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Transfer Pricing, Tax Avoidance, and the Role of Good Corporate Governance

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ABSTRACT

This quantitative study aims to examine the effect of transfer pricing on tax avoidance and the moderating role of good corporate governance in energy sector companies listed on the Indonesia Stock Exchange during 2020-2024. Based on multiple linear regression and moderated regression analysis, the result shows that transfer pricing has a negative and significant effect on tax avoidance, indicating that higher transfer pricing exposure increases regulatory risk and thereby constrains aggressive tax avoidance practices. Furthermore, good corporate governance significantly weakens the negative relationship between transfer pricing and tax avoidance, indicating that the implementation of good corporate governance may still be symbolic and therefore is unable to effectively suppress tax avoidance practices. This study provides practical implications regarding the importance of strengthening transfer pricing regulations and encourages more substantive implementation of good corporate governance in enhancing oversight of transfer pricing practices.

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1. INTRODUCTION

Tax serves as one of the most vital components in supporting the implementation of national development. In 2024, 82.44% of the state's revenue came from taxes (Syawal et al., 2024). Given the significant contribution of taxes to state revenue, it is not surprising that there are ongoing efforts by the Indonesian government to increase tax collection. One such initiative is the enactment of the tax reform policy through Law Number 7 of 2021 on the Harmonization of Tax Regulations (UU HPP). Among the many provisions introduced in the UU HPP, several key points directly aim to optimize tax revenue, such as introducing a carbon tax, adjusting the Value Added Tax (VAT) rate, and implementing the Voluntary Disclosure Program (PPS). These initiatives reflect the government's commitment to tackling challenges in tax revenue, including Indonesia's low tax ratio. Back in 2025, the Organisation for Economic Co-operation and Development (OECD) reported that Indonesia's tax-to-GDP ratio in 2023 stood at only 12%, falling below 7.5% than the Asia-Pacific average and 21,9% below the OECD average. From a historical perspective, DDTC News reported that between 2007–2023, Indonesia's tax ratio has never reached 15%, which is the ideal standard set by the International Monetary Fund (IMF). This condition indicates that Indonesia's tax potential has not been fully optimized.

Tax avoidance is one of the factors affecting the tax ratio (Fasita et al., 2022). In contrast to the government's attempt to increase tax revenue, companies often strive to reduce tax payments to maximize profits. A commonly used strategy is tax avoidance, as it is considered legal (Sipayung et al., 2023). This practice is regarded as legal because it involves taking advantage of loopholes or gaps within existing tax regulations (Handoyo et al., 2022). Although it doesn't violate the law, tax avoidance is considered a complex issue since it may decrease potential state revenue (Sunarsih & Oktavia, 2017). Santoso, Laturette and Mastan (2021) further emphasize that such practices may be deemed irresponsible, as the associated revenue loss can contribute to taxpayer inequality, limitations in government spending, and diminished social welfare.

Transfer pricing is a common method used as a tax avoidance tool, especially among multinational corporations (Kalra & Afzal, 2023). From a business perspective, transfer pricing is a normal practice aimed at operational efficiency. However, in the context of taxation, it is often misused for tax evasion purposes, a practice that is widely known as abuse of transfer pricing. This manipulation typically involves exploiting differences in tax rates among countries by shifting profits to a low-tax jurisdiction or artificially inflating or deflating prices in intercompany transactions. Therefore, even though transfer pricing transactions may occur in both domestic and international settings, abusive transfer pricing practices are more likely to arise in cross-border transactions due to tax rate differentials between countries that create opportunities for profit shifting. Nevertheless, public access to firms' transfer pricing transactions is very limited. Consequently, prior empirical studies commonly used related party transactions (RPT) for transfer pricing measurement, since it reflects the extent of a firm's engagement in intercompany transactions, thereby indicating its exposure to transfer pricing activities (Barus et al., 2024; Hidayati & Sulistyowati, 2025; Putri & Kartika, 2025).

This research focuses on the energy sector due to its vulnerability to transfer pricing practices for tax avoidance purposes. The mining sector, as a major component of the energy sector, involves large-scale operations, high capital intensity, and extensive cross-border transactions, which create greater opportunities to do profit shifting through transfer pricing.

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The Corruption Eradication Commission (KPK) supported this argument by stating that the mining sector is highly prone to tax avoidance practices. KPK findings revealed that unpaid taxes from mining operations within forest areas amount to Rp15.9 trillion per year (Maheswari et al., 2024). Additionally, the mining sector also faces challenges related to tax transparency. In 2021, PricewaterhouseCoopers reported that only approximately 30% of the world's top 40 mining firms had adopted tax transparency reporting in 2020. This finding indicates that the majority of mining firms still provide limited disclosure regarding their tax practices, which reduces accountability and increases the risk of aggressive tax planning, including transfer pricing abuse. Considering the high exposure to transfer pricing practices and the limited level of tax transparency in the mining sector, further examination in this context becomes highly relevant.

