

# THE IMPACT OF TUNNELING INCENTIVE BONUS MECHANISM AND DEBT COVENANT ON TRANSFER PRICING

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## ABSTRACT

### Keywords:

Tunneling Incentive,  
Bonus Mechanism,  
Debt Covenants,  
Transfer Pricing

*Transfer pricing decisions are influenced by several factors, one of which is tunneling incentives. This study aims to determine the influence of Tunneling Incentives, Bonus Mechanisms, and Debt Covenants on Transfer Pricing. This study analyzes manufacturing companies listed on the Indonesia Stock Exchange. In this study, the input data comes from the company's annual report which is a research sample starting from 2018-2021 with criteria so that a total sample of 15 companies is obtained. Furthermore, the input data will be processed according to quantitative methods. The data analysis technique uses descriptive statistics, classical assumption tests, multiple linear regression tests and hypothesis testing. The results of this study show that the following variables: (1) Tunneling Incentive have a negative and significant influence on Transfer Pricing; (2) The Bonus Mechanism has a negative and significant effect on Transfer Pricing; (3) The Debt Covenant has a positive and significant effect on Transfer Pricing. Based on the results of the analysis and discussion, it can be concluded that the Tunneling Incentive has a negative and significant influence on Transfer Pricing, which means that the higher the tunneling incentive, the lower the transfer pricing carried out by the company.*

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## INTRODUCTION

Transfer pricing decisions are influenced by several factors, one of which is tunneling incentives. Tunneling incentive is a behavior of majority shareholders who transfer company assets and profits for their own benefit, but the costs are borne by minority shareholders (Rinaldo & Putri, 2023). Apart from tunneling incentive reasons, transfer pricing can also be influenced by bonus mechanisms. The bonus mechanism is a gift given by the GMS to managers if the company makes a profit. This bonus giving system will influence managers regarding earnings management (Nuradila & Wibowo, 2018b). Research conducted by (T Refgia, 2017) states that taxes, foreign ownership and tunneling incentives have an effect on transfer pricing, while bonus mechanisms and company size have no effect. Furthermore, research conducted by (Hartati, 2015) stated that the bonus mechanism influences the decision to carry out transfer pricing.

Transfer pricing decisions can also be influenced by debt covenants, which are contracts shown to debtors to limit activities that could damage the loan value and loan recovery (Verawaty, 2022). In accordance with the debt covenant hypothesis, companies with high debt ratios tend to implement accounting policies that result in high company profits. Research on debt covenants has been conducted by (Rosa et al., 2017) and (Nuradila & Wibowo, 2018b) who found that debt covenants have an effect on transfer pricing. Meanwhile, research (Indrasti & Wahyu, 2016) shows that debt covenants have no influence on transfer pricing.

The practice of transfer pricing is very detrimental and has an impact on state revenue receipts. Due to this, the transfer pricing phenomenon must be taken more seriously by creating effective and binding regulations for companies, especially multinational companies, regarding transfer pricing. In accordance with the problems presented, it shows that there is a phenomenon, controversy over the results and recommendations from research, the problem in this research is what is the influence of tunneling incentives, bonus mechanisms and debt covenants on transfer pricing in Manufacturing Companies Listed on the IDX in 2018 – 2021.

**METHOD**

This type of research is quantitative. In this research, the researcher wants to identify the extent of influence of variable.

*Table 1: Operational Definition of Variables*

No	Variable	Definition	Indicator	Scale
1.	Transfer Pricing (Y)	Transfer Pricing is the price of transferring the selling price of goods, services and intangible assets to subsidiaries or companies that have special relationships located in different countries (T Refgia, 2017)	$\text{RPT} = \frac{\text{Total Receivables from Special Parties}}{\text{Total Receivables}} \times 100\%$ <p>(T Refgia, 2017)</p>	Ratio
2.	Tunneling Incentive (X <sub>1</sub> )	Tunneling Incentive is a behavior of majority shareholders who transfer company assets and profits for their own benefit, but the costs are borne by minority shareholders	$\text{Tunneling Incentive} = \frac{\text{largest number of shareholdings}}{\text{Number of shares outstanding}} \times 100\%$	Ratio
3.	Bonus Mechanism (X <sub>2</sub> )	The bonus mechanism is a reward given to managers by the company owner if the manager meets the company's performance targets (Saraswati & Sujana, 2017)	$\text{ITRENDLB} = \frac{\text{Net Profit Year } t}{\text{Net Profit Year } t - 1} \times 100\%$ <p>(Saraswati &amp; Sujana, 2017)</p>	Ratio
4.	Debt Covenant (X <sub>3</sub> )	Debt covenants are contracts aimed at borrowers by creditors to limit activities that might damage the loan value and loan recovery	$\text{DER} = \frac{\text{Total Amount of liabilities}}{\text{Equity}} \times 100\%$ <p>(AH Pramana, 2017)</p>	Rasio

