

TRANSFER PRICING AND TAX AVOIDANCE ON PROFITABILITY THROUGH THIN CAPITALIZATION

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ABSTRACT

Palm oil is the most important plantation product because it has a high value compared to other plantation products and is also one of the main sources of exchange rates from other countries. Taxes are corporate obligations paid to the government for profits obtained by companies. Tax avoidance is to reduce taxes while still complying with tax regulations and laws. Profitability is the lifeblood of a company's management. This study examines tax avoidance and thin transfer pricing on profitability mediated by thin capitalisation using multiple linear regression and path analysis. The population in this study is oil palm plantation companies listed on the Indonesia Stock Exchange for the period 2018 – 2023. Transfer pricing does not affect profitability directly, but the presence of thin capitalization mediating factors can affect profitability. Meanwhile, tax avoidance does not affect thin capitalization or profitability.

Keywords: Palm oil; tax avoidance; thin capitalization; transfer pricing, profitability

ABSTRAK

Kelapa sawit merupakan yang menghasilkan minyak merupakan produk perkebunan yang paling utama karena memiliki nilai yang tinggi dibandingkan dengan produk perkebunan lainnya dan juga merupakan salah satu sumber utama sumber nilai tukar dari negara lain. Pajak merupakan kewajiban perusahaan yang dibayarkan kepada pemerintah atas profit yang diperoleh perusahaan. Tax avoidance merupakan untuk mengurangi pajak tetapi masih memenuhi peraturan dan hukum perpajakan. Profitability menjadi urat nadi dalam pengelolaan suatu perusahaan. Studi ini bertujuan untuk mengkaji tax avoidance dan thin transfer pricing terhadap profitability yang dimediasi oleh thin capitalization menggunakan regresi linear berganda dan path analysis. Populasi dalam penelitian ini adalah perusahaan perkebunan kelapa sawit yang terdaftar di Bursa Efek Indonesia periode 2018 – 2023. Transfer pricing tidak mempengaruhi profitabilitas secara langsung tetapi adanya faktor mediasi thin capitalization dapat mempengaruhi profitabilitas. Sementara tax avoidance tidak mempengaruhi thin capitalization maupun profitabilitas.

Kata Kunci: Palm oil; tax avoidance; thin capitalization; transfer pricing, profitability

INTRODUCTION

Indonesia is a producer of various plantation commodities, including quinine, sugarcane, rubber, cocoa, tea, and palm oil. The plantation sector is a pillar of the economy and a foundation of the nation. The plantation sector contributes IDR 429 trillion to the national Gross Domestic Product (GDP). The plantation sector generates more revenue compared to the oil and gas industry, which only generates IDR 365 trillion. Only 15 out of 127 plantation products generate foreign exchange. Among these 15 commodities, palm oil provides the largest contribution, amounting to IDR 260 trillion (Pratiwi & Khoiriawati, 2023).

Palm oil, as the main plantation product in Indonesia, has a higher economic value compared to other plantation products and is one of the main sources of the country's foreign exchange. Crude Palm Oil (CPO) is the primary product of palm oil. Indonesia has now become the world's largest CPO producer, producing 51.8 million tons globally in 2019. The increase in local demand is one of the main factors influencing the high production of CPO in Indonesia. Domestic demand increased significantly in 2019, reaching 16.7 million tons of CPO, or 24% of total production. This high demand was driven by the high use of biodiesel (49%), followed by high food consumption (14%), and high oleochemical consumption (9%). Statistical data from the Ministry of Agriculture indicates that palm oil production increases every year (Pratiwi & Khoiriawati, 2023).

Palm oil companies, as one of the taxpayers in Indonesia, are required to pay taxes to the state and the regions where they operate. Law No. 7 of 2021 on the Harmonization of Tax Regulations explains that tax is a mandatory contribution to the state owed by individuals or entities that is coercive according to the law, without receiving direct compensation, and used for state purposes for the greatest welfare of the people. Taxpayers who meet the objective and subjective criteria are required to register with the Directorate General of Taxes office whose scope of work includes the domicile or place of residence of the taxpayer and are given a Taxpayer Identification Number (Hayani, 2023).

