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Internal Determinants of Tax Planning: The Mediating Role of Transfer Pricing in Industrial Firms

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ABSTRACT
This study investigates the effect of financial performance, leverage, and firm size on tax planning, with transfer pricing as a mediating variable. Grounded in Agency Theory and Positive Accounting Theory, this research explains how firm characteristics influence tax planning strategies. The sample consists of manufacturing firms listed on the Indonesia Stock Exchange. Tax planning is proxied by the Effective Tax Rate (ETR), financial performance by Return on Equity (ROE), leverage by Debt to Equity Ratio (DER), firm size by the natural logarithm of total assets, and transfer pricing by related-party receivables. The results show that financial performance and leverage significantly affect tax planning, while firm size does not consistently influence tax planning. Transfer pricing is proven to mediate the relationship between financial performance and tax planning, as well as between leverage and tax planning. However, it does not mediate the relationship between firm size and tax planning. These findings indicate that profitable and highly leveraged firms tend to use transfer pricing as a strategic tool for tax optimization, whereas larger firms are more cautious due to regulatory pressure. This study contributes to the literature on corporate tax behavior and provides practical implications for regulators and firms in designing effective and compliant tax strategies.

INTRODUCTION

The manufacturing industry in Indonesia is a strategic sector that serves as the backbone of the national economy. It makes a substantial contribution to employment creation, investment growth, and Gross Domestic Product (GDP). Despite global challenges such as commodity price volatility, intensifying international competition, and economic uncertainty, the sector has demonstrated resilience and sustained growth. In 2024, the manufacturing sector accounted for 18.98 percent of Indonesia's GDP, highlighting its critical role as both an economic driver and a major source of government tax revenue. Consequently, this sector has become a primary focus of national tax policy, accompanied by increasingly stringent oversight from tax authorities.

In this context, manufacturing firms are required to implement effective and efficient tax planning strategies to optimize their tax burden while ensuring compliance with applicable regulations. Tax planning is a legitimate managerial practice aimed at minimizing tax liabilities through the utilization of available incentives and regulatory provisions. However, the effectiveness

of tax planning is influenced by internal firm characteristics, including financial performance, leverage, and firm size. These factors shape managerial decisions regarding the extent and approach of tax planning activities. In addition, transfer pricing is frequently associated with corporate tax strategies, particularly in multinational or affiliated firms, as it facilitates the allocation of income and expenses across jurisdictions, thereby affecting the overall tax burden. Therefore, examining the mediating role of transfer pricing in the relationship between internal factors and tax planning is essential, especially in a highly regulated and competitive industrial environment.

The complexity and dynamic nature of tax regulations in Indonesia further increase the importance of effective tax planning. Corporate taxpayers must carefully interpret and adapt to regulatory changes to ensure sound decision-making and long-term business sustainability. For firms, taxes represent a financial burden that must be managed efficiently to avoid eroding profitability. This issue is particularly relevant for manufacturing firms, which typically operate with complex structures involving export–import activities, reliance on imported raw materials, depreciation of fixed assets, and utilization of sector-specific investment incentives. Accordingly, tax planning in this sector is not only intended to legally minimize tax liabilities but also to ensure compliance with various tax obligations, including corporate income tax, value-added tax (VAT), and import duties. Effective tax planning enables firms to improve cash flow management, enhance financial efficiency, and optimize net income, thereby supporting long-term competitiveness.

Furthermore, tax planning allows firms to benefit from government-provided incentives such as tax holidays and tax allowances, while also functioning as a risk management tool to avoid administrative and legal sanctions. Previous studies have examined the relationship between internal firm factors and tax planning; however, the findings remain inconclusive. Some studies report that profitability has a positive effect on tax planning, as firms with higher profits are more motivated to reduce tax burdens, while others find no significant relationship, suggesting that managerial discretion and external advisory roles may play a more dominant role. Similarly, leverage has been found to influence tax planning through the tax deductibility of interest expenses, although other studies argue that its effect is insignificant due to firms prioritizing debt obligations over tax considerations. Firm size is also a debated factor, with some evidence indicating that larger firms are more capable of engaging in tax planning due to greater resources and access to incentives, while other studies suggest that large firms tend to prioritize compliance and corporate reputation, thereby limiting aggressive tax strategies.

Despite the growing body of literature on tax planning, several important research gaps remain. First, prior studies have largely focused on the direct relationship between internal firm characteristics and tax planning, while neglecting the underlying mechanisms through which these relationships operate. In particular, the mediating role of transfer pricing remains underexplored, despite its recognition as a key instrument in corporate tax strategy, especially in firms with complex operational structures. Second, existing empirical evidence is inconsistent regarding the effects of profitability, leverage, and firm size on tax planning, suggesting that the relationships may be indirect or contingent rather than purely direct, potentially involving mediating mechanisms such as transfer pricing.

