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The Effect of Taxes, Leverage and Bonus Mechanisms on Transfer Pricing Decisions

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Abstract: This study aims to examine the impact of taxes on transfer pricing practices, with leverage and bonus mechanisms included as control variables. Transfer pricing is a strategic issue for multinational companies engaging in transactions with related parties, as it may be used to shift profits and reduce tax burdens. This research employs a quantitative approach using multiple linear regression analysis. The study utilizes secondary data obtained from the annual financial statements of multinational companies listed on the Indonesian Stock Exchange for the period 2020–2024. Data analysis includes descriptive statistics, model feasibility testing using the F-test, hypothesis testing using the t-test, and evaluation of the coefficient of determination. The results indicate that taxes, proxied by Book Tax Difference, have a positive and significant impact on transfer pricing practices, suggesting that a larger gap between accounting profit and taxable profit increases the likelihood of transfer pricing. In contrast, leverage measured by the Debt to Equity Ratio shows a negative but statistically insignificant effect, while bonus mechanisms do not have a significant impact on transfer pricing. Furthermore, the coefficient of determination indicates that the explanatory power of the model is relatively low, implying that transfer pricing decisions are influenced by other factors beyond those examined in this study.

Keywords: Transfer Pricing, Taxes, Leverage, Bonus Mechanisms

INTRODUCTION

Building up a country requires a lot of money, so the government needs a big income to fund all the necessary sectors. One of the main sources of funding for the government is taxes. Taxes are an important part used to carry out development. Some of the main sources of government revenue include income tax, value-added tax, luxury goods sales tax, property tax, export tax, international trade tax, and import duties and excise taxes. According to Pietersz et al. (2021) taxes serve as a source of funds for government spending as outlined in the National

Budget (APBN), and taxes are considered domestic revenue. In Indonesia, taxes are divided into two types: local taxes and central taxes.

One of the local taxes we often encounter is restaurant tax, which is applied when we buy food from a restaurant. This sometimes leads to different perceptions in society, where some people mistakenly think restaurant tax is the same as value-added tax. Taxes are an essential part of business activities in the global economy. Today, businesses and investments are growing rapidly without borders. This has led many domestic companies to develop into multinational corporations with activities involving branches in other countries (Nielsen et al., 2025).

Multinational companies often engage in transactions between related entities or those with special relationships (Mardiasmo, 2016). In Indonesia, transfer pricing practices are closely related to tax avoidance behavior in Indonesia, especially in sectors with limited enforcement of anti-tax avoidance regulations (Ghifari et al., 2025). According to Financial Accounting Standards (PSAK) Number 7 (Revised 2015), which deals with disclosing related parties, a related party is an entity or individual that has a special connection. This connection means there is a possibility that one party could influence or control the financial and operational decision-making of the other. Multinational companies often take advantage of tax rules to manage their taxes by using transfer pricing, which involves shifting profits or income to affiliated companies in other countries. This helps reduce the overall tax paid by the company and increases its profits. Transfer pricing is achieved by adjusting the prices at which affiliated companies buy or sell goods, and then moving the profits to companies located in countries with lower tax rates (Jannah, 2023).

Amidu et al. (2017) found that transfer pricing has a significant impact on reducing the tax obligations of multinational companies. Some examples of transfer pricing include the case of Starbucks in the UK. In 2011, Starbucks reported sales of £398 million but did not pay corporate tax. By 2018, Starbucks claimed a loss of £112 million. However, according to reports in the US, Starbucks made large profits in the UK between 2008 and 2010, totaling £1.2 billion. Due to these losses, Starbucks did not pay any taxes. Starbucks has been operating in the UK for 14 years but has paid only £8.6 million in taxes. Another example of transfer pricing is PT Adaro Energy Tbk (ADRO), which is suspected of avoiding taxes through transfer pricing.

A investigation by the organization International Global Witness found that Adaro sold coal to a company in Singapore at a low price, which then sold it again at a higher price. This practice reduced the potential tax revenue for Indonesia from its expected amount of $125 million (Wareza, 2019). One study that shows the impact of taxes on transfer pricing is the research conducted by (Hertanto et al., 2023).