The case of PT Adaro Energy Tbk serves as a notable example of how transfer pricing schemes can be utilized for tax avoidance. In 2019, the international non-profit organization Global Witness released a report alleging that the firm engaged in tax avoidance through a transfer pricing scheme between 2009-2017. This was allegedly done by selling coal at low prices to its Singapore-based subsidiary, Coaltrade Services International, which then resold it at higher prices in the international market. Furthermore, Adaro was accused of shifting a significant portion of its profits from Singapore to tax haven countries such as Mauritius and Labuan. Global Witness stated that this practice allowed PT Adaro Energy Tbk to cut its Indonesian tax liabilities by approximately US$125 million.

Prior research on how transfer pricing affects tax avoidance has produced mixed findings. While Zarkasih & Maryati (2023) and Laili & Tjaraka (2023) identify a positive effect, research by Fasita et al. (2022) and Nabila & Aryani (2025) shows a negative effect, whereas some studies detect no meaningful relationship between the two variables (Barus et al., 2024; Pratiwi & Fauzan, 2025; Putri & Kartika, 2025). These inconsistent findings suggest that other factors may affect the relationship between transfer pricing and tax avoidance. One such factor is Good Corporate Governance (GCG), which has been shown to reduce tax avoidance practices once implemented effectively (Apriani, 2025). Strong governance structures are expected as an internal control mechanism that could enhance transparency and accountability, while also protecting stakeholders from fraudulent practices, including the misuse of transfer pricing by management (Dharmawan et al., 2024). Conversely, weak corporate governance provides managers with greater discretion and access to superior information, which could encourage opportunistic behavior. In such conditions, managers may deploy transfer pricing to shift profits and minimize tax burdens, ultimately maximizing their personal incentives. This aligns with the agency theory, which posits that information asymmetry and conflict of interest between the principal and the agent can enhance opportunistic behavior by management, leading to the agency problem.

Accordingly, this research seeks to fill these gaps and by examining how GCG moderates the impact of transfer pricing on tax avoidance in the energy sector, where empirical evidence remains limited. Moreover, this study employs Modified Book-Tax Differences (MBTD), a proxy that captures only the portion of book-tax differences that reflects tax avoidance activity and isolates the effects of earnings management, which is still not widely found in previous studies that generally use Book-Tax Differences (BTD), Effective Tax Rate (ETR), and Cash Effective Tax Rate (CETR) proxies (Dharmawan et al., 2024; Hidayati & Sulistyowati, 2025; Indrastuti & Apriliawati, 2023; Indriani & Ramli, 2024; Stanley & Widianingsih, 2025). In addition, GCG is

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measured using a comprehensive index outlined in SEOJK No. 32/SEOJK.04/2015, whereas most previous studies used partial GCG proxies, such as audit quality, institutional ownership, audit committees, independent commissioners, and managerial ownership (Alqatan et al., 2025; Gunawan et al., 2021; Handoyo et al., 2022; Marfiana & Adriyanto, 2021; Rizqia & Lastiati, 2021). Unlike most prior studies, this study employs a more targeted sample by specifically focusing on energy-sector firms that conduct cross-border transactions with related entities, where the actual presence of transfer pricing abuse is more likely happen due to tax rate differences.

Agency theory, as conceptualized by Jensen & Meckling (1976), explained the contractual relationship between principals (owners) and agents (management), in which agents are granted authority to make decisions and act on behalf of the principals. However, this relationship often gives rise to agency problems due to differences in interests between the two parties, resulting in a misalignment between the objectives of owners and management. As a consequence, management may not always act in accordance with the owners' interests (Marfiana & Adriyanto, 2021). On one hand, owners expect stable performance and sustainable profits; on the other hand, management may not always be able to meet these expectations (Hidayati & Sulistyowati, 2025). This delegation of authority gives rise to information asymmetry, as management possesses greater knowledge regarding the firm's actual condition compared to shareholders. Such information imbalance creates opportunities for management to prioritize personal interests over those of shareholders. Consistent with Indrastuti and Apriliawati (2023), information asymmetry also affects corporate performance and strategic decisions, including in the taxation aspect.

Within the agency theory framework, transfer pricing can increase the risk of agency problem since management can use it as a tax avoidance tool to gain personal benefits. Management, as agents, may exploit their discretion in determining transfer prices for intercompany transactions to allocate profits across countries and suppress tax burdens, thereby maximizing the company's reported profits and simultaneously increasing their personal incentives. This practice is further exacerbated by the presence of information asymmetry, as principals' ability to directly observe and evaluate transfer pricing decisions becomes more limited.

To mitigate this issue, GCG can function as an internal control mechanism that could reduce information asymmetry and constrain managerial discretion. Effective governance mechanisms are expected to limit opportunistic behavior by strengthening monitoring and transparency. Management tends to engage in tax avoidance activities within levels that remain acceptable to shareholders when corporate governance is implemented effectively, thereby showing how GCG could help align management action with the principal interest (Sulardi & Pramudya, 2024).

Kalra & Afzal (2023) defined transfer pricing as the determination of prices for goods and services exchanged between related parties, particularly among subsidiaries of multinational corporations. However, this practice may be exploited by management for tax avoidance purposes by allocating profits from high-tax countries to jurisdictions with lower tax rates or tax haven countries, leading to abuse of transfer pricing. Profit shifting can be carried out by manipulating transfer prices above or below market levels. Subsidiaries operating in high-tax countries may be charged inflated prices for goods or services, increasing costs and reducing

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taxable profits. Conversely, subsidiaries in low-tax countries may receive goods or services at lower prices, resulting in higher reported profits that are subject to lower or no taxation. Through this mechanism, profits are strategically relocated across countries to minimize the company's overall tax burden, thereby reported profits may appear higher than the firm’s actual economic performance, making management’s performance seem favorable in the eyes of owners.

