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The Effects of Transfer Pricing and Thin Capitalization on Tax Aggressiveness in Multinational Companies

Annisa Fitri Anggraeni[1], Ai Lastari[2]
[1]Universitas Winaya Mukti, Bandung, Indonesia, annisafitrianggraeni@gmail.com
[2]Universitas Winaya Mukti, Bandung, Indonesia, ailestari163@gmail.com

Corresponding Author: annisafitrianggraeni@gmail.com [1]

Abstract: The increase in nominal tax revenue has not been accompanied by an increase in the tax ratio. The low tax ratio indicates the presence of tax avoidance in Indonesia. Some tax avoidance practices that can be employed include transfer pricing and thin capitalization. This study aims to identify and empirically test the effects of thin capitalization and transfer pricing on tax aggressiveness. The data used in this study are secondary data. This study uses a sample of companies in the Primary Consumer Goods (Consumer Non-Cyclicals Goods) sector listed on the Indonesia Stock Exchange from 2022 to 2023. The population of the study consists of 89 companies observed over a two-year period. This study employs a purposive sampling method. The total sample for this study comprises 178 financial statements. The data analysis techniques used include descriptive statistical analysis, estimation of panel data regression models, panel data regression model selection techniques, hypothesis testing, and the coefficient of determination, utilizing the *Eviews* 13 software. The results of this study indicate that, partially, transfer pricing has a negative and significant effect on tax aggressiveness, and similarly, thin capitalization has a negative and significant effect on tax aggressiveness. Simultaneously, transfer pricing and thin capitalization together have a significant effect on tax aggressiveness.

Keyword: Transfer pricing, Thin capitalization, Tax Aggressiveness.

INTRODUCTION

According to Law No. 28 of 2007, a tax is defined as a mandatory contribution to the state owed by individuals or entities, which is enforced by law, without direct compensation, and is used for state purposes to maximize the people's prosperity. In Indonesia, the public works together with the government for national development.(Vitaloka et al., 2023:115)

In terms of implementation, collection, and legislation, taxes are one of the state's largest sources of revenue. Companies use the taxable income base and applicable rates in accordance with Law No. 36 of 2008, Article 6, paragraph (1), which states that taxable income is calculated by deducting expenses incurred to earn, collect, and maintain income from gross income. Taxes are levies paid by the people to the state for the national interest. The people pay taxes for the public good, not for personal or self-interest. (Isnaini et al., 2024:808)

The Indonesian tax system is a self-assessment system. Under this system, taxpayers have full discretion to calculate their own taxable income, and they consistently utilize this system to minimize their tax liability through tax planning. As a result, taxpayers can gain personal benefits that they would not otherwise receive through their business operations. According to Article 21 of the General Provisions and Taxation Law, however, in practice, the law allows taxpayers to increase business expenses to reduce the amount of tax paid by business owners.

Tax revenue accounted for 108.8% of the state's revenue in 2023. As a result, the Indonesian government continues to strive to optimize tax revenue. This contrasts with companies, which aim to maximize profits by minimizing their tax burden. Therefore, companies strive to minimize their tax burden. According to Tang & Firth (Lestari & Syofyan, 2023) states that one of the methods taxpayers use to reduce their tax liability is tax aggressiveness.



