

## Foreign ownership as a moderating factor in transfer pricing: Evidence from multinational firms in Indonesia

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### Abstract

This study examines the relationship between taxation, tunneling incentives, foreign ownership, and transfer pricing among multinational companies listed on the Indonesia Stock Exchange (IDX) during the 2021–2023 period. Using purposive sampling, 27 firms were selected, resulting in 81 firm-year observations. The study employs multiple linear regression and moderated regression analysis (MRA) to assess both direct and interaction effects. The results show that taxation is not statistically significantly associated with transfer pricing, whereas tunneling incentives are negatively and significantly associated with it. Furthermore, foreign ownership plays a significant moderating role, strengthening the relationships between taxation and transfer pricing and between tunneling incentives and transfer pricing. These findings indicate that transfer pricing decisions are shaped by the interaction between internal governance mechanisms and external ownership structures rather than by individual factors in isolation. This study contributes to the literature on transfer pricing behavior in developing economies by highlighting the conditional role of foreign ownership. However, the model does not incorporate several potential control variables, such as firm size, profitability, leverage, and industry characteristics. Future research is therefore encouraged to include additional firm-level and macroeconomic variables to improve the model's robustness and explanatory power.

**Keywords:** *Foreign ownership; Tax; Tunneling incentive; Transfer pricing*

**JEL Classification:** F23, G34, H26

### INTRODUCTION

The intensification of global economic activity has reshaped international taxation dynamics, particularly in developing economies where institutional capacity remains limited. One of the most critical issues in this context is transfer pricing, defined as the determination of prices for transactions between related entities within multinational corporations (Kumar et al., 2021). While transfer pricing is a legitimate mechanism for

coordinating intra-group transactions, it also creates opportunities for firms to reallocate profits across jurisdictions, thereby influencing tax liabilities and potentially reducing government revenues.

The growing concern over transfer pricing is closely linked to profit shifting, in which multinational corporations strategically allocate income to low-tax jurisdictions to minimize their global tax burden (de Mooij & Liu, 2020). In Indonesia, this issue has become increasingly prominent, as the Directorate General of Taxes has identified aggressive transfer pricing as a key challenge to maintaining tax revenue stability (Hosiana & Tjen, 2019). Empirical studies suggest that such practices can significantly erode the domestic tax base by shifting profits away from high-tax jurisdictions (Robu & Căpățină-Verdeș, 2017; Liu et al., 2020). Although regulatory frameworks, such as Minister of Finance Regulation No. 213/PMK.03/2016, have been implemented to address this issue, transfer pricing manipulation remains prevalent in practice (Pratama, 2020; Susanti & Firmansyah, 2018).

The implications of transfer pricing are particularly significant for developing countries that rely heavily on corporate taxation as a source of public revenue. Evidence indicates that tax avoidance through transfer pricing contributes to fiscal leakage and undermines governments' capacity to finance development (Wier, 2020). This concern is further underscored by data from Global Financial Integrity, which estimates that Indonesia experienced illicit financial outflows of approximately USD 123 billion between 2001 and 2010 (Maftuchan, 2013). In such contexts, transfer pricing is not merely a corporate strategy but also a policy concern related to economic sovereignty and fiscal sustainability.

From a theoretical perspective, transfer pricing behavior is closely related to both tax incentives and corporate governance structures. Prior studies have shown that differences in tax rates across jurisdictions create strong incentives for multinational firms to shift profits through intra-company transactions (Rego, 2003; Gao & Zhao, 2015). Empirical evidence from international contexts confirms that firms actively manipulate transfer prices to minimize tax liabilities (Cravens, 1997; Rossing et al., 2017; Wiederhold, 2013), often by adjusting intra-firm trade prices in response to tax differentials (Clausing, 2003; Uyar, 2014; Cristea & Nguyen, 2016). In addition, the broader literature indicates that tax avoidance behavior is influenced not only by statutory tax rates but also by institutional conditions and regulatory environments (Brock & Pogge, 2014; Henn, 2013; Taylor & Richardson, 2012; Carnahan, 2015; de Mooij & Liu, 2020; Flanagan, 2017; Janský & Prats, 2015; Liu, 2024; Vicard, 2015).

