

Conference Paper

Does Transfer Pricing Improve the Tax Avoidance through Financial Reporting Aggressiveness?

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Abstract

The purpose of this study is to test and analyze the effect of transfer pricing on tax avoidance with aggressiveness of financial reporting as mediating variable. The study sample used a manufacturing company listed on the Indonesia Stock Exchange (IDX) for the period 2013-2017 with a sampling technique using purposive sampling, so that the number of final samples obtained was 305 sample observations. This study uses a panel data approach to test the research hypothesis with eviews version 10. The results show that transfer pricing has a positive and significant effect on tax avoidance and the financial reporting aggressiveness, financial reporting aggressiveness has a positive and significant effect on tax avoidance, and financial reporting aggressiveness can positively mediate the effect of transfer pricing on tax avoidance.

Keywords: transfer pricing, financial reporting aggressiveness, tax avoidance

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1. Introduction

The Indonesian government is still experiencing various obstacles in increasing tax revenues. Based on reports made jointly between IMF investigators in 2016, based on surveys, and re-analyzed by the PBB University using the International Center for Policy and Research (ICTD) database, and the International Center for Taxation and Development (ICTD), data on corporate tax avoidance was found. in 30 countries. One of them is Indonesia with the rank of tax avoidance ranked 11th largest with a value estimated at 6.48 billion USD which is not paid by companies in Indonesia to the Tax Office in Indonesia (Tribunews.Com). The result is the optimization of state revenues from taxable sources is not achieved. Tax avoidance is a way to reduce taxes that are still within the limits of tax laws and regulations and can be justified, especially through tax planning (Anderson, 2011).

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Cases of tax avoidance that occur like PT. Asian Agri, Tbk; PT. Bumi Resources, Tbk and its subsidiaries, namely, PT. Kaltim Prima Coal (KPC) and Arutmin Indonesia. Even the cases of Panama papers and paradise papers that have recently occurred provide a brief description that the phenomenon of tax avoidance is still an important part of a business organizations. One important factor that can influence tax avoidance is transfer pricing. Transfer pricing is the price contained in each product or service from one division to another in the same company or between companies that have a special relationship (Santosa & Suzan, 2017). The purpose of company management is to transfer pricing to manipulate the amount of accounting earnings, thereby affecting the tax to be received by the government and dividends that will be received by shareholders. Transfer pricing schemes are used by management to reduce the company's tax burden, either through transactions with business groups that obtain tax holiday facilities, transfer profits to business groups that suffer losses, or make transactions to business groups in countries tax free or low tax rates.

The transfer pricing phenomenon related to tax avoidance as reported by the Directorate General of Tax of the Ministry of Finance (DGT of the Ministry of Finance) that as many as 2,000 multinational companies operating in Indonesia do not pay Agency Income Tax (PPH) Article 25 and Article 29 for reasons of loss. The foreign company uses three main modes to avoid taxes. The 2,000 companies are foreign investment companies handled by the Special Tax Office (Kanwil). Furthermore, 2,000 foreign investment companies consist of companies in the trade sector and so on. The company does not pay taxes for ten (10) years through transfer pricing schemes or transfer profits or taxable profits from Indonesia to other countries (Liputan6.Com).

Transfer pricing can not only affect tax avoidance. But it tends to be done by management to manage company earnings. Aharony et al. (2010) stated that many companies use related party transactions to improve company performance during the period of the initial public offering (IPO). His findings prove that sales transactions with related parties are mostly used by companies conducting IPOs with parent companies to enable companies to regulate accounting profit figures, so that they can affect the market. Although this transaction can benefit the company.

Ying & Wang (2013) explained that most companies carry out financial reporting aggressiveness followed by excessive tunneling by controlling shareholders to eliminate earnings imported from IPO companies. Hwang et al. (2013) stated that most transactions with related parties are regulated to meet management objectives. Beuselink & Deloof (2014) states that members of business groups tend to be involved in the financial reporting aggressiveness compared to non-business groups. Rasheed et al. (2018) and

Marchini (2018) state that the higher the transfer pricing carried out by related parties, the higher the company of financial reporting aggressiveness.

