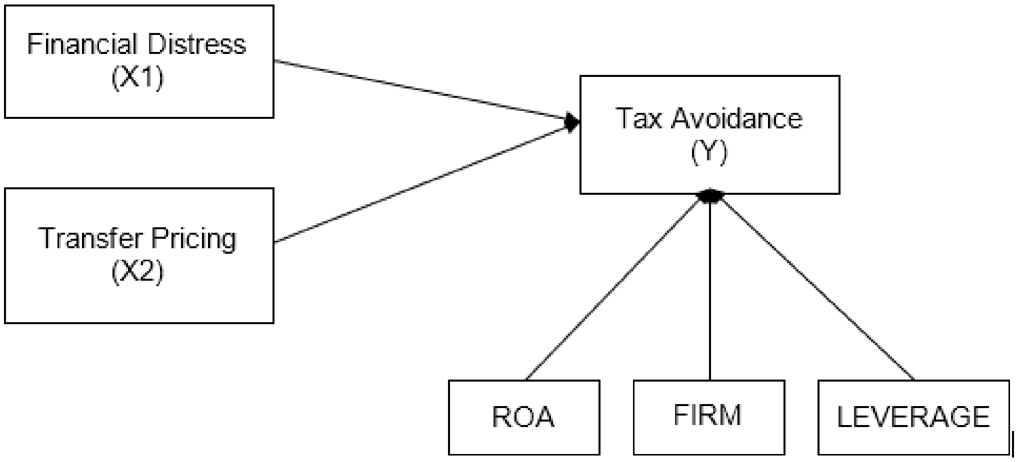
Transfer pricing refers to the method or rules for setting transfer prices in transactions conducted within and between companies under joint ownership or control (related parties). Transfer pricing is a popular issue commonly used by multinational corporations to transfer profits by exploiting loopholes in tax regulations. This profit transfer is carried out in different jurisdictions by transferring profits within a business group experiencing losses or by transferring profits to countries with lower tax rates, known as tax haven countries. These transactions may involve the transfer of intangible assets, goods, or services, or financial transactions conducted between companies under common ownership or related parties. Transfer pricing is one of the causes of reduced tax revenue because the practice involves manipulating transfer prices or the abuse of transfer pricing. This practice involves engineering the profit value of a company with the aim of receiving minimal dividends for shareholders, thereby reducing the taxable income. Based on explanations aligned with Amidu et al. (2019) and Maulana et al. (2018), it can be evidenced that the increasing practice of transfer pricing indicates an increase in the number of companies avoiding tax obligations. Therefore, based on this explanation, the second hypothesis results in:

H2: Transfer pricing has a positive effect on tax avoidance.

RESEARCH METHOD

This study utilizes secondary data obtained from the financial reports of multinational corporations listed on the Indonesia Stock Exchange within the period of 2020-2022. The sample was selected using purposive sampling, involving the selection of samples based on predetermined criteria. This research employs qualitative data with two independent variables, financial distress, and transfer pricing. The dependent variable used in this study is tax avoidance and the control variable is return of assets, firm size, and leverage.

Figure 1. Research Framework



$$Y = \alpha + \beta 1FDS + \beta 2TPRICE + \beta 3ROA + \beta 4FS + \beta 5LEV + \mathcal{E}$$

RESULTS

Table 1. Descriptive Statistics Example (*N* = 125)

Variable	N	Minimum	Maximum	Mean	Std. Deviation
CETR	125	0,0500	0,87	0,4502	0,21974
TPRICE	125	0,0000	1,00	0,652	0,41262
ZSCORE	125	-0,2498	4,7111	1,8882	1,05976
ROA	125	-0,0345	0,687	0,0127	0,00222
SIZE	125	25,7581	33,5372	29,5707	1,66095
LEV	125	0,0000	0,686	0,3289	0,14939

Note: M = Mean, SD = Standard Deviation.