Beyond tax considerations, transfer pricing is also shaped by internal corporate incentives, particularly those associated with agency conflicts. Agency theory suggests that conflicts between controlling and minority shareholders may lead to opportunistic behavior, including tunneling practices, whereby controlling shareholders transfer resources for private benefit (Donaldson & Davis, 1991; Eisenhardt, 1989; Jensen & Meckling, 1976; Ross, 1973; Healy & Palepu, 2001). In emerging markets, where ownership structures tend to be highly concentrated, such behavior becomes more pronounced (Claessens et al., 2000). Empirical studies provide mixed evidence regarding the role of tunneling incentives, with some findings indicating a positive relationship with transfer pricing (Azzura & Pratama, 2019; Hapsari, 2021; Mispriyanti, 2016; Noviaastika et al., 2016), while others report no significant association (Holmén & Högfeltdt, 2009; Juliarto et al., 2013). These inconsistencies suggest that the relationship between ownership structure and transfer pricing is not straightforward and may depend on contextual factors.

Foreign ownership represents another important dimension influencing corporate decision-making. In multinational firms, foreign investors often possess greater control and access to strategic information, enabling them to influence managerial policies, including transfer pricing practices (Yulia et al., 2019). Prior studies suggest that higher levels of foreign ownership are associated with stronger incentives for profit shifting due to cross-border operational structures (Azzura & Pratama, 2019; Noviaastika et al., 2016). At the same time, foreign ownership may also function as a governance mechanism that constrains opportunistic behavior. This dual role indicates that foreign ownership may not only directly influence transfer pricing decisions but also condition the relationship between tax incentives, tunneling behavior, and transfer pricing.

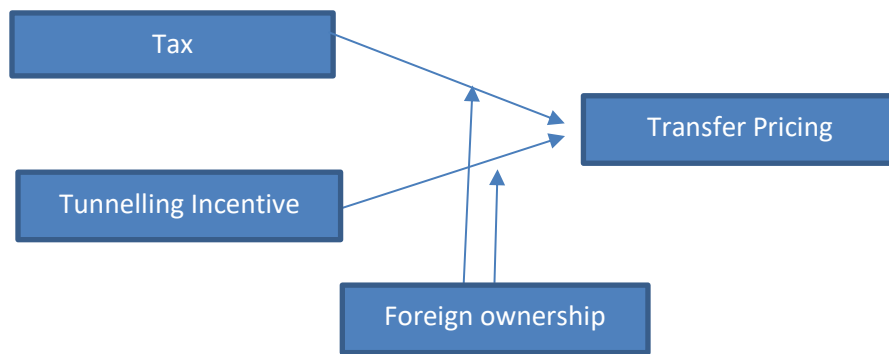
In addition, transfer pricing decisions are influenced by practical and operational considerations. Firms may use transfer pricing to manage internal cash flows, particularly when subsidiaries face liquidity constraints (Burns, 1980; Plasschaert, 1979). Other studies highlight that administrative simplicity and cost considerations also shape transfer pricing strategies (Borkowski, 1992). These findings suggest that transfer pricing is a multidimensional phenomenon influenced simultaneously by tax, governance, and operational factors.

Despite the extensive literature on transfer pricing, several important gaps remain. First, empirical evidence on the role of tunneling incentives in transfer pricing decisions remains inconclusive, particularly in developing countries such as Indonesia. Second, while prior studies have examined taxation and ownership structure independently, limited research has examined their interaction, especially the moderating role of foreign ownership. Third, most existing studies focus on developed economies, whereas developing countries face distinct institutional constraints, including limited tax enforcement capacity and a narrower tax base (Schneider et al., 2010; F, 2019). These differences may lead to variations in corporate behavior that are not fully captured in existing research.

Based on the theoretical arguments and empirical evidence discussed above, taxation is expected to shape corporate incentives in determining transfer pricing practices, as firms may seek to minimize their tax burden through income-shifting mechanisms. At the same time, tunneling incentives arising from ownership concentration may encourage the transfer of resources across affiliated entities, suggesting a potential association between tunneling behavior and transfer pricing decisions. However, given the mixed findings in prior studies, the strength of these relationships remains an empirical question, particularly in emerging economies such as Indonesia.

