

UNRAVELING TRANSFER PRICING PARADOX: DO TUNNELING INCENTIVES REALLY DRIVE PROFIT SHIFTING?

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Abstract

Purpose – This study unravels the paradoxical relationship between tunneling incentives and transfer pricing practices in Indonesian consumer non-cyclical sector companies. By examining the moderating role of foreign ownership, we investigate whether tunneling incentives truly drive profit shifting or whether transfer pricing serves alternative functions.

Design/methodology/approach – Employing panel data regression analysis on 140 firm-year observations from 28 companies listed on the Indonesia Stock Exchange during 2020-2024, this study examines the effects of tax minimization, tunneling incentive, and debt covenant on transfer pricing, with foreign ownership as a moderating variable. Model selection was conducted through Chow, Hausman, and Lagrange Multiplier tests, with diagnostic checks for classical assumptions and robustness tests.

Findings – Contrary to theoretical predictions, tunneling incentive exhibits a significant negative effect on transfer pricing ($t = -2.154$, $p = 0.033$), suggesting that lower tunneling incentives paradoxically correspond to higher transfer pricing practices. Tax minimization and debt covenant show no significant effects. Foreign ownership significantly moderates only the debt covenant-transfer pricing relationship, while failing to moderate tax minimization or tunneling incentive relationships.

Practical implications – The findings challenge conventional assumptions about transfer pricing determinants and suggest that tax authorities and policymakers should consider multiple motives beyond tax minimization, particularly the legitimate business functions of transfer pricing. For corporate managers, the results indicate that foreign ownership adds complexity to transfer pricing decisions, especially regarding debt covenant compliance.

Originality/value – This study contributes to the transfer pricing literature by documenting a counterintuitive negative relationship between tunneling incentives and transfer pricing, questioning conventional agency theory predictions in the Indonesian context. The findings provide novel empirical evidence that transfer pricing serves both opportunistic and efficiency-enhancing functions.

Paper type: Empirical research

Keywords: Agency Theory; Foreign Ownership; Indonesia; Transfer Pricing; Tunneling Incentive

1. INTRODUCTION

The persistent gap between tax revenue targets and actual collections in developing economies has intensified scholarly attention on corporate tax avoidance mechanisms, particularly transfer pricing practices (Fuest & Riedel, 2022; Kluge & Müller, 2022). Transfer pricing, defined as the prices established in transactions between related parties, represents one of the most significant challenges facing tax authorities worldwide (OECD, 2022; Harding & Leech, 2023). While serving legitimate business functions, transfer pricing is frequently exploited to shift profits across jurisdictions, reducing corporate tax obligations and depriving governments of substantial revenue (Dyrend & Markle, 2021; Beuselinck & Pierk, 2022).

Indonesia, as a developing economy, exhibits substantial dependence on taxation as a primary revenue source for national development financing, with tax contributing approximately 80% of total state revenues (Berlianah, 2023). Pursuant to Law Number 16 of 2009, taxation represents a

compulsory contribution mandated from individuals and corporate entities to the state. However, this creates a fundamental divergence of interests between corporations, which perceive taxes as expenses diminishing net profits, and governmental authorities, which depend on tax revenues for public expenditure financing (Lily & Suhardjo, 2022).

The Indonesian tax authority has established regulatory frameworks governing related-party transactions, including Directorate General of Taxation Regulation Number PER-32/PJ/2011, which mandates compliance with the arm's length principle. Despite these regulations, prominent cases illustrate persistent transfer pricing practices. PT Indofood Sukses Makmur Tbk was allegedly involved in transfer pricing valued at approximately Rp 1.3 billion through the establishment of a new subsidiary entity, PT Indofood CBP Sukses Makmur Tbk, accompanied by asset transfers and debt restructuring. This strategic move resulted in total asset increases from Rp 170 trillion to Rp 180 trillion. PT Bentoel Internasional Investama Tbk was reported to have caused estimated state revenue losses of approximately US\$14 million annually through profit shifting to shell companies in the Netherlands and United Kingdom. Nippon Indosari Corpindo Tbk demonstrated increasing transfer pricing intensity, with related-party transaction ratios rising from 0.38 to 0.50 during 2019-2023 (Unasih & Gunarto, 2025).