Frank et al. (2009) stated that the financial reporting aggressiveness is an earnings management action carried out by company management within the limits or beyond the limits of applicable accounting principles. One of management's motivations for managing earnings on an accrual basis is to get incentives in the form of bonuses (Watts & Zimmerman, 1990). To get a bonus, management must convince shareholders that the company's performance has been fulfilled. One attempt to convince management that performance has been fulfilled by managing earnings in the interests of management. Efforts to maintain profits even increase accounting earnings can be done through reducing the tax burden that must be borne by the company by utilizing the applicable tax laws and regulations.

Various cases of financial reporting aggressiveness involving giant companies have occurred, such as Enron, Worldcom, Tyco, Health South, and Xerox. This case of financial reporting aggressiveness has a negative impact on the development of global business, thereby reducing the level of trust of shareholders in the company's business processes. has a negative impact on the company's business development. The case of aggressive financial reporting is not only happening to giant companies globally. However, it has also happened in Indonesia such as, PT. Kimia Farma, Tbk; PT. Indofarma, Tbk; PT. Lippo, Tbk; PT. Katarina Utana, Tbk; PT. Bumi Resources, Tbk; and PT. Ades Affindo. In addition, in recent years there have been cases of aggressiveness in financial reporting on electronic companies originating from Japan, Toshiba. These cases prove that the phenomenon of financial reporting aggressiveness is an important part of the company's business processes.

The financial reporting aggressiveness is then used by management as one of the important factors in linking transfer pricing schemes to minimize the company's tax burden. That is, transfer pricing schemes are carried out by management to minimize the tax burden owed through aggressive earnings management in accordance with the wishes of management. The goal is to maintain or improve the performance of the company, so as to give a signal to shareholders that the company has good prospects. This motivation is carried out by management to fulfill bonus incentives, debt contracts, or political costs (Watts & Zimmerman, 1989). In addition, Scott (2015) states that the opportunistic policies of management to manage earnings are motivated by the amount of tax that is borne by the company, so that the tax burden owed becomes smaller because the accounting profit has been managed by the management. Based on the description of the background, the formulation of this research problem is can transfer

pricing increase tax avoidance through the financial reporting aggressiveness? Thus, the purpose of this study is to test and analyze the effect of transfer pricing on tax avoidance which is moderated by the financial reporting aggressiveness.

2. Theory and Hypothesis Development

2.1. Transfer Pricing and Tax Avoidance

The aim of the company is to maximize accounting earnings. One way that company management does to maximize accounting profits is by minimizing the tax burden owed. The motivation of company management to carry out this strategy is to get incentives in the form of bonuses because the company's financial performance has been achieved. This is done by the management of the company because of the inconsistency of interests between the management of the company and the shareholders. That is, shareholders delegate authority to company management to manage the company with the aim of meeting the interests of shareholders. However, company management also has personal interests, thus affecting management's opportunistic behavior. The opportunistic behavior of company management is carried out through various regulatory loopholes, for example through the loophole of tax legislation.

The management of the company takes advantage of tax laws and regulations to minimize the tax burden owed. One of the company's management strategies to minimize the tax burden is owed through a transfer pricing scheme. Transfer pricing is the price contained in each product or service from one division to another in the same company or between companies that have a special relationship (Santosa & Suzan, 2017). The purpose of company management is to transfer pricing to manipulate the amount of accounting profits, thereby affecting the tax to be received by the government and dividends that will be received by shareholders. The transfer pricing policy mechanism is used by management to reduce the company's tax burden, either through transactions with business groups that obtain tax holiday facilities, transfer profits to business groups that suffer losses, or make transactions to business groups in countries tax free or low tax rates.

Transfer pricing tends to be done in business groups that have special relationships to minimize the tax burden owed (Jung et al. 2009; Lee, 2010; Choi et al., 2011; Lee & Yoon, 2012). Lee (2010) and Lee & Yoon (2012) examined the effect of related party transactions on income shifts. The findings indicate that the shift in income occurs because of the motivation of company management to minimize the tax burden owed

through related party transactions. Jacob (1996) explains that United States multinational companies carry out tax avoidance through transactions with related parties to reduce the tax burden owed by multinational companies in business groups by increasing related party transactions.

Transactions with related parties can affect net income and company prospects because the product or service sold to a business group is subject to a fee that is likely to not apply to companies outside the business group. This happens because related parties have a substantial influence on the company in enhancing the company's business development. Transactions with related parties in the business group only show the names of related parties and the number of transactions. However, the transaction does not disclose the conditions of a particular transaction (Choi et al., 2011). Companies that have a high tax burden can reduce taxable income by doing business with related parties that have a low tax burden with favorable conditions, and such decisions will be made to minimize the tax burden at the business group level.