Taxes are a source of state funding that plays a role in programs that promote economic growth, infrastructure development, public facilities, education, public welfare, and other assets. Therefore, tax payments must comply with the law, (Kurniawan, 2020). Taxes are one of the government's revenue sources for development and fulfilling government needs in efforts to prosper the people of a nation. Tax collection in Indonesia is regulated by law and is coercive. All companies within the territory of Indonesia and/or benefiting from Indonesia are required to comply with these provisions (Sari, 2019).

Tax avoidance is a way to reduce taxes that is still within the limits of tax laws and regulations and can be justified, especially through tax planning. Tax avoidance is an effort to avoid taxes that is carried out legally and safely for taxpayers without conflicting with applicable tax provisions (not contrary to the law), where the methods and techniques used tend to take advantage of weaknesses. weaknesses (grey areas) contained in the tax laws and regulations themselves, to reduce the amount of tax payable (Ukhriyawati & Malia, 2018).

Large taxpayers more utilize the application of the tax avoidance principle above than small taxpayers because large taxpayers (large companies) have legal divisions or a strong team of in-house lawyers who can look for loopholes in the Tax Law. It also has an internal team of accountants and fiscal administration who prepare adequate commercial and fiscal bookkeeping and financial reports to minimise financial risks and save taxes. Mathematically, if large taxpayers want to make tax savings, then they must minimise their profits in the eyes of the public (Hassan et al., 2022).

Tax avoidance is an aggressive tax strategy carried out by companies to minimize the tax burden, so that this activity may pose risks for the company (Yahya et al., 2023). Tax avoidance is engineering, 'tax affairs' which still remain within the framework of tax provisions (lawful). Based on that, the main aim of tax avoidance is to make the tax burden paid lower because companies consider paying taxes as a very large additional cost or a transfer of wealth from the company to the government which can reduce company profits (Mandasari et al., 2023).

There are several ways to engage in tax avoidance, including (1) Substantive tax planning, which involves shifting the taxpayer and/or taxable object to a country that offers special tax treatment or tax relief (tax haven country) for a certain type of income, (2) Formal

tax planning, which is the effort to avoid taxes by maintaining the economic substance of a transaction through formal choices that result in the lowest tax burden, and (3) The General Anti-Avoidance Rule, which includes anti-avoidance provisions for transactions such as transfer pricing, thin capitalization, treaty shopping, and controlled foreign corporations (Specific Anti-Avoidance Rule), as well as transactions that lack business substance (Wulandari & Dasman, 2023).

Tax avoidance refers to any activities that affect tax obligations, whether they are permitted by tax law or specifically aimed at reducing taxes. Tax avoidance practices typically exploit weaknesses in tax laws without violating tax regulations. There are three characteristics of tax avoidance: (1) Artificial Arrangement, which involves artificial elements where various regulations seem to be applied, even though they are not, and are done in the absence of tax factors, (2) Legal loopholes, which involve exploiting legal loopholes to apply legal provisions for various purposes, even though this was not the intention of the lawmakers, and (3) The element of secrecy, where secrecy is a characteristic in which tax consultants generally provide tools or methods for tax avoidance on the condition that taxpayers maintain confidentiality (Li et al., 2022).

There are several schemes for conducting tax avoidance: (1) Shifting the taxpayer or the taxable object of a certain type of income to countries that offer special tax treatment or tax relief (tax haven country) for that type of taxable income (substantive tax planning), (2) Maintaining the economic substance of transactions through formal choices that result in the lowest tax burden (formal tax planning), and (3) Anti-avoidance provisions for transactions such as transfer pricing, thin capitalization, treaty shopping, and controlled foreign corporations (specific anti-avoidance rule), as well as transactions that lack business substance (Qawqzeh, 2023).

Tax avoidance is measured using the tax effective rate (ETR) (Asiah et al., 2022; Permatasari et al., 2022) or cash effective tax rate (CETR) (Yahya et al., 2021). If the CETR percentage is lower than the corporate income tax rate, it indicates the company is likely engaging in tax avoidance. Conversely, if the percentage is higher than the corporate income tax rate, it indicates a lower likelihood of tax avoidance. If the CETR value is higher than the corporate income tax rate, the company is less likely to engage in tax avoidance. However, if the CETR value is lower than the corporate income tax rate, the company tends to engage in tax avoidance (Haztania & Lestari, 2023).