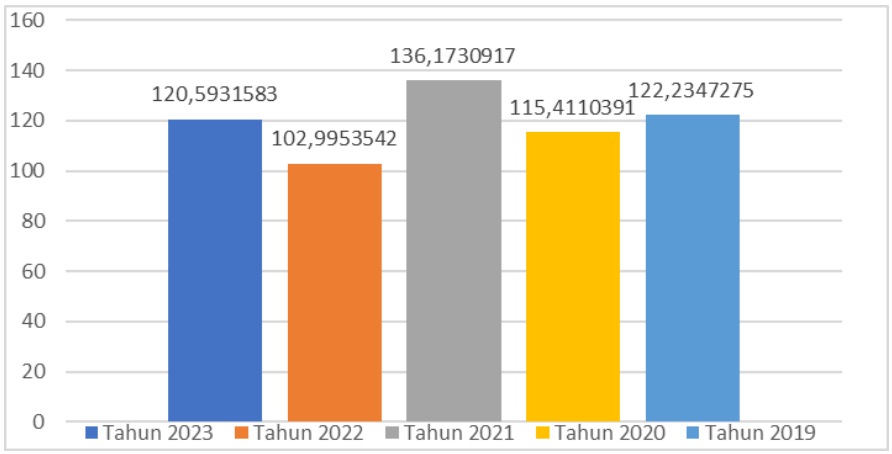
Source: komwasjak.kemenkeu.go.id : 2023

Figure 1. Tax Revenue Infographic

In recent years, the debate over international tax policy has centered on the tax avoidance strategies employed by multinational corporations.

Multinational corporations (MNCs) are companies that operate in multiple countries with the aim of expanding their markets and achieving a global competitive advantage. However, a company's presence in multiple countries presents complex challenges in financial management, particularly regarding foreign exchange risk. Foreign exchange risk is the risk arising from changes in exchange rates between the countries where a business operates. The revenue, expenses, and cash flows of multinational corporations can be significantly affected by exchange rate fluctuations. Multinational corporations have become increasingly active in conducting cross-border business in the era of globalization and advancements in information technology. This has led these businesses to engage in complex foreign exchange transactions, which can impact financial risk.

Foreign currency refers to currencies used in countries other than the company's domestic currency. In addition to common foreign exchange risks, such as exchange rate fluctuations, multinational companies in Indonesia must also consider applicable regulations and tax provisions, which can impact their risk management strategies. Foreign exchange risk in the financial management of multinational companies plays a crucial role in maintaining the company's financial stability, protecting its value, and increasing profits. An appropriate currency risk management strategy can help multinational companies mitigate the negative impact of currency fluctuations on their cash flow, profits, and assets. (Febrianto & Ibrahim, 2024:249).



Source: Researcher-compiled data, based on the annual report, 2025

Figure 2. Stock Valuation Using the Price-to-Earnings Ratio

EPS fluctuations over the past five years are shown in the bar chart above. Analysis indicates that EPS varies from year to year. The highest value occurred in 2021, and the lowest value occurred in 2022. This trend may reflect the stability of the company's profitability, as changes in EPS are influenced by numerous factors, such as operational performance, business strategy, market dynamics, and changes in regulations and economic policies worldwide. When EPS fluctuates, companies tend to be more strategic in managing taxes to maintain net profit stability. When EPS declines, companies become more aggressive in seeking ways to reduce their tax burden, such as utilizing tax incentives, implementing more complex tax planning, or even employing tax avoidance strategies. Companies with fluctuating EPS typically have inconsistent ETRs. If EPS falls, companies may attempt to lower their ETR through various aggressive tax strategies. Conversely, if EPS increases, companies are more transparent in their tax reporting because they have larger profit margins.

One example of tax avoidance was reported by the Tax Justice Network: as a result of tax avoidance, Indonesia is estimated to lose 4.86 billion U.S. dollars annually. This figure is equivalent to 68.7 trillion rupiah, calculated using the rupiah exchange rate at the close of the spot market on Monday (November 22, 2020), which was 14,149 rupiah per U.S. dollar. As stated in the Tax Justice Network's report titled : The State of Tax Justice 2020: Tax Justice in the Time of Covid-19, 4.78 billion US dollars, or Rp 67.6 trillion, stems from corporate tax avoidance in Indonesia, while the remainder approximately 78.83 million US dollars, or Rp 1.1 trillion comes from individual taxpayers. According to the report, multinational companies typically shift their profits to countries considered tax-free. The goal is to avoid reporting the actual amount of profit generated in the country where the company operates. Ultimately, companies pay less tax than they would otherwise. (Yoga Sukmana, 2020).

