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(Research) Article

The Effect of Transfer Pricing and Thin Capitalization on Tax Avoidance With Profitability As A Moderating Variable

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Abstract: Tax avoidance is a form of tax planning, which refers to the implementation of tax reduction strategies by companies through legal means due to imperfections in tax legislation. This study aims to obtain empirical evidence regarding the effect of transfer pricing and thin capitalization on tax avoidance with profitability as a moderating variable. The research was conducted on all companies listed on the Indonesia Stock Exchange (IDX) for the period 2020–2023. The sample was determined using a purposive sampling method, resulting in 127 companies, with a total of 508 observations across four (4) periods. Data collection was carried out using a non-participant observation method by accessing financial statements from the official website of the Indonesia Stock Exchange (IDX). Data were analyzed using Moderated Regression Analysis (MRA) with the SPSS application. The results show that profitability moderates by weakening the relationship between transfer pricing and tax avoidance. However, profitability does not moderate the effect of thin capitalization on tax avoidance.

Keywords: Tax Avoidance; Transfer Pricing; Thin Capitalization; Profitability; Moderated Regression Analysis (MRA)

1. INTRODUCTION

Tax is a mandatory contribution to the state and constitutes the largest source of national revenue compared to other income sources. In terms of tax collection, Indonesia adopts a self-assessment system, which means that taxpayers are entrusted to calculate, pay, and report their tax obligations independently. Indonesia's tax revenue from 2020 to 2023 increased beyond the target: IDR 1,070.0 trillion in 2020, IDR 1,231.8 trillion in 2021, IDR 1,716.8 trillion in 2022, and IDR 1,869.2 trillion in 2023. However, despite the increase in tax revenue, Indonesia's tax ratio in 2022 was recorded at only 10.39%, which is significantly below the average tax ratio of ASEAN and G20 countries (tbrights.com). This low tax ratio has led to Indonesia's continued reliance on foreign debt and its inability to fully finance national development. One of the key causes of the low tax ratio is the practice of tax avoidance and tax evasion by taxpayers.

Tax avoidance refers to the legal implementation of tax reduction strategies by companies due to imperfections in tax laws (Suryantari & Mimba, 2022). Loopholes in taxation regulations make it common for taxpayers to engage in tax avoidance. Although this practice does not violate the law, it contradicts the fundamental objectives of taxation, which is to maximize national revenue (pajak.go.id). Tax avoidance leads to reduced state income, as taxpayers consistently seek to reduce their tax burdens (Debora & Joni, 2021).

Several companies in Indonesia have been involved in tax avoidance. For example, PT Smart Indonesia was suspected of engaging in tax avoidance through transfer pricing in 2021. The company purchased electronics from Smart Corp at USD 110 per unit and resold them at USD 125 per unit. The tax authority adjusted the purchase price by USD 5.88, stating that the fair market value per unit

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should have been USD 104.12 (ortax.org). Another case involved PT Adaro Energy Indonesia in 2019, which allegedly shifted profits to its foreign affiliate, Coaltrade Services International in Singapore, using transfer pricing, reducing the taxes paid to the Indonesian government (Global Witness, 2019). Adaro sold coal mined in Indonesia at a low price to Coaltrade, which then resold it at a higher price (Rizal, F. G., 2023). That same year, PT Bantoel Internasional Investama was reported to have engaged in tax avoidance through intercompany loans, causing an estimated annual loss of USD 11 million to the Indonesian state.

The main theoretical foundation for this research is Agency Theory. According to Scott (2015), Agency Theory explains the contractual relationship designed to motivate agents to act on behalf of principals when conflicts of interest exist. The theory assumes that individuals act in their own self-interest, creating potential conflicts between principals and agents. In the context of tax avoidance, such conflicts arise when managers, acting as agents, are incentivized to engage in tax avoidance to report higher net income and thereby present favorable performance to the principal. Managers are more likely to participate in tax avoidance only if they derive personal benefits from doing so (Suryantari & Mimba, 2022).