Third, most previous studies rely on pre-reform data, with limited attention given to the post-reform context following the implementation of Indonesia's Tax Regulation Harmonization Law (UU HPP) in 2021, which introduced significant changes in tax rates, compliance requirements, and enforcement mechanisms. Consequently, there is a lack of updated empirical evidence capturing firms' responses to these regulatory changes. Fourth, many studies are conducted across mixed or non-specific sectors, which may obscure industry-specific dynamics. Given the complexity of

manufacturing firms, which often involve cross-border transactions, integrated supply chains, and substantial capital investment, tax planning and transfer pricing behavior in this sector may differ significantly from other industries. Therefore, a sector-specific analysis is necessary to generate more precise insights.

Based on these gaps, this study extends the existing literature by examining the mediating role of transfer pricing in the relationship between internal firm factors (financial performance, leverage, and firm size) and tax planning in Indonesian manufacturing firms, using recent post-UU HPP data for the period 2020–2024. This study is expected to provide a more comprehensive and contemporary understanding of corporate tax behavior in a changing regulatory environment.

LITERATURE REVIEW

Tax planning is a strategic managerial activity undertaken by firms to optimize tax burden through lawful utilization of tax regulations, incentives, and accounting flexibility. It is an essential component of corporate financial strategy as it directly affects after-tax profitability and firm value. In modern corporate practice, tax planning is not only considered a compliance function but also a value-maximization strategy within competitive and regulated environments.

Grand Theory

This study is grounded in Agency Theory (Jensen & Meckling, 1976) and Positive Accounting Theory (Watts & Zimmerman, 1986). Agency Theory explains that conflicts of interest between principals and agents may lead managers to engage in tax planning activities to maximize firm value as well as their personal incentives, meaning managerial actions are not only driven by shareholders' interests but also by individual benefits. In addition, leverage arises from conflicts of interest between shareholders, managers, and creditors, where the use of debt can serve as a monitoring mechanism to reduce agency problems because creditors often supervise managerial actions through debt agreements and financial obligations. Thus, a higher Debt to Equity Ratio (DER) indicates greater reliance on debt financing, which may place pressure on managers to improve company performance in order to meet debt obligations and maintain creditor confidence. Furthermore, larger firms tend to have more complex operations and a greater separation between ownership and management, which can increase agency problems; therefore, under Agency Theory, managers as agents are responsible for managing the company on behalf of shareholders as principals. As a result, shareholders expect managers to maximize firm performance and profitability because higher financial performance leads to greater shareholder wealth, and Return on Equity (ROE) is used as an indicator to evaluate how effectively management utilizes shareholders' funds to generate profits. Moreover, a higher ROE reflects better managerial performance and greater efficiency in managing company resources, while as firm size increases, monitoring costs also rise, making it more difficult for shareholders to directly oversee managerial actions. Consequently, firm size is often associated with stronger governance mechanisms to reduce information asymmetry and agency conflicts.

Positive Accounting Theory suggests that managerial choices, including tax strategies, are driven by economic incentives such as tax savings, political costs, and debt contracts. Under Positive Accounting Theory, managers are assumed to act rationally and choose accounting methods that maximize their own interests while responding to contractual, political, and regulatory pressures. This theory can be linked to the variable of tax planning proxied by the Effective Tax Rate (ETR). A lower ETR suggests that a company is engaging in more aggressive tax planning to minimize tax payments. managers are assumed to act rationally in responding to contractual, political, and economic

pressures. Firms may use transfer pricing strategies through related-party transactions to minimize tax burdens, manage reported earnings, or meet contractual obligations such as debt covenants. In this context, a higher proportion of related-party receivables to total assets reflects more intensive related-party transactions, which may indicate more aggressive managerial strategies in financial reporting and tax planning.

Tax Planning (Dependent Variable)
Tax planning is proxied using the Effective Tax Rate (ETR), which reflects the proportion of tax expense relative to pre-tax income. A lower ETR indicates more aggressive tax planning.
Formula:

ETR= Tax Expense / Pre-Tax Income

Furthermore, recent empirical studies in emerging markets, including Indonesia, continue to employ ETR as a primary measure of tax aggressiveness and tax planning behavior, particularly in manufacturing firms, due to its ability to reflect variations in corporate tax strategies across industries and regulatory environments (Yudhistira et al., 2026; Fernández-Rodríguez et al., 2023).