Transfer pricing is a company's policy on setting the transfer price of goods or services with affiliated companies. Transfer pricing refers to the price calculated for the transfer of goods, services, or other intangible assets from one company to another that has a special relationship, based on the principle of fair market price, (Adelia & Asalam, 2024). Transfer pricing is a company's policy in determining the transfer price of a transaction, whether it involves goods, services, or financial transactions conducted by the company (Abdul et al., 2023).

There are several objectives for determining transfer prices between responsibility centers, including: (1) Providing freedom to responsibility centers to make decisions, (2) Providing relevant information to business units to determine the optimal trade-off between company costs and revenues, (3) Increasing business unit profits while simultaneously increasing company profits to achieve corporate objectives, (4) Helping to accurately evaluate the economic performance of business units, and (5) Ensuring that the system in each business unit is simple, easy to understand, and easy for business unit staff to execute. Transfer pricing can occur between domestic taxpayers or domestic taxpayers and foreign entities, especially those in tax haven countries (countries that impose lower taxes than Indonesia). For

transactions between taxpayers with a special relationship, Indonesia's tax law adheres to the substance over form rule (Dutta & Reichelstein, 2021).

Transfer pricing serves as a decision-making guide for managers when making decisions related to selling and purchasing goods or services between divisions within the company or from external parties. Ultimately, multinational companies use transfer pricing to minimize global corporate taxes (Rafiqah Asaff, 2022).

First, transfer pricing objectives are to manipulate profit amounts so that tax payments and dividend distributions are minimized. Second, to inflate profits to embellish (window-dress) financial reports. The state loses trillions of rupiah due to transfer pricing practices by foreign companies in Indonesia. There are several commonly used methods for determining transfer prices, including cost-based transfer pricing, market-based transfer pricing, and negotiated transfer pricing. These methods are defined as: (1) Cost-Based Transfer Pricing, where many companies use cost-based methods to determine transfer prices. Due to the numerous definitions of cost, companies may use variable costs, full costs, or standard costs, while others may use actual costs in determining transfer prices (Nurwati et al., 2021).

Thin capitalization is a tax avoidance scheme that exploits loopholes in tax regulations by converting equity investments from parties with special relationships into loans, either directly or through intermediaries. Thin capitalization is a tax avoidance framework where debt becomes the dominant funding source compared to equity. Companies engage in thin capitalization by taking advantage of differences in tax regulations, particularly concerning interest payments, which can be classified as tax-deductible, while dividend payments to fund owners are not considered tax-deductible expenses (Fauzi, 2024).

Equity and debt are the two methods businesses use to obtain funding. The reported tax costs of a company are influenced by how the company acquires funding. Thin capitalization is a tax avoidance scheme by setting debt as the primary source of funding instead of equity from parties with special relationships, either directly or through intermediaries. The term thin capitalization itself refers to companies often labelled as "highly leveraged" or having a much higher debt-to-equity ratio. In calculating taxable income, Indonesia's Tax Law specifically allows for the deduction of interest expenses on loans. Therefore, debt financing is considered more advantageous for companies. Companies frequently use debt as a tool to avoid taxes, posing a challenge for tax authorities (Indonesiyin, 2023).

The stipulations related to Thin Capitalization Rules (TCR) are: (1) Loans from shareholders in affiliated companies are classified as equity, (2) If interest payments on loans exceed a certain debt-to-equity ratio, they are considered dividend payments, and (3) Interest expenses on loans from shareholders in affiliated companies that exceed the predetermined debt-to-equity ratio cannot be deducted. Hidden loans that exceed reasonable limits are also covered by Thin Capitalization Rules. Multinational companies that use this concept typically engage in loans, either in the form of cash, capital from shareholders, or other parties (Abubakar Abubakar et al., 2023).

In implementing the TCR concept, include: (1) Parallel Loan: An Indonesian company is made a partner by a foreign investor on the condition that the company must have a subsidiary in the investor's country, (2) Back-to-Back Loan: A loan between a parent and subsidiary company that occurs abroad using different currencies, with banks or other financial institutions acting as intermediaries or third parties, and (3) Direct Loan: A subsidiary receives a direct loan from a foreign investor, who may determine the interest rate, (Rahmadani et al., 2024).