Watts and Zimmerman (1978) in (Buntu et al., 2025) explains that accounting policies pose a challenge for companies and stakeholders of financial statements, particularly in predicting which accounting policies a company will adopt under specific conditions. This positive theory guides the understanding and estimation of a company's accounting policy choices. These accounting policies are determined by the company's organizational structure, which is based on industry conditions and accrual accounting policies, through the treatment of profit-related transactions to better align with the company's expected value. Management has the freedom to control the quantification of events affecting profit. This condition is reinforced by the flexibility granted by professional accounting associations in selecting a set of permissible accounting policies, including patterns of accrual usage.

Jensen and Meckling (1976) in (Anan et al., 2023) argues that an agency relationship arises when shareholders (principals) grant management (agents) the authority to make decisions regarding the operation of the company. This principal-agent relationship can lead to

information asymmetry, as agents possess more information about the company's condition than principals, thereby incentivizing managers to act in their own self-interest (Rosani & Andriyanto, 2024). The objectives of managers and shareholders are the same: to increase the value of the company by enhancing shareholder wealth. However, managers do not always act in the best interests of shareholders or may take actions that conflict with shareholder wishes, leading to a conflict between company managers and shareholders. This conflict is known as the agency problem (Jensen & Meckling, 1976). The agency problem arises between the tax collector (the government) and the taxpayer (company management). The government seeks to maximize revenue from tax collection, while management believes the company should generate significant profits with a low tax burden.

Based on the above discussion, tax aggressiveness remains an issue that warrants attention, particularly the phenomenon of tax aggressiveness in Indonesia and the ongoing inconsistencies in previous research findings, which have prompted the researcher to conduct further research on this topic. This study will contribute to knowledge, particularly regarding transfer pricing and thin capitalization. Based on the analysis of the issues above, by combining the more relevant factors typically found in the tax audit sector in developing countries, specifically transfer pricing and thin capitalization.

METHOD

Types and Research Approaches

This study employs a quantitative descriptive research method, with the aim of understanding the influence and causal relationship between two or more variables. (Sugiyono, 2019:15) states that quantitative methods can be defined as research methods grounded in the philosophy of positivism, used to study a specific population or sample.

Table 1. Summary of Research Variables

Variable	Concept of Variables	Indicator	Measurement
Transfer Pricing (X1)	Transfer pricing is the process of determining prices in transactions between parties that have a special relationship. (Zahri et al., 2025)	Return On Cost Off good sold	$\frac{laba\ Bersih\ Usaha}{(COGS+Biaya\ Operasional} x\ 100\%$
Thin Capitalization (X2)	Thin capitalization is a strategy used by a company to minimize or avoid its tax liabilities. (Lestari & Syofyan, 2023)	Mad Ratio	$\frac{average\ interest\ bearing\ debt}{Safe\ Harbor\ Debt\ Amount}$
Agresivitas Pajak (Y)	Tax aggressiveness is a complex phenomenon with many definitions and aspects (Bintara, 2022)	Earning tax rate	$\frac{Beban\ Pajak\ Penghasilan}{Pendapatan\ Sebelum\ Pajak}$

Source: Researcher's Analysis, 2026

Population and Sample

The population used in this study consists of multinational companies in the non-cyclical consumer goods sector listed on the Indonesia Stock Exchange (IDX) from 2022 to 2023, totaling 132 companies. The sampling technique used in this study is a non-probability sampling method, specifically purposive sampling, based on the following criteria:Perusahaan multinasional sektor *non cyclical costumer good* yang terdaftar di bursa efek indonesia pada tahun 2022 dan 2023.

1) A multinational company in the non-cyclical consumer goods sector that regularly submitted audited financial statements in 2022 and 2023.
2) A multinational company in the non-cyclical consumer goods sector that did not incur losses in 2022 and 2023.
3) A multinational company in the non-cyclical consumer goods sector that has released its annual report.

