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Do Intangible Assets, Income Tax, and Debt Agreement Have an Impact on Transfer Pricing Strategy in Multinational Companies?

Reza Kumala[1], Muhamad Raffi Faruqi Ruslan[1], Murtanto [1*]
[1]Faculty of Economics and Business Universitas Trisakti Jakarta, Indonesia
e-mail: [(*)]murtanto@trisakti.ac.id
* Corresponding Author

Abstract

Background: Intangible assets afford firms a degree of flexibility in establishing values for tax efficiency, yet they are not without inherent risks, as they are susceptible to manipulation. Prior research has yielded inconclusive results, creating ambiguity regarding the fundamental factors influencing transfer pricing decisions. This study is therefore of great importance, as it aims to provide clarity, reduce the risk of manipulation, and support fair regulations to promote good corporate governance. **Objectives:** This study employs a comprehensive approach to examine the influence of intangible assets, income tax, and debt covenants on transfer pricing practices within corporate entities. **Method:** The research employs quantitative methods and focuses on all companies listed on the LQ45 index of the Indonesia Stock Exchange. The data utilized in the study were obtained from secondary sources, and logistic regression was selected as the analytical technique. **Results:** The findings indicate that intangible assets and income tax have a notable impact on transfer pricing. However, it is important to acknowledge that the results in this domain remain inconclusive. In contrast, debt covenants were found to have no significant effect.

Keywords: Debt Covenant; Income Tax; Intangible Assets; Transfer Pricing
JEL Classification: M41; M48

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INTRODUCTION

The phenomenon of globalization is advancing at a rapid pace, effectively dismantling the barriers between countries with regard to the processes of exporting and importing (Cristea & Nguyen, 2016). This wave of globalization has been a significant factor in the growth of business, facilitating the expansion of companies into multinational operations. Multinational companies are defined as firms that engage in economic activities across national borders, establishing subsidiaries, branches, and representatives in foreign countries (Ardillah & Vanesa, 2022). Such companies engage in international transactions, purchasing and selling goods or services through their operations abroad. It should be noted, however, that the process is not without its difficulties. Multinational firms encounter a number of challenges, including discrepancies in tax rates across countries and the complex issue of

pricing (Wardhana et al., 2024). This is where transfer pricing becomes relevant. It is the practice of transactions between related parties, and it often gives rise to questions about the fairness of such arrangements. It is not uncommon for companies to engage in the practice of transfer pricing, which may involve inflating purchase prices, reducing selling prices, or shifting profits to subsidiaries in countries with lower tax rates. For countries with higher tax rates, this can have adverse consequences, as it reduces their tax revenues (Ivanda et al., 2024). The government believes that transfer pricing practices can result in a loss of revenue for the state, as multinational firms shift their tax obligations from high-tax countries to low-tax jurisdictions (Merle et al., 2019). This strategy allows firms to reduce their tax burden by moving profits to countries with lower tax rates. However, it is the high-tax countries that ultimately bear the burden of this strategy.

The practice of transfer pricing was revealed at PT Adaro Energy Tbk. in 2019, when Global Witness exposed the company for engaging in tax avoidance through a transfer pricing scheme. The scheme involved Adaro utilizing its subsidiary, Coal trade Service International, to facilitate the transaction (Irawan & Ulinnuha, 2022). The coal was sold to Coal trade at an extremely low price, which was then resold to other countries at a significantly higher rate. As a result, Adaro was able to generate greater profits while simultaneously reducing its tax obligations in Indonesia. Ultimately, Adaro paid only US$125 million (approximately Rp1.75 trillion) in taxes, a sum that was significantly below the amount they were legally obligated to pay. (Wardhana et al., 2022) Meanwhile, Coal trade in Singapore received a bonus of US$55 million, subject to a lower tax rate of 17%, compared to Indonesia's higher rates. Global Witness asserted that Adaro shifted income to its overseas subsidiaries in order to avoid paying the full amount of taxes owed (Global Witness, 2019). In accordance with Regulation of the Minister of Finance Number 172 of 2023, concerning fairness and business norms in transactions with special relationships, Article 2 delineates that such ties exist when one taxpayer holds a minimum of 25% ownership, directly or indirectly, in another (Irawan & Ulinnuha, 2022). Multinational firms frequently employ transfer pricing as a strategic tax minimization technique. Transactions between entities with special relationships utilize price adjustments to shift profits to low-tax jurisdictions, maximizing profits while minimizing their tax burdens (Firmansyah & Yunidar, 2020).