As described, companies may engage in tax avoidance through transfer pricing, which involves setting transfer prices for intra-group transactions. Profit-oriented companies have the incentive to minimize tax burdens through such strategies. Wijaya & Rahayu (2021) found that aggressive transfer pricing positively affects tax avoidance. Chrisandy & Simbolon (2022) and Aminullah et al. (2024) also confirmed the significant positive influence of transfer pricing on tax avoidance. However, Suryantari & Mimba (2022) and Rahmadhani & Lastanti (2024) reported no significant effect of transfer pricing on tax avoidance.

In addition to transfer pricing, companies can also use thin capitalization as a tax avoidance mechanism. Thin capitalization refers to the practice of financing operations predominantly with debt rather than equity. One common approach is intergroup lending across countries with lower tax rates (Suryantari & Mimba, 2022). Interest expenses from such loans may be used to reduce taxable income (Taylor & Richardson, 2013). Debt can enhance firm value through tax benefits derived from interest expenses, thus reducing the tax base (Heidy et al., 2021). Research by Widodo et al. (2020) showed that thin capitalization positively influences tax avoidance. Companies with high debt-to-equity ratios incur greater interest expenses, thereby reducing taxable profits. Similar findings were reported by Sarif & Surachman (2022) and Kurniawati & Mukti (2023). However, Anggraeni & Oktaviani (2021) found no significant relationship between thin capitalization and tax avoidance.

Considering the above, this study investigates the influence of transfer pricing and thin capitalization on tax avoidance, incorporating profitability as a moderating variable. A moderating variable strengthens or weakens the relationship between an independent and a dependent variable (Sugiono, 2020:69). In this study, profitability—previously examined as an independent variable—is introduced as a moderating factor affecting the relationship between transfer pricing, thin capitalization, and tax avoidance.

Profitability reflects a company's ability to generate profit. The higher a company's profitability, the greater the net income and the corresponding tax burden (Putriningsih et al., 2018). Highly profitable companies are more likely to minimize tax liabilities through tax avoidance. Danardhito et al. (2023) found a significant positive relationship between profitability and tax avoidance. This suggests that profitable companies are more inclined to utilize tax planning to reduce taxable income. Similar conclusions were drawn by Putriningsih et al. (2018) and Prasetya & Muid (2022), who found that profitability positively affects tax avoidance.

This study uses data from a four-year period (2020–2023), with the research objects being companies listed on the Indonesia Stock Exchange. Based on the background and previous research inconsistencies, the researcher proposes the title: "The Effect of Transfer Pricing and Thin Capitalization on Tax Avoidance with Profitability as a Moderating Variable."

2. METHOD

This study employs a quantitative approach with a causal associative design, aiming to analyze the cause-and-effect relationships between variables such as transfer pricing and thin capitalization on tax avoidance, as well as the role of profitability as a moderating variable. The research objects are companies listed on the Indonesia Stock Exchange (IDX) during the 2020–2023 period. The data used are secondary data in the form of financial statements obtained from the official IDX website. The sampling technique applied is purposive sampling with specific criteria, such as the consistent publication of financial statements and the presence of related party receivables (Sugiyono, 2021).

The variables in this study consist of tax avoidance as the dependent variable, measured using the Cash Effective Tax Rate (CETR); transfer pricing as the independent variable, measured by the proportion of receivables from related parties to total receivables; and thin capitalization, measured using the Debt to Equity Ratio (DER). Meanwhile, profitability is measured by Return on Assets (ROA) and serves as the moderating variable. These measurement indicators are adopted from previous studies such as Thoriq & Rahman (2020), Anggraeni & Oktaviani (2021), and Danardhito et al. (2023) to ensure the validity and reliability of variable measurements.

To analyze the data, this study utilizes Moderated Regression Analysis (MRA) with the aid of SPSS software. Classical assumption tests are conducted to ensure the feasibility of the regression model, including an autocorrelation test using Durbin-Watson and a heteroscedasticity test using the significance of absolute residuals. Normality and multicollinearity tests are not conducted, based on the Central Limit Theorem assumption and the use of a moderating variable that may induce correlations among independent variables. The regression model used in this study is expressed in the form of a multiple linear regression equation that accommodates the interaction between independent and moderating variables (Ghozali, 2021).