Furthermore, foreign ownership is likely to play a conditioning role in these relationships. As foreign investors often possess greater control and access to strategic information, their presence may strengthen the influence of tax considerations on transfer pricing decisions. It may also shape the extent to which tunneling incentives are translated into corporate transfer pricing practices. Therefore, this study examines how taxation and tunneling incentives are associated with transfer pricing and investigates whether foreign ownership moderates these relationships among multinational firms listed on the Indonesia Stock Exchange during the 2021–2023 period. In doing so, the study contributes to the literature by positioning foreign ownership as a moderating factor in the relationship between tax incentives, tunneling behavior, and transfer pricing decisions in an emerging market context.

The conceptual relationships examined in this study are illustrated in Figure 1.



**Figure 1.** Research framework model

## METHODS

This study employs a quantitative approach to examine the relationships among taxation, tunneling incentives, and transfer pricing, with foreign ownership serving as a moderating variable. The analysis focuses on identifying associative patterns among the variables rather than establishing strict causal inference.

The data used in this study are secondary data derived from the annual financial statements of multinational corporations listed on the Indonesia Stock Exchange (IDX). These data were obtained from the official IDX website ([www.idx.co.id](http://www.idx.co.id)) and company annual reports for the 2021–2023 period. The use of firm-level financial data enables consistent measurement of corporate behavior related to transfer pricing practices.

The sample was selected using a purposive sampling technique based on several criteria to ensure data relevance and comparability. The selected firms: (i) were multinational companies listed on the IDX during the observation period; (ii) did not report losses, ensuring meaningful calculation of tax variables; (iii) had controlling shareholders with ownership exceeding 20%, capturing potential tunneling behavior; (iv) engaged in related-party transactions, as indicated by receivables from affiliated entities; and (v) had foreign ownership exceeding 20%, reflecting significant external influence. Based on these criteria, 27 firms were selected, resulting in 81 firm-year observations.

The operational definitions of the variables are as follows. Taxation is proxied by the Effective Tax Rate (ETR), calculated as total tax expense divided by profit before tax. ETR is widely used in prior studies as an indicator of tax burden and tax avoidance behavior (Atan et al., 2022). Tunneling incentives are measured by the proportion of shares held by controlling shareholders relative to total outstanding shares, reflecting the potential for resource expropriation within the firm (Jiang et al., 2021). Foreign ownership is measured as the proportion of shares owned by foreign investors relative to total outstanding shares, representing the extent of external ownership influence (Rahman & Hamid, 2023; Hanlon et al., 2005). Transfer pricing is proxied by the ratio of related-party sales to total sales, capturing the intensity of intra-group transactions (Hanlon et al., 2005).

To examine the moderating role of foreign ownership, this study applies Moderated Regression Analysis (MRA). This approach enables the estimation of interaction effects between the independent variables and the moderating variable within a linear regression framework. The empirical model is specified as follows:

$$Y = a + b_1X_1 + b_2X_2 + b_3Z + b_4(X_1 \times Z) + b_5(X_2 \times Z) + e$$

where Y represents transfer pricing,  $X_1$  denotes taxation,  $X_2$  represents tunneling incentives, Z refers to foreign ownership, and the interaction terms ( $X_1 \times Z$ ) and ( $X_2 \times Z$ ) capture the moderating effects.

Before estimation, classical assumption tests were conducted to ensure the adequacy of the regression model. The normality of residuals was assessed using the Kolmogorov–Smirnov test; multicollinearity was evaluated using the Variance Inflation Factor (VIF) and tolerance values; heteroscedasticity was examined using the Glejser test; and autocorrelation was assessed using the Durbin–Watson statistic. These diagnostic tests were intended to ensure that the regression estimates were not biased by violations of classical assumptions.

Model evaluation was conducted using the coefficient of determination ( $R^2$ ) to assess explanatory power. At the same time, hypothesis testing was performed using t-tests for partial effects and F-tests for overall model significance. The inclusion of interaction terms enables the identification of whether foreign ownership strengthens or weakens the relationships among taxation, tunneling incentives, and transfer pricing.