Based on the predetermined criteria, the sample for this study consists of 89 multinational companies in the non-cyclical consumer goods sector, covering two research periods, resulting in a total sample size of 178.

Types and Sources of Data

The data sources used by the researcher are secondary data, specifically data obtained from the Idx.co.id website and the official websites of multinational companies in the non-cyclical consumer goods sector for the years 2022 and 2023, in the form of annual reports, as well as library research.

Data Analysis Techniques

This study uses descriptive analysis and panel data regression to test hypotheses in accordance with the research objectives, utilizing the Econometric Views Student Version 13 (Eviews 13) software to process the data for regressing the formulated model, thereby creating a reliable and unbiased predictive tool. The analysis stages include: 1. Descriptive Analysis, 2. Model Selection (Chow Test, Hausman Test, and Lagrange Multiplier Test), 3. Hypothesis Testing (T-Test, F-Test, and Coefficient of Determination Test).

Research Hypothesis

Based on the theoretical framework, the hypothesis proposed in this study is:
H1 : Transfer pricing has a negative impact on tax aggressiveness.
H2 : Thin capitalization has a negative impact on tax aggressiveness.
H3 : Transfer pricing and thin capitalization has a significant impact on tax aggressiveness.

RESULTS AND DISCUSSION

Overview

Multinational companies in the non-cyclical consumer goods sector produce goods needed daily, such as food, beverages, household products, personal care items, and agricultural products. These goods remain in demand regardless of whether the economy is thriving or struggling. Companies producing non-cyclical goods will continue to generate sales under any circumstances.

Companies in this sector produce goods or services that are always in demand and needed by consumers. Their growth is relatively stable and does not spike sharply, even during recessions. This is because, even when economic conditions are declining, companies in this sector continue to grow and some even see their revenue multiply, such as herbal medicinem companies that were in high demand during the pandemic. Consequently, their revenue and profits tend to be more stable.

Decriptive Analysis

Table 2 Results of Descriptive Statistics

	Agresivitas Pajak	Transfer pricing	Thin capitalization
Mean	0.225225	0.124326	0.699663
Median	0.220000	0.080000	0.655000
Maximum	0.960000	0.700000	2.020000
Minimum	0.000000	0.000000	0.030000
Std. Dev.	0.160913	0.134441	0.419704
Skewness	1.769635	1.817850	0.715569
Kurtosis	7.879306	6.529785	3.117123
Jarque-Bera	269.4776	190.4429	15.29222
Probability	0.000000	0.000000	0.000478
Sum	40.09000	22.13000	124.5400
Sum Sq. Dev.	4.583041	3.199169	31.17878
Observations	178	178	178

Source: Secondary Data, E-Views Output, 2026

The transfer pricing variable is calculated using the return on cost of goods sold, which is the ratio of gross profit to cost of goods sold (COGS). It shows a minimum (lowest) value of 0.0000000, meaning there are companies that do not engage in transfer pricing at all, and a maximum (highest) value of 0.700000, indicating the presence of significant profit shifting. Thus, this indicates that transfer pricing values range from 0.000000 to 0.700000, with a mean of 0.124326 and a standard deviation of 0.134441. Transfer pricing behavior among the sample companies is highly varied. Although most companies engage in transfer pricing at a low level, some do so at a very high level, reaching 70% of cost of goods sold for specific purposes, such as shifting their profits to entities with lower tax rates. When viewed from the mean being greater than the standard deviation, this indicates that the transfer pricing variable has a non-varied or homogeneous data distribution.

The thin capitalization variable is calculated using the Mad ratio a metric used to assess a company's reasonable debt levels showing a minimum value of 0.030000 and a maximum value of 2.020000. Thus, this indicates that the tax aggressiveness value ranges from 0.000000 to 2.020000, with a mean of 0.699663 and a standard deviation of 0.419704. When viewed from the – the mean is greater than the standard deviation, which means that the thin capitalization variable has a uniform or homogeneous data distribution.