This behavior shows consistency with the agency theory, emphasizing that managerial authority combined with information asymmetry can encourage opportunistic behaviors pursued for personal interests, thus arising agency problems. While management possesses greater information and discretion in determining transfer prices, principals have a limited ability to directly observe whether transfer pricing decisions truly reflect economic substance. This condition allows management to employ transfer pricing as a tool to boost reported performance and personal incentives through tax savings, even if such actions can increase regulatory and reputational risks for shareholders in the long-term. Several prior studies showed that transfer pricing positively affects tax avoidance (Amidu & Coffie, 2019; Laili & Tjaraka, 2023; Rezeki et al., 2021; Zarkasih & Maryati, 2023), indicating that multinational firms commonly use transfer pricing to lower tax obligations. Based on the discussion above and prior studies, the following hypothesis is proposed:

H1: Transfer pricing has a positive effect on tax avoidance.

GCG encompasses a set of principles aimed at ensuring that companies are managed transparently, accountably, and responsibly Within the context of agency theory, GCG serves as a monitoring mechanism that can constrain managerial opportunism. Waluyo (2017) supports this argument by stating that the implementation of GCG can address managerial opportunism, including tax avoidance practices. Alqatan et al. (2025) provide empirical evidence that strong audit committee attributes, notably financial expertise, independence, and the size of audit committees, can effectively act as a monitoring control to limit managerial opportunism and reduce tax aggressiveness. Moreover, research by Rizqia & Lastiati (2021) and Gunawan et al. (2021) shows that stronger audit quality, measured by Big 4 accounting firms, is related to lower levels of tax avoidance practices, as auditors in large accounting firms tend to have better competencies in detecting the possibility of profit manipulation for tax purposes.

Accordingly, effective corporate governance is considered capable of mitigating agency problems that arise between principals and agents, as monitoring activities are more transparent and accountable. In this context, strong corporate governance can constrain management's ability to make opportunistic decisions for personal gain, such as exploiting transfer pricing policies for tax avoidance. This statement is supported by Lestari and Bwarleling (2024), stating that companies with good governance and supervision will reduce the risk of management engaging in transfer pricing activities solely to increase bonuses. Previous study by Dharmawan et al. (2024) reveals that GCG weakens the positive impact of transfer pricing on tax avoidance, indicating that companies implementing stronger corporate governance mechanisms are less aggressive in tax avoidance activities. Based on prior research and the discussion above, the second hypothesis is proposed:

H2: Good corporate governance weakens the positive effect of transfer pricing on tax avoidance.

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2. METHODOLOGY

This study employs a quantitative approach, drawing on secondary data obtained from the annual reports and financial statements of energy sector firms listed on the Indonesia Stock Exchange (IDX) throughout the 2020-2024 observation period. As shown in Table 1, sample selection was determined using a purposive sampling method based on several criteria. First, the study includes energy sector companies listed on the IDX that consistently disclose annual reports and financial statements ending on December 31 during the observation period to ensure data availability and comparability across firms and years. Second, the sample is restricted to companies that report receivables from related parties because transfer pricing measurement in this study relies on the proportion of related-party receivables. Finally, the study only includes companies that have foreign affiliates or overseas subsidiaries and have conducted cross-border transactions with these related parties, as transfer pricing activities are mainly relevant in cross-border related-party transactions, where there are differences in tax jurisdictions that can create opportunities for profit shifting.

Table 1.
Sample Distribution by Year

Descriptions	2020	2021	2022	2023	2024	Total
Energy sector firms listed on the IDX during the observation period	66	71	75	83	89	384
Firms that did not publish annual reports and financial statements ending on December 31 during the observation period	(7)	(7)	(6)	(8)	(7)	(35)
Firms that do not have receivables from related parties	(9)	(14)	(15)	(19)	(24)	(81)
Firms that do not have foreign affiliates or overseas subsidiaries	(15)	(19)	(16)	(17)	(16)	(83)
Firms that do not conduct cross-border transactions with foreign affiliates or overseas subsidiaries	(12)	(8)	(13)	(16)	(18)	(67)
Total Observations	23	23	25	23	24	118

Source: Processed Secondary Data (2026)

Operational Definition and Variable Measurement

The related party transaction (RPT) ratio, calculated by dividing receivables from related parties by total receivables, was used to measure transfer pricing as the independent variable in this study (Barus et al., 2024; Hidayati & Sulistyowati, 2025; Putri & Kartika, 2025). Although this proxy does not directly capture transfer prcing manipulation behavior, it reflects the firm’s exposure to transfer pricing activities as a higher ratio indicates greater reliance on related-party transactions, which potentially reflect transfer pricing practices. The proxy's limitation is minimized by restricting the sample to firms that engaged in cross-border transactions with their foreign affiliates or subsidiaries.