Secondary data sources in this research are used to support information whose data is taken from the financial reports of manufacturing companies listed on the IDX for 2018-2021. Secondary data was obtained from the official website of the Indonesian Stock Exchange, namely [www.idx.co.id](http://www.idx.co.id). In this research, the population is manufacturing companies listed on the Indonesia Stock Exchange for the 2018-2021 period, totaling 198 companies.

Researchers took research samples using a non-probability sampling method with a purposive sampling technique with the following criteria:

- 1) Manufacturing companies registered on the IDX in 2018 – 2021.
- 2) Manufacturing companies that publish annual financial reports consistently from 2018 – 2021.
- 3) The sample company is controlled by a foreign company with an ownership percentage of 20% or more.
- 4) The company presents its financial reports in rupiah currency, for foreign companies it has been converted into the rupiah exchange rate.

Table 2: Sample Determination Criteria

No	Keterangan	Jumlah
1	Manufacturing companies listed on the IDX in 2018 – 2021	198
2	Manufacturing companies that publish annual financial reports consistently from 2018 – 2021	(71)
3	The sample companies are controlled by foreign companies with an ownership percentage of 20% or more.	(75)
4	The company presents its financial reports in rupiah currency, for foreign companies it has been converted into the rupiah exchange rate.	(37)
Final Sample Size		15
Year of Observation		4
Number of Observations (15 companies x 4 years)		60

Source: Processed Data, 2024

## RESULTS AND DISCUSSION

Table 3 : Multiple Linear Regression Test Results

Coefficients <sup>a</sup>		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
Model		B	Std. Error	Beta		
1	(Constant)	0.192	0.013		14.272	0.000
	Tunneling Incentive	-0.134	0.018	-0.623	-7.497	0.000
	Bonus Mechanism	-0.023	0.005	-0.394	-4.809	0.023
	Debt Covenant	0.033	0.006	0.487	5.894	0.000

a. Dependent Variable: Transfer Pricing

Table 3 above explains the partial influence of Tunneling Incentive (X1), Bonus Mechanism (X2), and Debt Covenant (X3) on Transfer Pricing (Y) as follows:

### 1. Tunneling Incentive (X1)

From table 3 it can be explained that the Ttest between Tunneling Incentive (X1) and Transfer Pricing (Y) obtained a tcount of  $-7.497 < t_{table} 1.671$  with a significance figure of 0.000 less than the  $\alpha$  value of 0.05 ( $0.000 < 0.05$ ). So this value shows that the Tunneling Incentive variable has a significant (negative) influence on Transfer Pricing. So it is concluded that H1 is rejected and H0 is accepted.

### 2. Bonus Mechanism (X2)

From table 3 it can be explained that the Ttest between Bonus Mechanism (X2) and Transfer Pricing (Y) obtained a t count of  $-4.809 < t_{table} 1.671$  with a significance figure of 0.023 less than the  $\alpha$  value of 0.05 ( $0.023 < 0.05$ ). So this value shows that the Bonus Mechanism variable has a significant (negative) effect on Transfer Pricing. So it is concluded that H2 is rejected and H0 is accepted.

### 3. Debt Covenant (X3)

From table 3 it can be explained that the Ttest between Debt Covenant (X3) and Transfer Pricing (Y) obtained tcount of  $5.894 > t_{table} 1.671$  with a significance figure of 0.023 less than the  $\alpha$  value of 0.000 ( $0.000 < 0.05$ ). So this value shows that the Debt Covenant variable has a significant (positive) effect on Transfer Pricing. So it is concluded that H3 is accepted and H0 is rejected.