3. RESULTS AND DISCUSSION

3.1. Description of Research Variables

Table 1. Descriptive Statistics Results.

Variables	N	Minimum	Maximum	Mean	Std. Deviation
Transfer Pricing	508	0.0005	0.9894	0.267467	0.3109180
Thin Capitalization	508	0.0673	50,1898	1.821977	3,1776989
Profitability	508	0.0002	16,9373	0.094910	0.7524807
Tax Avoidance	508	0.0007	9,6159	0.468161	0.8748410

Source: processed data, 2025

3.2. Research Data Analysis Results

3.2.1. Classical Assumption Test

The classical assumption test is a prerequisite analysis that must be fulfilled before conducting further analysis, to ensure that the resulting research model meets the appropriate research criteria. The classical assumption tests used in this study consist of the autocorrelation test and the heteroscedasticity test.

1) Autocorrelation Test

The autocorrelation test is conducted to determine whether there is a correlation in the time series between the current period and the previous periods (Ghozali, 2021:162). This test was carried out using the Durbin-Watson test, the results of which are presented in Table 2.

Table 2. Autocorrelation Test Results

N	k	DU	Durbin-Watson
508	2	1,767	1,543

Source: processed data, 2025

Based on Table 2 above, the autocorrelation test result of 1.543 does not meet the Durbin-Watson test criteria (DU < DW < 4 – DU), indicating the presence of autocorrelation in this study. According to Ghozali (2018:125), one way to address the issue of autocorrelation is by performing the Cochrane-Orcutt test. Therefore, in this study, autocorrelation was treated using the Cochrane-Orcutt method. Table 3 below presents the results of the autocorrelation test using the Cochrane-Orcutt method.

Table 3. Results of Autocorrelation Test with Cochrane-Orrcutt Test

N	k	DU	Durbin-Watson
508	2	1,767	2,037

Source: data processed, 2025

Based on Table 3 above, the result of the autocorrelation test after performing the Cochrane-Orcutt procedure shows 1.767 < 2.037 < 2.233, which meets the Durbin-Watson test criteria (DU < DW < 4 – DU). Therefore, it can be concluded that this study is free from autocorrelation.

2) Heteroscedasticity Test

The purpose of the heteroskedasticity test is to examine whether the regression model exhibits variance inequality of the residuals from one observation to another. In this study, the heteroskedasticity test was conducted using the Glejser method, with the requirement that the significance value (Sig) must be greater than 0.05. The results of the heteroskedasticity test are presented in Table 4 below.

Table 4. Results of Heteroscedasticity Test

Variables	Sig.	Information
Transfer Pricing	0.637	Free of Heteroscedasticity
Thin Capitalization	0.290	Free of Heteroscedasticity
Profitability	0.855	Free of Heteroscedasticity

Source: data processed, 2025

Based on Table 4, it can be seen that the significance value for the transfer pricing variable is 0.637, for the thin capitalization variable is 0.290, and for the profitability variable is 0.855. Since the significance values for all variables are greater than 0.05 or 5%, it can be concluded that there is no indication of heteroskedasticity.

3.3. Moderated Regression Analysis(MRA)

Moderated Regression Analysis (MRA) is an analytical approach that preserves sample integrity and provides a basis for controlling the influence of the moderator variable (Ghozali, 2021:257). The results of the MRA test are presented in Table 5 below.

Table 5. ResultsModerated Regression Analysis (MRA)

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	0.384	0.061		6,344	0,000
Transfer Pricing	0.681	0.145	0.242	4,685	0,000
Thin Capitalization	-0.011	0.018	-0.041	-0.625	0.532
Profitability	0.146	0.075	0.126	1,952	0.051
X1Z	-4,799	1,100	-0.300	-4,364	0,000
X2Z	0.033	0.041	0.059	0.803	0.422

Source: data processed, 2025

Based on the results of the MRA test presented in Table 5, the following regression model is obtained:

$$\mathbf{Y = 0,384 + 0,681X_1 - 0,011X_2 + 0,146Z - 4,799X_1Z + 0,033X_2Z + e}$$

Based on the regression model above, the interpretation is as follows.