Multinational companies must decide whether to invest by establishing a new subsidiary or acquiring an existing company through cross-border investment. A

multinational company must decide whether to use debt, equity, or a combination of both. Debt financing differs from equity financing because interest rates on debt are fixed (interest-bearing debt), while equity financing returns are based on dividends (Dasman, Julyanti Rachman, et al., 2023).

There are several stipulations related to TCR, including: (1) Some or all loans from shareholders in affiliated companies are classified as equity, (2) Interest payments on loans exceeding a certain Debt to debt-equity ratio (DER) are treated as dividend payments, and (3) Interest expenses on loans from shareholders in affiliated companies that exceed the established DER and loan ratios cannot be deducted (Curry & Fikri, 2023).

Profitability ratios are used to assess the company's ability to generate profits. This indicator is also a measure of the effectiveness of corporate governance. Profitability ratios measure the company's ability to generate profit by utilizing all its resources and capabilities, which are derived from sales activities, asset utilization, and capital usage. The higher the profit or the higher the company's profits, the more secure the company's sustainability, and the greater the disclosure of social information conducted by the company, which can send positive signals to stakeholders (Dasman et al., 2021).

Profitability is a tool used to describe a company's performance, measured by how effectively the company manages its resources to maximize profits. Profitability is one of the methods used to evaluate the company's performance, and therefore, profitability is linked to tax avoidance practices. Profitability indicates the effectiveness of the company's management in managing its assets and capital to generate profit (Sarah & Dasman, 2023).

Profitability becomes a determinant for tax avoidance, as companies that earn high profits tend to pay taxes well, but on the contrary, are pressured by potential losses due to tax payments. Profitability can be proxied by ROA (Return on Assets), which compares net profit with total assets over a period to predict the company's ability to generate profit (Dasman, Purnomo, et al., 2023).

The purpose of using profitability ratios for companies and external parties is as follows: (1) To measure or calculate the profits earned by the company in a given period, (2) To assess the company's profit position from the previous year compared to the current year, (3) To evaluate profit growth over time, (4) To assess the amount of net profit after taxes about equity, (5) To measure the productivity of all company funds used, both borrowed and equity capital, (6) To measure the productivity of all company funds used, whether from equity and (7) For other purposes (Dasman et al., 2024).

Meanwhile, the benefits derived from profitability are: (1) To understand the amount of net profit after taxes about equity, (2) To understand the company's profit position from the previous year compared to the current year, (3) To understand profit growth over time, (4) To understand the amount of net profit after taxes about equity, (5) To understand the productivity of all company funds used, whether borrowed or equity capital and (6) other benefits (Dasman, 2021).

Profitability is the company's ability to generate profit in an effort to increase shareholder value. Profitability is the primary ratio in a company's financial statements, aiming to generate high profits. Profitability is a measure used to evaluate a company's performance. It reflects the company's ability to efficiently utilize its assets to generate profit, known as Return on Assets (ROA). A positive ROA indicates that the total assets used in operations can generate profit for the company. ROA is expressed as a percentage, and the higher the ROA value, the better the company's performance. Profit is the basis for tax imposition. The higher the company's profit, the higher the tax burden paid (Sarah Ginting & Nera Marinda Machdar, 2023).

The results of previous research showed that there was a gap in research related to the influence of transfer pricing and tax avoidance on profitability. Profitability has no effect on tax avoidance due to the higher profitability, (Umar et al., 2021). Profitability significantly affects tax avoidance, (Rahmayani et al., 2023). Profitability and the capital intensity ratio have a positive effect on tax avoidance, (Darsani & Sukartha, 2021). There is a negative relationship between the tax avoidance measure (ETR) and the measure of profitability (Zhu et al., 2019).

An increase in profitability followed the transfer pricing decision to reduce tax expenses in the company, (Baroroh et al., 2021). Transfer pricing can maximize the total profit of the supply chain network, (Huang & Ohmori, 2021). Profitability and thin capitalization affect transfer pricing, (Kusbandiyah et al., 2024). Transfer pricing policies improve positively the profitability of manufacturing firms in Nigeria (Aduwo et al., 2023). There is the impact between profitability and transfer pricing (Arifin et al., 2020).