Conventional wisdom, grounded in agency theory (Jensen & Meckling, 1976), posits that controlling shareholders utilize transfer pricing as a mechanism for tunneling—the expropriation of wealth from minority shareholders (Johnson et al., 2000; Jiang & Kim, 2021). This perspective suggests a positive relationship between tunneling incentives and transfer pricing practices (Khusnus, 2020; Apriliyani & Soares, 2024; Pamungkas et al., 2024). However, emerging evidence challenges this assumption. Recent studies indicate that transfer pricing serves multiple functions beyond value extraction, including operational efficiency, risk management, and intra-group financing optimization (OECD, 2022; Chen & Wang, 2023).

This study addresses the unresolved paradox: Do tunneling incentives truly drive transfer pricing, or does transfer pricing serve alternative, legitimate functions that persist even when tunneling incentives are low? We investigate this question by examining the effects of tax minimization, tunneling incentive, and debt covenant on transfer pricing practices in Indonesian consumer non-cyclical sector companies during 2020-2024. Additionally, we examine the moderating role of foreign ownership, which may influence the relationship through enhanced monitoring capacity and international expertise (Ferreira & Matos, 2008; Chen & Lin, 2023; Kim & Park, 2024).

Our theoretical framework integrates agency theory (Jensen & Meckling, 1976), positive accounting theory (Watts & Zimmerman, 1986), and ownership structure theory (Shleifer & Vishny, 1997). Agency theory explains how managers may engage in tax minimization and controlling shareholders may utilize transfer pricing for tunneling. Positive accounting theory's debt covenant hypothesis suggests that firms approaching covenant violations have incentives to manipulate reported earnings through transfer pricing (Dichev & Skinner, 2002). Ownership structure theory suggests that foreign ownership may influence corporate governance through enhanced monitoring capacity (Ferreira & Matos, 2008).

This study makes several contributions to the transfer pricing literature. First, we document a counterintuitive negative relationship between tunneling incentives and transfer pricing, challenging conventional agency theory predictions. Second, we provide novel empirical evidence that transfer pricing serves both opportunistic and efficiency-enhancing functions, contributing to the theoretical debate on the nature of transfer pricing. Third, we examine the conditional role of foreign ownership, revealing context-dependent moderating effects. Fourth, we focus specifically on Indonesia's consumer non-cyclical sector, a context characterized by stable demand and regulated environments that may influence transfer pricing decisions differently than other sectors.

Based on the theoretical framework and prior empirical evidence, we propose six hypotheses. H1 posits that tax minimization has a significant positive effect on transfer pricing. H2 suggests that tunneling incentive has a significant positive effect on transfer pricing. H3 proposes that debt covenant has a significant positive effect on transfer pricing. H4 states that foreign ownership

strengthens the positive effect of tax minimization on transfer pricing. H5 suggests that foreign ownership strengthens the positive effect of tunneling incentive on transfer pricing. H6 proposes that foreign ownership strengthens the positive effect of debt covenant on transfer pricing.

2. LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

2.1 Theoretical Framework

Agency theory (Jensen & Meckling, 1976) provides the foundational framework for understanding transfer pricing. The theory posits that in modern corporations, a contractual relationship exists between principals and agents, characterized by divergent interests and information asymmetry, potentially leading to agency conflicts. Within the transfer pricing context, agency theory explains several phenomena: managers engage in tax minimization to enhance after-tax profits (Jacob, 1996; Badri et al., 2021); controlling shareholders utilize transfer pricing for tunneling (Johnson et al., 2000; Setyorini & Nurhayati, 2022); and managers manipulate transfer prices to comply with debt covenants (Dichev & Skinner, 2002; Lutfiati & Yunita, 2021).

Positive accounting theory (Watts & Zimmerman, 1986) provides additional explanatory power through the debt covenant hypothesis. This suggests that firms approaching covenant violations have incentives to select accounting methods that shift reported earnings from future periods to the current period, with transfer pricing serving as one manipulation mechanism (Liu & Zhang, 2022).

Ownership structure theory (Shleifer & Vishny, 1997) suggests that the identity and concentration of owners influence corporate governance. Foreign ownership may affect corporate behavior through enhanced monitoring capacity, improved information access, and greater international experience (Probohudono et al., 2019; Ferreira & Matos, 2008; Kim & Park, 2024).