Choi et al. (2011) states that company management who wants to avoid tax with related party transactions make decisions with tax considerations of the two companies. That is, related party transactions are carried out at the level where the corporate tax burden is reduced with a lower tax rate. Companies with lower tax rates will conduct related party transactions while maintaining a low tax rate, and companies with high tax rates will try to reduce tax rates with related party transactions. The results of his research Lutfia & Pratomo (2018), Park (2018) show that transfer pricing has a positive and significant effect on tax avoidance. Based on the description, the hypothesis proposed in this study is as follows.

H_1 : Transfer Pricing has a positive effect on tax avoidance

2.2. Transfer Pricing and Financial Reporting Aggressiveness

Agency theory explains that management as the party managing the company may have the motivation not to act in accordance with the interests of shareholders. This can occur because management has opportunistic behavior to fulfill its interests (Shleifer & Vishny, 1997). Finally, shareholders seek to reduce management's opportunistic behavior through various monitoring mechanisms such as good corporate governance or improving management welfare. The impact is the existence of cost sacrifice called agency costs (Jensen & Meckling, 1976). Management's opportunistic behavior can be identified through acts of aggressive financial reporting. Aggressiveness in financial reporting is an earnings management action carried out by company management

within the limits or beyond the limits of applicable accounting principles (Frank et al., 2009).

financial reporting aggressiveness is described as a situation where managers use available accounting valuations to structure transactions in a way that misrepresents the actual economic conditions of a company's position with the intention of influencing contract agreements based on reported accounting figures. There are various kinds of management motivation to aggressively conduct financial reporting, avoid small profits, beat analyst estimates, maintain company performance and others (Roychowdhury, 2006; Cohen et al., 2008). Ding et al. (2007) state that companies can manage earnings through accrual earnings management or non-operating related party transactions.

The company uses related party transactions with the aim of increasing the company during the period of the initial public offering. Most sales transactions with related parties are used by IPO companies with parent companies to enable companies to regulate profit figures in such a way that they can affect the market (Aharony et al., 2010). Although this transaction can benefit the company. Ying & Wang (2013) explained that most companies carry out financial reporting aggressiveness followed by excessive tunneling by controlling shareholders to eliminate profits imported from IPO companies. Hwang et al. (2013) stated that most transactions with related parties are regulated to meet management objectives. The results of Rasheed et al. (2018), Marchini (2018) shows that special relationship transactions have a positive and significant effect on earnings management. Based on the description, the hypothesis proposed in this study is as follows.

H₂: Transfer Pricing has a positive effect on Financial Reporting Aggressiveness

2.3. Financial Reporting Aggressiveness and Tax Avoidance

Asymmetrical interests between company management and shareholders provide opportunities for management to manage earnings on an accrual basis. This is done by management to fulfill its interests. As a result, the interests of shareholders are not met. One of management's motivations for managing earnings on an accrual basis is to get incentives in the form of bonuses (Watts & Zimmerman, 1990). To get a bonus, management must convince shareholders that the company's performance has been fulfilled. One attempt to convince management that performance has been fulfilled by managing earnings in the interests of management. Efforts to maintain profits even increase accounting profits can be done through reducing the tax burden that must be borne by the company by utilizing the applicable tax laws and regulations.

The company's initial public offering (IPO) provides an opportunity for management to manage profits (Scott, 2015). To improve the company's business prospects, the company then offers additional shares through a right issue or second offering and so on. Teoh et al. (1998) and Marquadt & Wiedman (2004) state that companies that offer additional shares have the motivation to report an increase in accounting profits during the equity offering period. The goal is to influence the perception of shareholders that the company has better prospects. Tang (2006) and Tang & Firth (2011) state that companies that carry out rights issues or public offerings tend to increase accounting profits by making earnings management which is characterized by the greater book tax difference (BTD) value. Wang & Chen (2012), Arief et al. (2016), and Novitasar et al. (2017) shows that earnings management has a positive and significant effect on tax aggressiveness. Based on the description, the hypothesis proposed in this study is as follows.