The tax aggressiveness variable is calculated using the effective tax rate, which is the average tax percentage paid by a company or individual, calculated by dividing total tax expense by pre-tax profit. It shows a minimum (lowest) value of 0.000000 and a maximum (highest) value of 0.960000. Thus, this indicates that tax aggressiveness values range from 0.000000 to 0.960000, with a mean of 0.225225 and a standard deviation of 0.160913. Since the mean is greater than the standard deviation, this indicates that the tax aggressiveness variable has a uniform or heterogeneous data distribution.

Regression Model Estimation Analysis
Chow Test

Table 3 Result Of The Chow Test

Effects Test	Statistic	d.f.	Prob.
Cross-section F	1.770321	(88,87)	0.0041
Cross-section Chi-square	182.678105	88	0.0000

Source: Secondary Data, E-Views Output, 2026

The table above shows that the cross-section F probability value is 0.0041 < 0.05, which meets the specified criteria, namely that H0 is rejected and Ha is accepted, meaning that the Fixed Effect Model (FEM) is better than the *Common Effect Model (CEM).*

Hausman Test

Table 4 Result Of The Hausman Test

Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	3.221206	2	0.1998

Source : Secondary Data, E-Views Output, 2026

The table above shows that the cross-section random probability value of 0.1998 > 0.05, so it meets the specified criteria, namely H0 is accepted and Ha is rejected, which means that the Random Effect Model (FEM) is better than the *Fixed Effect Model (CEM).*

Langrange Multiplier Test

Table 5 Result Of The Hausman Test

	Test Hypothesis		
	Cross-section	Time	Both
Breusch-Pagan	5.953400	0.973316	6.926716
	(0.0147)	(0.3239)	(0.0085)

Source : Secondary Data, E-Views Output, 2026

The Breusch-Pagan cross-section statistic is 0.0147, which is smaller than the probability value of 0.05 (0.0147 < 0.05), meaning that H0 is rejected and H1 is accepted. Thus, the selected model is the Random Effects Model (REM). A summary of the panel data regression model selection test is presented in the following table:

Table 6 Summary Of Model Selection

Uji	Prob	Sig	Selected Model
Chow Test	0,0041	0,05	Fixed Effect Model
Hausman Test	1,3875	0,05	Random Effect Model
Lm Test	0,0147	0,05	Random Effect Model

Source : Researcher-processed data, 2026

Panel Data Regression Analysis

Table 7 Panel Data Regression Analysis

Variable	Coefficient	Std. Error	t-Statistic	Prob.
AG	-1.818146	0.164665	-11.04151	0.0000
TF	-1.458149	0.504339	-2.891207	0.0050
TC	-0.780786	0.335110	-2.329941	0.0224
R-squared	0.654409	Mean dependent var		-2.029437
Adjusted R-squared	0.615038	S.D. dependent var		1.356296
S.E. of regression	0.841518	Akaike info criterion		2.598312
Sum squared resid	55.94403	Schwarz criterion		2.877934
Log likelihood	-105.6249	Hannan-Quinn criter.		2.711019
F-statistic	16.62158	Durbin-Watson stat		2.054804
Prob(F-statistic)	0.000000			

Source : Secondary Data, E-Views Output, 2026

The table above shows the results of the panel data regression test, which yields the following regression equation:

AG = -1,818146 - 1.458149 *TF -0.780786*TC + e

Hypothesis Testing

Based on Table 6, Hypothesis 1 that is, " $thitung$ " is greater than " $ttabel$ specifically 2.891207 > 1.97369, with a probability value of 0.005 and a negative hypothesis direction indicated by the negative t-statistic ($thitung$). Therefore, according to the hypothesis testing criteria, "H0 " is rejected and "Ha " is accepted, meaning that, partially, transfer pricing has a significant negative effect on tax aggressiveness.

