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Bonus Mechanisms, Profitability, and Intangible Assets on Transfer Pricing Decisions in ASEAN 5

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Abtract

This study aims to examine the effect of bonus schemes or commonly known as bonus mechanism, the concept of company's profitability described by Return on Asset (ROA) and company's intangible assets on transfer pricing decisions conducted by using multiple regression analysis. The sample of this study is consistently consist 56 companies with the observation period from 2019 to 2022 collected from consumer sector companies in the ASEAN-5 region. The results of the study is bonus mechanism and intangible assets positively have a significant influence with transfer pricing intensity. The bonus mechanism is able to motivate decision making related to transfer pricing and the difficulty of measuring the right measurement for intangible assets' value become a loophole in making the decision of transfer pricing, but there is no influence on profitability described by the Return on Asset (ROA) ratio high profits cause company to pay large tax obligations to also have to be paid as part of the consequences of political costs.

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1. Introduction

Tarifs and tax regulations that differ from country to country are important guidelines for each transacting country. The transfer pricing mechanism is no stranger to international tax issues. This high-level issue has become very controversial and sensitive because of the stereotype that most people think that this mechanism is detrimental to one of the parties involved. On the one hand, the transfer pricing mechanism is known as a form of strategic planning regarding taxation (Rossing, 2013; Chen et al., 2013; Taylor et al., 2015; Richardson & Taylor, 2015; Rahmiati & Sandi, 2016; and Sebele-Mpofu et al., 2021). Transfer pricing is done to minimise the tax burden (Nadezda & Oksana, 2019; Wahyudi et al., 2021; and Evi et al., 2023). Transfer pricing mechanism is considered as a form of violation in the form of tax avoidance if the transaction involves transfer pricing and sets a price that is not reasonable or beyond the principles of reasonableness and business prevalence.

International transfer pricing covers transactions with affiliated parties because they have higher flexibility than transactions with independent parties. Transactions between affiliated parties are always notable transactions due to the influence of unique relationships, such as ownership relationships with a share of at least 25% participation, as stated in Law Number 36 of 2008 Article 18 (4). The term transfer pricing is also discussed in Management Accounting, where intra-company transfer pricing occurs between departments within the same company. In contrast, for tax issues, the transfer pricing that occurs is within the inter-company scope. Provisions regarding how many commodities are the object of outbound trade, as well as policies in determining transfer prices, are very dependent on two considerations such as considering marginal production costs or considerations regarding high tariffs and tax policies so that there is a gap for discrimination in international trade transactions (Kanee, 2019; and Rathke et al., 2021). However, nowadays, countries with low tax rates (tax haven countries) are targets for multinational companies to establish subsidiaries or subsidiary entities so that the tax burden incurred is lower.

This issue has attracted attention and has become a hot topic of discussion regarding how public policy addresses problems related to global taxation. It is known that the composition of corporate tax and value-added tax from trade and service transactions, both domestic and international, partially contributes to more than 20% of total tax revenue. Moreover, considering the after-effects of the difficult times of the COVID-19 pandemic, of course, this problem will become even more crucial when the government must increase additional revenues through tax obligations paid by the public to offset the sharp increase in the amount of state debt (Muthitacharoen & Samphantharak, 2022). As a result of this action, the potential for state revenue through tax revenues will automatically decrease drastically, with the fact that more than 80% of developing countries' revenues come from taxation and more than 60% of multinational companies in Indonesia are caught in tax disputes which are indicated by manipulation of transfer pricing, which can be resolved through tax dispute resolution procedures. This transfer pricing practice usually occurs as an effort to minimize tax liabilities by exploiting loopholes or loopholes in tax regulations and provisions without violating tax regulations (tax avoidance) or vice versa, namely transactions in a series of minimizing tax liabilities by not complying with tax regulations (tax evasion).

One aspect that has the potential to motivate transfer pricing decisions in companies is the bonus mechanism. The existence of this bonus distribution mechanism will motivate the board of directors in their efforts to increase the company's profits and does not rule out the possibility that the financial reports will be manipulated in such a way as to increase the company's profit figures so that the bonuses received are also maximized. Indications of profit manipulation were found when the action of the bonus mechanism significantly influenced the transfer pricing practice because it was considered the easiest method to carry out in company operations by company directors (Lo et al., 2010; Fitri et al., 2019; Moardi et al., 2020; Arifin et al., 2020; and Baroroh et al., 2021). A high level of profitability will increase a company's initiative to make transfer pricing decisions. The tax burden will be reduced if the company's profits increase. So that transfer pricing will be set as low as possible so that the tax burden is not too significant (Becker & Fuest, 2012; Roslita, 2020; and Choi et al., 2020).