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In this study, an index based on 25 recommendations of good corporate governance principles issued by Otoritas Jasa Keuangan in Financial Services Authority Circular Letter No. 32/SEOJK.04/2015 is used to measure the moderating variable, which is GCG (Indriani & Ramli, 2024; Sari et al., 2023). Each fulfilled recommendation is scored as 1, while unfulfilled ones Is scored 0. The Firm's GCG score is subsequently obtained by dividing the total score fulfilled by the firm by the total number of GCG recommendations required by the SEOJK.

Tax avoidance, the dependent variable, is proxied through a modified form of BTD, namely MBTD (Desai & Dharmapala, 2006). BTD is calculated as the difference between earnings before tax and taxable income. Meanwhile, total accrual is measured by deducting operating cash flow from net income. Higher positive MBTD denotes a higher level of tax avoidance. MBTD is derived as the residual value from the regression model below:

$BTD_{it} = \beta_1 TA_{it} + \mu_i + \varepsilon_{it}$ (1)

Where i and t mean firm i in year t. BTD_{it} is the total of book tax difference scaled by previous year total assets, TA_{it} is total accruals scaled by previous year total assets, μ_i captures the average residual over the 2020-2024 sample period, and ε_{it} represents the deviation of average residual.

This research incorporates several control variables, namely profitability, capital intensity, firm size, sales growth, leverage, and taxable income score. Profitability is represented by Return on Equity (ROE), measured by dividing net income by total equity (Hoseini et al., 2018). Capital intensity (CAPI) is calculated by dividing fixed assets by total assets (Hidayati & Sulistyowati, 2025). Firm size (SIZE) is calculated by the natural logarithm of total assets (Stanley & Widianingsih, 2025). Sales growth (SLGW) is calculated by dividing the difference between current and previous year sales by the previous year sales (Nabila & Aryani, 2025). Leverage (LEVE) is calculated by the Debt to Asset Ratio (DAR), measured by dividing total liabilities by total assets (Nabila & Aryani, 2025). In addition, taxable income score (TISC) is specified as a dummy variable, assigned a value of 0 for firms reporting zero or negative taxable income and a value of 1 for those reporting positive taxable income. This control variable is included because firms with negative or no taxable income generally have lower marginal incentives to engage in tax-sheltering activities.

Data Analysis Techniques

There were 2 data analysis methods used in this study, namely the multiple linear regression analysis and moderated regression analysis (MRA). Multiple linear regression is used in Model 2 to investigate the relationship between transfer pricing and tax avoidance, thereby addressing H1. The regression equation for Model 2 is specified as follows:

$MBTD_{it} = \alpha + \beta_1 TFPC_{it} + \beta_2 ROE_{it} + \beta_3 CAPI_{it} + \beta_4 SIZE_{it} + \beta_5 SLGW_{it} + \beta_6 LEVE_{it} + \beta_7 TISC_{it} + \varepsilon_{it}$ (2

Moderated regression analysis is employed in Model 3 to test H2, which investigates whether GCG could influence the relationship between transfer pricing and tax avoidance. The Model 3 equation is specified as follows:

$MBTD_{it} = \alpha + \beta_1 TFPC_{it} + \beta_2 GCG_{it} + \beta_3 TFPC_{it} * GCG_{it} + \beta_4 ROE_{it} + \beta_5 CAPI_{it} + \beta_6 SIZE_{it} + \beta_7 SLGW_{it} + \beta_8 LEVE_{it} + \beta_9 TISC_{it} + \varepsilon_{i,t}$ (3)

Description: MBTD= Modified Book Tax Difference; α= Constant; TFPC= Transfer Pricing; GCG=Good Corporate Governance; ROE= Return on Equity; CAPI= Capital Intensity; SIZE= Firm

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Size; SLGW= Sales Growth; LEVE= Leverage; TISC= Taxable Income Score; ε= Error; β= Coefficients.

3. RESULT AND DISCUSSION

Descriptive Statistics

Following on the tight sampling criteria outlined in Table 1, a total of 118 observations were obtained. However, after conducting outlier testing, 17 observations were identified as outliers and removed, resulting in a final sample of 101 observations in this study.

Table 2 summarises the distributional properties of each variable. Tax avoidance, calculated using the MBTD proxy, has a mean value of -0.0635 or -6.35%, indicating that energy companies tend to have a relatively low indication of aggressive tax avoidance. TFPC records a mean of 0.2512, meaning roughly a quarter of corporate receivables are conducted with related parties, which signals the potential presence of transfer pricing practices among the sample. Furthermore, GCG records a high mean of 0.9398 against a maximum of 1, showing that most sample firms have implemented good corporate governance practices at a high level. The standard deviation values for MBTD, TFPC, ROE, and SLGW are 0.1166, 0.2669, 0.2481, and 1.0044, respectively. These values exceed their corresponding means, indicating a fairly wide distribution of data across the sample.