Bonus mechanisms are one of the factors that can influence transfer pricing activities. This mechanism is a company policy aimed at improving the performance of its employees, creating a better work environment. When carrying out their duties, directors tend to want to show good performance to the company's owners. If the company's owners or shareholders evaluate the directors' performance positively, they will reward the directors who have managed the company well.

Leverage is another factor that encourages companies to engage in transfer pricing practices. Leverage refers to a company's ability to use its assets and sources of funds to maximize the wealth of its shareholders. Using debt makes the owners expect managers to be more disciplined, as managers are responsible for the debt they use (Brigham & Houston, 2019), one reason debt is chosen as a source of funding is because of the tax benefits. Multinational companies with high leverage tend to avoid taxes by arranging their debt structure. Good debt management makes it easier for companies to perform transfer pricing by taking advantage of special relationships in operational needs, especially those related to COGS

and other expenses that can affect the company's profit. Based on the background discussion above, the writer is interested in conducting research titled "The Effect of Taxes, Leverage, and Bonus Mechanisms on Transfer Pricing Practices."

Despite the extensive literature on transfer pricing, prior studies still show inconsistent results regarding the determinants of transfer pricing practices, particularly in emerging economies such as Indonesia. Several studies emphasize the role of taxation as a dominant factor, while others report insignificant or mixed effects of leverage and managerial incentives such as bonus mechanisms. Moreover, empirical evidence focusing on Indonesian multinational companies remains limited, especially those combining tax aggressiveness, capital structure, and bonus mechanisms within a single research model. This gap indicates the need for further empirical investigation to clarify how these factors jointly influence transfer pricing practices in the Indonesian context.

This study is expected to contribute both theoretically and practically. From a theoretical perspective, this research enriches the transfer pricing literature by providing empirical evidence on the combined effect of taxes, leverage, and bonus mechanisms in an emerging market setting. From a practical perspective, the findings are expected to provide insights for tax authorities in strengthening transfer pricing regulations and enforcement, as well as for corporate management in designing financial and compensation policies that align with regulatory compliance and ethical business practices.

METHOD

This kind of research is called quantitative research. The way data is collected is through documentation, which means gathering, recording, and reviewing secondary data. The data comes from the annual reports and periodicals of mining manufacturing companies listed on the Indonesian Stock Exchange, which can be found on the website www.idx.co.id. These reports are published by the Indonesia Stock Exchange (IDX). The researcher uses the documentation method to collect this secondary data. This involves gathering annual reports, financial reports, and audit reports from independent auditors, along with any other necessary information based on earlier explanations. Other supporting data is obtained indirectly through literature studies from scientific journals and other materials that discuss topics related to this research. The secondary data obtained from www.idx.co.id is in the form of annual reports published by the IDX.

The population for this research includes mining manufacturing companies listed on the IDX from 2020 to 2024. A purposive sampling method was used to select the sample. This method is based on matching the characteristics of the samples with the sampling criteria set for the study. Multinational companies were chosen as samples because they are easier to apply transfer pricing to. This is done to avoid any bias in the study.

This study employed several analytical methods. Descriptive statistics summarized sample characteristics, including the mean, standard deviation, and range for each variable. Correlation analysis examined relationships between variables to identify potential multicollinearity issues and the direction of association. Hypotheses were tested through multiple regression analysis, measuring the impact of taxes, bonus mechanisms, and leverage on transfer pricing. Robustness checks were conducted using alternative measures for the dependent and independent variables to validate the results.

RESULTS AND DISCUSSION

Results

Transfer Pricing

According to Sari et al. (2021) Transfer Pricing is the process of setting prices for goods or services in transactions between parties that have a special relationship, whether within

different divisions of a single company or between companies in the same group. However, this practice is basically legal and considered a normal part of business strategy management, especially to support efficiency in managing subsidiaries or affiliated companies, including how assets and services are allocated among group members. These transactions, if not based on the arm's length principle, can be used to transfer assets between subsidiaries and reduce the overall tax burden (Ghifari et al., 2025).