## RESULTS AND DISCUSSION

### Results

Before examining the regression model, this study first describes the distribution of the main variables used in the analysis. Table 1 presents the descriptive statistics for tax, tunneling incentives, transfer pricing, and foreign ownership. The results show that the average transfer pricing level is 0.205, with a standard deviation of 0.253, indicating variation in intra-group transaction activities across firms. The tax variable exhibits substantial dispersion, as reflected in a relatively large standard deviation relative to its mean, suggesting heterogeneity in effective tax burdens among the sampled firms. Tunneling incentives have the highest mean value (0.557), indicating a relatively concentrated ownership structure. In contrast, foreign ownership averages 0.599, reflecting a substantial presence of foreign investors among the observed firms.

**Table 1.** Descriptive statistics

	N	Minimum	Maximum	Mean	Std. Deviation
Tax	81	.01	38.99	1.9082	6.27907
Tunneling Incentive	81	.21	.93	.5571	.22231
Transfer Pricing	81	.00	.95	.2053	.25257
Foreign Ownership	81	.20	.93	.5991	.22114
Valid N (listwise)	81				

The correlation matrix in Table 2 presents the pairwise relationships among the variables. Tunneling incentives are negatively correlated with transfer pricing ( $r = -0.301$ ;  $p < 0.01$ ), while foreign ownership also shows a negative correlation with transfer pricing ( $r = -0.254$ ;  $p < 0.05$ ). In contrast, the correlation between tax and transfer pricing is negative but not statistically significant ( $r = -0.165$ ).

The correlation between tunneling incentives and foreign ownership is relatively high ( $r = 0.793$ ). However, this does not indicate severe multicollinearity, as confirmed by the regression analysis's acceptable VIF values.

**Table 2.** Correlation matrix

		Tax	Tunneling Incentive	Transfer Pricing	Foreign Ownership
Tax	Pearson Correlation	1	.074	-.165	.027
	Sig. (2-tailed)		.514	.141	.811
Tunneling Incentive	Pearson Correlation	.074	1	-.301**	.793**
	Sig. (2-tailed)	.514		.006	<.001
Transfer Pricing	Pearson Correlation	-	-.301**	1	-.254*
	Sig. (2-tailed)	.165	.141	.006	.022
Foreign Ownership	Pearson Correlation	.027	.793**	-.254*	1
	Sig. (2-tailed)	.811	<.001	.022	

\*\**. significant at the 0.01 level (2-tailed). \*significant at the 0.05 level (2-tailed).*

Before the regression analysis, several diagnostic tests were conducted to ensure that the model satisfied the classical assumptions. The normality test indicates that the residuals are normally distributed ( $p > 0.05$ ), while multicollinearity is not a concern, as reflected by the Variance Inflation Factor (VIF) values close to 1. The heteroscedasticity test using the Glejser method shows that none of the independent variables are statistically significant, indicating the absence of heteroscedasticity. Furthermore, the Durbin–Watson statistic of 1.838 falls within the acceptable range, indicating no autocorrelation in the model. Overall, these results indicate that the regression model satisfies the classical assumptions required for estimation.

**Table 3.** Glejser's heteroscedasticity

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
1 (Constant)	.326	.042		7.797	<.001
Tax	-.004	.002	-.168	-1.622	.109
Tunneling Incentive	-.240	.070	-.357	-1.437	.095

*Dependent Variable: Resabs*

Table 4 presents the baseline regression results. The findings indicate that tunneling incentives are negatively and significantly associated with transfer pricing ( $\beta = -0.330$ ;  $t = -2.710$ ;  $p = 0.008$ ), suggesting that higher ownership concentration is associated with lower transfer pricing intensity. In contrast, tax does not show a statistically significant association with transfer pricing ( $\beta = -0.006$ ;  $t = -1.341$ ;  $p = 0.184$ ). The baseline model explains 30.8% of the variation in transfer pricing, as indicated by the adjusted  $R^2$  value of 0.308, suggesting moderate explanatory power.