Table 2.
Descriptive Statistics

Variable	Obs	Mean	Std. Deviation	Min	Max
MBTD	101	-0.0635	0.1166	-0.3375	0.4169
TFPC	101	0.2512	0.2669	0.0000	0.9649
GCG	101	0.9398	0.0956	0.44	1
ROE	101	0.1465	0.2481	-0.9750	1.1192
CAPI	101	0.3082	0.2691	0.0023	0.8461
SIZE	101	29.9203	1.4166	26.9288	32.4819
SLGW	101	0.2271	1.0044	-0.5047	8.0576
LEVE	101	0.4748	0.2108	0.1217	0.8781
TISC	101	0.5842	0.4953	0	1

Source: Processed Secondary Data (2026)

Classical Assumption Test

Table 3 collects the outcomes of various classical-assumption tests used in this study. Normality, assessed using the skewness test, returns a probability of 0.7964, well above 0.05, showing the residuals were normally distributed. Multicollinearity is gauged with the Variance Inflation Factor (VIF), whose mean of 1.42 sits far below the conventional threshold of 10, showing no multicollinearity issue in the regression models. Heteroscedasticity is examined through the Breusch-Pagan/Cook-Weisberg test, which yields a value exceeding 0.05, suggesting no heteroscedasticity problem. Nevertheless, robust standard errors are applied as a precautionary measure to account for potential temporal dependence and minor heteroskedasticity, thereby enhancing the reliability of statistical inference and ensuring the robustness of the results in a multi-year setting (Hoechle, 2007).

Table 3.
Classical Assumption Test

Description	Results
Normality (Prob>chi2)	0.7964
Multicollinearity (Mean VIF)	1.42
Heteroscedasticity (Prob>chi2)	0.0753

Source: Processed Secondary Data (2026)

Hypothesis Testing

Table 4 displays the regression results for Model 2. Column (1) reports the main regression model, while Column (2) presents the robustness model by the inclusion of year fixed effects to account for unobserved time-specific factors. The TFPC value of -0.0783 and 1% level of significance suggest that a higher level of transfer pricing correlates with a weaker tax avoidance level. Among the control variables, only ROE presents a 1% significant level with a coefficient of 0.3492. The positive sign of the ROE coefficient signals that firms with higher profitability are more likely inclined towards tax avoidance activities. In contrast, the other control variables, namely CAPI, SIZE, SLGW, LEVE, and TISC, do not show any significant effect on MBTD. The overall F-test results are significant, confirming the statistical validity of the regression model. The R^2 of approximately 0.64 indicates that Model 2 accounts for roughly 64% of the variation in tax avoidance, leaving the remainder to factors outside the model. The consistent results after adding the year fixed effect confirm the robustness of this finding.

Table 4.
Multiple Linear Regression Test Results

MBTD	(1)	(2)
TFPC	-0.0783***	-0.0812***
	(-3.07)	(-3.17)
ROE	0.3492***	0.3498***
	(8.10)	(8.15)
CAPI	-0.0086	-0.0126
	(-0.24)	(-0.35)
SIZE	0.0034	0.0024
	(0.44)	(0.31)

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SLGW	-0.0040	-0.0037
	(-0.91)	(-0.84)
LEVE	-0.0272	-0.0198
	(-0.70)	(-0.50)
TISC	-0.0092	-0.0065
	(-0.58)	(-0.40)
Constant	-0.1744	-0.1621
	(-0.76)	(-0.70)
YEAR FE	No	Yes
F	16.51***	12.97***
R^2	0.6391	0.6477
N	101	101

t-statistics in parentheses
*p less than 0.1, **p less than 0.05, ***p less than 0.01

Source: Processed Secondary Data (2026)

The regression results presented in Table 5 show that GCG significantly moderates the relationship between transfer pricing and tax avoidance. Overall, the GCG variable exhibits a coefficient of -0.2764 and is significant at the 5% level, meaning that stronger governance mechanisms are effective in reducing tax avoidance. However, the interaction term between TFPC and GCG has a positive and significant coefficient of 0.4194 at the 5% level, indicating that strong GCG attenuates the negative relationship of transfer pricing on tax avoidance. After adding GCG into the model, the TFPC coefficient remains negative and significant at -0.4560. These findings remain consistent after controlling for year fixed effects, further supporting the robustness of the results. In relation to control variables, the results in Model 3 remain consistent with those in Model 2. In this model, ROE continues to show a positive and statistically significant effect on MBTD, with a coefficient of 0.3380, while CAPI, SIZE, SLGW, LEVE, and TISC remain insignificant. The F-test remain significant, confirming that the regression model is statistically acceptable. Furthermore, the R^2 values for Model 2 are 0.6598, which indicates that Model 3 is able to explain almost 66% of the variance in tax avoidance, with the remaining 34% is attributable to influences beyond the study.