Intangible assets, despite their lack of physical form, possess considerable value due to their long economic life, making them indispensable to a company's operations (Sujarwo & Sjahputra, 2022). Intangible assets such as brands, patents, and copyrights afford companies a significant competitive advantage. (Rachmawati & Fitriana, 2021) discovered that firms with robust intangible assets frequently employ transfer pricing strategies to redirect profits to entities situated in low-tax jurisdictions. The additional value of these assets enables more strategic intercompany transactions, which in turn facilitates the reduction of tax burdens. The flexibility to set prices for goods or services tied to high-value intangible assets is a characteristic of companies that possess such assets. However, this flexibility necessitates the implementation of prudent policies. (Firmansyah & Yunidar, 2020) posit that firms must align transfer pricing with the market value of their intangible

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assets, as any ambiguity can give rise to tax disputes and legal disputes. It is therefore essential that transparent and consistent policies are implemented in order to avoid these potential issues. The intangible nature of these assets makes them susceptible to exploitation for the purpose of tax avoidance. Firms may transfer these assets to subsidiaries in low-tax jurisdictions or to closely affiliated entities (Putri & Sekar Mayangsari, 2023). Intellectual property, including research and development costs, is frequently shifted between groups (Wulandari & Fitrianti, 2024). Consequently, the higher a firm's intangible asset value, the more likely it is to engage in transfer pricing irregularities.

(Rachmawati et al., 2019) have demonstrated that firms are inclined to modify their transfer pricing strategies in order to circumvent substantial income tax liabilities. When a country imposes a high tax rate on corporate profits, firms may relocate their operations to jurisdictions with lower tax rates, employing aggressive transfer pricing strategies to minimize their overall tax burden. This frequently entails reducing transfer prices for sales to subsidiaries in high-tax jurisdictions while increasing them for transactions with subsidiaries in low-tax regions. Multinational firms must consider the tax implications of their pricing decisions carefully (Damayanti & Prastiwi, 2017). It is important to note, however, that strict tax regulations and audits can significantly limit a firm's flexibility. The Organization for Economic Co-operation and Development (OECD, 2017) posits that countries with stringent tax legislation and rigorous oversight are more likely to identify and reject unfair transfer pricing arrangements (Damayanti & Prastiwi, 2017). Therefore, while tax minimization may be an attractive strategy, firms must adhere to the established regulations to avoid penalties. It is a challenging equilibrium to achieve: the pursuit of astute tax savings versus the adherence to the directives of the tax authority. Transfer pricing is the practice of shifting profits from firms in high-tax countries to affiliates where taxes are lower. Firms that pay less tax are more likely to engage in transfer pricing. Increased tax burdens often prompt businesses to explore these tactics. After all, most entrepreneurs view taxes as a cost they would rather reduce to maximize profits (Wulandari & Fitrianti, 2024).

The debt covenant is an additional non-tax component that plays a role in determining whether or not a corporation will engage in transfer pricing. This element is in addition to taxes. Long-term debt contracts, often known as debt covenants, are agreements that are made to safeguard lenders against managerial activities that are detrimental to the interests of creditors. These actions may include excessive dividend distribution or the provision of equity that is below a set amount. This agreement limits all company activities that can damage the value of the loan. With these limitations, it can trigger violations by the company because it is unable to move freely (Nurul Alawiyah et al., 2022). To avoid these violations, one of the practices carried out by companies tends to be transfer pricing. In accordance with the debt covenant hypothesis in positive accounting theory, the more a company tends to be in debt, the more managers will tend to choose accounting procedures that can transfer future period profits to the current period. Based on positive accounting theory, debt covenants will encourage majority shareholders to carry out transfer pricing. Related research on debt covenants has been conducted by (Nurul Alawiyah et al., 2022) which shows that debt covenants have a positive effect on transfer pricing. However, the results of this study do