**Table 4.** Baseline regression results

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
1 (Constant)	.400	.073		5.496	<.001
Tax	-.006	.004	-.144	-1.341	.184
Tunneling Incentive	-.330	.122	-.290	-2.710	.008

Model Fit: Adjusted  $R^2 = .308$

*Dependent Variable: Transfer Pricing*

The results of the moderated regression analysis are presented in Table 5. The interaction between tax and foreign ownership (Tax × FO) is positive and statistically significant ( $\beta = 0.050$ ;  $t = 2.784$ ;  $p = 0.044$ ), indicating that foreign ownership strengthens the association between tax and transfer pricing. Similarly, the interaction between tunneling incentives and foreign ownership (TI × FO) is also statistically significant ( $\beta = 0.482$ ;  $t = 3.574$ ;  $p = 0.006$ ), suggesting that foreign ownership moderates the relationship between tunneling incentives and transfer pricing.

In the moderation model, the direct effects of tax, tunneling incentives, and foreign ownership are not statistically significant, whereas the interaction terms are significant. This suggests that foreign ownership plays a more important role as a moderating factor than as a direct predictor. The model's explanatory power remains relatively stable after including the interaction terms, with the adjusted  $R^2$  decreasing slightly from 0.308 to 0.306. This indicates that the moderating variables do not substantially increase the model's overall explanatory power.

**Table 5.** Moderation analysis results

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
1 (Constant)	.588	.292		2.015	.048
Tax	-.037	.041	-.920	-.903	.369
Tunneling Incentive	-.640	.652	-.563	-.981	.330
Foreign Ownership	-.323	.464	-.283	-.696	.489
Tax FO	.050	.063	.799	2.784	.044
TI FO	.482	.840	.499	3.574	.006

Model Fit: Adjusted  $R^2 = .306$

*Dependent Variable: Transfer Pricing*

## Discussion

The findings indicate that the effective tax rate is not statistically significantly associated with transfer pricing. This suggests that tax considerations alone are not sufficient to explain transfer pricing practices among multinational firms operating in Indonesia. From a theoretical perspective, this result can be understood through Dunning's Eclectic Paradigm, which emphasizes that firms engage in international operations to exploit ownership, location, and internalization advantages rather than purely to minimize tax burdens (Dunning, 1993). In developing economies, multinational enterprises tend to prioritize location-specific advantages, such as market expansion opportunities, resource availability, and cost efficiency. As a result, strategic and operational considerations may outweigh tax-driven motives in shaping transfer pricing behavior.

This finding also reflects the role of institutional and regulatory environments in limiting aggressive tax practices. Although prior studies have documented that transfer pricing is frequently used to minimize tax (Clausing, 2003; Cristea & Nguyen, 2016), the absence of a significant tax effect in this study suggests that firms may adopt more compliant strategies under existing regulatory frameworks. In addition, transfer pricing does not necessarily constitute an illegal practice, as firms are allowed to engage in legitimate tax planning within regulatory boundaries (J. V. Chen et al., 2022). Therefore, the non-significant effect of tax may indicate that firms rely on broader strategic considerations rather than solely exploiting tax differentials across jurisdictions.

In contrast, tunneling incentives are found to have a significant and negative association with transfer pricing. This result provides an interesting extension of ownership concentration theory, which posits that controlling shareholders may use their power to extract private benefits through intra-group transactions (La Porta et al., 1999). While prior studies often associate tunneling behavior with opportunistic practices, the negative relationship observed in this study suggests a different mechanism. Firms with highly concentrated ownership structures may prefer direct control over corporate resources rather than relying on more complex and less transparent mechanisms such as transfer pricing. In this context, controlling shareholders may exercise their authority through internal decision-making processes rather than through indirect profit-shifting strategies.

This interpretation can also be supported by the regulatory arbitrage perspective, which suggests that firms operate within institutional constraints that shape their strategic choices. Stronger monitoring mechanisms and regulatory oversight may reduce transfer pricing's effectiveness as a tool for resource diversion, thereby weakening the link between tunneling incentives and transfer pricing. As a result, ownership concentration may lead to more centralized and direct control over firm resources, reducing reliance on intra-group transactions as a mechanism for extracting private benefits.

The moderation analysis provides further insight into the role of foreign ownership. The interaction between tax and foreign ownership is positive and statistically significant, indicating that foreign ownership strengthens the relationship between tax and transfer pricing. This finding suggests that although tax does not have a direct effect, it becomes relevant when firms are characterized by substantial foreign ownership. Foreign investors typically possess greater expertise in international tax systems and greater familiarity with cross-border regulatory environments, enabling them to exploit differences in tax regimes more effectively (Eden & Smith, 2001). This is consistent with prior studies showing that foreign ownership increases the likelihood of profit shifting and tax avoidance through transfer pricing mechanisms (Tran & Xu, 2024).