Financial Performance (Independent Variable)
Financial performance is measured using Return on Equity (ROE), which indicates the efficiency of equity in generating profit.
Formula:

ROE= Net Income / Total Equity

Higher ROE reflects stronger profitability, which may increase incentives for tax planning due to higher taxable income exposure and greater motivation to optimize after-tax returns. ROE is widely used in financial and tax-related studies as a key indicator of firm profitability and performance. Recent empirical studies confirm that ROE remains a relevant proxy for financial performance in explaining corporate tax behavior, including tax planning and tax avoidance strategies (Ali et al., 2024; Kim & Zhang, 2023). These studies suggest that more profitable firms tend to engage in more active tax planning due to increased tax burden and stronger incentives for earnings optimization. ROE significantly influences tax planning decisions, particularly in manufacturing firms where profitability fluctuations directly affect tax liability and managerial tax strategies (Pratama et al., 2025; Sari & Putri, 2023). This indicates that financial performance plays an important role in shaping corporate tax planning behavior under different regulatory environments.

Leverage (Independent Variable)
Leverage reflects the extent of debt usage in financing firm operations and is measured using the Debt to Equity Ratio (DER).
Formula:

DER= Total Debt / Total Equity

Firms with higher leverage may benefit from tax shields through interest deductibility, which reduces taxable income and influences corporate tax planning behavior. In this context, leverage is an important financial structure variable that shapes managerial decisions regarding tax optimization strategies. Recent empirical evidence confirms that leverage plays a significant role in corporate tax behavior, as highly leveraged firms tend to utilize interest expenses as a mechanism to reduce tax

burdens (Nguyen & Tran, 2024; Zhang et al., 2023). These findings are consistent with Positive Accounting Theory, which posits that firms adjust financial policies, including tax strategies, in response to debt-related incentives and contractual constraints. Some studies find that leverage significantly increases tax planning intensity due to tax shield benefits, while others suggest that highly leveraged firms may prioritize debt servicing obligations over aggressive tax strategies (Putra et al., 2025; Lee & Ho, 2023). This inconsistency indicates that the effect of leverage on tax planning may depend on firm-specific financial conditions and governance structures.

Firm Size (Independent Variable)

Firm size represents the scale of company operations and is commonly measured using the natural logarithm of total assets.

Formula:

SIZE= ln (Total Assets)

Recent empirical studies confirm that firm size remains a significant determinant of corporate tax behavior, as larger firms tend to have more sophisticated tax planning strategies due to greater resources and access to professional tax advisors (Chen et al., 2024; Almeida & Silva, 2023). These studies suggest that larger firms are more capable of engaging in structured tax planning and utilizing available tax incentives effectively. Some studies report that larger firms are more active in tax planning due to economies of scale and better access to tax incentives, while others indicate that large firms tend to adopt more conservative tax strategies due to higher regulatory scrutiny and reputational risk (Putri et al., 2025; Lim & Wong, 2023). This inconsistency indicates that the effect of firm size on tax planning may depend on institutional environment and corporate governance mechanisms.

Transfer Pricing (Mediating Variable)

Transfer pricing is proxied using related-party transactions intensity, measured by the proportion of related-party receivables to total assets.

Formula:

TP = Related Party Receivables / Total Assets

This proxy is commonly used in empirical studies as an indicator of the extent of intra-group transactions that may be associated with profit shifting and tax planning strategies. Higher levels of related-party transactions indicate greater potential for transfer pricing practices in corporate tax management. Recent empirical studies confirm that transfer pricing is a significant mechanism in corporate tax strategies, particularly in multinational and affiliated firms, as it facilitates income shifting across entities to optimize tax burdens (Richardson et al., 2023; Taylor & Richardson, 2024). These studies suggest that firms with higher levels of related-party transactions are more likely to engage in tax planning activities through strategic allocation of income and expenses. Furthermore, that transfer pricing practices are influenced by firm-specific characteristics such as profitability, leverage, and firm size, and are often used as a strategic tool for tax minimization (Prabowo et al., 2025; Nguyen & Le, 2023). However, the extent of its effect may vary depending on regulatory enforcement strength and corporate governance quality, indicating that transfer pricing plays a context-dependent role in corporate tax behavior.