According to a report by the Organization for Economic Co-operation and Development (OECD), about 60% of global trade involves transactions that use Transfer Pricing mechanisms by multinational companies. In many cases, this strategy is used to shift some profits from countries with high tax rates to jurisdictions with lower tax rates. In Plasschaet's view, Transfer Pricing can also be considered a form of systematic price manipulation aimed at artificially reducing reported profits, giving the appearance that the company is experiencing losses, or to avoid paying taxes and duties in sixteen particular countries. Although Transfer Pricing is generally a legal strategy, in practice, it is often associated with negative connotations because it can create opportunities for misconduct or fraud, especially when used aggressively to gain one-sided benefits for the company. For this reason, the issue of Transfer Pricing has become a major concern in tax regulations and cross-border oversight.

$$Transfer\ Pricing = \frac{Receivables\ from\ Related\ Parties}{Total\ Receivables}$$

Tax

According to the Tax Law (Law No. 36 of 2008), tax is defined as: "A mandatory contribution to the state by individuals or entities, based on law, without receiving any direct benefit, and used for the state's purposes to achieve the greatest welfare for the people." S.I Djajadinigrat defines tax as a duty to transfer part of one's wealth to the state's treasury, resulting from a certain condition, event, or action that gives a particular status, but not as a punishment, according to government regulations, and it can be enforced, though there is no direct service or return from the state, aimed at maintaining general well-being. J Feldmann states that tax is a one-sided obligation imposed by and owed to the authority, according to generally established norms, without any counter-performance, and is solely used to cover general government expenses.

Based on the above definitions, it can be concluded that tax is an obligation to pay to the state imposed on individuals or entities that meet certain conditions, and it is used by the state for the benefit of the broader community. Although tax laws are designed to help the country collect more revenue through taxes, in reality, there are still some legal gaps that allow taxpayers to avoid paying taxes. This action doesn't break the law clearly, but it often goes against the main purpose of tax regulations. This phenomenon attracts some taxpayers because they see it as a legal way to reduce their tax burden. However, on the other hand, it has a negative impact on the country's revenue. The taxes paid no longer reflect the actual responsibility because they have gone through a systematic process that lowers the amount of tax owed. As a result, the country's potential revenue can't be maximized.

According to Sumarsan (2017), there are three forms of actions that fall under tax avoidance. First is withholding, which is when taxpayers deliberately avoid activities that could be taxed. Second is relocation, where taxpayers move their residence or business from areas with high tax rates to places with lower rates. Third is legal tax avoidance, where taxpayers use the ambiguity or gaps in the law to ensure their actions aren't taxed. These three forms show that tax avoidance is part of tax planning that stays within legal limits.

$$BTD = \frac{(Accounting\ Profit\ Before\ Tax - Taxable\ Profit)}{Total\ Asset}$$

Leverage

Leverage is a financial ratio that shows how a company's assets are funded by debt (Hidayat, 2018). This ratio is also used to evaluate a company's ability to meet all short-term and long-term obligations. In practice, companies can use various methods to meet capital needs, one of which is by borrowing or taking out debt. External funding not only provides unlimited additional funds but can also encourage management to perform better because there is an obligation to repay the loan.

According to Rahayu & Sari (2018) leverage is part of a financial policy related to a company's decision to choose a financing source. In this case, a company can choose between internal or external financing sources. If a company decides to use debt as a funding source, it will be obligated to pay interest and principal on its debt. The use of debt-based financing inevitably involves financial risks, one of which is the possibility of bankruptcy if the company is unable to meet these obligations. Therefore, the decision to use debt must be adjusted to the company's ability to generate profits.

$$DER = \frac{Total\ Liabilities}{Total\ Equity}$$

According to Setyaningsih et al. (2021), in general, there are several types of financial ratios used to measure a company's leverage level. These ratios aim to assess the extent to which a company uses debt-based funding sources in its capital structure and to evaluate the company's ability to meet short-term and long-term obligations. The ratio used is the Debt to Equity Ratio (DER): DER is a ratio that shows the ratio of a company's total debt to its total equity. This ratio provides an overview of a company's capital structure, particularly in assessing the ratio of funds obtained from creditors to owners.