H₃: Financial Reporting Aggressiveness has a positive effect on Tax Avoidance

2.4. Transfer Pricing, Financial Reporting Aggressiveness, and Tax Avoidance

The company operates to meet profit targets in increasing the welfare of shareholders. However, management as the party that manages the operations of the company has interests that are different from those of shareholders. This creates a conflict of interest, so companies must spend agency costs to reduce conflicts of interest. Motivation of conflict of interest is an incentive in the form of bonus for management in fulfilling their welfare. This incentive allows management to opportunistically behave aggressively in managing profits to minimize the company's tax burden. As a result, management can maintain profits according to their expectations within the framework of the bonus incentive target.

The management of the company takes advantage of tax laws and regulations to minimize the tax burden owed. One of the efforts made by management to reduce the tax burden owed was through a transfer pricing scheme. Transfer pricing is the price contained in each product or service from one division to another in the same company or between companies that have a special relationship (Santosa & Suzan, 2017). Transfer pricing schemes are carried out by management to reduce the tax burden owed by the company to the government and dividends to be received by shareholders. Lutfia & Pratomo (2018) and Park (2018) state that transfer pricing is carried out by management to reduce the company's tax burden. Rasheed et al. (2018) and Marchini (2018) state

that a high transfer pricing scheme provides an opportunity for management to manage earnings aggressively, called aggressiveness in financial reporting.

The aggressiveness of financial reporting is then used by management as one of the important factors in linking transfer pricing schemes to minimize the company's tax burden. Transfer pricing schemes are carried out by management to minimize the tax burden owed through aggressive earnings management in accordance with the wishes of management. The goal is to maintain or improve the performance of the company, so as to give a signal to shareholders that the company has good prospects. This motivation is carried out by management to fulfill bonus incentives, debt contracts, or political costs (Watts & Zimmerman, 1989). In addition, Scott (2015) states that the opportunistic policies of management to manage earnings are motivated by the amount of tax that is borne by the company, so that the tax burden owed becomes smaller because the accounting profit has been managed by management. Wang & Chen (2012); Arief et al. (2016) and Novitasari et al. (2017) states that the financial reporting aggressiveness is carried out by management to reduce the tax burden owed by the company to the government. Based on the description, the research hypothesis is as follows.

H₄: Financial Reporting Aggressiveness can positively mediate the effect of transfer pricing on tax avoidance

3. Method

The data used in this study are sourced from the company's financial statements that have been published through the site www.idx.co.id. This study uses a sample of manufacturing companies listed on the Indonesia Stock Exchange (IDX) for the period 2012-2017. However, the year of analysis starts from 2013-2017. This is because 2012 was used by researchers to calculate the aggressiveness of financial reporting that needed one year earlier. The sampling technique uses a purposive sampling with the following criteria.

This study uses transfer pricing variables as independent variables, the aggressiveness of financial reporting as an intervening variable, and tax avoidance as the dependent variable. The following is a description of the operational definitions of this research variable.

TABLE 1: Sample Selection Process.

No.	Criteria	Not according to criteria	Total
1.	Manufacturing companies that publish financial reports on the Indonesia Stock Exchange (IDX) during the 2013-2017 period.		128
2.	The financial statements of manufacturing companies during the 2013-2017 period were reported in rupiah.	(26)	102
3.	The company obtained pre-tax profit during the period 2013-2017.	(41)	61
The number of samples that meet the criteria		61	
Year		5 year	
Number of sample observations		305	

3.1. Transfer Pricing

Transfer pricing is the price contained in each product or service from one division to another in the same company or between companies that have a special relationship (Santosa & Suzan, 2017). This study uses Related Party Transaction (RPT) to measure tax avoidance adapted from research by Kiswanto & Purwaningsih (2014); Melmusi (2016); and Nuradila & Wibowo (2018). Following is the equation for calculating transfer pricing.

$$\text{Related Party Transaction} = \frac{\text{Accounts Receivable from Related Parties}}{\text{Total Accounts Receivable}}$$

3.2. Financial Reporting Aggressiveness

Financial reporting aggressiveness is an earnings management action carried out by company management within the limits or beyond the limits of applicable accounting principles (Frank et al., 2009). This study uses discretionary accruals to measure the financial reporting aggressiveness adapted from the research of Kothari et al. (2005). The following is an equation for calculating discretionary accruals.