not support the results of research from (Ramadhany & Amin, 2023) which states that debt covenants do not affect transfer pricing decisions, where in large companies the control and supervision system is tighter, because the financial statements will be published. The closer the company is to violating the debt agreement, the more likely the manager is to choose an accounting method that can increase profits. Debt covenants can limit activities that may damage the value of the loan or loan recovery. To avoid such violations, companies can carry out transfer pricing. The results of research on the effect of debt covenants on transfer pricing are not always the same . Several studies show that debt covenants have a positive effect on transfer pricing, while other studies show that debt covenants have no effect or even a negative effect (Sejati & Triyanto, 2021).

A number of studies have previously investigated the phenomenon of transfer pricing, utilizing a diverse range of variables. This study examines the impact of various factors, including taxes, intangible assets, and company size. The research conducted by Cahyani and Oktaviani (2023) posits that taxes exert a positive and significant influence on transfer pricing. However, a study by Ginting et al. (2017) suggests that taxes have no significant impact on transfer pricing. With regard to intangible assets, the findings of Wulandari and Fitrianti (2024) indicate that they exert a positive and significant influence on transfer pricing. Nevertheless, Sejati and Triyanto (2021) propose an alternative hypothesis, suggesting that intangible assets exert minimal influence on transfer pricing decisions. The role of debt covenants in transfer pricing decisions is a topic that warrants further investigation. Indeed, studies from Nurul Alawiyah et al. (2022) posit that they exert a positive influence on transfer pricing. However, there is an additional consideration. Ramadhany and Amin (2023) posit that debt covenants do not directly influence the process of making transfer pricing decisions. The disparate findings illustrate the complexity of identifying the factors that influence transfer pricing. It is imperative for both companies and researchers to delve more profoundly into these variables to elucidate the prevailing uncertainties in this field.

METHOD

The purpose of this study is to investigate the influence of intangible assets, income tax, and debt covenants on transfer pricing, with profitability serving as a moderating variable (Ghozali, 2018). The research that is being conducted makes use of a quantitative design and has a positivist viewpoint.

The study makes use of secondary sources, such as public corporate financial records, in order to collect data. Additionally, a ratio scale is utilized in order to measure variables, which guarantees the accuracy of the data. Logistic regression, which is an ideal statistical method for assessing the link between a categorical dependent variable (such as a binary outcome) and one or more independent variables, which may be numeric or categorical, is the basis for the analysis. The analysis is based on the correlation between the two variables. The purpose of logistic regression is to create a model that can predict the likelihood of an event occurring based on the values of the variables that are considered independent. The

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year 2018 (Ghozali) In order to build a relationship between the variables, this technique makes use of the logit function.

The result is the generation of coefficients that reflect the degree to which each independent variable impacts the likelihood of an outcome. In addition to this, the use of odds ratios makes it easier to comprehend the influence that each variable has. In terms of the scope of the study, it includes all of the firms that are listed on the LQ45 index of the Indonesia Stock Exchange between the years 2019 and 2023. Data was acquired from secondary sources, including financial reports, which were the primary sources. In this technique, the focus is on thorough data analysis and the utilization of relevant statistical tests to support the conclusions. This approach is firmly rooted within the realm of quantitative research.

RESULTS AND DISCUSSION

Overall Model Fit

We study the Log Likelihood Value (LL) in order to evaluate the complete fit of the model. This involves making a comparison between the start LL value, which is equal to zero, and the end LL value, which is equal to one from the beginning (block number = 0). According to the findings of the regression study, the initial -2Log likelihood value (block number = 0) prior to the incorporation of independent variables is 285.417. This value occurred before the addition of the variables. The final -2Log likelihood value (block number = 1) is seen to fall to 204.684 after the integration of the four independent variables. This is the result of the subsequent observation. There was a decrease of 81.110, as indicated by the disparity between the original and final -2Log probability values. Based on the fact that the initial -2Log probability value (block number = 0) is higher than the final one (block number = 1), it is possible to draw the conclusion that there has been a decreased likelihood. This means that the hypothesized model is a good match for the data, and that the incorporation of independent variables into the model indicates an improvement in the regression model, or, to put it another way, that the null hypothesis (H0) is accepted.