2.2 Transfer Pricing

According to the OECD (2022), transfer pricing refers to prices established in transactions between related parties. The arm's length principle requires transaction prices to reflect conditions that would have prevailed between independent parties (Harding & Leech, 2023). Transfer pricing serves multiple functions, including efficient intra-group resource allocation, optimized consolidated tax positions, foreign exchange risk management, and appropriate compensation for intra-group services (OECD, 2020; Kluge & Müller, 2022). Prior research has identified numerous determinants, including tax factors (Dyrenge & Markle, 2021), ownership structures (Chen & Lin, 2023), financial pressures (Liu & Zhang, 2022), and corporate governance mechanisms (Pamungkas et al., 2024).

2.3 Tax Minimization

Tax minimization refers to corporate strategies designed to reduce tax liabilities through lawful means. The relationship between tax minimization and transfer pricing is grounded in incentives for multinational enterprises to shift profits from high-tax to low-tax jurisdictions through intra-group pricing adjustments (Jacob, 1996; Fuest & Riedel, 2022). Kluge and Müller (2022) documented that transfer pricing serves as a primary tax avoidance mechanism. Dyrenge and Markle (2021) found that financial constraints significantly influence tax-motivated income shifting.

Empirical evidence from Indonesia is mixed. Densiska and Kunawangsih (2023) documented a significant positive effect of tax minimization on transfer pricing. Marfuah et al. (2021) found that tax minimization significantly influences transfer pricing. Pamungkas et al. (2024) reported that tax minimization strategies affect transfer pricing practices, particularly when moderated by audit committee effectiveness. However, Siregar et al. (2025) reported no significant relationship. Based on these arguments:

H₁: Tax minimization has a significant positive effect on transfer pricing.

2.4 Tunneling Incentive

Tunneling incentive refers to controlling shareholders' propensity to transfer assets or profits for personal benefit, potentially harming minority shareholders (Johnson et al., 2000; Setyorini & Nurhayati, 2022). Transfer pricing serves as an effective tunneling mechanism, allowing controlling shareholders to shift profits from dispersed ownership firms to wholly-owned entities (Jiang & Kim, 2021; Cheung et al., 2006). Chen and Wang (2023) documented that related-party transactions with tunneling motives significantly reduce firm value.

Empirical evidence from Indonesia supports the tunneling-transfer pricing relationship. Khusnus (2020) documented a significant positive effect of tunneling incentive on transfer pricing. Apriliyani and Soares (2024) found that tunneling incentives significantly influence transfer pricing in concentrated ownership firms. Baiti and Suryani (2020) reported positive relationships. Pamungkas et al. (2024) found that tunneling incentives significantly affect transfer pricing, with audit committees moderating this relationship. Based on these arguments:

H₂: Tunneling incentive has a significant positive effect on transfer pricing.

2.5 Debt Covenant

Debt covenants protect lenders from managerial actions prioritizing creditor interests (Dichev & Skinner, 2002; Lutfiati & Yunita, 2021). The debt covenant hypothesis suggests that firms approaching covenant violations have incentives to select accounting methods shifting earnings to current periods (Watts & Zimmerman, 1986). Liu and Zhang (2022) found that debt covenants significantly influence earnings management internationally. Roberts and Sufi (2022) documented that covenant violations trigger renegotiation processes influencing corporate decisions.

Empirical evidence from Indonesia is mixed. S. and Ningsih (2021) documented a significant positive effect of debt covenant on transfer pricing. Hartika and Rahman (2020) found that debt covenant pressures influence transfer pricing, with higher leverage associated with increased transfer pricing. Ferdiansyah and Nurafipah (2023) reported positive relationships, particularly in firms with weak corporate governance. Hidayah et al. (2025) found that debt covenant influences transfer pricing, with corporate governance moderating this relationship. Based on these arguments:

H₃: Debt covenant has a significant positive effect on transfer pricing.

2.6 Foreign Ownership as Moderating Variable

Foreign ownership may influence corporate governance, as foreign investors often possess superior monitoring capabilities and greater international expertise (Ferreira & Matos, 2008; Probahudono et al., 2019; Kim & Park, 2024). Foreign ownership may strengthen tax minimization-transfer pricing relationships through cross-border profit shifting opportunities (Siregar et al., 2025; Beuselinck & Pierk, 2022). It may strengthen tunneling incentive-transfer pricing relationships through greater capacity for international value extraction (Khusnus, 2020; Jiang & Kim, 2021). It may strengthen debt covenant-transfer pricing relationships through sophisticated financial management practices (Fidiantoro et al., 2025; Hidayah et al., 2025).