Financial Performance and Tax Planning

Financial performance, proxied by Return on Equity (ROE), reflects a firm's ability to generate profit from its equity capital. According to Agency Theory, managers in more profitable firms are incentivized to engage in tax planning activities to maximize after-tax earnings and enhance shareholder value. Higher profitability also increases tax burden exposure, thereby encouraging firms to adopt more efficient tax strategies. Because managers act as agents who are motivated to maximize firm value and align their actions with shareholders' interests, firms with higher financial performance measured by Return on Equity (ROE) have stronger incentives to engage in tax planning activities. Higher profitability increases taxable income and, consequently, the tax burden, which encourages managers to adopt more efficient tax strategies to maximize after-tax earnings and enhance shareholder wealth. Empirical studies suggest that profitability is positively associated with tax planning behavior, as firms with higher earnings have stronger incentives to manage their tax obligations efficiently (Dyreng et al., 2017; Ali et al., 2024). Therefore, the first hypothesis is formulated as follows:

H1: Financial performance (ROE) has a significant effect on tax planning.

Leverage and Tax Planning

Leverage represents the extent of debt financing used by a firm. Based on Positive Accounting Theory, firms with higher leverage have incentives to utilize interest expense deductions as tax shields, thereby reducing taxable income. This creates a strong motivation for tax planning strategies aimed at minimizing tax burden. Based on Agency Theory, leverage can influence tax planning through conflicts of interest between shareholders, managers, and creditors. Higher leverage increases monitoring by creditors through debt agreements and financial covenants, which reduces managerial discretion but also creates pressure on managers to ensure the firm is able to meet debt obligations. In order to avoid financial distress and maintain creditor confidence, managers may engage in more efficient financial and tax management, including tax planning strategies that reduce taxable income and improve cash flows.

From the agency perspective, debt also acts as a disciplining mechanism that aligns managerial behavior with firm value maximization. However, the increased monitoring and pressure associated with high leverage may also encourage managers to optimize tax outcomes strategically to ensure compliance with covenants while maintaining profitability. Empirical evidence shows that leverage is significantly related to corporate tax behavior due to its tax shield benefits (Nguyen & Tran, 2024; Zhang et al., 2023). Therefore:

H2: Leverage has a significant effect on tax planning.

Firm Size and Tax Planning

Firm size reflects the scale and complexity of a company's operations. Larger firms generally have greater resources, better access to tax expertise, and more opportunities to utilize tax incentives such as tax holidays and tax allowances. However, they are also subject to higher regulatory scrutiny and reputational risk. Based on Agency Theory, firm size can be linked to agency problems that arise from the separation of ownership and control. As firms become larger, their operations become more complex and ownership becomes more dispersed, which increases information asymmetry between managers (agents) and shareholders (principals). This situation makes it more difficult for shareholders to directly monitor managerial actions, thereby increasing agency costs. In response,

larger firms are expected to implement stronger governance mechanisms and managerial controls to align interests and reduce inefficiencies.

At the same time, larger firms typically have greater resources, better access to tax expertise, and more opportunities to utilize tax incentives such as tax holidays and tax allowances. These advantages may encourage managers to engage in more structured tax planning in order to improve firm efficiency and after-tax performance. However, higher regulatory scrutiny and reputational risk may also constrain overly aggressive tax strategies. Prior studies show mixed results regarding the influence of firm size on tax planning, indicating that its effect may depend on institutional and governance factors (Putri et al., 2025; Lim & Wong, 2023).

H3: Firm size has a significant effect on tax planning.

Financial Performance, Transfer Pricing, and Tax Planning

Transfer pricing is a strategic mechanism used by firms to allocate income and expenses across related entities. Firms with higher profitability may utilize transfer pricing to optimize tax burdens by shifting income across jurisdictions. According to Agency Theory, managers may use transfer pricing to improve financial outcomes and reduce tax obligations. Empirical literature confirms that transfer pricing plays a key role in corporate tax strategies (Taylor & Richardson, 2024; Richardson et al., 2023). Based on Agency Theory, financial performance can influence managerial incentives and decision-making, particularly in relation to tax planning activities. Firms with higher financial performance tend to generate higher taxable income, which increases the tax burden and creates incentives for managers to engage in tax planning strategies to optimize after-tax earnings. However, this relationship may not occur directly, but rather through managerial actions in structuring transactions within the firm group. In this context, transfer pricing proxied by the intensity of related-party transactions acts as a mechanism that managers can use to shift income, allocate costs, or manage profits across entities within a corporate group. From an agency perspective, managers may exploit transfer pricing practices due to information asymmetry and the difficulty of monitoring related-party transactions, thereby using it as a tool to achieve tax efficiency while also aligning with internal performance objectives. Therefore, transfer pricing is expected to serve as an mediating mechanism that explains how financial performance affects tax planning behavior.

H4: Transfer pricing mediates the effect of financial performance on tax planning.