Goodness of Fit Test

Table 1. Hosmer and Lemeshow Test

Step	Chi-square	df	Sig.
1	14,137	8	,078

Source: data processed

The chi-square value that was obtained from the Hosmer and Lemeshow Goodness-of-Fit Test was 14.137, and the degree of significance that was obtained was 0.078. Based on the findings of the test, it can be concluded that the probability value, also known as the P-value, is higher than the significant value of 0.05, with a value of 0.078. The conclusion that can be drawn from this is that the null hypothesis (H0) is accepted, which indicates that there is no substantial difference between the hypothesis and the data. The conclusion that

can be drawn from this is that the regression model that was used in this investigation is reliable and able to accurately predict the values that were observed.

Nagelkerke's R Square

Table 2. Model Summary

Step	-2 Log likelihood	Cox & Snell R Square	Nails R Square
1	204,684 [a]	,221	,322

a. Estimation terminated at iteration number 5 because parameter estimates changed by less than .001 .
Source: data processed

The findings of the regression analysis suggest that the value of the Nagelkerke R-square offers a coefficient of determination that is equal to 0.322 percentage points. This suggests that the value of the independent variables (liquidity, leverage, profitability, company size, sales growth, and taxes) in terms of their ability to explain the dependent variable (dividend policy) is only 32.2%. The remaining 67.8% of the variance can be attributed to other variables that are not accounted for in this research model. In addition, the classification matrix provides evidence that the logistic regression model is rather effective in terms of its capacity to estimate the likelihood of dividend distribution by the corporation.

Table 3. Classification Table

			Predicted		
			Transfer Pricing		
	Observed		No	Yes	Percentage Correct
Step 1	Transfer Pricing	No	157	8	95.2
		Yes	38	22	36.7
	Overall Percentage				79.6

a. The cut value is ,500
Source: data processed

Within the realm of forecasting the incidence of transfer pricing, the regression analysis produced a rate of accuracy that was 79.6%. According to the information that is displayed in the table, the chance of a business engaging in transfer pricing is 36.7% of the whole sample size, which consists of 225 data points. The firms who do not engage in transfer pricing, on the other hand, constitute a massive 95.2% of the overall sample of 225 data points. As a result, this reveals that the model possesses a robust capability for forecasting both situations, despite the fact that transfer pricing is seen in a lesser fraction of enterprises.

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Logistic Wald and Logistic Regression

Table 4. Variables in the Equation

		B	SE	Wald	df	Sig.	Exp(B)	95% CIfor EXP(B) Lower	Upper
Step 1 [a]	Intangible Assets	-4,028	1,555	6,714	1	,010	,018	,001	,375
	Income Tax	,000	,000	28,915	1	,000	1,000	1,000	1,000
	Debt Covenant	-,054	,082	,443	1	,506	,947	,807	1,112
	Constant	-1,565	,247	40,099	1	,000	,209		

a. Variable(s) entered on step 1: Intangible Assets, Income Tax, Debt Covenant.

Source: data processed

With a regression coefficient of -4.028, a standard error (SE) of 1.555, and a Wald statistic of 6.714 (p = 0.010), the results of the logistic regression suggest that the variable "Intangible Assets" has a statistically significant negative influence on the dependent variable. This is indicated by the fact that the dependent variable is negatively affected by the variable. This demonstrates that there is a correlation between an increase in intangible assets and a significant decrease in the likelihood of the event taking place. The coefficient for the "Income Tax" variable is 0.000, the standard error is also 0.000, and the Wald statistic is 28.915 (p = 0.000). All of these values are significantly different from one another. This demonstrates that, despite the fact that it does not have any practical effects, it is extremely significant, which means that its presence does not change the likelihood of the event taking place.