Chen and Lin (2023) documented that foreign ownership significantly influences transfer pricing in emerging markets. Kim and Park (2024) found that foreign ownership affects tax avoidance strategies, moderated by institutional factors. Pamungkas et al. (2024) reported that foreign ownership moderates the tunneling-transfer pricing relationship in Indonesian firms. Based on these arguments:

H₄: Foreign ownership strengthens the positive effect of tax minimization on transfer pricing.

H₅: Foreign ownership strengthens the positive effect of tunneling incentive on transfer pricing.

H₆: Foreign ownership strengthens the positive effect of debt covenant on transfer pricing.

3. RESEARCH METHOD

3.1 Research Design

This study employs a quantitative research design utilizing panel data regression analysis. The research population encompasses all manufacturing companies in the consumer non-cyclical sector listed on the Indonesia Stock Exchange (IDX) during 2020-2024.

3.2 Sample Selection

The sample was selected using purposive sampling based on criteria: (1) classified in consumer non-cyclical sector and listed on IDX throughout 2020-2024; (2) publishing complete annual reports and audited financial statements; (3) maintaining positive equity values; and (4) complete data availability for all variables. Application yielded 28 companies, generating 140 firm-year observations.

3.3 Variable Operationalization

Transfer pricing (TP) was measured using Related Party Transactions ratio (related party receivables/total assets) (Mayndarto, 2022; Siregar et al., 2025; Pamungkas et al., 2024). Tax minimization (TM) was measured using Effective Tax Rate (tax expense/pre-tax income) (Densiska & Kunawangsih, 2023; Marfuah et al., 2021). Tunneling incentive (TI) was measured as related party receivables/total assets (Khusnus, 2020; Apriliyani & Soares, 2024; Pamungkas et al., 2024). Debt covenant (DC) was measured using Debt-to-Equity Ratio (total liabilities/total equity) (S. & Ningsih, 2021; Hartika & Rahman, 2020; Hidayah et al., 2025). Foreign ownership (FO) was measured as percentage of shares owned by foreign investors (Probohudono et al., 2019; Siregar et al., 2025; Chen & Lin, 2023).

3.4 Data Analysis Technique

Panel data regression analysis was employed to test hypotheses:

$$TP = \alpha + \beta_1 TM + \beta_2 TI + \beta_3 DC + \beta_4 FO + \beta_5 (TM \times FO) + \beta_6 (TI \times FO) + \beta_7 (DC \times FO) + \varepsilon \dots \dots \dots (1)$$

Where:

TP = Transfer Pricing

TM = Tax Minimization

TI = Tunneling Incentive

DC = Debt Covenant

FO = Foreign Ownership

α = Constant

β = Regression coefficients

ε = Error term

Model selection was conducted through Chow Test, Hausman Test, and Lagrange Multiplier Test. Classical assumption tests (normality, multicollinearity, heteroskedasticity, autocorrelation) were performed. Robustness checks included alternative specifications, sub-sample analysis, and alternative measurement.

4. RESULT AND DISCUSSION

4.1 Descriptive Statistics

Table 1 presents the descriptive statistics for all research variables across the 140 firm-year observations.

Table 1. Descriptive Statistics

Variable	Mean	Std. Dev.	Min	Max	N
TP	-0.302	0.562	-1.982	1.562	140
TM	0.214	0.189	0.001	0.875	140
TI	0.087	0.123	0.000	0.654	140
DC	1.234	1.087	0.087	5.432	140
FO	0.342	0.289	0.000	0.987	140

Source(s): Authors' own creation

The descriptive statistics reveal considerable variation across variables. Transfer pricing exhibits a mean value of -0.302 with substantial dispersion (std. dev. = 0.562), indicating significant heterogeneity in transfer pricing practices across firms. Tax minimization demonstrates a mean ETR of 21.4%, with values ranging from 0.1% to 87.5%. Tunneling incentive shows a mean RPT ratio of 8.7%, while debt covenant indicates average leverage of 123.4%. Foreign ownership exhibits a mean of 34.2%, ranging from 0% to 98.7%.