Similarly, the interaction between tunneling incentives and foreign ownership is also significant, indicating that foreign ownership moderates the relationship between internal governance mechanisms and transfer pricing decisions. This result highlights that ownership structure does not operate independently but interacts with external ownership characteristics. In firms with substantial foreign participation, internal incentives such as tunneling may be translated into more structured and strategic transfer pricing practices. This aligns with the view that corporate groups frequently engage in related-party transactions as part of broader business strategies (Khanna & Palepu, 2000) and that such transactions can be used to optimize resource allocation within multinational networks (Bhandari et al., 2022; C. L. Chen et al., 2020).

Furthermore, ownership structure plays a critical role in shaping corporate tax behavior and financial decision-making. Prior studies have shown that corporate governance mechanisms, including ownership concentration and foreign ownership, significantly influence tax avoidance strategies (Alkurdi & Mardini, 2020; Qawqzeh, 2023). Tax avoidance can enhance firm value by reducing tax liabilities and increasing after-tax profits, thereby strengthening internal cash flows and reducing dependence on external financing (Balsam et al., 2017; Ryngaert & Thomas, 2012; C. L. Chen et al., 2020). In this context, foreign ownership may facilitate the implementation of more sophisticated tax planning strategies, particularly in firms with access to international networks and financial expertise.

Overall, this study's findings suggest that a complex interaction among tax considerations, internal governance structures, and external ownership characteristics shapes transfer pricing behavior. The absence of significant direct effects, combined with significant interaction effects, indicates that transfer pricing decisions are not driven by a single factor but by the interplay among multiple dimensions. Foreign ownership emerges as a key conditioning factor that influences how internal and external incentives are translated into corporate decision-making. This highlights the importance of adopting a more integrated approach to understanding transfer pricing behavior, particularly in developing economies where institutional and governance structures play a critical role.

## **CONCLUSION AND RECOMMENDATIONS**

### **Conclusion**

This study examines the relationship between taxation, tunneling incentives, foreign ownership, and transfer pricing among multinational firms in Indonesia. The results indicate that tax does not have a statistically significant association with transfer pricing, whereas tunneling incentives are significant. This suggests that internal governance mechanisms, particularly ownership concentration, play a more prominent role in shaping transfer pricing decisions than tax considerations alone.

The findings also reveal that foreign ownership plays a significant moderating role. Specifically, foreign ownership strengthens the relationships between tax and transfer pricing, as well as between tunneling incentives and transfer pricing. This indicates that although tax does not directly affect transfer pricing, its impact becomes more relevant in firms with higher levels of foreign ownership. Overall, these results highlight that transfer pricing decisions are shaped by the interaction between internal governance structures and external ownership characteristics rather than by single factors in isolation.

### **Recommendations**

This study provides several implications for both policymakers and future research. From a policy perspective, the findings suggest the importance of strengthening regulatory oversight of intra-group transactions, particularly in firms with substantial foreign ownership. Enhancing monitoring mechanisms and improving institutional capacity within tax authorities may help mitigate potential risks associated with transfer pricing practices.

From an academic perspective, this study is subject to several limitations. The model does not incorporate control variables such as firm size, profitability, leverage, and industry characteristics, which may influence transfer pricing decisions. Future research is therefore encouraged to include additional firm-level and macroeconomic variables, such as exchange rates, inflation, and capital flows, to improve model robustness. Moreover, future studies may focus on specific sectors or employ alternative analytical approaches, including the inclusion of mediating or intervening variables, to provide deeper insights into the determinants of transfer pricing behavior.

## **AUTHOR CONTRIBUTIONS**

Conceptualization: Indah Yuliana

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Writing – Review & Editing: Indah Yuliana, Salma Rasheeda  
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Project Administration: Salma Rasheeda  
Funding Acquisition: Indah Yuliana

### CONFLICT OF INTEREST

The authors declare no conflict of interest.

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