Based on the results of descriptive statistics, the findings for the variable TPRICE indicate values ranging from a minimum of 0 to a maximum of 1. When the value approaches 1, it can be inferred that transfer pricing practices are being implemented, and vice versa. The average value for the TPRICE variable is 0.6520 or 65%, suggesting that companies show indications of engaging in transfer pricing. Moving on to the Z-SCORE variable, the minimum value is -0.2498, and the maximum is 4.7111. This implies that some companies are in a grey area, where the financial distress condition has a minimum value smaller than 1.10, specifically -0.2498. Additionally, for the CETR variable, the mean value is 0.4502 or 45.02%, indicating a percentage that allows companies not to engage in tax avoidance since it exceeds the corporate income tax rate in Indonesia, which is 22%. Furthermore, the mean values for the control variables are noted as follows, ROA at 0.128, SIZE at 29.570, and LEV at 0.329.

Table 2. Result of Kolmogorov-Smirnov Test

N			99
Normal Parameters[ab]	Mean		0.0000
	Std. Deviation		0.2081
Most Extreme Differences	Absolute		0.070
	Positive		0.070
	Negative		-0.062
Test Statistics			0.070
Asymp. Sig (2-tailed)[c]			0.200
Monte Carlo Sig. (2-tailed)[e]	Sig		0.277
	99% Confidence Inter	Lower Bound	0.266
		Upper Bound	0.289

Based on the results of the normality test above, it can be concluded that the asymptotic significance is at the value of 0.200, indicating that the data is normally distributed as it is smaller than 0.05.

Figure 2. Result of Normality Test Using Histogram

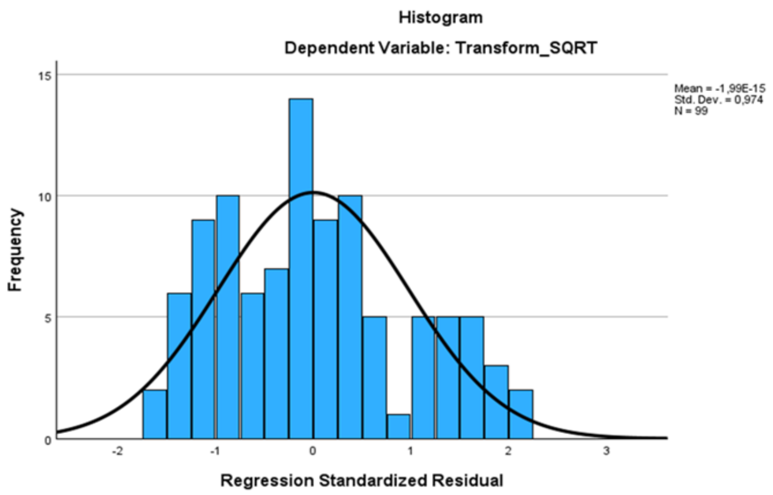
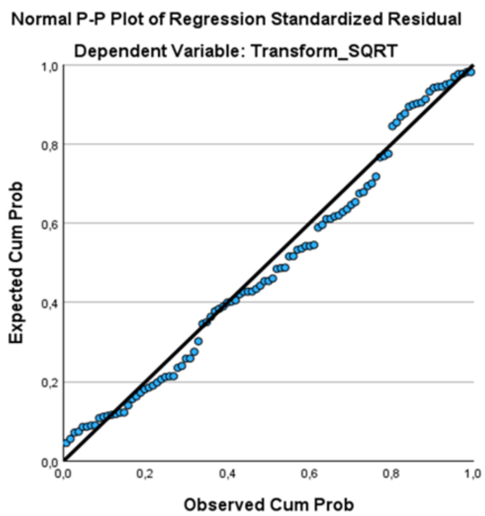


Figure 3. Normal P-Plot



In addition to the K-S test, the normality test using Histogram and Normal P-P Plot in the figure above reinforces the evidence that the data is normal because the graph is bell-shaped. In the scatterplot, the points do not deviate from the diagonal line and are not widely dispersed.