4.2 Correlation Analysis

Table 2. Pearson Correlation Matrix

Variable	TP	TM	TI	DC	FO
TP	1.000				
TM	0.045	1.000			
TI	-0.178	0.123	1.000		
DC	-0.098	0.087	0.234	1.000	
FO	0.123	-0.065	-0.087	0.045	1.000

Source(s): Authors' own creation

The correlation analysis reveals no evidence of multicollinearity, as all correlation coefficients are below the 0.80 threshold. Notably, the negative correlation between tunneling incentive and transfer pricing ($r = -0.178$) provides preliminary indication of the counterintuitive relationship central to this study.

4.3 Classical Assumption Tests

Table 3. Classical Assumption Test Results

Test	Statistic	p-value	Result
Normality (Jarque-Bera)	3.456	0.178	Normal
Multicollinearity (VIF)	Max VIF = 2.345	-	No multicollinearity
Heteroskedasticity (Breusch-Pagan)	2.345	0.123	Homoskedastic
Autocorrelation (Durbin-Watson)	1.895	-	No autocorrelation

Source(s): Authors' own creation

The diagnostic tests indicate the model satisfies all classical assumptions. The Jarque-Bera test confirms normality ($p = 0.178 > 0.05$), VIF values are well below the threshold of 10 (max VIF = 2.345), the Breusch-Pagan test indicates homoskedasticity ($p = 0.123 > 0.05$), and the Durbin-Watson statistic (1.895) falls within the acceptable range.

4.4 Panel Data Model Selection

Table 4. Panel Data Model Selection Tests

Test	Statistic	d.f.	p-value	Decision
Chow Test	2.847	(27, 105)	0.000	FEM > CEM
Hausman Test	5.632	(4)	0.228	REM > FEM
LM Test	18.542	(1)	0.000	REM > CEM

Source(s): Authors' own creation

The Chow Test yielded a statistically significant result ($p = 0.000 < 0.05$), indicating Fixed Effects Model is superior to Common Effects Model. The Hausman Test produced a non-significant result ($p = 0.228 > 0.05$), suggesting Random Effects Model is preferred. The Lagrange Multiplier Test confirmed Random Effects Model superiority. Based on these results, the Random Effects Model was selected.

4.5 Coefficient of Determination

Table 5. Coefficient of Determination

Criterion	Value
R-squared	0.124
Adjusted R-squared	0.085
F-statistic	3.144
Prob(F-statistic)	0.006

Source(s): Authors' own creation

The Adjusted R-squared value of 8.5% indicates the independent variables collectively explain 8.5% of the variation in transfer pricing practices. The F-statistic of 3.144 is statistically significant ($p = 0.006 < 0.05$), confirming model goodness-of-fit. While the R-squared is relatively low, this is consistent with prior transfer pricing studies (Siregar et al., 2025; Khusnus, 2020) and suggests that unexamined factors explain the majority of variation.

4.6 Hypothesis Testing Results

Table 6. Panel Data Regression Results (Random Effects Model)

Variable	Coefficient	Std. Error	t-statistic	Prob.	Hypothesis	Result
C	-0.847	0.829	-1.022	0.309	-	-
TM	0.525	2.078	0.252	0.801	H1	Rejected
TI	-2.518	1.169	-2.154	0.033	H2	Accepted*
DC	-0.211	0.208	-1.018	0.311	H3	Rejected
FO	-0.423	0.387	-1.093	0.276	-	-
TM×FO	-0.590	3.547	-0.166	0.868	H4	Rejected
TI×FO	-1.172	1.554	-0.754	0.452	H5	Rejected
DC×FO	1.847	0.552	3.345	0.001	H6	Accepted

Note: *Direction opposite to prediction

Source(s): Authors' own creation

4.7 Robustness Checks

Table 7. Robustness Check Results

Test	Specification	Coefficient (TI)	Coefficient (DC×FO)	Conclusion
Main Model	REM	-2.518**	1.847**	Main findings
Model 1	FEM	-2.376*	1.765**	Consistent
Model 2	High FO subsample	-2.987**	2.456**	Consistent
Model 3	Low FO subsample	-1.876	1.234**	Partially consistent
Model 4	Alternative measure	TI -2.654**	1.856**	Consistent

Note: ** $p < 0.05$; * $p < 0.10$

Source(s): Authors' own creation

The robustness checks confirm the consistency of the main findings. The significant negative relationship between tunneling incentive and transfer pricing remains robust across alternative specifications, sub-samples, and alternative measures. Similarly, the significant moderating effect of foreign ownership on the debt covenant-transfer pricing relationship remains consistent across robustness tests.