Table 5.
Moderated Regression Analysis (MRA) Test Results

MBTD	(1)	(2)
TFPC	-0.4560***	-0.4616***
	(-2.90)	(-2.99)
GCG	-0.2764**	-0.3141**

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	(-2.32)	(-2.48)
TFPC*GCG	0.4194**	0.4199**
	(2.40)	(2.45)
ROE	0.3380***	0.3358***
	(7.33)	(7.05)
CAPI	0.0126	0.0127
	(0.33)	(0.33)
SIZE	0.0062	0.0057
	(0.78)	(0.71)
SLGW	-0.0049	-0.0037
	(-1.05)	(-0.79)
LEVE	-0.0148	-0.0047
	(-0.37)	(-0.12)
TISC	-0.0130	-0.1123
	(-0.75)	(-0.62)
Constant	-0.0113	0.0125
	(-0.05)	(0.06)
YEAR FE	No	Yes
F	15.84***	13.33***
R^2	0.6598	0.6724
N	101	101

t-statistics in parentheses
*p less than 0.1, **p less than 0.05, ***p less than 0.01

Source: Processed Secondary Data (2026)

The Effect of Transfer Pricing on Tax Avoidance

The regression results of Model 2 indicate that H1 is rejected. This reveals that transfer pricing has a significant negative impact on tax avoidance, indicating that a higher level of transfer pricing activities is associated with reduced tax avoidance practices. While this result is consistent with prior research by Fasita et al. (2022) and Nabila & Aryani (2025), it contradicts studies by Amidu & Coffie (2019); Laili & Tjaraka (2023); Rezeki et al. (2021); Zarkasih & Maryati (2023), which concludes a significant positive impact of transfer pricing on tax avoidance.

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This negative influence can be explained by the measurement of transfer pricing used in this study. As higher RPT indicates higher transfer pricing activities, firms with high RPT may increase the potential of tax audits and monitoring intensity by tax authorities, as such transactions are commonly associated with profit shifting risk. Under these circumstances, firms with higher transfer pricing exposure may strategically reduce aggressive tax avoidance to mitigate regulatory risk by ensuring that conducted intercompany transactions can be justified under the arm's length principles if examined, particularly because transfer pricing adjustments can result in additional tax liabilities and administrative consequences. This interpretation is in line with Mediaty et al. (2025), who find that stricter oversight, stronger documentation requirements, and more intensive enforcement tend to reduce incentives for aggressive transfer pricing behavior, particularly in environments where transfer pricing transactions are closely monitored. Such regulatory pressure may encourage firms to prioritize defensible and transparent transfer pricing arrangements over tax-saving strategies that could increase their exposure to tax adjustments. Accordingly, the negative result doesn't imply that transfer pricing directly reduces tax avoidance, but rather suggests that higher transfer pricing exposure intensifies regulatory scrutiny, which may discourage firms' aggressive tax avoidance behavior.

This argument is consistent with Fasita et al. (2022), suggesting that transfer pricing activities are often associated with profit-shifting practices by multinational enterprises, making firms that aggressively engage in transfer pricing activities likely to be perceived as high-risk taxpayers. As a result, multinational entities tend to avoid conducting aggressive transfer pricing simultaneously to prevent being the prime targets of the Indonesian tax authority. In this context, transfer pricing becomes a high-monitoring activity that encourages managers to restrain opportunistic tax avoidance behavior to protect both corporate and personal reputational interests. As firms with greater transfer pricing exposure are more visible to tax authorities and subject to intensive monitoring, managers might reconsider their intention to use transfer pricing as a tax avoidance strategy to reduce potential tax audits, disputes, and reputational damage. This condition may encourage managers to seek other alternative methods that can minimize tax burden while still being compliant with tax regulations (Lestari & Bwarleling, 2024).

From the agency theory perspective, the cautious behavior by management in reducing tax avoidance reflects managerial risk aversion in response to a stricter transfer pricing regulatory environment under the Regulation of the Minister of Finance Number 172 of 2023 (PMK-172/2023). The regulation strengthens compliance with the arm's length principle by requiring an ex-ante approach to the preparation of transfer pricing documentation (TP Doc). Under this approach, the Master and Local File must be prepared according on data available at the time the related-party transaction is carried out, as stated in Article 17 paragraph (1) under the PMK-172/2023. Non-compliance with these requirements may result in tax adjustments and administrative sanctions as specified in Article 28 of PMK-172/2023, thereby increasing the overall costs related to misuse of transfer pricing practices that may outweigh the potential tax savings. This argument is consistent by Sebele-mpofu et al. (2021), stating that the existence of penalties for violating transfer pricing legislation helps reduce income shifting practices. Consistent with this view, Yoo (2020) provides empirical evidence that domestic transfer pricing regulations effectively constrain profit shifting, thereby significantly

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increasing reported profits in the home country. Similarly, a recent study by Teles et al. (2026) shows that the implementation of TP Doc requirements in France can effectively reduce multinational firms' tax avoidance activities through profit shifting.

Moreover, this tendency is further reinforced by the implementation of Global Anti-Base Erosion (GloBE) rules under the Regulation of the Minister of Finance Number 136 of 2024 (PMK-136/2024). These rules require multinational enterprises that meet the criteria specified in Article 2 paragraph (1) to be subject to a global minimum effective tax rate of 15%. Although its implementation in Indonesia is only effective starting from the 2025 tax year, the GloBE framework had been agreed upon earlier by over 135 countries through the OECD/G20 Inclusive Framework (IF) under Pillar II in October 2021. Consequently, multinational enterprises may have begun anticipating this policy shift and gradually adjusting their tax planning strategies, particularly those with foreign affiliates operating in jurisdictions that have implemented GloBE rules earlier. Under this framework, transfer pricing loses its effectiveness as a tax avoidance tool, as any decrease in taxable income in one jurisdiction may be offset by top-up taxes in another. In this context, the increasingly stringent regulatory environment may encourage firms to behave more cautiously and comply with the existing regulations. Consequently, greater transfer pricing exposure does not necessarily indicate higher abusive transfer pricing activities, but may instead reflect legitimate operational transactions that still comply with the regulatory requirements. As firms ensure that affiliated transactions comply with transfer pricing rules, such adherence may also be reflected in their broader tax practices, potentially reducing the likelihood of aggressive tax avoidance.