Thin capitalization does not impact on financial performance which is measured by return on asset in multinationals in Nigeria (Osamor et al., 2023). There is no significant relationship between thin capitalization and profitability of listed pharmaceutical companies in Nigeria, (Jackson & Abraham, 2023). Profitability can weaken the effect of thin capitalization on tax avoidance, (Julianti & Ruslim, 2023). There is a positive relationship between thin capitalization and firms' performance, (Abdul et al., 2023).

The hypotheses developed in this study are as follows:

- H1: There is an effect of transfer pricing on thin capitalization in oil palm plantation sub-sector companies listed on the Indonesia Stock Exchange in 2018-2023.
- H2: There is an effect of tax avoidance on thin capitalization in oil palm plantation sub-sector companies listed on the Indonesia Stock Exchange in 2018-2023.
- H3: There is an effect of transfer pricing on profitability in oil palm plantation sub-sector companies listed on the Indonesia Stock Exchange in 2018-2023.
- H4: There is an effect of tax avoidance on profitability in oil palm plantation sub-sector companies listed on the Indonesia Stock Exchange in 2018-2023.
- H5: There is an effect of thin capitalization on profitability in oil palm plantation sub-sector companies listed on the Indonesia Stock Exchange in 2018-2023.
- H6: There is an effect of transfer pricing on profitability through thin capitalization in oil palm plantation sub-sector companies listed on the Indonesia Stock Exchange in 2018-2023.
- H7: There is an effect of tax avoidance on profitability through thin capitalization in oil palm plantation sub-sector companies listed on the Indonesia Stock Exchange in 2018-2023.

The effect of transfer pricing (TP) and tax avoidance (TA) on profitability (PR) mediated by thin capitalization (TC) in oil palm plantation sub-sector companies listed on the Indonesia Stock Exchange in 2018-2023 can be seen in the research model which can be described in figure 1:

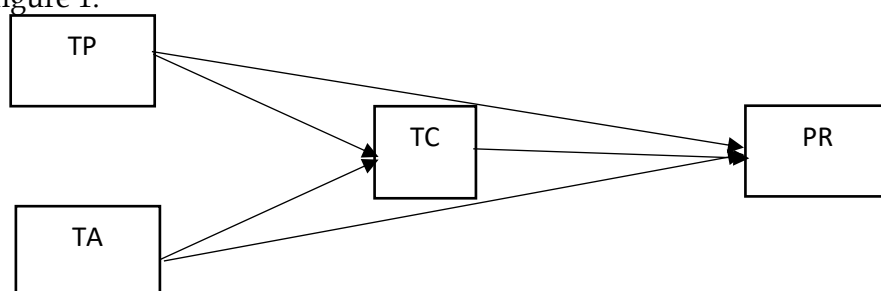


Figure 1. Research Model

Source: Research Data, 2024

RESEARCH METHODS

This study consists of two exogen variables, namely transfer pricing and tax avoidance, one endogenous variable, namely profitability, and one intervening variable, namely profitability. The operationalization of research variables can be seen in table 1 as follows:

Table 1. Operationalization of Research Variable

| Variable | Indicator | Indicatt |
|--|---|----------------------|
| Transfer pricing (TP) is purely a business strategy and tactic without the motive of reducing the tax burden and as an effort to reduce the tax burden with tactics, (Haztania & Lestari, 2023). | Account Receivable to related parties (AR), Total Receivable (TR) | $TP = \frac{AR}{TR}$ |
| Thin capitalization (TC) is a condition in which a company has a much larger amount of debt compared to its capital or is often referred to as high leveraged, (Utami & Irawan, 2022). | Total Debt (TD), Total Equity (TE) | $TC = \frac{TD}{TE}$ |
| Tax avoidance (TA) is an effort to avoid taxes that is carried out legally and safely for taxpayers without contradicting the applicable tax provisions (Gumono, 2021; Widati et al., 2024) | Tax Payment (TX), Profit before Tax (BT) | $PR = \frac{TX}{BT}$ |
| Profitability (PR) is a measure used to assess a company's ability to generate profits. | Profit After Tax (AT), Total Asset (TA) | $PR = \frac{AT}{TA}$ |

The population used in this study is all companies in the oil palm plantation industry sub-sector listed on the Indonesia Stock Exchange in 2018-2023. The sampling method in this study uses the purposive sampling method and was obtained by 15 companies. The type of data collected in this study is secondary data, which in this case data is in the form of annual reports and financial statements of companies in the oil palm plantation industry sub-sector listed on the IDX in the 2018-2023 period. This data can be obtained by accessing the Indonesia Stock Exchange website on the www.idx.co.id and the official website of each company that is used as a sample to calculate transfer pricing, tax avoidance, thin capitalization, and profitability.