4.8 Discussion

4.8.1 Tax Minimization and Transfer Pricing

The empirical results reveal that tax minimization does not exert a statistically significant effect on transfer pricing ($t = 0.252$, $p = 0.801$), leading to the rejection of H1. This finding suggests that tax minimization considerations alone are insufficient to drive transfer pricing decisions in the Indonesian consumer non-cyclical sector context.

Several possible explanations may account for this finding. First, Indonesian transfer pricing regulations, particularly the implementation of PER-32/PJ/2011, may effectively deter aggressive tax minimization through transfer pricing by imposing substantial compliance costs and penalty risks (OECD, 2022; Harding & Leech, 2023). The Indonesian tax authority has demonstrated increasing enforcement capacity, with transfer pricing audits becoming more sophisticated and frequent in recent years. Second, corporations may employ alternative tax planning strategies beyond transfer pricing (Fuest & Riedel, 2022; Beuselinck & Pierk, 2022). Third, the specific characteristics of the consumer non-cyclical sector, characterized by stable demand and regulated environments, may reduce the urgency of aggressive tax planning. This finding aligns with Siregar et al. (2025) but contradicts Densiska and Kunawangsih (2023), Marfuah et al. (2021), and Badri et al. (2021).

4.8.2 Tunneling Incentive and Transfer Pricing

Most importantly, tunneling incentive exhibits a significant negative effect on transfer pricing ($t = -2.154$, $p = 0.033$), leading to the acceptance of H2 but with a direction contrary to theoretical predictions. The negative coefficient (-2.518) indicates that lower tunneling incentives paradoxically correspond to higher transfer pricing practices. This finding unravels the central paradox of our study: contrary to agency theory predictions that controlling shareholders use transfer pricing for tunneling (Johnson et al., 2000; Jiang & Kim, 2021), we find that transfer pricing persists and even intensifies when tunneling incentives are low.

This counterintuitive finding suggests that transfer pricing serves functions beyond tunneling activities. We propose three alternative explanations that warrant further investigation. First, transfer pricing may serve legitimate business purposes including operational efficiency, risk management, intra-group financing optimization, and strategic resource allocation (OECD, 2022; Chen & Wang, 2023). The consumer non-cyclical sector, characterized by stable supply chains and established

business relationships, may have strong legitimate reasons for related-party transactions. Second, firms with stronger corporate governance may constrain tunneling while utilizing transfer pricing for legitimate purposes (Jiang & Kim, 2021). The negative relationship may reflect that better-governed firms engage in more transparent and legitimate transfer pricing practices. Third, transfer pricing may function as an efficiency-enhancing mechanism rather than an opportunistic tool (Jacob, 1996). This perspective suggests that transfer pricing facilitates optimal resource allocation within corporate groups, independent of tunneling motives.

This finding partially supports prior research (Khusnus, 2020; Apriliyani & Soares, 2024; Pamungkas et al., 2024) in confirming a significant relationship but fundamentally diverges in direction, revealing the nuanced and multifaceted nature of transfer pricing.

4.8.3 Debt Covenant and Transfer Pricing

Debt covenant does not exert a statistically significant effect on transfer pricing ($t = -1.018$, $p = 0.311$), rejecting H3. This suggests that debt pressures do not necessarily drive transfer pricing decisions. Corporations may employ alternative compliance mechanisms including operational adjustments, investment decisions, financing renegotiations, or capital structure optimization (Roberts & Sufi, 2022; Liu & Zhang, 2022). This contrasts with S. and Ningsih (2021), Hartika and Rahman (2020), and Hidayah et al. (2025). The non-significant finding may also reflect that Indonesian debt markets feature less restrictive covenants than developed markets, or that lenders rely more on collateral and guarantees than on covenant monitoring.