These findings imply that stricter transfer pricing regulations by the government may have contributed to constraining transfer pricing abuse for tax avoidance purposes among the energy sector firms in this study. As higher transfer pricing exposure might increase potential tax audits, firms may be discouraged from engaging in aggressive tax avoidance behavior. This suggests that consistent enforcement of transfer pricing rules can encourage greater compliance with the arm's length principle and reduce opportunities for profit shifting through related-party transactions. Therefore, it is crucial for the government to continuously strengthen transfer pricing regulations to further suppress tax avoidance practices.

The Moderating Role of Good Corporate Governance on the Influence of Transfer Pricing on Tax Avoidance

The regression result of Model 3 reveals that GCG weakens the negative relationship between transfer pricing and tax avoidance, thus resulting in the rejection of H2. Contrary to initial expectations, this result suggests that companies with higher GCG scores are more likely to engage in tax avoidance through a transfer pricing scheme, implying that the GCG mechanism does not always effectively restrain tax avoidance practices. This discrepancy may occur since higher GCG scores do not reflect the quality of the GCG itself but may simply reflect firms' formal compliance with the governance regulations. This results contrasts with the finding of Dharmawan et al. (2024), who reveal that strong corporate governance can mitigate the positive impact of transfer pricing on tax avoidance. One plausible explanation is that GCG implementation is more symbolic than substantive, where companies comply with governance requirements in terms of formal structures and disclosures, but the actual

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monitoring and control functions are not fully implemented. In such cases, GCG fails to effectively limit managerial discretion, allowing management to design structured tax avoidance strategies while still complying with governance standards.

According to Rasyid (2023), companies that implement GCG can enhance trust among shareholders, stakeholders, and public, while also supporting the firm's sustainable growth. As a highly regulated sector, energy companies tend to actively promote and good corporate governance practices to strengthen stakeholder trust and signal accountability. However, results of this study suggest that such trust may not always translate into effective oversight, as managerial discretion can still be used to pursue personal or economic interests, including reducing corporate tax burdens through transfer pricing arrangements. In this context, strong governance practices may create a perception of transparency and accountability among stakeholders without necessarily ensuring that complex tax-related decisions are subject to rigorous scrutiny. This suggests that stakeholder confidence generated by GCG may coexist with managerial discretion when governance mechanisms focus more on meeting formal expectations than on closely monitoring the substance of managerial decisions.

This finding matches with Fasita et al. (2022), suggesting that corporate governance may place economic interests over ethical considerations, by enabling unethical tax savings behavior while simultaneously using GCG practices to decrease stakeholder scrutiny over such activities. In practice, information regarding transfer pricing is very limited, thus creating information asymmetry and increasing the costs borne by shareholders and tax authorities to assess the actual extent of transfer pricing activities and management's performance. According to agency theory, such information asymmetry enables managers to engage in opportunistic behavior and prioritize their personal interests. As a result, management may pursue aggressive tax strategies while maintaining the appearance of compliance through a good governance structure. Consequently, GCG is often treated as a strategic tool to manage ethical pressure related to taxation practices from various stakeholders, rather than as a strict control mechanism aimed at reducing tax avoidance. Although strong governance mechanisms are theoretically expected to enhance monitoring and suppress such behavior, governance structures that are implemented primarily at a formal or symbolic level may fail to constrain managerial discretion in tax-saving strategies, including tax avoidance.

Furthermore, transfer pricing decisions are generally characterized by substantial managerial discretion since they involve complex judgments in determining the most appropriate transfer pricing methods, identifying comparable transactions, and providing adequate economic justifications that are often difficult for external stakeholders to verify. In practice, the scarcity of reliable comparable data further intensified managerial discretion, making it difficult for external stakeholders to confirm whether transfer prices genuinely comply with the arm's length principle. Consequently, managers may exploit this information advantage by structuring affiliated transactions in ways that appear commercially reasonable while potentially concealing tax avoidance motives. Supporting this view, Sebele-mpofu et al. (2021) note that arm's-length pricing is especially difficult to verify for intangible assets, since these transactions often lack comparable prices or comparable data to benchmark against, making them one of the most frequently abused items in transfer pricing arrangements. However, the difficulty in establishing comparability is not limited to intangible transactions but represents a broader challenge in applying the arm's-length principle. Transactions that appear similar may still differ substantially in their terms, timing, volume, and risk profile, making it difficult to identify a truly matching independent transaction to use as a benchmark.

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This issue is especially pronounced in the energy sector, where the capital-intensive nature of business operations often results in related-party transactions involving customized financing arrangements, specialized services, or commodity deliveries with terms that are not easily matched with publicly available comparable data.