The "Debt Agreement" variable, on the other hand, appears to have a minor influence, as demonstrated by a coefficient of -0.054, a standard error of 0.082, and a Wald statistic of 0.443 (p = 0.506). Together, these numbers indicate that the variable is not significant. Taking this into consideration, it appears that it does not have a significant impact on the results. In the process of evaluating hypotheses using the Wald test, which is comparable to the t-test, the critical value for statistical significance at a significance level of 5% is 1.99. The variables "Intangible Assets" (6.714) and "Income Tax" (28.915) have Wald statistics that are more than 1.99, which indicates that they are statistically significant at the 5% level. This is demonstrated by the Wald statistics. At the 5% level of statistical significance, the "Debt Agreement" variable has a Wald statistic of 0.443, which is lower than the critical value of 1.99. This indicates that the variable does not meet the criteria for statistical significance. One may draw the conclusion that the variables "Intangible Assets" and "Income Tax" have a considerable impact on the dependent variable, however the variable "Debt Agreement" does not have such an influence. This conclusion can be reached in light of the facts shown here.

Omnibus Tests of Model Coefficients

Table 5. Omnibus Tests of Model Coefficients

		Chi-square	df	Sig.
Step 1	Step	56,277	3	,000
	Block	56,277	3	,000
	Model	56,277	3	,000

Source: data processed

The overall relevance of the model is showcased through the use of the Omnibus Test of Model Coefficients. The Chi-square value for the "Step" variable is 56.277, with three degrees of freedom. Additionally, the significance value is 0.000 ($p < 0.05$), which indicates that the total model is statistically significant at the 5% level. Based on this, it can be deduced that the independent variables in the model, specifically Intangible Assets, Income Tax, and Debt Covenants, collectively have a considerable impact on the variable that is being studied (the dependent variable). As a result of the fact that the Chi-square value of 56.277 and the significance value of 0.000 were observed for both the "Block" and "Model" tests, it can be concluded that the incorporation of these variables considerably improves the model's ability to predict outcomes. In light of this, it is possible to draw the conclusion that the entire regression model is extremely significant, and that the variables that are included are offering vital insights that assist in explaining the variable that is being explained.

Discussion

The valuation of intangible assets is a challenging process, which has a significant impact on transfer pricing. Assets such as trademarks, patents, copyrights, and technology frequently lack a discernible market value, affording companies considerable flexibility in establishing transfer prices between their entities. (Wulandari & Fitrianti, 2024) This flexibility allows companies to allocate higher or lower values to these assets in cross-border transactions, which in turn permits the shifting of profits to entities located in countries with lower tax rates, thereby reducing the overall tax burden. In the context of signaling theory (Merle et al., 2019), the management of intangible assets can be utilized by companies as a means of signaling to the market that they possess a competitive advantage through the deployment of high-value assets. The signaling theory posits that companies utilize intangible assets as a means of demonstrating their capacity for strategic value creation (Merle et al., 2019). By establishing elevated transfer prices for select intangible assets, companies can convey to stakeholders, including investors, that they possess robust growth potential and valuable innovation. However, the utilization of this signal in transfer pricing can also present a potential risk of manipulation if companies deliberately set transfer prices with the intention of obtaining fiscal benefits. (Utami, R.D., 2020) This practice highlights the necessity for rigorous tax regulations and audits to guarantee that the evaluation of intangible assets in transfer pricing accurately reflects their intrinsic economic value, while maintaining transparency and fairness in taxation. According to the findings of the study that was carried out by Wulandari and Fitrianti (2024), intangible assets have a large and

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favorable impact on transfer pricing. On the other hand, the results of the research conducted by Sejati and Triyanto (2021) indicate that transfer price is not significantly affected by intangible assets.