Leverage, Transfer Pricing, and Tax Planning

Highly leveraged firms may combine debt tax shields with transfer pricing strategies to further optimize taxable income. Transfer pricing enables firms to allocate costs and revenues across related entities, enhancing the tax benefits derived from leverage. Based on Agency Theory, leverage can influence managerial behavior through increased monitoring by creditors and heightened pressure to meet debt obligations. Firms with higher leverage face stricter debt covenants and closer scrutiny from creditors, which may constrain managerial discretion but also incentivize managers to improve financial efficiency, including tax-related decisions, in order to maintain liquidity and avoid financial distress.

In this context, managers may utilize transfer pricing as a strategic mechanism within corporate groups to manage income allocation and cost shifting between related entities. Due to information asymmetry and the complexity of intercompany transactions, transfer pricing provides managers with flexibility to adjust reported performance and optimize tax outcomes while still complying with

contractual obligations. Thus, transfer pricing serves as a channel through which leverage pressures are translated into tax planning behavior. Therefore, based on Agency Theory, transfer pricing is expected to act as an mediating mechanism linking leverage and tax planning. Studies indicate that financial structure influences the use of intra-group transactions for tax purposes (Nguyen & Le, 2023).

H5: Transfer pricing mediates the effect of leverage on tax planning.

Firm Size, Transfer Pricing, and Tax Planning

Large firms are more likely to operate in complex organizational structures involving subsidiaries and related-party transactions. This increases the likelihood of using transfer pricing as a tax planning mechanism. Larger firms also have better access to professional tax planning expertise. Based on Positive Accounting Theory, firm managers are assumed to act rationally in responding to contractual, political, and economic pressures in order to maximize their own utility and firm value. Firm size is closely related to political cost considerations, where larger firms tend to attract greater public attention, regulatory scrutiny, and tax authority intervention. As a result, managers of large firms have stronger incentives to engage in strategies that manage reported performance and reduce tax burdens.

In this context, transfer pricing proxied by the intensity of related-party transactions can be used as a strategic tool to shift income and expenses among related entities within a corporate group. Through transfer pricing, managers can respond to political cost pressures while simultaneously optimizing taxable income and reported earnings. This mechanism reflects how firms adjust accounting and tax policies in response to external pressures as explained by Positive Accounting Theory. Therefore, transfer pricing is expected to serve as an mediating variable that explains the relationship between firm size and tax planning behavior. Empirical studies suggest that firm size is positively associated with the extent of transfer pricing activities (Prabowo et al., 2025).

H6: Transfer pricing mediates the effect of firm size on tax planning.

RESEARCH METHODS

The research methodology is systematically and comprehensively designed, beginning with the preparation stage, which includes literature review, hypothesis development, and the preparation of valid research instruments. The objective of this study is to examine the effect of internal firm factors on tax planning, with transfer pricing as a mediating variable. The independent variables representing internal factors in this study consist of financial performance, measured by Return on Equity (ROE); leverage, measured by the debt-to-equity ratio; and firm size, measured by the natural logarithm of total assets . The mediating variable, transfer pricing, is measured using the proportion of related-party receivables to total assets. Meanwhile, the dependent variable, tax planning, is proxied by the Effective Tax Rate (ETR), calculated as the ratio of tax expense to pre-tax income, without distinguishing between current and deferred tax expenses.

Based on the literature, firms tend to implement strategies to maximize tax efficiency without violating regulations, which may potentially influence ROE. Therefore, this study proposes the hypothesis that there is a significant relationship between ROE and tax planning (H1). Furthermore, higher levels of debt may encourage tax planning strategies through the utilization of interest expenses as tax deductions; thus, leverage is hypothesized to have a significant effect on tax planning (H2). In addition, larger firms are assumed to have greater resources and capabilities to design more effective tax planning strategies; therefore, firm size is expected to influence tax planning (H3).

Transfer pricing practices enable firms to optimize profits across subsidiaries, thereby enhancing tax planning effectiveness. Accordingly, this study hypothesizes that transfer pricing strengthens the relationship between ROE and tax planning (H4). Similarly, transfer pricing allows firms to more effectively utilize debt-related expenses for tax reduction strategies; thus, it is hypothesized that transfer pricing strengthens the relationship between leverage and tax planning (H5). Finally, large firms may also utilize transfer pricing to support tax minimization strategies; therefore, it is hypothesized that transfer pricing strengthens the relationship between firm size and tax planning (H6).