1. Calculating Total Accrual (TA) as follows.

$$TA = NI - CFO$$

2. Regulate the equation below to obtain residuals.

$$\frac{TA}{At - 1} = \frac{1}{At - 1} + \frac{\Delta REV - \Delta REC}{At - 1} + \frac{PPE}{At - 1} + ROA + e$$

3. Enter the results of the estimation of the second residual equation to calculate the equation below.

$$NDA = \frac{1}{A_{t-1}} + \frac{\Delta REV - \Delta REC}{A_{t-1}} + \frac{PPE}{A_{t-1}} + ROA$$

4. Calculating discretionary accruals with the equation below.

$$DA = \frac{TA}{A_{t-1}} - NDA$$

Notes:

TA = Total accrual

NI = Net Income

CFO = Cash Flow Operation

A_{t-1} = Total Asset t-1

ΔREV = Revenue t – Revenue t-1

ΔREC = Account Receivable t – Account Receivable t-1

PPE = Fixed Asset

ROA = Return on Asset

NDA = Non discretionary Accrual

DA = Discretionary Accrual

3.3. Tax Avoidance

Tax avoidance is tax avoidance which is legal manipulation of income which is still in accordance with the provisions of tax laws and regulations with the aim of minimizing the amount of tax payable (Barr et al., 1977). This study uses Book-Tax Differences (BTD) to measure tax avoidance adapted from the research of Weber (2006) and Jackson (2009). Following are the equations for calculating tax avoidance.

$$Book\ Tax\ Differences = \frac{EBIT + NI}{Total\ Asset}$$

4. Results and Discussion

This study uses descriptive statistics to provide an explanation of the research variables used. The following are table 2 descriptive statistics on transfer pricing (TRP) variables, financial reporting aggressiveness (APK), and tax avoidance (PPJ) over the past five years (2013-2017).

TABLE 2: Descriptive Statistics.

Year	Transfer Pricing (TRP)	Financial Reporting Aggressiveness (APK)	Tax Avoidance (PPJ)
2013	0.1966	0.0805	0.2682
2014	0.2067	0.0418	0.2329
2015	0.2091	-0.0109	0.2014
2016	0.2001	0.0065	0.2215
2017	0.1900	-0.0096	0.2051

Table 2 shows that the average related party transaction (RPT) as a proxy (indicator) in transfer pricing measures has fluctuated over the past five years (2013-2017). The highest transfer pricing value is in 2015. In contrast, the lowest transfer pricing value is in 2017. The average value shows that in 2015 manufacturing companies in Indonesia increasingly increased transactions with related parties. Conversely, in 2017 manufacturing companies in Indonesia began to reduce transactions with related parties.

One of the factors in the reduction in related party transactions that have a special relationship is the issuance of Regulation of the Minister of Finance of the Republic of Indonesia Number 213/PMK.03/2016 concerning Types of Documents and/or Additional Information that Must be Stored by Taxpayers who Carry Out Transactions with Related Parties that Have Relations Special, and Procedures for Management. This regulation was established on December 30, 2016 to enter into force in 2017. The purpose of issuing these regulations is to increase transparency and accountability of companies in conducting transfer pricing practices, so as to reduce unethical behavior that leads to tax avoidance practices.

The discretionary average accrual as a proxy (indicator) in measuring the financial reporting aggressiveness shows fluctuations over the past five years (2013-2017). In 2013, the average financial reporting aggressiveness was higher than in 2014-2017. In contrast, the lowest aggressiveness average is in 2017. The average aggressiveness of financial reporting in 2013 shows that manufacturing companies in Indonesia manage earnings aggressively to increase earnings. On the contrary, the financial reporting aggressiveness in 2017 shows that manufacturing companies in Indonesia manage earnings aggressively to reduce corporate earnings.

The important factor is that the company manages profits aggressively with the aim of increasing or decreasing earnings influenced by three important factors, namely (1) bonus plans, (2) debt contracts, and (3) political costs (Watts & Zimmerman, 1990). Companies using bonus plans tend to use accounting methods to increase earnings

in the current period. The goal is to get a bonus. Furthermore, companies that have a higher debt ratio tend to try to choose accounting methods to report higher earnings. The aim is to influence creditors that debt contracts can be fulfilled. Finally, companies that have high political costs tend to use accounting methods to reduce profits. This happens to reduce regulator intervention in the company's business processes that can increase the political costs that must be borne by the company.