Income tax is a significant factor that motivates companies to utilize transfer pricing as a financial management strategy. By leveraging discrepancies in tax rates across jurisdictions, corporations can redirect profits to countries with lower tax rates, thus mitigating their overall tax liability. (Kusuma et al., 2022) Transfer pricing is frequently conducted through pricing transactions between company entities, such as the sale of goods, services, or the utilization of intangible assets. This strategy allows companies to remain compliant with international tax regulations, yet it also creates opportunities for exploiting existing loopholes. However, this practice frequently attracts the attention of tax authorities due to the potential for transfer price manipulation, which can result in a reduction of state revenues. In the context of agency theory (Ginting et al., 2017), also known as entrenchment theory, transfer pricing can be utilized by management as a means of maintaining control over the company. The theory posits that, when granted authority, management will typically make decisions that benefit their position, including those pertaining to taxation. The utilization of transfer pricing by management enables the redirection of profits to entities situated in tax-advantaged regions, thus enhancing the company's image and securing the confidence of shareholders (Wardhana et al., 2024). Nevertheless, these decisions are frequently made without sufficient consideration of the company's long-term interests or the potential legal risks that could result. It is therefore imperative for companies to ensure that their transfer pricing strategy not only benefits management but also complies with the principles of good corporate governance. The results of research on tax variables, as presented by Cahyani and Oktaviani (2023), indicate that taxes have a positive and significant impact on transfer pricing. However, the findings of Ginting et al. (2017) challenge this assertion, suggesting that taxes do not exert a discernible influence on transfer pricing.

The results indicate that debt covenants have no statistically significant impact on transfer pricing practices. (Nurul Alawiyah et al., 2022) While debt covenants frequently impose specific financial ratios and restrictions on firms, the absence of a notable impact indicates that firms may rely extensively on transfer pricing to manage their financial statements in order to fulfill covenant obligations. (Anam et al., 2023) In such instances, firms with debt obligations may not necessarily employ transfer pricing as a principal instrument for the purpose of influencing earnings or financial statements in a manner that aligns with the expectations of creditors. (He et al., 2019). This result may be explained by the fact that, in practice, firms may prioritize other strategies, such as operational adjustments, cost management, or even renegotiating terms with creditors, in order to maintain compliance with debt covenants. The absence of a substantial correlation may also indicate that creditors may enforce their debt covenants with greater rigor than anticipated, thereby enabling firms to sustain stable financial performance without resorting to transfer pricing manipulation. Furthermore, from the perspective of agency theory (Wardhana et al., 2024), despite the potential for a conflict of interest between management and creditors,

companies may not perceive the necessity to utilize transfer pricing as a means of circumventing covenant violations. (Chen et al., 2014) Alternatively, management may prioritize alternative strategies for ensuring compliance that do not involve the manipulation of intercompany transactions. Therefore, despite the fact that debt covenants are designed to protect the interests of creditors, in this case, they do not appear to encourage significant transfer pricing practices within the company. This is not aligned with the findings of Nurul Alawiyah et al. (2022), who demonstrated that debt covenants have a positive impact on transfer pricing. However, the results of this study corroborate the findings of Lubab's research (Ramadhany & Amin, 2023), which indicates that debt covenants do not influence transfer pricing decisions.

CONCLUSION

Intangible assets and income tax have a significant influence on transfer pricing, though the results of research related to these variables remain inconclusive. This is distinct from the influence of debt covenants, which do not exert a significant impact. Intangible assets provide flexibility in assessment, thereby facilitating profit shifting for the purpose of achieving greater tax efficiency. However, they are susceptible to manipulation. Income tax encourages transfer pricing to reduce the tax burden through differences in rates between countries. However, this practice often attracts the attention of the relevant authorities. Debt covenants do not affect transfer pricing. Therefore, in order to meet the requirements of creditors and maintain financial stability, transfer pricing does not have to be carried out, despite the potential for a conflict of interest. It is therefore evident that strict regulation and good corporate governance are required to ensure transparency and fairness. Companies must develop transfer pricing policies that are transparent and in accordance with international tax regulations to avoid manipulation and legal risks. The use of objective valuation methods for intangible assets, tax optimization without violating regulations, and compliance with debt covenants must be supported by good corporate governance and strong internal audits. A transparent transfer pricing policy can foster stakeholder trust and mitigate potential conflicts with tax authorities or creditors. Furthermore, this strategy can preserve the company's financial stability and business reputation while ensuring long-term operational sustainability. However, transfer pricing studies are often constrained by the lack of access to sensitive company financial data. Additionally, differences in tax regulations between countries and the complexity of intangible asset valuation can complicate the implementation of uniform and fair policies across jurisdictions.

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