Intangible asset transactions are also considered to be a weapon for diverting profits. They are often easy targets for tax officials to detect whether each transaction supports the principle of fairness. This manifestation is the reason why transfer pricing actions that are not based on the principle of fairness are often found because they are difficult to detect so that transfers are easy to carry out either to subsidiary companies or to companies with a strong level of relationship. Apart from these reasons, a company's competitive advantage is not only determined by affordable prices and good product quality but also by the acquisition and development of intellectual property and other intangible wealth, which also influence the company's competitive advantage to strengthen its business among similar competitors (Barker et al., 2017; Klassen et al., 2017; and Kalra & Afzal, 2023). This type of asset is considered difficult to measure its fair value due to the uncertainty of its value, so companies can carry out transfer pricing actions by paying for patents, technology, licenses, trademarks, and other intangible assets for the reason of handing over royalties to related companies (Lim et al., 2020; Novira et al., 2020; Marinotti, 2022; and Trequattrini et al., 2022).

This study aims to see how independent factors such as bonus provision, profitability and intangible assets of each company will affect the transfer pricing decision-making policy as one of the series in tax planning or avoidance both legally and illegally in order to transfer profits and minimize tax burdens, especially in the consumer sector in the Asean-5 region. The clear difference between previous empirical studies and this study is that the sample studied came from a population of 13 consumer sec-tors in the Asean-5 region where in research related to transfer pricing most were in the secondary sector such as manufacturing and mining. The selection of this tertiary sector is because in its consumer market, Asean countries are the third most populous economic countries and domestic consumption creates a portion of 60% from gross domestic income and is expected to continue to multiply due to the increasing level of needs and the level of desire that requires the consumer sector to innovate to meet it (Asean, 2023). In addition, the Asean-5 countries that are specifically targeted in the study also still have tax ratios to GDP below the average of OECD countries and the average of Latin American and Caribbean countries. This shows that the strong and stable increase in gross domestic product growth in developing countries is not a reference if the tax revenues received are also strong and stable. Before COVID-19 hit, these countries did not achieve tax revenues of up to 15% of gross domestic product due to low tax administration and tax bases that did not cover the minimum level of sustainable development standards (Asian Development Bank, 2021).

2. Hyphotesis Development

Bonus Mechanism on Transfer Pricing

The bonus plan hypothesis suggests that company managers may manipulate accounting methods to inflate reported income, allowing them to earn larger bonuses that are tied to their performance evaluations. This creates a strong incentive for upper management to prioritize profit maximization, as their financial rewards depend on how well the company performs. This behavior supports the principles of positive accounting theory, which posits that managers will act in their own self-interest to enhance their compensation packages (Bosse & Phillips, 2016; and Prananda & Triyanto, 2020). On the other hand, the political cost hypothesis discusses the relationship between governments and companies regarding taxation. Companies often engage in transfer pricing strategies to minimize their political costs, particularly their tax responsibilities. By exploiting gaps or inconsistencies in tax regulations across different countries, especially in regions designated as tax havens, these companies can significantly reduce their tax liabilities.

As the bonuses for directors increase, this can lead to a surge in transfer pricing activities, as the potential for higher personal rewards encourages managers to make more transactions focused on profit manipulation. The direct link between the size of bonuses and transfer pricing decisions suggests that management may be more inclined to pursue aggressive tactics to achieve better financial results. Ultimately, the lure of substantial bonuses can lead to unethical practices, as managers may prioritize their financial gain over the long-term stability and ethical standards of the company. This dynamic creates a cycle where the pursuit of personal financial rewards can drive companies to engage in dubious accounting and financial practices.. According to Saifudin & Putri (2018) that the motivation of directors who work to show their performance is one of the important assessment of company owners in providing appreciation with overall profit indicators so that the bonus mechanism influences transfer pricing decisions. A similar empirical study from Putri et al. (2022) reveals that the motivation for manipulating transfer pricing will only be carried out if there are benefits to be gained for management.

H_1: The bonus mechanism has a positive effect on Transfer Pricing.

Profitability on Transfer Pricing.

The ability of a company to achieve profits through sales activities, total assets owned, or capital capabilities as a foundation for the company can be assessed through profitability ratio analysis. This capability cannot be separated from the influence of profitability; a high profit level indicates that the company is capable of managing its resources effectively in its operations. Earnings management typically conducted by company managers, can be manipulated or engineered according to the company's desired priorities (Widya & Nugrahani, 2018; Sari & Widaninggar, 2020; Baskaran et al., 2020; Palacios-Manzano et al., 2021; and Jaunanda & Oktaviyanti, 2023).