1) The constant value of 0.384 statistically indicates that when transfer pricing, thin capitalization, the interaction between transfer pricing and profitability, and the interaction between thin capitalization and profitability are held constant, the value of tax avoidance is 0.384.

2) The regression coefficient of the transfer pricing variable (X1) is positive at 0.681, indicating that if transfer pricing increases by one unit, assuming other independent variables remain constant, the value of the tax avoidance variable will increase by 0.681.

3) The regression coefficient of the thin capitalization variable (X2) is negative at -0.011, indicating that if thin capitalization increases by one unit, assuming other independent variables remain constant, the value of the tax avoidance variable will decrease by 0.011.

4) The regression coefficient of the profitability variable (Z) is positive at 0.146, indicating that if profitability increases by one unit, the value of the tax avoidance variable will increase by 0.146.

5) The regression coefficient for the interaction between transfer pricing and profitability (X1Z) is negative at -4.799, indicating that if the interaction between transfer pricing and profitability increases by one unit, assuming other independent

variables remain constant, the value of the tax avoidance variable will decrease by 4.799.

6) The regression coefficient for the interaction between thin capitalization and profitability (X2Z) is positive at 0.033, indicating that if the interaction between thin capitalization and profitability increases by one unit, assuming other independent variables remain constant, the value of the tax avoidance variable will increase by 0.033.

3.4. Hypothesis Testing

1) Model Feasibility Test (F Test)

The model feasibility test or F-test is conducted to determine the appropriateness of the regression model used in the study. The results of the model feasibility test (F-test) are presented in Table 6 below.

Table 6. Results of Model Feasibility Test (F Test)

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	21,321	5	4,264	5,837	.000b
	Residual	366,710	502	0.730		
	Total	388,031	507			

Source:data processed, 2025

Based on Table 6 above, the significance value is 0.000 < 0.05, indicating that the regression model is feasible to be used.

2) Coefficient of Determination Test (R2 Test)

The coefficient of determination test is used to measure how well the model explains the variance in the dependent variable. The value of the coefficient of determination ranges between zero and one. The closer the R^2 value is to 1, the greater the influence of the independent variables on the dependent variable. The results of the coefficient of determination test (R^2) are presented in Table 7.

Table 7. Results of the Coefficient of Determination Test (R^2 Test)

Model	R	R Square	AdjustedR Square	Std. Error of The Estimate
1	0.234a	0.055	0.046	0.8546914

Source: processed data, 2025

Based on Table 7 above, the magnitude of the influence of independent variables on the dependent variable is indicated by the Adjusted R Square value of 0.046. This means that 4.6% of the variance in the dependent variable tax avoidance can be explained by the variance in the variables transfer pricing, thin capitalization, and the interaction of profitability with the independent variables. Meanwhile, the remaining 95.4% is explained by other factors not included in this research model.

3) Hypothesis Test (t-Test)

The hypothesis test (t-test) is conducted to determine the effect of each independent variable on the dependent variable partially. If the significance value is ≤ 0.05, then the hypothesis is accepted and the independent variable has a significant effect on the dependent variable. Conversely, if the significance value is > 0.05, the hypothesis is rejected and the independent variable does not have a significant effect on the dependent variable.

1) First Hypothesis Testing (H1)

The first hypothesis states that the higher the transfer pricing, the higher the tax avoidance, particularly in companies with high profitability. Based on Table 7, the regression coefficient for the interaction between transfer pricing and profitability is -4.799 with a significance value of 0.000. The negative regression coefficient of -4.799 indicates that the moderating variable weakens the effect of transfer pricing on tax avoidance. A significance value of 0.000 < 0.05 indicates that the interaction between transfer pricing and profitability has a significant effect on tax avoidance. Therefore, it can be concluded that H0 is accepted and H1 is rejected, because the moderation of profitability weakens the effect of transfer pricing on tax avoidance, which contradicts the hypothesis that profitability strengthens the effect of transfer pricing on tax avoidance.