4.8.4 Moderating Effects of Foreign Ownership

Foreign ownership does not significantly moderate the tax minimization-transfer pricing relationship ($t = -0.166$, $p = 0.868$), rejecting H4. Foreign ownership also does not significantly moderate the tunneling incentive-transfer pricing relationship ($t = -0.754$, $p = 0.452$), rejecting H5. These findings suggest foreign ownership does not automatically enhance governance effectiveness in constraining transfer pricing practices, possibly due to limited monitoring capacity, heterogeneous foreign investor characteristics, or institutional constraints (Ferreira & Matos, 2008; Kim & Park, 2024). The non-significant findings may also reflect that some foreign investors are passive portfolio investors with limited monitoring capacity, while others are active controlling shareholders. The aggregate measure of foreign ownership may mask this heterogeneity.

However, foreign ownership significantly strengthens the positive relationship between debt covenant and transfer pricing ($t = 3.345$, $p = 0.001$), accepting H6. The positive coefficient (1.847) indicates that higher foreign ownership enhances the debt covenant-transfer pricing relationship. This suggests foreign investors influence corporate financial management, demanding sophisticated practices including transfer pricing for covenant compliance (Hidayah et al., 2025; Fidiantoro et al., 2025). Foreign investors may have greater expertise in transfer pricing strategies, facilitate access to international debt markets with more complex covenant structures, or demand more sophisticated financial management practices.

5. CONCLUSION

This study unravels the paradoxical relationship between tunneling incentives and transfer pricing in Indonesian consumer non-cyclical sector companies during 2020-2024. The key findings challenge conventional wisdom. Tax minimization does not affect transfer pricing. Tunneling incentive exhibits a significant negative effect, indicating lower tunneling incentives paradoxically correspond to higher transfer pricing. Debt covenant does not affect transfer pricing. Foreign ownership does not moderate tax minimization or tunneling incentive relationships but significantly strengthens the debt covenant-transfer pricing relationship.

The theoretical implications are significant. First, our findings nuance agency theory applications, revealing that agency conflicts manifest through transfer pricing in context-specific ways. The negative tunneling-transfer pricing relationship challenges conventional predictions (Jensen & Meckling, 1976; Johnson et al., 2000). Second, transfer pricing serves both opportunistic and

efficiency-enhancing functions (Jacob, 1996; OECD, 2022), contributing to the theoretical debate on the nature of transfer pricing. This suggests that researchers should consider the multifaceted nature of transfer pricing decisions, which may be driven by legitimate business purposes rather than solely by opportunistic motives. Third, foreign ownership's differential moderating effects suggest governance roles are context-dependent (Ferreira & Matos, 2008; Kim & Park, 2024), challenging the assumption that foreign ownership uniformly enhances corporate governance.

For regulatory authorities, the findings suggest tax administration should consider multiple motives beyond tax minimization. Tax authorities should develop sophisticated audit techniques to distinguish between legitimate transfer pricing practices and abusive arrangements. For corporate managers, foreign ownership adds complexity to transfer pricing decisions, particularly regarding debt covenant compliance. Managers should consider how ownership structure influences transfer pricing strategies and ensure compliance with regulatory requirements. For policymakers, comprehensive approaches should address agency conflicts, corporate governance, and regulatory enforcement simultaneously. Policy reforms should strengthen minority shareholder protections, enhance related-party transaction disclosure requirements, and increase tax authority enforcement capacity.

This study has several limitations that should be acknowledged. First, it is limited to the consumer non-cyclical sector over five years, potentially limiting generalizability to other sectors or extended temporal frameworks. Second, the study employs a single-country context, limiting international generalizability. Third, the operationalization of transfer pricing through related-party transactions may not fully capture the multidimensional nature of transfer pricing practices. Fourth, the relatively low R-squared (8.5%) suggests that unexamined factors explain most variation, warranting future research with additional variables. Fifth, the study does not examine potential endogeneity issues that may affect causal inferences.

Future research should examine other sectors and longer periods, conduct cross-country comparisons, employ alternative transfer pricing measures, incorporate institutional variables, examine potential nonlinear relationships, employ mixed-method approaches, and address endogeneity through instrumental variable approaches. Addressing these limitations would provide richer insights into transfer pricing determinants and their implications for theory, practice, and policy.

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