Bonus Mechanism

The bonus mechanism is a reward given by company owners to managers for achieving company performance targets. A manager might receive a bonus based on net income or according to the target increase in net income (Hansen & Mowen, 2007). The bonus mechanism is calculated using the index trend of profit and loss (ITRENDLB) (Rachmat, 2019). The giving of bonuses is not only based on the amount of profit in a company during a certain period, but also on the performance of the board of directors in managing the company. Therefore, the board of directors tend to show their performance to the company owners in order to get a reward or bonus. Therefore, the board of directors is measured using the indicator of the number of board members in a company.

In addition, the motivation of bonuses is the drive for managers to report the profits they have earned in order to receive a bonus calculated based on these profits. Managers with a bonus plan are more likely to use accounting methods that increase the reported income for the current period. The reason for this is to increase the percentage of the bonus value if there is no adjustment for the method chosen. The research by (Mardjono et al., 2025) used a management bonus program approach and found that managers will receive a bonus positively when profit is between the lower limit (bogey) and upper limit (cap). Companies use bonus systems to improve employee performance, which helps increase annual profits. Based on profit levels, managers or directors can manipulate profits and even take actions to control net income in order to maximize profits and receive bonuses. In a bonus system that involves

managing profits, financial managers prepare modified financial reports to gain benefits, such as receiving bonuses.

$$Bonus\ Mechanism = \frac{Net\ Profit\ for\ Year\ t}{Net\ Profit\ for\ Year\ t-1}\ x\ 100\%$$

Based on the theoretical framework and previous empirical studies discussed above, the hypotheses of this study are formulated as follows:
H_1: Taxes has an impact on transfer pricing.
H_2: Leverage has an impact on transfer pricing.
H_3: Bonus mechanisms has an impact on transfer pricing.

The variables used in this research include the dependent variable (Y) namely transfer pricing decisions and the independent variable (X) namely taxes, Leverage and bonus mechanisms. The results of testing these variables are descriptive as shown in table 1.

Table 1. Descriptive Statistics Result

	BTD	DER	BM	TP
Mean	0.006	1.905	4.902	0.286
Median	0.009	0.865	0.817	0.117
Maximum	0.325	35.328	676.300	1.011
Minimum	-0.915	-9.001	-250.815	0.000
Std. Dev.	0.110	4.631	78.248	0.340

Based on the mean values, the variable BTD has an average of 0.006, indicating that overall, the difference between accounting profit and tax profit is relatively small. The variable DER has an average value of 1.905, showing that the company's capital structure tends to use debt almost twice the amount of equity. Meanwhile, the variable BM has an average of 4.902, while TP has an average of 0.286, reflecting that the company's tax planning is at a moderate level. The median values for each variable show differences compared to the mean values, especially for DER and BM, indicating that the data distribution is not symmetrical. The median for DER is 0.865 and the median for BM is 0.817, which are much lower than their maximum values, suggesting the presence of extreme values (outliers). Based on the maximum and minimum values, all variables show a fairly wide range of data. BTD has a maximum value of 0.325 and a minimum of -0.915, indicating the existence of companies with significant differences between book profit and tax profit, both positive and negative. DER has a maximum of 35.328 and a minimum of -9.001, showing a very high variation in capital structure across companies. The variable BM has the most extreme range, with a maximum of 676.300 and a minimum of -250.815, while TP has a maximum of 1.011 and a minimum of 0.000.