*Tabel 4 : F Test Results  
ANOVA<sup>a</sup>*

		F				
Model		Sum of Squares	df	Mean Square		Sig.
1	Regression	.083	3	.028	2.354	.082 <sup>b</sup>
	Residual	.048	56	.001		
	Total	.131	59			

a. Dependent Variable: Transfer Pricing

b. Predictors: (Constant), Debt Covenant, Bonus Mechanism, Tunneling Incentive

Based on table 4 of the F-Test above, the calculated F result is 2.354 while the F table is 2.77. This calculation shows that Fcount is smaller than Ftable and the significance value is  $0.082 > 0.05$ , so the decision is that  $H_0$  is accepted and  $H_a$  is rejected. This proves that the independent variables (Tunneling Incentive, Bonus Mechanism, and Debt Covenant) together have no effect on the dependent variable (Transfer Pricing).

*Tabel 5: Coefficient of Determination Test Results*

<b>Model Summary<sup>b</sup></b>				
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	0.795 <sup>a</sup>	0.633	0.613	0.02931

a. Predictors: (Constant), Bonus Mechanism, Debt Covenant, Tunneling Incentive

b. Dependent Variable: Transfer Pricing

In table 5, the results of the correlation analysis of Tunneling Incentive, Bonus Mechanism, and Debt Covenant on Transfer Pricing have an Adjusted R Square value of 0.613 or 61.30%. This shows that Tunneling Incentive, Bonus Mechanism, and Debt Covenant is 61.30%, while the remaining 38.70% is explained by other variables outside the regression model of this research.

### **The Effect of Tunneling Incentives on Transfer Pricing**

Tunneling incentive is a behavior of majority shareholders who transfer company assets and profits for their own benefit, but minority shareholders share in the costs they impose. The behavior of management or majority shareholders by transferring company assets and profits for personal interests, but the burden is passed on to minority shareholders, which is usually referred to as tunneling.

The results of the hypothesis test for the tunneling incentive variable obtained a t-statistic value of -7.497 with a significance level of 0.000. The significance level is smaller than 0.05 ( $0.000 < 0.05$ ), so the first hypothesis ( $H_1$ ) is rejected. This means that tunneling incentives have a significant effect on transfer pricing but the effect is negative. Tunneling incentives have a negative effect on transfer pricing practices. This shows that the larger the shares owned by shareholders, the less likely it is to carry out transfer pricing. This explains that foreign shareholders do not use their control to order management to carry out transfer pricing or it can also be interpreted that whether there are foreign shareholders or not, the company will still carry out transfer pricing (Junaidi & Zs, 2020). Related party transactions are more commonly used for asset transfer purposes than dividend payments, as listed companies are required to pay dividends to parent companies and other minority shareholders (Rosa et al., 2017).

This was done in the company's efforts to stabilize company profits with transfer pricing without causing conflict within the company. Where this conflict will later have an impact on the company's operational activities and investments. Another reason for the small possibility of transfer pricing practices occurring is also due to the implementation of good and strict regulations from the government and law enforcement regarding the transparency of company financial report information, thereby making minority shareholders more protected from transfer pricing practices.

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The results of this research are in accordance with the results obtained in previous research by (Rosa

et al., 2017) that tunneling incentives have a negative effect on transfer pricing practices. However, these results are not in accordance with research conducted by (Marfuah & Azizah, 2014; Saraswati & Sujana, 2017; Yuniasih et al., 2012) as well as research conducted by Nuradila and Wibowo (2018) where the results of the research show that Tunneling Incentive has an effect on Transfer Pricing (Nuradila & Wibowo, 2018c).

### **The Effect of Bonus Mechanism on Transfer Pricing**

The bonus mechanism is additional compensation or rewards given to employees for successfully achieving the goals targeted by the company. The profit-based bonus mechanism is the method most often used by companies to give awards to directors or managers. Hypothesis testing of the bonus mechanism variable obtained a t-statistic value of -4.809 with a significance level of 0.023. The significance level is smaller than 0.05 ( $0.023 < 0.05$ ), so the second hypothesis (H2) is rejected. This means that the bonus mechanism has a significant effect on transfer pricing but the effect is negative.

This research shows that the bonus mechanism variable has an effect on transfer pricing, but the effect is negative. This is because increasing the bonus mechanism will reduce the implementation of Transfer Pricing because the bonus mechanism is a company burden for incentives to business managers which can reduce business profits so that the implementation of Transfer Pricing is no longer needed. Because based on the level of profit, directors or managers can manipulate these profits to maximize bonus receipts.