Table 3. Multicollinearity Test

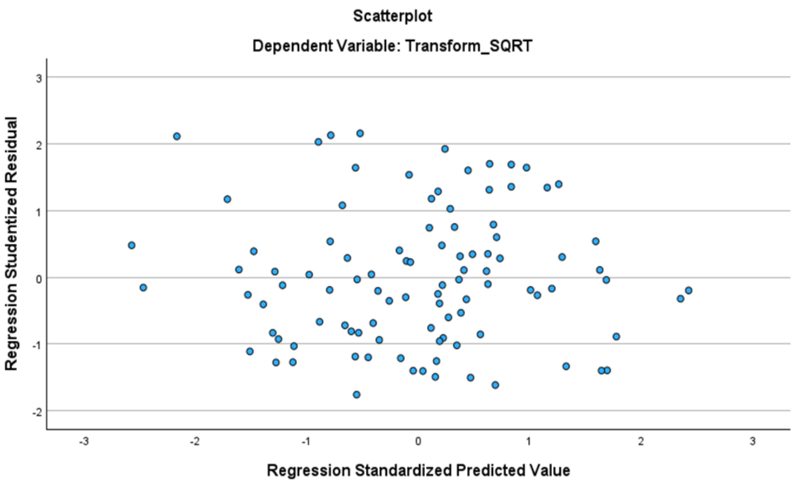
Model	Collinearity Tolerance	Statistics VIF
TPRICE	0.815	1.227
ZSCORE	0.628	1.592
ROA	0.802	1.248
SIZE	0.753	1.328
LEV	0.622	1.606

Note: Tolerance > 0.1, VIF < 10.

Based on the multicollinearity test results above, it can be stated that a regression model is considered good if it exhibits tolerance values above 0.1 (> 0.1) and variance inflation factor (VIF) values below 10 (< 10). The test results indicate that all independent variables meet the criteria, and therefore, there is no multicollinearity since the tolerance values are greater than 0.1, and the VIF values are less than 10.

Heteroscedasticity Test

Figure 4. Heteroscedasticity Test



The results of the heteroskedasticity test using a scatterplot in the above figure show that the points are evenly spread and not clustered into one group. This indicates that the data is normal, and there is no heteroskedasticity problem incurred.

Autocorrelation Test

The results of the autocorrelation test are evaluated based on the presence of correlation, indicating the existence of autocorrelation. However, a good regression model should not exhibit autocorrelation. The autocorrelation test using Durbin-Watson shows a value of 1.826, where the DW value is 1.789 < 1.826 < 2.174. Based on the data analysis, it is indicated that there is no autocorrelation.

T-Test (Partial)

Table 4. T-Test Results

Model		**Unstandardized B**	**Coefficients Std. Error**	**Standardized Coefficients B**	**t**	**Sig.**
1	Constant	0.77	0.433		1.780	0.078
	TPRICE	-0.45	0.059	-0.081	-0.754	0.453
	ZSCORE	-0.58	0.025	-0.284	-2.312	0.023
	ROA	2.759	1.067	0.282	2.587	0.011
	SIZE	-0.007	0.015	-0.052	-0.466	0.642
	LEV	-0.045	0.182	-0.030	-0.246	0.807

Based on Figure 1 above, it can be said that ZSCORE has a negative t-value, which can be interpreted that the lower the ZSCORE value concerning CETR, the higher the company's efforts to engage in tax avoidance. Therefore, ZSCORE is significantly positively correlated with tax avoidance. The ZSCORE variable has a negative t-value of -2.312 with a significance of 0.023, which is less than 0.05. Thus, based on the t-table results, it can be implied that ZSCORE has a positive effect on tax avoidance. On the other hand, ROA has a positive t-value and also significantly influences TA because it has a significant value of 0.11, which is greater than 0.05. However, the variables TPRICE, SIZE, and LEV are negatively and insignificantly correlated with tax avoidance.

DISCUSSION

The Influence of Financial Distress on Tax Avoidance

From the hypothesis testing results, it is concluded that the FDS variable, using the Altman Z-Score method, has a negative effect on CETR and a significantly positive effect on tax avoidance with a value of < 0.023. This implies that FDS has a positive influence on a company's motivation to engage in tax avoidance. Therefore, H1 can be accepted. The findings regarding the influence of FDS align with the research conducted by Meilia and Adnan (2017), stating that FDS has a positive impact on tax avoidance because companies experiencing FDS benefit more from avoiding tax payments than reducing other company costs. Consequently, companies have no choice but to take higher-risk and more proactive actions in managing their taxes, as this is crucial for improving their financial situation (Richardson et al., 2015). When a company faces financial challenges, strategies that were once considered risky and expensive become more profitable. Thus, when a company experiences financial difficulties, its tendency is to take more aggressive actions to avoid tax payments.