As a company's profitability increases, it often becomes more aggressive in using transfer pricing to manage its tax obligations. Transfer pricing involves setting prices for transactions between affiliated companies to shift profits to lower-tax jurisdictions. When a company is highly profitable, it may use this strategy more frequently to lower its overall tax burden. This is because companies with high profitability, reflected in a high return on assets (ROA), have more incentive to reduce taxes by moving profits to entities in regions with lower tax rates. The direct proportionality means that as profitability grows, so does the likelihood of using transfer pricing to minimize tax liabilities, taking advantage of less stringent tax regulations in certain jurisdictions.

The influence of the profitability variable, as explained by the Cahyadi & Noviari (2018) study, shows that an increase in profitability, which is translated into a ROA proxy, will create high initiative by the company to carry out transfer pricing actions intensively. Prayudiawan & Pamungkas (2020) if the company's ability to produce This advantage triggers aggressive transfer price manipulation actions.

H_2: Profitability has a positive effect on Transfer Pricing

Intangible Asset on Transfer Pricing.

In an economy driven by innovation and cuttingedge discoveries, a company's value is often determined by intangible assets that frequently provide a competitive advantage. These intangible assets are easily transferable and become objects of tax planning, leading to issues of transfer pricing. Some multinational companies shift their intangible assets to affiliate countries with low tax jurisdictions, such as through royalties or licenses from entities in high tax jurisdictions. The benefit of this scheme is that it facilitates profit shifting (Merle et al., 2019). The geographic allocation of these intangible assets to subsidiaries in low-tax countries increases investment in intangible assets. Marques et al. (2019) that intangible asset indicators are often used to gauge how responsive tax policies are to investment flows, which tend to be lower due to international income shifting. The OECD's BEPS Action 8 addresses the issue of income diversion through investment in intangible assets, specifying that profits from these assets should be reported based on their actual value. It underscores that legal ownership alone does not determine profit allocation. However, measuring the true value of intangible assets remains challenging. Rahman & Cheisviyanny (2020) highlight this difficulty as a gap that companies exploit to shift income to affiliated entities. Wahyudi & Fitriah (2021) further demonstrate that when multinational companies allocate intangible assets to affiliates in lower-tax jurisdictions, it can lead to aggressive transfer pricing due to varying interpretations of asset valuation. Additionally, the complexity in defining intangible asset transactions contributes to the prevalence of transfer pricing issues.

According to Wahyudi and Fitriah (2021), subsequent empirical studies prove that intangible asset transactions can divert profits to reduce affiliated groups' global tax obligations. Differences in views in determining the transaction price of assets without certainty in measuring their value create an increased risk of transfer price manipulation. Rahman & Cheisviyanny (2020) research concluded the positive influence of transfer pricing transactions using non-identifiable intangible assets such as R&D expenses and royalties. This character of assets gives companies the freedom to manipulate their value and price.

The gap in defining all activities that relate to intangible assets gives companies the opportunity to carry out transfer pricing as a method of shifting profits. The difficulty in determining one market price is because the differences in intangible assets, both in terms of creation and acquisition of these assets, are also utilized by companies, especially as intangible assets are considered to be the value of a company's competitive advantage.

H_3: Intangible assets have a positive effect on Transfer Pricing.

3. Data and Methods

The population of this study is manufacturing sector companies and mining companies listed in Indonesia, Singapore, Malaysia, Thailand, Philippines (Asean-5) This research collects data from annual report, the official website of each sample company as well as information on inflation and GDP from the World Bank (worldbank.org) and SnP Capital IQ. Total research data for 2019-2022 is 224 companies.

The variables and operationalization of the research variables are presented in Table 1. The research variables consist of dependent variables (transfer pricing), independent variables (bonus mechanisms, profitability, and intangible assets), control variables (Inflation, Gross Domestic Product (GDP), Age Firm, Covid years, and Sales growth)

Table 1. Operational Definition of Variables

Variabel		Definition	Source
Dependent Variable			
Transfer Pricing	RPT	$RPT = \frac{Related\ Party\ Receivables}{Total\ Receivables}$	(Merle et al., 201)
independent variables			