The next stage involves data collection through a structured sampling process to obtain relevant and representative data. The initial step includes identifying and accessing relevant data sources to ensure accuracy and alignment with the research objectives. The sample is determined using a purposive sampling method with the following criteria: publicly listed manufacturing firms that have complete financial statements during the 2020–2024 observation period and disclose data related to transfer pricing and tax planning. The population of this study consists of all manufacturing firms listed on the Indonesia Stock Exchange (IDX) during the 2020–2024 period.

Data are collected systematically by recording variables, time periods, and units of analysis from each source to facilitate data processing. The final stage of data collection is data verification, which ensures consistency and completeness by checking for duplicates and missing values. The verified data are then processed using statistical software, namely EViews 12. The collected data are analyzed using quantitative methods to produce accurate and reliable findings, focusing on examining relationships between variables through numerical data.

RESULTS AND DISCUSSION

The population of this study comprises companies listed on the Indonesia Stock Exchange (IDX) between 2018 and 2022. A purposive sampling technique was utilized based on the following criteria:

a. Companies consistently listed during the observation period.
b. Companies providing complete audited annual reports including details on related-party receivables.
c. Companies reporting in a consistent currency to avoid exchange rate

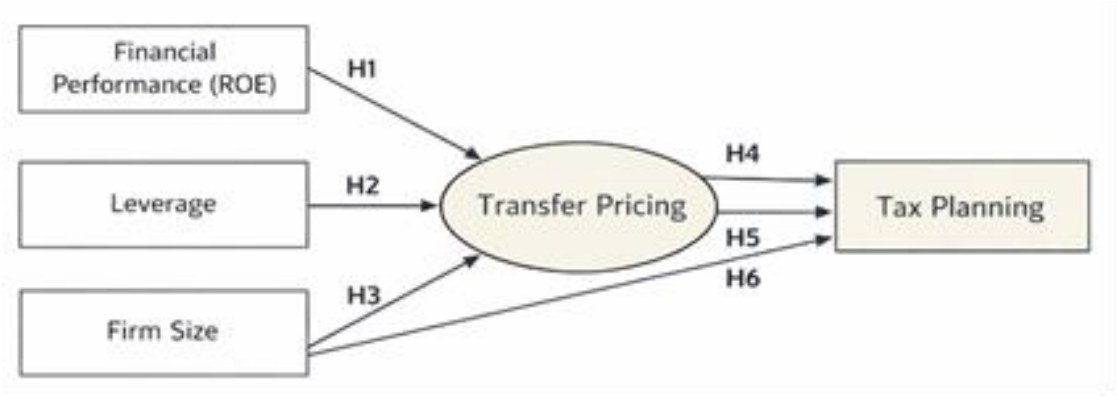

Figure 1. Research Framework

The variables are operationalized and measured as follows:

a. Tax Planning (Y): Measured using the Retention Ratio, calculated as Net Income divided by Pre-tax Income.
b. Financial Performance (X1): Proxied by Return on Equity (ROE), calculated as Net Income / Total Equity.
c. Leverage (X2): Proxied by Debt to Equity Ratio (DER), calculated as Total Debt / Total Equity.
d. Firm Size (X3): Measured by the Natural Logarithm of Total Assets (Ln Assets).
e. Transfer Pricing (Z): Measured by the ratio of Related Party Receivables to Total Assets.

This equation tests the effect of all independent variables and the mediator on Tax Planning (TAX).

$$TAXit = \alpha 2 + \beta 1ROEit + \beta 2LEVit + \beta 3SIZEit + \beta 4TPit + \varepsilon it$$

Information:
TAXit = Transfer Pricing for company in year
ROEit = Financial Performance (Return on Equity).
LEVit = Leverage (Debt to Equity Ratio).
SIZEit = Firm Size (Ln of Total Assets).
TPit = Intercept/Constant for Equation 1.
εit = Error term (Residual).

Based on table 1 is to decide between the Common Effect Model (CEM) and the Fixed Effect Model (FEM).

Hypothesis:

a. H0: Common Effect Model (CEM) is preferred.
b. Ha: Fixed Effect Model (FEM) is preferred.

Decision Rule is if Prob. Cross-section F < 0.05, reject H0. Use Fixed Effect Model (FEM).
Purpose: To decide between the Fixed Effect Model (FEM) and the Random Effect Model (REM).

Hypothesis:

a. H0: Random Effect Model (REM) is preferred.
b. Ha: Fixed Effect Model (FEM) is preferred.

Decision Rule is if Prob. Cross-section Random < 0.05, reject H0 Use Fixed Effect Model (FEM). If Prob. > 0.05, use Random Effect Model (REM). So the final model is using Fixed Effect Model (FEM).