This verification difficulty persists despite Indonesia's more demanding documentation rules under PMK-172/2023. The regulation obliges taxpayers to prepare comprehensive documentation, including Local File documentation containing details of related-party and independent transactions, comparability analyses, a functional analysis (functions, assets, and risks), and the selection and application of the arm’s length transfer pricing method. However, the reliability of these analyses ultimately depends on the availability of appropriate comparable data. When reliable comparables are limited, firms retain considerable discretion in selecting benchmark transactions and justifying their transfer pricing positions, making it difficult for tax authorities to substantively evaluate whether the documented arm's-length outcomes genuinely reflect market conditions rather than merely satisfying formal documentation requirements. As a result, even firms with relatively strong governance structures may still avoid tax through more carefully designed transfer pricing arrangements that are difficult to detect, since oversight bodies such as audit committees or independent commissioners rarely possess the specialized transfer pricing expertise needed to challenge management's pricing judgments. Therefore, the effectiveness of GCG in constraining tax avoidance ultimately depends on the substantive quality of oversight over tax planning activities rather than on the formal existence of governance mechanisms alone.

In addition, these findings further suggest that the effectiveness of corporate governance depends not only on the presence of governance mechanisms, but also on how well they are implemented in practice. Giannopoulos et al. (2025) report that conventional governance attributes, such as board size, board independence, gender diversity, and audit committee composition, exert limited influence on tax avoidance in weak institutional settings, whereas external audit quality and ownership structure play a more crucial role. This implies that establishing governance structures alone does not necessarily improve oversight if those structures lack the independence, expertise, or authority required to challenge managerial decisions related to taxation. Similarly, Rizqia & Lastiati (2021) reach a compatible conclusion, finding that independent commissioners presence alone do not significantly strengthen the audit quality and tax avoidance relationship, whereas audit committees' financial expertise does. Their findings indicate that the effectiveness of governance depends more on the capability of governance actors to perform their monitoring responsibilities than on the formal establishment of governance mechanisms. Consequently, governance practices that emphasize procedural compliance rather than substantive oversight may provide managers with greater flexibility to implement sophisticated tax planning strategies while maintaining the appearance of accountability. In this context, higher GCG scores may reflect stronger governance disclosure rather than stronger governance quality, thereby limiting the ability of GCG to effectively curb tax avoidance.

This interpretation is further supported by the nature of the GCG measurement instrument itself. The corporate governance index used in this study is constructed based on SEOJK No. 32/SEOJK.04/2015 on the Corporate Governance Guidelines for Public Companies, which adopts a comply or explain approach rather than imposing mandatory governance requirements. The index primarily captures whether listed companies have established and disclosed recommended governance practices, instead of directly assessing how effectively

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these mechanisms operate in overseeing managerial decisions. For example, the guideline recommends that companies establish and disclose governance mechanisms such as communication policies with shareholders, anti-corruption policies, whistleblowing systems, and succession policies. However, the index does not evaluate whether these mechanisms are effectively implemented or whether they successfully strengthen oversight over complex managerial decisions, including transfer pricing. Consequently, companies may achieve relatively high GCG scores by complying with governance recommendations and disclosure requirements, even though the actual quality of governance may vary across firms. This may explain why higher GCG scores in this study are associated with a weaker, rather than stronger, constraint on tax avoidance through transfer pricing.

The weakening effect of GCG on this negative relationship implies that firms with stronger governance structures may still engage in tax avoidance through more structured and less visible strategies. This suggests that mere compliance with governance standards alone is insufficient to fully restrain managerial opportunism in tax planning. Accordingly, companies should focus on strengthening the substantive effectiveness of their corporate governance mechanisms, particularly in overseeing and monitoring tax-related decisions. Furthermore, regulators should establish more stringent governance guidelines to ensure that GCG implementation extends beyond symbolic compliance and effectively promotes transparency and responsible corporate tax behavior.

4. CONCLUSION

This research examines how transfer pricing affects tax avoidance behavior, while utilizing GCG as a moderating factor. The findings reveal a significant negative influence between transfer pricing and tax avoidance, suggesting that higher exposure to related-party transactions may increase regulatory risk and monitoring intensity, thereby encouraging firms to reduce tax avoidance as a response to mitigate potential tax sanctions. In addition, GCG is found to weaken this negative influence, suggesting potential limitations in the effectiveness of governance mechanisms to restrain tax avoidance. As for the control variables, only profitability shows a positive and significant effect on tax avoidance, while capital intensity, firm size, sales growth, leverage, and taxable income score do not yield significant effects. Overall, these findings highlight that effective transfer pricing regulations and substantive corporate governance implementation are both essential in limiting tax avoidance. Strengthening governance mechanisms beyond symbolic compliance is crucial to ensure that GCG functions as an effective control mechanism to limit managerial discretion in taxation practices.

This study is subject to several limitations. First, GCG is measured based on annual report analysis, which introduces a degree of subjectivity, particularly where firms do not report governance items explicitly against the SEOJK index. Second, the sample is confined to Indonesian energy firms, which may limit generalizability across industries and institutional contexts. Future work could therefore extend the analysis to other sectors or countries and adopt longer observation windows. In addition, future research may incorporate other determinants of tax avoidance, such as earnings management, political connections, and corporate social responsibility, to enrich the analysis and provide deeper understandings about factors that could drives tax avoidance behavior.

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