2) Second Hypothesis Testing (H2)

The second hypothesis states that the higher the thin capitalization, the higher the tax avoidance, particularly in companies with high profitability. Based on Table 7, the regression coefficient for the interaction between thin capitalization and profitability is 0.033 with a significance value of 0.422. The positive regression coefficient of 0.033 indicates that the moderating variable strengthens the effect of thin capitalization on tax avoidance. However, the significance value of 0.422 > 0.05 indicates that H0 is accepted and H1 is rejected. Thus, it can be concluded that the interaction between profitability and thin capitalization does not have a significant effect on tax avoidance.

4. DISCUSSION OF RESEARCH RESULTS

4.1. Profitability Moderates the Effect of Transfer Pricing on Tax Avoidance

The first hypothesis (H1) states that the higher the transfer pricing, the higher the level of tax avoidance, particularly in companies with high profitability. The results of this study show that profitability moderates (weakens) the effect of transfer pricing on tax avoidance. The negative regression coefficient may indicate that managers engage in transfer pricing primarily to obtain bonuses or incentives, rather than as a strategy for tax avoidance.

Highly profitable companies tend to place greater emphasis on their reputation. Managers who are aware that their actions can affect the company's image are more likely to act ethically and responsibly. They may perform better when they have incentives to maintain a good corporate reputation, which in turn reduces the likelihood of engaging in tax avoidance through aggressive transfer pricing.

Managers operating in more profitable firms may also prioritize long-term sustainability and growth over short-term gains from tax avoidance. Therefore, a focus on corporate reputation and sustainable development can reduce potential agency conflicts between managers (agents) and owners (principals), thus encouraging more ethical and responsible tax practices. Moreover, highly profitable companies often have better access to resources and information necessary for effective tax management. With adequate resources, managers are able to develop transparent and regulation-compliant tax strategies, thereby reducing their reliance on risky transfer pricing practices.

4.2. Profitability Moderates the Effect of Thin Capitalization on Tax Avoidance

The second hypothesis (H2) posits that the higher the level of thin capitalization, the higher the degree of tax avoidance, particularly in companies with high profitability. However, the results of this study indicate that profitability does not significantly moderate (neither strengthen nor weaken) the relationship between thin capitalization and tax avoidance. In this study, profitability is proxied by the Return on Assets (ROA) ratio, which may not adequately capture how management handles the proportion of debt to equity.

It is possible that management continues to engage in thin capitalization practices even when profitability is high, due to limited control over capital structure decisions. This could lead to unintentional tax avoidance despite the company exhibiting strong earnings performance. Although profitability, as measured by ROA, reflects good financial performance, it does not appear to influence the reduction of thin capitalization practices. Managers may still engage in tax avoidance if they lack sufficient incentives or benefits to change their behavior, even when the company is generating high profits. Agency theory explains that managers often pursue objectives that differ from those of shareholders. They may be more focused on achieving short-term profit targets that increase their compensation, rather than considering the long-term implications of engaging in tax avoidance.

5. CONCLUSION

This study aims to analyze the effect of transfer pricing and thin capitalization on tax avoidance, with profitability as a moderating variable. Based on the results of the research analysis through testing and discussion in the previous chapter, the following conclusions can be drawn:

1) Profitability has a significant negative effect on the relationship between transfer pricing and tax avoidance. The findings indicate that when a company's profitability increases, the influence of transfer pricing on tax avoidance tends to decrease. This suggests that more profitable companies are less likely to engage in aggressive transfer pricing practices, as managers are more concerned with maintaining the company's reputation.

2) Profitability does not moderate the effect of thin capitalization on tax avoidance. The moderating effect of profitability on the relationship between thin capitalization and tax avoidance is positive but not statistically significant. Although there is a

tendency for profitability to moderate this relationship, the effect is not strong enough to be considered significant. This implies that managers may still engage in thin capitalization practices regardless of the company's level of profitability.

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