The average book tax differences (BTD) as a proxy (indicator) in measuring tax avoidance shows fluctuations over the past five years (2013-2017). In 2013, the average tax avoidance was higher than in 2014-2017. In contrast, the lowest average tax avoidance was in 2015. The average tax avoidance in 2013 showed that the possibility of manufacturing companies in Indonesia doing off balance sheets, for example by not recognizing corporate debt in financial statements. This gives a signal regarding the quality of company profits. Book tax difference (BTD) is one indicator in measuring tax avoidance. High book tax difference values indicate that the quality of corporate profits is low. This happens because the possibility of the company doing off-balance sheet.

Testing the first hypothesis (H_1) as the main effect, namely, the effect of transfer pricing on tax avoidance. This study uses three panel data regression methods to test the first hypothesis. The three methods are, (1) common effect, (2) fixed effect, and (3) random effect. To determine one of the three methods, the researcher uses a paired test, namely, (1) chow test, (2) lagrange multiplier test, and (3) hausman test. The following are the three paired tests to estimate the main effects of the effect of transfer pricing on tax avoidance.

TABLE 3: Stepsof Panel Data.

Methods	Test	Results
Chow Test	Sig. Cross-Section Fis 0.0000 < 0.05	Fixed Effect
Lagrange Multiplier Test	Sig. Breush Paganis 0.0000 < 0.05	Random Effect
Hausman Test	Sig. Cross-Section Random is 0.0465 < 0.05	Fixed Effect
Conclusion		Fixed Effect

Based on table 4, it can be seen that the effect of transfer pricing on tax avoidance has a coefficient of 0.027788, t-statistic of 2.328200, and significance of 0.0207. Significance value (0.0207 < 0.05) proves that the estimation of the main effects of transfer pricing has a positive and significant effect on tax avoidance. Thus, the first hypothesis (H_1) is supported.

TABLE 4: Main Effect Test.

Independent Variable	Expectation Sign	Fixed Effect Dependent Variable: PPJ	
		Coefficient	t-statistic
TRP	+	0.027788	2.328200**
Constant	±	0.220240	100.7909***
F-Statistic		121.3159***	
R ²		0.968207	
Durbin-Watson Statistic		1.703552	
N		305	

Note: Correction heteroscedasticity usewhite cross-section. ***, **, *. Sig of level 1%, 5%, and 10%.

Transfer pricing is the price contained in each product or service from one division to another in the same company or between companies that have a special relationship (Santosa & Suzan, 2017). The management of the company takes advantage of tax laws and regulations to minimize the tax burden owed. The strategy used by management to minimize the tax burden is owed through a transfer pricing scheme. Transfer pricing schemes are used by management to reduce the company’s tax burden, either through transactions with business groups that obtain tax holiday facilities, transfer profits to business groups that suffer losses, or make transactions to business groups in countries tax free or low tax rates. The findings of this study are consistent with research conducted by Lutfia & Pratomo (2018) and Park (2018) which shows that transfer pricing has a positive and significant effect on tax avoidance.

Testing the second hypothesis (H₂), namely, the effect of transfer pricing on the aggressiveness of financial reporting using the three paired testing methods, namely, (1) common effect, (2) fixed effect, and (3) random effect. To determine one of the three methods, the researcher uses a paired test, namely, (1) chow test, (2) lagrange multiplier test, and (3) hausman test. The following are the three paired tests to estimate the effect of transfer pricing on the aggressiveness of financial reporting.

TABLE 5: Steps of Panel Data.

Methods	Test	Results
Chow Test	Sig. Cross-Section F is 0.0184 < 0.05	Fixed Effect
Lagrange Multiplier Test	Sig. Breush Pagan is 0.0075 < 0.05	Random Effect
Hausman Test	Sig. Cross-Section Random is 0.0421 < 0.05	Fixed Effect
Conclusion		Fixed Effect

TABLE 6: Mediating Effect.