Hypothesis 2 states that$thitung$ is greater than $ttabel$, i.e., 2.329941 > 1.97369, with a probability value of 0.0223 and a negative hypothesis direction indicated by the negative sign of the t-statistic ($thitung$). Therefore, in accordance with the hypothesis testing criteria, the null hypothesis (H0) is rejected and the alternative hypothesis (Ha) is accepted, meaning that, partially, thin capitalization has a significant negative effect on tax aggressiveness.

Table 6 shows that the value of "$Fhitung$ " is 7.53, while the value of " $Ftabel$ " is 3.05. Therefore, based on this, the value of "$Fhitung$ " is greater than that of " $ttabel$," namely 16.62 > 3.05, with a probability value of 0.0000. Thus, in accordance with the hypothesis testing criteria, "H0 " is rejected and "Ha " is accepted, meaning that simultaneously, transfer pricing and thin capitalization together have a significant effect on tax aggressiveness.

The Effect of Transfer Pricing on Tax Aggressiveness

Transfer pricing is a policy for determining the transfer price of goods, services, intangible assets, or transactions between parties with a special relationship (H Feubravally, 2024) . The results of the tests in this study indicate that transfer pricing has a negative effect. This is due to the obligations of companies as corporate taxpayers related to transfer pricing practices. According to the Arm's Length Principle (ALP), transactions or transfer prices with affiliated and non-affiliated companies must not be discriminated against. With such regulations, it becomes increasingly difficult for businesses to use transfer pricing for tax avoidance. Companies wishing to engage in transfer pricing must meet requirements related to the principles of reasonableness and business norms. To maximize global income and reduce corporate income tax (PPh 25) and import duties, as well as for other objectives, multinational companies employ transfer pricing policies. The tax-motivated objective of implementing transfer pricing is to minimize the company's tax burden as much as possible by shifting income to countries with lower tax rates. From the perspective of Accounting Theory developed by Watts and Zimmerman (1986), companies will choose accounting procedures that minimize

contracting costs and political costs. Companies in the non-cyclical consumer goods sector, which are generally large issuers with high public visibility, face significant political costs if exposed as perpetrators of massive tax aggressiveness. Therefore, although transfer pricing is a legally valid tax planning instrument, companies tend to use it in a measured manner and do not push the overall level of tax aggressiveness to a level that could attract the attention of regulators. The research findings align with studies such as (Hasyim et al., 2022) , (Susanto et al., 2022) and (Amelia et al., 2024) , which state that transfer pricing has a negative effect on tax aggressiveness. The results of this study differ from those of the studies (Lestari & Syofyan, 2023) , (Utami & Irawan, 2022) , (Zahri et al., 2025) , and (Dewi et al., 2023) which reveal that transfer pricing has a positive effect on tax aggressiveness. This difference arises due to the use of proxies in transfer pricing.

The Effect of Thin Capitalization on Tax Aggressiveness

Thin capitalization is a strategy employed by a company to minimize or avoid its tax obligations. Thin capitalization is defined as a capital structure where the proportion of debt exceeds that of equity. This indicates that thin capitalization, as measured by the debt-to-equity ratio, has a negative impact on the assessment of potential tax avoidance. This also means that the banking sector in Indonesia cannot avoid taxes by charging interest on debt. However, such debt is used for other purposes, such as expanding business operations. This is evidenced by corporate interest-bearing debt, which largely consists of short-term debt, whose borrowing is constrained by specific financial ratios. Thin capitalization can be an issue in taxation due to differences in treatment between equity financing and debt financing (Pradana et al., 2024) . In equity financing, returns on equity in the form of dividends may be subject to tax, whereas debt financing incurs interest expenses that can be used as a deduction from taxable income. In relation to agency theory, where the agent seeks to maximize the principal's profits by minimizing the taxes the company must pay thereby increasing the principal's net profits the agent also stands to receive substantial compensation or bonuses through tax avoidance schemes such as thin capitalization. The research supports agency theory, as all agents will strive to obtain substantial rewards by demonstrating optimal financial performance for the principal by exploiting loopholes in tax regulations using thin capitalization. The research findings align with studies at (Zahara & Marundha, 2025) , (Prayoga, 2019) and (Amelia et al., 2024) , which state that thin capitalization has a negative effect on tax aggressiveness. The results of this study differ from those of the studies (Devriadi & Achyani, 2023) , (Utami & Irawan, 2022) , (Septiani & Winata, 2022) which reveal that thin capitalization has a positive effect on tax aggressiveness.