The Influence of Transfer Pricing on Tax Avoidance

Based on the hypothesis testing results, there is a negatively correlated relationship between the TPRICE variable and the practice of TA, where the TPRICE variable has a coefficient of 0.453 with a significance value of 0.453, greater than 0.05 (alpha 5%). Therefore, hypothesis H2 must be rejected. This indicates that the intensity of transfer pricing has no influence on the practice of tax avoidance. These results are consistent with the findings of Falbo & Firmansyah (2018) and Nadhifah & Arif (2020), possibly due to strict and transparent transfer pricing rules limiting a company's ability to freely transfer profits to jurisdictions with lower taxes, reducing opportunities for tax avoidance.

Additionally, the Covid-19 pandemic, with government-imposed restrictions impacting transactions between related companies and tax avoidance. The pandemic has shifted companies focus to maintaining business continuity rather than engaging in tax avoidance through transfer pricing (Pesak et al., 2022).

Control Variables

The control variables used in this study are ROA, SIZE, and Leverage. The first variable, ROA, emphasizes that the impact of profitability is significant because the more efficient a company is in its economic activities, the more challenging it becomes for the company to avoid taxes. The results of the T-test show that the ROA control variable has a significantly positive effect on tax avoidance, with a value of 0.011, supporting H3. Moving on to the second variable, SIZE, higher total assets, and sales revenue correspond to a larger company size. Larger companies tend to have higher revenues, potentially influencing tax avoidance activities. However, the results show that the SIZE control variable has a coefficient of 0.015 and a significance value of 0.642. This indicates that SIZE has a significantly negative effect on Tax Avoidance, rejecting H4. These findings align with research by Julianty et al. (2023), Suyanto et al. (2022), and Maulana et al. (2018), suggesting that the maturity level of a company, regardless of its size, makes it more reliable to financial institutions and more likely to meet its financial needs, reducing the tendency to engage in tax avoidance. The last variable is LEV, and the results indicate that the LEV control variable does not have a significantly negative effect on tax avoidance, with a value of 0.807, leading to the rejection of H5. This is consistent with the research by Djaya and Pradipta (2022), which states that leverage has no significant impact on tax avoidance because most company assets are not financed through loans, eliminating interest costs that could reduce tax obligations. Therefore, tax avoidance activities cannot be conducted. In financing their assets, companies tend to rely more on internal funding than external funding.

CONCLUSION

In this study, the researcher investigated whether financial distress and transfer pricing can influence tax avoidance. The analysis utilized 120 samples from multinational companies listed on the Indonesia Stock Exchange for the period 2020-2022. Due to the discovery of extreme data, the researcher performed outlier handling, resulting in 125 data samples from 2020 to 2022. This study contributes significantly to understanding the factors affecting tax avoidance practices in multinational companies in Indonesia. The results show that financial distress has a positive impact on tax avoidance, indicating that financially distressed companies are more aggressive in managing their taxes. On the other hand, transfer pricing has a negative impact on tax avoidance, revealing that strict and transparent transfer pricing rules can limit a company’s ability to transfer profits to lower-tax jurisdictions. Additionally, control variables such as return on assets (ROA) significantly influence tax avoidance, while firm size (SIZE) and leverage have no significant impact on tax avoidance.

Overall, this study provides valuable insights for multinational companies and tax regulators in understanding the factors influencing tax avoidance practices. In the context of tax avoidance, companies need to consider the social and moral impacts of tax avoidance practices and adhere to applicable tax regulations. Furthermore, tax regulators need to tighten tax rules and enhance transparency to limit tax avoidance practices by multinational companies. Thus, the author hopes that this research will make a positive contribution to creating a fair and sustainable business environment.

LIMITATION

The limitations of this study include the diversity of sectors in multinational corporations that can be used as samples. Considering that this study only focuses on examining multinational companies with a minimum foreign ownership of 25% in the manufacturing sector listed on the Indonesia Stock Exchange for the period 2020-2022. Additionally, the R2 value is considered low, indicating that the variables used in this study have quite limitations in influencing tax avoidance.

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DECLARATION OF CONFLICTING INTERESTS

The authors sincerely declare that there are no conflicting interests that could affect the results or interpretation of this research. The authors have no financial, personal, or professional relationships that could be considered to influence the objectivity or integrity of this research. This declaration is an effort to disclose transparency to ensure that the research results can be accounted for and respected in an academic and scientific context.

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