Independent Variable	Expectation Sign	Fixed Effect Dependent Variable: APK	
		Coefficient	t-statistic
TRP	+	0.054160	2.661561***
Constant	±	-0.054160	-2.2376664**
F-Statistic		2.994916***	
R ²		0.429162	
Durbin-Watson Statistic		2.537119	
N		305	

Note: Correction heteroscedasticity use white cross-section. ***, **. Sig of level 1% and 5%

Based on table 6, it can be seen that the effect of transfer pricing on the financial reporting aggressiveness has a coefficient of 0.054160, t-statistics of 2.661561, and a significance of 0.0083. Significance value (0.0083 < 0.05) proves that the estimation of transfer pricing mediation effects has a positive and significant effect on the aggressiveness of financial reporting. Thus, the second hypothesis (H₂) is supported.

Financial reporting aggressiveness is described as earnings management actions carried out by company management within the limits or beyond the limits of applicable accounting principles (Frank et al., 2009). The company uses related party transactions with the aim to improve company performance through financial reporting aggressiveness to meet management needs. The aim is to influence the perception of shareholders and the market that the profit target has been reached. Beuselink & Deloof (2014) states that members of business groups tend to be involved in the aggressiveness of financial reporting compared to non-business groups. The findings of this study are consistent with the research conducted by Rasheed et al. (2018) and Machini (2018).

Testing the third hypothesis (H₃), namely, the effect of the financial reporting aggressiveness on tax avoidance. Testing the third hypothesis involves the main effects and effects of mediation (Baron & Kenney, 1986; Hair et al., 2008; and Kock, 2011, 2013). Testing the main effects must be insignificant and the mediating effect must be significant because together the main effects have been included in the mediation effect, and the main effects of the previous test have been significant.

Based on table 8, it can be seen that the effect of the financial reporting aggressiveness on tax avoidance has a coefficient of 0.240055, t-statistic of 5.034847, and significance of 0.0000. Significance value (0.0000 < 0.05) proves that the estimated effect of mediation on the aggressiveness of financial reporting has a positive and significant effect on tax avoidance. Thus, the third hypothesis (H₃) is supported.

TABLE 7: Steps of Panel Data.

Methods	Test	Results
Chow Test	Sig. Cross-Section F is 0.0000 < 0.05	Fixed Effect
Lagrange Multiplier Test	Sig. Breush Pagan is 0.0000 < 0.05	Random Effect
Hausman Test	Sig. Cross-Section Random is 0.3093 > 0.05	Random Effect
Conclusion		Random Effect

TABLE 8: Mediating Effect.

Independent Variable	Expectation Sign	Fixed Effect Dependent Variable:PPJ	
		Coefficient	t-statistic
TRP	+	-0.000465	-0.020361
APK	+	0.240055	5.034847***
Constant	±	0.225937	3.706506***
F-Statistic		4.076097**	
R ²		0.026284	
Durbin-Watson Statistic		1.391556	
N		305	

Note: Correction heteroscedasticity use white cross-section, and free of multicollinearity test. ***, **, Sig of level 1% and 5%.

Both the initial public offering and additional stock offerings such as rights issues and second offers can provide management the opportunity to manage earnings aggressively (Teoh, 1998; Marquadt & Wiedman, 2004; and Scott, 2015). The goal is to influence the perception of shareholders that the company has better prospects. Companies that conduct rights issues or public offerings are motivated to manage earnings aggressively which is marked by the increasing value of book tax differences (BTD). This study is consistent with research conducted by Wang & Chen (2012); Arief et al. (2016); and Novitasar et al. (2017) which proves that the aggressiveness of financial reporting has a positive and significant effect on tax avoidance.

Testing the fourth hypothesis (H₄), namely, the effect of transfer pricing on tax avoidance through the aggressiveness of financial reporting. The fourth hypothesis testing (H₄) will use the Variance Accounted Factor (VAF) method to determine the mediating effect. Following is the calculation of Variance Accounted Factor (VAF).

Table 9 shows the results of the calculation of mediation effects through the Variance Accounted Factor (VAF) method. The results of these calculations indicate that the value of Variance Accounted Factor (VAF) is 0.318737 or 31.8% with a coefficient value of

TABLE 9: Calculation of Mediation Effects Through VAF.