The data processing method in this study is by using multiple linear regression and analysis of variance (ANOVA) to check the impact of each variable and path analysis to check mediating effect. Direct and indirect influence test was carried out to see the magnitude of the influence between variables. This test was carried out using the path analysis to check intervening effect. Intervening variables are said to be able to mediate the influence of exogenous variables on endogenous variables, the t-value is statistically greater than that of t-table ($t > 1.96$) or ($p\text{-value} < 0.05$). The multiple linear regression model as mentioned in equation 1.

$$PR_{i,t} = \alpha + \beta_1 TP_{i,t} + \beta_2 TA_{i,t} + \beta_3 TC_{i,t} + \epsilon_{i,t} \dots \dots \dots (1)$$

The path analysis to check the effect of Thin Capitalization (TC) as intervening variable between Transfer Pricing (TP) and Tax Avoidance (TA) on Profitability (PR) as mentioned in equation 2, 3, 4, and 5.

Direct impact:

$$TC_{i,t} = \alpha + \beta_1 TP_{i,t} + \varepsilon_{i,t} \dots\dots\dots (2)$$

$$TC_{i,t} = \alpha + \beta_2 TA_{i,t} + \varepsilon_{i,t} \dots\dots\dots (3)$$

Indirect impact:

$$TC_{i,t} = \alpha + \beta_3 TP_{i,t} + \beta_4 TA_{i,t} + \varepsilon_{i,t} \dots\dots\dots (4)$$

$$PR_{i,t} = \alpha + \beta_5 TC_{i,t} + \varepsilon_{i,t} \dots\dots\dots (5)$$

Where:

- PR_{i,t} = profitability of company i and period t
- TP_{i,t} = transfer pricing of company i and period t
- TA_{i,t} = tax avoidance of company i and period t
- TC_{i,t} = thin capitalization of company i and period t
- α = constant
- β₁- β₅ = regression coefficient of each variable
- ε_{i,t} = error term of company i and period t

RESULTS AND DISCUSSION

Descriptive Statistic

The statistic descriptive of each variable namely transfer pricing (TP), tax avoidance (TA), thin capitalization (TC), and profitability (PR) are presented in table 2:

Table 2. Descriptive Statistic

| Period | TP | TA | TC | PR |
|--------|--------|---------|--------|---------|
| 2018 | 0.6593 | -0.3985 | 0.5155 | -0.0003 |
| 2019 | 0.6855 | -0.2491 | 0.5202 | -0.0241 |
| 2020 | 0.6960 | -0.4411 | 0.5167 | 0.0292 |
| 2021 | 0.7139 | -0.6727 | 0.5055 | 0.0554 |
| 2022 | 0.6681 | 0.0369 | 0.5033 | 0.0437 |
| 2023 | 0.6354 | -0.4163 | 0.5295 | -0.0236 |

The transfer pricing (TP) that occurred in oil palm plantation companies for the 2018-2023 period was between 0.6354 (63.54%) to 0.7139 (71.39%). Meanwhile, tax avoidance (TA) tends not to occur, which means that companies always pay their obligations except in the 2023 period with a tax avoidance of 0.0369 (3.69%). Thin Capitalization (TC) ranges from 0.5055 (50.55%) to 0.5295 (52.95%) which means that companies tend to maintain their debt ratios of 51% of their total assets on average. Meanwhile, profitability (PR) measured by net profit to asset value was the highest in the 2021 period of 0.0554 (5.54%).

Inferential Statistic

The influence of each independent variable: transfer pricing (TP), tax avoidance (TA), and thin capitalization (TC) on profitability (PR) can be seen in table 3.