Table 2. Coefficients of Determination Test

R-squared	0.103123	Mean dependent var	0.076512
Adjusted R-squared	0.073555	S.D. dependent var	0.190637

Based on the test results, the R-squared value is 0.103123. This indicates that the independent variables used in the research model can explain 10.31% of the variation in the dependent variable, while the remaining 89.69% is explained by other variables outside the model. The Adjusted R-squared value is 0.073555, which shows that after adjusting for the number of independent variables and observations, the model's ability to explain the dependent variable is 7.36%. The decrease from R-squared to Adjusted R-squared suggests that not all independent variables contribute significantly to improving the model's clarity. Although the values of R-squared and Adjusted R-squared are relatively low, this is still acceptable in

research within the fields of accounting and social sciences. This is because the behavior of the dependent variable is usually influenced by many factors, not all of which can be included in the research model. Meanwhile, the Mean dependent variable is 0.076512, which shows the average value of the dependent variable during the observation period. The Standard Deviation (S.D.) of the dependent variable is 0.190637, indicating a relatively large variation in the dependent variable data compared to its average value. This suggests that there is considerable heterogeneity in the dependent variable data. The coefficient of determination reflects the explanatory power of the regression model. Although the R-squared value is relatively low, this result is common in accounting and behavioral studies where corporate decisions are influenced by multiple internal and external factors. Therefore, the model remains appropriate for further hypothesis testing.

Table 3. F-Test (Model Feasibiity)

F-statistic	3.487711	Durbin-Watson stat	1.743878
Prob(F-statistic)	0.018929		

The probability value of the F-statistic is 0.018929, which is less than the 5% significance level. This indicates that the regression model simultaneously has a significant effect. Therefore, it can be concluded that tax, leverage, and bonus mechanisms simultaneously influence transfer pricing decisions. This means that the model used in this study is quite accurate in explaining the variation in transfer pricing decisions in the companies studied. These results support the theory that transfer pricing decisions are not influenced by a single factor but are the result of the interaction of several managerial and fiscal incentive factors simultaneously. Therefore, based on the F-test results, further hypothesis testing using the t-test can be conducted to examine the partial effect of each independent variable on transfer pricing decisions.

Table 4. T-Test (Hypothesis testing)

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.299552	0.071037	4.216830	0.0001
BTD	0.543769	0.197816	2.748862	0.0072
DER	-0.008925	0.004930	-1.810462	0.0735
BM	8.42E-06	0.000264	0.031829	0.9747

Based on the regression test results, the constant (C) value is 0.299552 with a probability value of 0.0001, which is less than the 5% significance level. This means that if all independent variables, Book Tax Difference (BTD), Debt to Equity Ratio (DER), and Bonus Management (BM) are zero, the dependent variable will be 0.299552. Therefore, the constant in this regression model is statistically significant.

The BTD variable has a regression coefficient of 0.543769, with a t-statistic of 2.748862 and a probability value of 0.0072, which is less than 0.05. This shows that taxes have a positive and significant effect on the dependent variable. In other words, every increase of one unit in BTD will increase the dependent variable by 0.543769, assuming other variables remain constant. This finding suggests that the larger the difference between accounting profit and fiscal profit, the higher the dependent variable tends to be.

The DER variable has a regression coefficient of -0.008925, with a t-statistic of -1.810462 and a probability value of 0.0735. The probability value is greater than 0.05 but less than 0.10, meaning that leverage has a negative effect but is not significant at the 5% significance level, though it is significant at the 10% level. This indicates that an increase in DER tends to decrease the dependent variable, although the effect is relatively weak statistically.

On the other hand, the bonus mechanism variable has a regression coefficient of 8.42E-06, with a t-statistic of 0.031829 and a probability value of 0.9747, which is much greater than 0.05. This shows that the bonus mechanism does not significantly affect the dependent variable. Therefore, changes in bonus management do not have a meaningful impact on the dependent variable in this research model.

This study aims to examine the impact of taxes, leverage, and bonus mechanisms on transfer pricing practices. Transfer pricing is a strategic issue for companies, especially those involved in transactions with related parties, as it is often used as a way to shift profits for tax efficiency or managerial benefits. Therefore, this research focuses on internal company factors that theoretically have the potential to influence transfer pricing decisions. The main contribution of this study is providing empirical evidence on the determinants of transfer pricing by testing the variables of taxes, leverage, and bonus mechanisms simultaneously. This research complements previous literature by showing that not all factors theoretically capable of influencing transfer pricing are actually significant in practice, particularly in the context of bonus mechanisms and leverage.