Indirect Effect = 0.054160×0.240055 (TRP -> APK = 0.054160; APK -> PPJ = 0.240055)	0.013001
Direct Effect (TRP-> PPJ without APK as mediating variable = 0.027788)	0.027788
Total Effect= $0.013001 + 0.027788$	0.040789
VAF = Indirect Effect/ Total Effect = $0.013001/0.040789$	0.318737

0.013001. According to Hair et al. (2013), the value of Variance Accounted Factor (VAF) between 20% -80% indicates partial mediation. Thus, the aggressiveness of financial reporting can positively mediate the effect of transfer pricing on tax avoidance. Thus, the fourth hypothesis (H4) is supported.

Transfer pricing policy mechanisms tend to be carried out on business groups that have special relationships to minimize the tax burden owed (Jung et al. 2009; Lee, 2010; Choi et al., 2011; Lee & Yoon, 2012). The company’s management uses a gap in tax laws to reduce taxes that must be paid to the government through a transfer pricing scheme. The findings of Lutfia & Pratomo (2018) and Park (2018) state that a high transfer pricing scheme demonstrates management’s efforts to minimize the company’s tax burden. Furthermore, Rasheed et al. (2018) and Marchini (2018) state that a high transfer pricing scheme is carried out by management to influence the aggressiveness of corporate financial reporting.

Frank et al. (2009) states that the financial reporting aggressiveness is an earnings management action carried out by company management within the limits or beyond the limits of applicable accounting principles. Management manages earnings aggressively through transfer pricing schemes with the aim of minimizing the company’s tax burden. The implication is that the tax burden is decreasing and dividends received by shareholders are low. Watts & Zimmerman (1989) states that this motivation is carried out by management to fulfill bonus incentives, debt contracts, or political costs. In addition, Scott (2015) explained that the opportunistic policy of management to manage earnings was motivated by the amount of tax that was borne by the company, so that the tax burden owed became smaller because the accounting profit was managed by management. Research findings of Wang & Chen (2012); Arief et al. (2016) and Novitasar et al. (2017) states that the financial reporting aggressiveness has a positive and significant effect on tax avoidance.

5. Conclusion

This study aims to estimate and analyze the effect of transfer pricing on tax avoidance through the financial reporting aggressiveness. The sample used in this study is a manufacturing company listed on the Indonesia Stock Exchange (IDX) for the period 2012-2017. However, the analysis period starts from 2013-2017 because the previous year, namely, 2012 was used as the base year in calculating the financial reporting aggressiveness. The data approach used is panel data, so this study uses panel data regression estimation with eviews version 10.0. The following is a summary of conclusions based on research findings (1) transfer pricing has a positive and significant effect on tax avoidance, (2) transfer pricing has a positive and significant effect on the financial reporting aggressiveness, (3) the financial reporting aggressiveness has a significant and positive effect on tax avoidance, and (4) the financial reporting aggressiveness can positively mediate the effect of transfer pricing on tax avoidance.

This study has several limitations and can be used as consideration in future studies. These limitations can be explained by the following (1) this study is only limited to manufacturing companies listed on the Indonesia Stock Exchange (IDX) for the period 2013-2017, (2) measurement of transfer pricing variables using related party transactions (RPT) while there are still several proxies transfer pricing, (3) this study only uses quantitative methods in answering the phenomena that occur while there are still other methods in answering phenomena to obtain more robust results, (4) measurement of the financial reporting aggressiveness using the Kothari (2005) model as modification of the modified Jones model while there are still other measures of aggressiveness, (5) this study does not use control variables to control the testing of research hypotheses to reduce decision-making bias, and (6) measurement of tax avoidance variables using the book tax difference (BTD) while remaining measurement measure other tax indications.

Based on the limitations that the researchers have described earlier, this study has several suggestions as considerations in future research. These suggestions can be described by the researcher as follows (1) further research can use a sample of mining companies or SOEs to detect tax avoidance behavior. In addition, further research can extend the research period, (2) further research can use other transfer pricing proxies such as export and import policies in special relationships or using dummy variables in categorizing companies that have special relationships and vice versa, (3) further research can using a combination of quantitative and qualitative methods through a triangulation approach to get better results, (4) further research can use measures of financial reporting aggressiveness other than the Kothari (2005) model, namely,

modified Jones models, Jones models, Healy models or other models, (5) further research can use control variables to reduce decision-making bias. Control variables that can be used such as company size, leverage, sales growth, company profits, or others, and (6) Further research can use other proxies to measure tax avoidance such as ETR cash, GAAP ETR, current ETR, or other stated by Hanlon & Heitzman (2010).

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