Table 3. Multiple Linear Regression

| Model | Unstd. Beta | Std. Error | Std. Beta | T | Sig. |
|------------|-------------|------------|-----------|--------|------|
| (Constant) | .099 | .028 | | 3.497 | .001 |
| TP | .036 | .033 | .110 | 1.108 | .271 |
| TA | .000 | .009 | -.005 | -.049 | .961 |
| TC | -.214 | .044 | -.491 | -4.925 | .000 |

Thin capitalization (TC) in the table is a very significant variable that affects the profitability (PR) of oil palm plantation companies for the 2018-2023 period. The more the company's debt, the lower the profit the company receives.

The use of regression models using transfer pricing (TP), tax avoidance (TA), and thin capitalization (TC) on profitability (PR) is a fit model. This can be seen in the results of the analysis of variance (ANOVA) which can be seen in table 4. The results of the ANOVA test showed an F value of 8,147 with a significance of 0.000 ($p < 0.05$).

Table 4. ANOVA

| Model | | Sum of Square | Df | Mean Square | F | Sig. |
|-------|------------|---------------|----|-------------|-------|-------------------|
| 1 | Regression | .193 | 3 | .064 | 8.147 | .000 ^b |
| | Residual | .679 | 86 | .008 | | |
| | Total | .872 | 89 | | | |

The most dominant variable affecting profitability (PR) is thin capitalization. Meanwhile, transfer pricing (TP) and tax avoidance (TA) do not affect profitability. The regression equation of the three independent variables can be written according to equation 1:

$$PR_{i,t} = 0.099 + 0.036TP_{i,t} + 0.000TA_{i,t} - 0.214TC_{i,t} \dots (1)$$

Path Analysis

Path analysis is used to test the effect of intervening or mediating thin capitalization (TC) variables between transfer pricing (TP) and tax avoidance (TA) on profitability (PR). The results of the path analysis test can be seen in figure 2 and table 5.

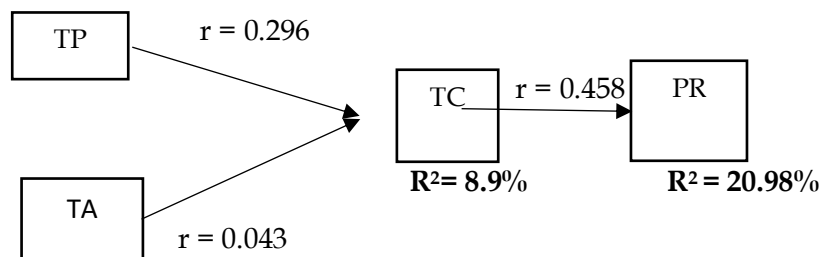


Figure 1. Path Analysis

Source: Research Data, 2024

Transfer pricing (TP) and tax avoidance (TA) affect thin capitalization (TC) by 8,762%. Transfer pricing (TP) has a significant effect on thin capitalization (TC). Meanwhile, tax avoidance (TA) has no effect on thin capitalization (TC).

Table 5. Path Analysis

| Path | r = correlation | R ² (%) | t-stat | F-stat | Prob. |
|-----------|-----------------|--------------------|--------|--------|-------|
| TP --> TC | 0.296 | 8.762 | 2.906 | 8.441 | 0.005 |
| TA --> TC | 0.043 | 0.185 | 0.406 | 0.165 | 0.686 |
| TC --> PR | 0.458 | 20.976 | -4.839 | 23.417 | 0.000 |

Source: Research Data, 2024

Thin capitalization itself has a significant effect on profitability (PR) of 20.98%. The increase in the R² value from 8.9% to 20.98% shows strengthening. Therefore, thin capitalization (TC) is an intervening variable that mediates transfer pricing (TP) and tax avoidance (TA) to profitability (PR).