The results show that taxes proxied by Book Tax Difference (BTD) have a positive and significant effect on transfer pricing. This finding indicates that the larger the difference between accounting profit and tax profit, the more likely a company is to engage in transfer pricing. These results support the research hypothesis and align with the tax avoidance theory, which suggests that companies try to minimize tax burden through profit shifting between entities with special relationships (Bird & Davis-Nozemack, 2018).

Next, the leverage variable proxied by Debt to Equity Ratio (DER) shows a negative effect on transfer pricing, although the effect is not significant at the 5% significance level. This finding indicates that the level of company debt is not a major factor in driving transfer pricing practices. These results are consistent with previous studies that state leverage is not always a motivation for profit shifting if the company has other funding sources and tax strategies that are more dominant (Taylor & Richardson, 2012).

On the other hand, the bonus mechanism variable does not show a significant effect on transfer pricing. This finding is not consistent with the principal-agent theory, which suggests that profit-based incentives can encourage managers to engage in opportunistic behaviors (Meckling & Jensen, 1976). However, these results align with studies that indicate modern management compensation systems do not only focus on short-term profits but also consider non-financial aspects and compliance with regulations, thereby limiting managers' motivation to engage in transfer pricing solely for the sake of bonuses (Armstrong et al., 2015).

The small effect of the bonus mechanism can be explained by several factors. First, management bonuses may not be fully based on accounting profit, but also on other indicators such as long-term performance and corporate governance. Second, external auditors and tax authorities may limit the ability of management to use transfer pricing as a tool to increase personal compensation. Additionally, stricter transfer pricing regulations can reduce the effectiveness of such strategies as a means of manipulating profits.

From a managerial perspective, the findings show that a company's tax policy plays an important role in influencing transfer pricing practices. Therefore, management should ensure that transfer pricing policies are based on the arm’s length principle, which is about fairness and common business practices. For tax authorities, the results suggest that companies with high levels of tax avoidance should be a priority for monitoring and tax audits.

This study has several limitations that may affect its internal and external validity. First, the relatively low coefficient of determination indicates that transfer pricing is influenced by many other factors outside the research model. Second, the use of certain proxies to measure taxes, leverage, and bonus mechanisms may limit the generalization of the study’s findings. Third, the limited period and number of samples may also impact the strength of the study’s

conclusions. Based on these limitations, future research is recommended to include additional variables such as foreign ownership, company size, quality of corporate governance, and intangible assets, which are theoretically closely related to transfer pricing.
Furthermore, future studies could use different methods, such as panel regression with a longer time period or qualitative approaches, to gain a deeper understanding of the motivations and practices behind transfer pricing.

CONCLUSION

The results of this study indicate that taxes, proxied by Book Tax Difference (BTD), have a positive and significant effect on transfer pricing practices. This finding shows that the larger the gap between accounting profit and tax profit, the higher the likelihood that a company will engage in transfer pricing through transactions with related parties. This result confirms that taxes remain one of the main incentives for companies to shift profits as part of their tax planning strategies.

Meanwhile, leverage measured by the Debt to Equity Ratio (DER) shows a negative effect on transfer pricing, although this effect is not statistically significant at the 5% significance level. This suggests that a company's debt level is not a primary driver of transfer pricing practices, indicating that decisions related to transfer pricing are not entirely influenced by debt-based financing structures. Companies may rely more on other tax-related strategies rather than leverage to manage their transfer pricing activities.

Furthermore, the bonus mechanism variable does not have a significant effect on transfer pricing. This finding implies that management compensation systems do not directly motivate managers to engage in transfer pricing practices. One possible explanation is that companies increasingly implement stricter monitoring systems and transfer pricing regulations, as well as utilize performance indicators beyond short-term profit in determining management bonuses. As a result, managers have limited incentives to manipulate transfer pricing solely for personal compensation purposes.

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