Table 1. Outcome Model

Test	Statistic	Prob.	Decision
Chow Test	F-stat: 5.67	0.0000	Reject H_0 (Use FEM)
Hausman Test	Chi-Sq: 15.30	0.0012	Reject H_0 (Use FEM)

Source: Processed Data

Table 2. Regression Results (Fixed Effect Model)

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	1.8452	0.4521	4.0813	0.0001
ROE (X1)	-0.2145	0.0652	-3.2898	0.0016
LEV (X2)	0.0784	0.0321	2.4423	0.0172
SIZE (X3)	0.0125	0.0094	1.3297	0.1882
TP (Z)	0.4215	0.1124	3.7500	0.0004

Source: Processed Data

Based on Table 2, there is a summary of the results of the significance values, both from testing through multiple linear regression and testing of the absolute difference value.

The Effect of Financial Performance (ROE) on Tax Planning

Based on Agency Theory, the statistical results showing that financial performance has a significant effect on tax planning can be interpreted as evidence that managers in highly profitable firms face stronger incentives to act in accordance with shareholder interests by maximizing after-tax returns. Because managers are agents responsible for enhancing shareholder wealth, higher profitability increases both the tax burden and the pressure to improve financial efficiency, thereby encouraging the adoption of tax planning strategies to reduce tax outflows. Consistent with this theoretical explanation, empirical findings by Nguyen and Nguyen (2024) indicate that profitable firms, particularly in emerging markets, possess greater financial capacity to implement more sophisticated tax planning strategies. Similarly, argue that firms with strong financial performance tend to prioritize tax efficiency as a means of maintaining stable cash flows and competitiveness, especially in post-pandemic economic conditions. Thus, in line with Agency Theory, financial performance plays an important role in shaping managerial tax planning behavior, as higher profitability increases both the incentive and the ability of firms to engage in tax minimization strategies.

The Effect of Leverage on Tax Planning

Based on Positive Accounting Theory, the finding that leverage has a significant effect on tax planning can be explained through managers' rational responses to contractual and economic incentives. Under this theory, managers are assumed to act in their own interests while responding to debt-related pressures, particularly debt covenant constraints. Higher leverage increases the importance of maintaining favorable financial outcomes to avoid violations of debt agreements, which encourages firms to engage in strategic tax planning to manage reported income and cash flows. In addition, leverage is closely associated with the tax shield benefit of debt, where interest expenses are tax-deductible and reduce taxable income. This creates an inherent incentive for firms to rely on debt financing as part of their tax planning strategy. Empirical evidence supports this view, as Hasan et al. (2022) find that corporate leverage is a key determinant of tax aggressiveness in Southeast Asia. Similarly, Al-Hadi et al. (2021) argue that firms utilize debt not only for financing purposes but also as a strategic tool for long-term tax optimization. Therefore, in line with Positive Accounting Theory, leverage plays an important role in shaping tax planning behavior, as firms rationally respond to financial and contractual incentives by optimizing their capital structure to minimize tax burdens.

Table 3. Regression Results (Fixed Effect Model)

Hypothesis	Indirect Path	Indirect Effect	p-value	Result
H_4	ROE→Transfer Pricing →Tax Planning	0.0064	0.003	Mediation
H_5	Leverage→Transfer Pricing→Tax Planning	-0.0032	0.038	Mediation
H_6	FirmSize→Transfer Pricing→Tax Planning	0.0012	0.812	No Mediation

Source: Processed Data

The Effect of Firm Size on Tax Planning

Based on Positive Accounting Theory, the finding that firm size significantly influences tax planning activities can be explained through the political cost hypothesis. This hypothesis suggests that larger firms tend to attract greater public attention, regulatory scrutiny, and political pressure, which creates incentives for managers to reduce reported profits in order to minimize political costs such as higher taxation and stricter regulation. At the same time, larger firms benefit from economies of scale that allow them to access professional tax expertise and implement more sophisticated tax planning strategies. However, this advantage is balanced by increased reputational risk and visibility. Empirical evidence supports this argument, as Zhu & Chen (2024) find that large corporations strategically manage their political visibility by balancing tax aggressiveness with enhanced corporate social responsibility reporting to mitigate reputational risks. Similarly, argue that the organizational complexity of large firms creates more opportunities for legal tax avoidance through structured financial and operational arrangements.