Hypothesis Testing

- Transfer pricing (TP) has a positive effect on thin capitalization (TC) with a t-statistic value 2.906 higher than 1.96) or sig. 0.005 less than 0.05.
- Tax avoidance (TA) has no effect on thin capitalization (TC) with t-statistic value 0.406 less than 1.96 or significancy 0.686 higher than 0.05.
- Transfer pricing (TP) has no effect on profitability (PR) with t-statistic value 1.108 less than 1.96 or significancy 0.271 higher than 0.05.
- Tax avoidance (TA) has no effect on profitability (PR) with t-statistic value (-0.049) less than 1.96 or significancy 0.961 higher than 0.05.
- Thin capitalization (TC) has a negative effect on profitability (PR) with t-statistic value 4.839 much higher than 1.96 or significancy 0.000 much lower than 0.05.
- Transfer pricing (TP) toward profitability (PR) through thin capitalization (TC) with R-squared 8.762% (direct impact) to 20.976% (indirect impact).
- Tax avoidance (TA) toward profitability (PR) though thin capitalization (TC) with R-squared increase from 0.815% (direct impact) to 20.976% (indirect impact)

Discussion

Transfer pricing toward thin capitalization

The more transfer pricing which is measured by account receivables, the higher the thin capitalization which is measured by debt to asset ratio. The company borrows money from creditors when account receivables are increasing. By having more transfer pricing, then they secure and confident to have more thin capitalization. The company has thin capitalization to get more tax benefit.

Tax avoidance toward thin capitalization

Palm oil companies are quite active in paying taxes so that they do not affect thin capitalization. The company's compliance in paying taxes between 24.9% till 67.3% of the company's profit before tax deduction. Only in 2021, the average company decreased in paying taxes by 3.67% from the company's profit before tax due to a decrease in the average income of oil palm plantation companies.

Transfer pricing toward profitability

The company conducts transfer pricing measured by account receivable (TP) in order to reduce the amount of income tax payments to the government. The company's receivables range from 63% to 71% of the company's total receivables. However, oil palm plantation companies also pay their tax obligations so that they do not affect the company's profits.

Tax avoidance toward profitability

Tax avoidance (TA) has no effect on profitability (PR) which measured by return on asset. Companies tend to be compliant with tax payments. Tax avoidance cannot be seen as a factor affecting profitability. The factor seen by the company is the amount of debt. If the amount of debt increases, then the profit received by the company.

Thin capitalization toward profitability

Thin capitalization (TC) has a negative effect on profitability (PR) which measured by return on asset. The amount of debt that the company has can reduce the amount of profit that the company earns. This is because the company has an obligation to pay loan interest first before getting a net profit. This finding is in accordance with the pecking order theory where the company will reduce debt funding if internal funding is sufficient for the company's operations.

Transfer pricing toward profitability through thin capitalization

Transfer pricing (TP) has a positive effect on profitability (PR) through thin capitalization (TC). In other words, the use of debt is able to mediate transfer pricing against profitability. An increase in the number of accounts receivable can increase the amount of debt. An increase in the amount of corporate debt due to an increase in receivables can reduce the amount of profit earned by the company. Increased debt can be used by companies to benefit from tax reductions. This is in accordance with the trade-off theory.

Tax avoidance toward profitability though thin capitalization

Tax avoidance (TA) does not affect to thin capitalization (TC) as an intervening variable but thin capitalization has significantly negative impact on profitability. In this case, thin capitalization strengthens the relationship between tax avoidance and profitability. Therefore, thin capitalization mediate tax avoidance in terms of profitability. Higher tax expenditure reduces profitability of the company. In order to increase their profitability, then company try to reduce tax expenditure by applying tax avoidance. One of the options to apply tax avoidance is debt utilization or thin capitalization. So, company has obligation to fulfil the interest of debt to reduce tax. In the other hand, increasing of thin capitalization also reduce profitability.

CONCLUSION

Profitability is the lifeblood of the company's operations. The amount of debt is an alternative source of funding other than equity funding. Thin capitalization, as measured by the debt-to-asset ratio, can reduce profitability. The increase in thin capitalization can be caused by transfer pricing where the company has a number of related accounts receivable which is used as the basis for decision-making to increase debt. In other words, thin capitalization is able to mediate thin capitalization against profitability. On the other hand, tax avoidance is a company's strategy to shift tax payments to other forms of obligations such as transfer pricing or thin capitalization. However, tax avoidance does not affect thin capitalization or profitability in oil palm plantation companies for the 2018-2023 period. The limitations of this study are only on companies in the oil palm plantation sector and the research period of 2018-2023. Further research needs to explore the factors that determine tax avoidance, for example thin capitalization, leasing, depreciation which can be used as a company's obligation to benefit from taxes.

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