Variabel	Definition		Source
Bonus Mechanisms	Bonus compensation arrangements for directors who have good performance and achi-eve targets set by the company	$ITRENDLB = \frac{Net\ Income_t}{Net\ Income_{t-1}}$	(Putri et al., 2022).
Profitability	Ratios are able to provide clues about the ability of company management to generate profits in a certain period	$ROA = \frac{Net\ Income\ After\ Tax}{Total\ Assets}$	(Cahyadi & Noviari, 2018)
Intangible assets	Identifiable non-monetary assets that do not have a physical form but which rep-resent privileges or positions that provide an advantage to the company in generating revenue	$IA = Ln(Intangible\ Assets)$	Merle et al., 2019)
Control Variable			
Inflation	general and continuous increase in the prices of goods and services over a certain period	CPI	
Gross Domestic Produk	the level of economic growth of a country in capita measurement units	GDP	
Age Firm	the age of the company from the time the company was founded was based on the deed of establishment until the research was carried out		Sinambela & Nur'aini, 2021
Covid years	Coronavirus disease causes the epidemic that is affect corona virush disease company's growth indicator is seen from the increase in sales	Years affected: 1 Years not affected: 0	Angelina et al., 2022.
Sales growth	transfer pricing policy for transactions of goods, services and other intangible assets to related parties		Sebastian & Handojo, 2019)

This research uses a data pool multiple li-near regression model to measure the relation-ship and direction of the independent and de-pendent variables. which can be translated with the following model:

$TPi,t = \alpha + \beta_1 ITRENDLB_{i,t} + \beta_2 ROA_{i,t} + \beta_3 IA_{i,t} + \beta_4 INF_{i,t} + \beta_5 GDP_{i,t} + \beta_6 AGE_{i,t} + \beta_7 COV_{i,t} + \beta_8 SG_{i,t} + \varepsilon$

Where: α= Constant; $\beta_{1,2,..8}$= Regression Coefficient TP= Transfer Pricing, ITRENDLB= Bonus Mecha-nism, ROA= Profitability, IA= Intangible assets, INF= Inflation, GDP= Gross Domestic Product, AGE= Company Age, COV= COVID-19, SG= Sales Growth

4. Result

The results of the analysis show that the – value of the determination coefficient R^2, amo-unting to 11.4% of transfer pricing decisions can be explained by variations in independent vari-ables in this research model. Meanwhile, 88.6% is influenced by interruption variables that are not included as variables in this study. The F test value shows a significance value of 0.001. So it can be concluded that this research model is feasible to be tested in hypothesis tes-ting.

The test results state the direction and sig-nificance of each independent variable on the dependent variable with a significance level of 1%, 5% or 10% which means the hypothesis is a-ccepted because it has an effect and vice versa for the hypothesis is not accepted because the independent variable has no effect. The results of the analysis show that the ITRENDLB variable (bonus mechanism) shows a positive direction with a level of 1% which means the bonus mechanism has a positive effect on transfer pricing so H_1 is accepted. The coefficient on the profitability variable (ROA) shows a negative di-rection with a level of more than 10% which is 0.323 It can be concluded that profitability with ROA calculation has a negative effect on transfer pricing decision making so H_2 is rejected. The coefficient on the IA (Intangible Assets) variable shows a positive direction with a level of 1% which means Intangible assets have a positive effect on transfer pricing.

Table 2. Test Result

	β	Std. Error	t-statistics	Sig. two-tailed	Sig. one-tailed
(Constant)	0.088	0.048	1.834	0.068	
ITRENDLB	0.014	0.004	3.146	0.002	0.001**
ROA	-0.094	0.205	-0.459	0.647	0.323
IA	0.012	0.003	3.690	0.000	0.000**
INF	-0.542	0.983	-0.552	0.582	
GDP	-0.257	0.478	-0.537	0.592	
AGE	0.000	0.000	0.390	0.697	
COV	-0.040	0.039	-1.049	0.295	
SG	0.134	0.106	1.264	0.208	
R	0.337				
R^2	0.114				
R^2_{adj}	0.081				
SE	0.221				
$F_{Account}$	3.451				
F_{Prob}	0.001				

* sig <0.05, **sig <0.01, ***sig <0.1

5. Discusssion

The Effect of Bonus Mechanism on Transfer Pricing

The results of the study show that the bonus mechanism has a positive influence on transfer pricing. Providing appreciation in the form of bonuses based on the increase in profits targeted by the company is a popular method. It is very logical if we trace its connection to profit manipulation. This is in line with the hypothesis of positive accounting theory, namely the bonus plan hypothesis. Choosing an accounting method that can maximize profit reporting will be the choice of top management. The theory that ultimately gave birth to agency theory proves that the choice of accounting method can predict the probability of the method chosen technically for a company's financial problems because of differences in interests between interested parties. The contractual relationships discussed in agency theory support the results of this research, where information asymmetry can make management carry out profit manipulation actions for their interests but still meet the expectations of company owners.