Therefore, in line with Positive Accounting Theory, firm size plays a significant role in shaping tax planning behavior as firms strategically respond to political costs, regulatory pressures, and organizational complexity. Based on Table 3, which summarizes the significance test results, the mediation analysis confirms that transfer pricing significantly mediates the relationship between financial performance and tax planning, as well as between leverage and tax planning. This finding indicates that firms with higher profitability and greater leverage tend to utilize transfer pricing mechanisms as a strategic channel for tax optimization. From an agency theory perspective, managers are incentivized to maximize after-tax profits, and transfer pricing provides flexibility in allocating income across jurisdictions to minimize the overall tax burden. Consistent with prior literature, Beer et al. (2020) highlight that transfer pricing remains one of the most dominant instruments of profit shifting globally, particularly among multinational enterprises. By setting intra-group prices, firms can shift taxable income from high-tax jurisdictions to low-tax affiliates. Furthermore, Dawson et al. (2022) demonstrate that highly leveraged firms are more likely to engage in intra-group financing arrangements, where transfer pricing is embedded in the determination of interest rates. These practices enable firms to exploit interest deductibility rules, thereby amplifying tax savings through internal debt structuring.

Additionally, this result aligns with the political cost hypothesis, which suggests that firms with strong financial performance are more capable of bearing the costs associated with sophisticated tax planning strategies, including compliance with transfer pricing documentation and advisory fees. Thus, profitability not only provides the incentive but also the capacity to engage in complex tax planning through transfer pricing channels. In contrast, the mediation effect of transfer pricing on the relationship between firm size and tax planning is found to be insignificant. This result suggests that firm size alone does not necessarily translate into greater reliance on transfer pricing as a tax planning mechanism. One plausible explanation lies in the increasingly stringent regulatory environment governing transfer pricing practices. In Indonesia, the implementation of Transfer Pricing Documentation requirements under PMK 213/PMK.03/2016 has significantly increased transparency and compliance obligations for large firms.

Moreover, as emphasized by Tandean et al. (2023), the global implementation of the OECD's Base Erosion and Profit Shifting (BEPS) Action Plan has heightened scrutiny on multinational corporations, particularly large and highly visible entities. These firms face greater regulatory, reputational, and political risks when engaging in aggressive transfer pricing practices. As a result, large firms may adopt more conservative tax planning strategies or shift toward alternative

mechanisms, such as tax incentives utilization, capital structure adjustments, or operational restructuring, which are perceived as less risky and more compliant with evolving international tax standards. From an institutional theory perspective, this finding also reflects how regulatory pressures and normative expectations shape corporate behavior. Larger firms, due to their visibility and accountability, are more likely to conform to regulatory frameworks and avoid aggressive tax strategies that could trigger audits or damage corporate reputation. Therefore, while firm size increases the resources available for tax planning, it simultaneously imposes constraints that limit the use of transfer pricing as a mediating mechanism.

CONCLUSION

This study examines the role of transfer pricing as a mediating variable in the relationship between financial performance, leverage, firm size, and tax planning. The findings indicate that financial performance and leverage have a significant effect on tax planning through transfer pricing. This suggests that firms with higher profitability and greater leverage tend to utilize transfer pricing as a strategic mechanism to optimize their tax burden. These results are consistent with Agency Theory, which posits that managers (agents) are motivated to maximize their own utility while also enhancing shareholder wealth. In this context, transfer pricing provides managerial discretion in allocating income and expenses across related entities, allowing firms to reduce tax liabilities and improve after-tax performance in line with principal agent incentives. In addition, these findings can be explained through Positive Accounting Theory, which argues that managerial accounting choices are driven by contractual, political, and economic pressures. Firms with higher profitability and leverage face stronger incentives related to tax burdens, debt covenants, and performance expectations, which encourage the use of accounting and tax strategies such as transfer pricing to manage reported earnings and minimize tax expenses. In contrast, firm size does not have a significant indirect effect on tax planning through transfer pricing. This indicates that larger firms are not necessarily more reliant on transfer pricing strategies. This finding may be attributed to stricter regulatory frameworks, higher compliance requirements, and increased scrutiny under global initiatives such as BEPS, which limit aggressive tax planning behavior. From a Positive Accounting Theory perspective, this reflects the political cost hypothesis, where larger firms face greater visibility and regulatory pressure, leading them to adopt more conservative and compliant tax strategies or shift toward alternative, less risky tax planning mechanisms. Overall, this study highlights the importance of transfer pricing as a strategic channel in corporate tax planning, particularly for firms with high profitability and leverage. It also underscores how agency conflicts and contractual pressures, as explained by Agency Theory, along with political and regulatory constraints emphasized in Positive Accounting Theory, jointly shape managerial tax planning decisions. These findings provide important implications for policymakers in strengthening transfer pricing regulations and for firms in designing tax strategies that balance efficiency, compliance, and reputational considerations.

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