The Effects of Transfer Pricing and Thin Capitalization on Tax Aggressiveness

The findings of this study indicate that transfer pricing and thin capitalization collectively have a negative impact on tax aggressiveness. This means that the combination of these two practices tends to reduce a company's level of tax aggressiveness, as measured by the Effective Tax Rate (ETR). This is because transfer pricing and thin capitalization trigger

stricter oversight from tax authorities and higher risks of penalties. The research results demonstrate that oversight mechanisms from various stakeholders including tax regulators, creditors, and shareholders significantly shape management behavior in determining the level of tax aggressiveness. These findings enrich the international tax literature by presenting empirical evidence that, within the context of Indonesia's increasingly stringent regulations, transfer pricing and thin capitalization do not necessarily have a positive relationship with tax aggressiveness, as was generally assumed in previous literature. According to agency theory, managers can use these two practices to maximize their personal compensation. Managers can do this by generating higher profits. The results of this study are consistent with the findings of

(Zahara & Marundha, 2025) , (Prayoga, 2019) and (Amelia et al., 2024) , which state that transfer pricing and thin capitalization jointly influence tax aggressiveness.

CONCLUSION

Transfer pricing has a negative effect on tax aggressiveness among multinational companies in the non-cyclical consumer goods sector listed on the Indonesia Stock Exchange (BEI) from 2022 to 2023, thus accepting the first hypothesis. This implies that higher intensity of transfer pricing practices does not lead to an overall increase in tax aggressiveness. This is due to the strict regulations of the Arm's Length Principle under PMK No. 172/PMK.03/2023, which create significant risks of detection, administrative sanctions, and tax adjustments, thereby prompting management to be more cautious in managing total tax risk.

Thin capitalization has a negative effect on tax aggressiveness among non-cyclical consumer goods multinational companies listed on the IDX in 2022–2023 ( ), so the second hypothesis is accepted. This means that an increase in the debt ratio (MAD Ratio) does not necessarily increase tax aggressiveness. This is due to the regulatory restrictions under PMK No. 169/PMK.010/2015, which sets a maximum debt ratio of 4:1, as well as intensive oversight by creditors through debt covenants that indirectly limit management's leeway to engage in excessive tax practices.

Transfer pricing and thin capitalization simultaneously have a negative effect on tax aggressiveness. The combination of these two practices actually tends to reduce a company's level of tax aggressiveness, as measured by the Effective Tax Rate (ETR). This is because the simultaneous use of both strategies increases the risk of detection by tax authorities (DJP) and triggers stricter oversight from various parties, including regulators, creditors, and shareholders, leading companies to reduce tax aggressiveness to maintain operational stability and corporate reputation.

The overall research findings support the relevance of Positive Accounting Theory (Watts & Zimmerman, 1986) and Agency Theory (Jensen & Meckling, 1976) in explaining the dynamics of tax aggressiveness behavior. Information asymmetry between management, shareholders, and tax authorities (DJP) is a fundamental factor shaping transfer pricing and thin capitalization behavior. However, external oversight mechanisms from regulators and creditors have proven to be effective in curbing management's aggressive tax behavior, particularly within the context of Indonesia's increasingly stringent regulations.

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