These results align with research by Saifudin & Putri (2018), which states that the appreciation strategy for directors' performance, targeted at the total profit achieved by the company through this bonus scheme, significantly impacts transfer pricing decisions. The existence of a correlation between the attitude of the directors and a perception formed from the bonus plan, which is seen from the amount of profit, influences the increase in the occurrence of intense transfer pricing actions so that there is a desire to take these actions because there are profits to be gained. The findings of this study strengthen the findings of research Thinh & An (2023), where the bonus mechanism has a positive effect on transfer pricing. The findings of this study do not support the findings of study Indriaswari & Nita (2018); Handayani (2021); and Sari et al., 2022).

The Effect of Profitabilty on Transfer Pricing

The results of the study show that profitability does not affect transfer pricing. The results of this study indicate that company's ability to generate profitability does not affect transfer pricing. This practice tendency can occur without being influenced by a company's profitability, whether high or low financial performance ratio numbers do not cover the fact that every company has the same opportunity to carry out transfer pricing actions. If a company's profitability is low, the company has likely carried out the practice of diverting profits; however, if the profitability is high, it also gives rise to indications that the company will plan action to reduce the value of tax liabilities in the next period, one way is by manipulating transfer prices to related parties. It is important to remember the function of financial performance ratios, which only describes a particular condition of an aspect of the financial report, not the overall condition.The results of this research do not follow the contractual relationship in agency theory, where the principal wants high profits but wants to pay the lowest taxes, thus putting pressure on the agent who has been given the authority to manage the company to be able to carry out any strategy to meet the principal's expectations.

These results align with research by Devita & Sholikhah (2021) and Anh et al. (2018). Devita & Sholikhah (2021) that companies with high profit levels would maximize internal funding potential without setting large transfer prices. Anh et al. (2018) also agreed that if profitability does not significantly influence transfer pricing practices, especially if the company struggles to make a profit but still insists on expanding its business, profitability information will be invalid when considering transfer pricing decisions. Information regarding profitability financial ratios is generally not a benchmark for decision-making, so companies must pay more attention to this information. However, the findings of this study do not support Baroroh et al. (2021). Where profitability has a positive effect on transfer pricing.

The Effect of Intangle assets on Transfer Pricing

The results of the study on the influence of intangible assets on transfer pricing indicate that intangible assets have a positive effect on transfer pricing. These intangible assets open up opportunities for multinational companies to carry out transfer pricing between their affiliated companies to reduce tax liabilities as a group. Even though previous literature has inconsistencies in results, in general, every company will always experience similarities in the problem of fair measurement value of intangible assets so that certain parties consider this not as a difficulty but an ample opportunity which is seen as a gap in the small carry out profit diversion actions through determining the transfer price of intangible assets.

These results align with research by Taylor, et. al. (2015) and Rahman & Cheisviyanny (2020) characteristics of this type of asset, which are challenging to interpret; the measurement of fair value and transaction assessment becomes a forum for income allocation so that there is a significant potential for profit shifting to be transferred in the form of this asset which provides an opportunity for multinational companies to divert profits to affiliated countries. with low tax rates through related party transactions. Generally, companies spend fantastic funds on several activities for product innovation or royalties from trademarks or intellectual property, such as technology transfers, which the parent company then licenses to subsidiary companies. The large allocation of intangible assets increases interest in seeking transfer pricing activities as a transfer of income. Research with similar results has also been proven by research by Wahyudi & Fitriah (2021) research proves that the allocation of this form of asset will be deliberately distorted from multinational companies towards affiliated companies with low tax rates, which is indicated as an act of diverting profits from affiliates domiciled with high tax rates to affiliates domiciled with low tax rates. This difference in interpretation in the assessment of intangible assets is the main supporting factor for transfer pricing decisions.

6. Conclusion and Suggestion

Conclusion

The research findings show that the Bonus Mechanism has a positive effect on transfer pricing. Profitability has no effect on transfer pricing. Intangible assets have a positive effect on Transfer pricing decisions. This study contributes to the literature on management accounting studies, especially in relation to transfer pricing. How companies set ethical transfer pricing in transactions with various countries. This study is limited to companies in Asean countries, which are developing countries.

Suggestion

This study is limited to Asean countries with limited industries. For further research, it can be done by expanding the scope of research with various industries and countries to obtain various perspectives on transfer pricing, because the business environment and regulations vary globally.

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