Apart from that, the decision to carry out transfer pricing is not based on the size of the company's profits, of course the company directors have created a strategy with new innovations so that the bonuses obtained can be maximized so that the possibility of the directors committing fraudulent transfer pricing practices is smaller. This is because the company owner will see the performance carried out by the directors in managing the company, as a consideration for giving bonuses. Usually company owners will assess the performance of directors by looking at overall profits.

As stated by Purwanti (2010), Tantiem / bonus is an award given by the GMS to members of the Board of Directors every year if the company makes a profit (Purwanti et al., 2010). This bonus compensation system can enable actors, especially managers in companies, to manipulate the company's financial reports in order to obtain maximum bonus mechanisms. Purwanto & Tumewu (2018), found that there is a tendency for management to utilize Transfer Pricing transactions to maximize the bonuses they receive if the bonuses are based on profits (Purwanto & Tumewu, 2018). So it can be concluded that managers will tend to take actions that regulate net profit by implementing transfer pricing practices in order to maximize the bonuses they receive.

This means that the higher the bonus mechanism implemented, it will actually cause a decrease in the company's ability to carry out transfer pricing. This situation is because the bonus mechanism is one of the strategies or calculation motifs in accounting whose aim is to reward directors or management by looking at profits in detail. whole. The higher the company's overall profit achieved, the higher the appreciation given by the owners to the directors. The results of this research support the positive accounting theory which explains that managers of companies with bonus plans tend to choose accounting procedures with changes in reported profits from the future period to the current period. Managers want high rewards in every period. If their reward depends on the bonus being reported on net income, then it is likely that they can increase their bonus in that period by reporting the highest possible net income.

The results of this research are parallel to research conducted by Andika Dwi Hertanto, Amor Marundha, Idel Eprianto, Cris Kuntadi (2023), with the results of their research showing that the bonus mechanism has a negative and significant effect on transfer pricing (Hertanto et al., 2023). However, this is different from research conducted by Saraswati and Sujana (2017) and Rosa, et al (2017) which shows that there is a positive but not significant relationship between the bonus mechanism provided by a company and transfer pricing (Rosa et al., 2017; Saraswati & Sujana, 2017).

### **The Effect of Debt Covenant on Transfer Pricing**

Debt covenants are contracts shown to borrowers by creditors to limit activities that might damage the loan value and loan recovery. Meanwhile, in the journal Sari and Mubarok (2018) a debt covenant is an agreement that aims to protect lenders from managers' actions against the interests of creditors (Sari & Mubarok, 2018). Examples include additional loans, excessive dividend distribution or allowing equity to fall below a predetermined level. In the debt covenant hypothesis, managers tend to choose accounting procedures that can increase profits to reduce debt contract costs when a company breaks its debt agreement or the closer a company is to violating a debt agreement. One way that companies can increase profits and avoid credit regulations is by transfer pricing.

In this research, the results of hypothesis testing for the debt covenant variable obtained a t-statistic

value of 5.894 with a significance level of 0.000. The significance level is smaller than 0.000 ( $0.000 < 0.05$ ), so the third hypothesis (H3) is accepted. This means that debt covenants have a positive and significant effect on transfer pricing. In this research, debt covenant identification uses a proxy for leverage level. Leverage is used to provide an overview of the company's capital structure, so that the risk of uncollectible debt can be seen. The higher the company's debt ratio, the greater the possibility of deviations from credit agreements and expenses, so one of the methods used by managers is to choose an accounting method that can increase profits so that they can relax credit limits and reduce the costs of technical errors and avoid credit regulations is by transfer pricing.

The results of this research are in line with research conducted by Nuradila and Wibowo (2018) where the research results show that debt covenants have an effect on transfer pricing (Nuradila & Wibowo, 2018a). However, the results of this research contradict research conducted by Anita Wahyu Indrasti (2016), Amanah, et al (2020) and Ginting (2016) where the research results stated that debt covenants had no effect on transfer pricing (Amanah, 2020; Indrasti, 2016).

## CONCLUSION

Based on the results of the analysis and discussion, the following conclusions can be drawn: First, Tunneling Incentive has a negative and significant effect on Transfer Pricing, indicating that higher Tunneling Incentive results in lower transfer pricing by the company. Second, the Bonus Mechanism also has a negative and significant effect on Transfer Pricing, meaning that an increased use of the bonus mechanism leads to reduced transfer pricing activities within the company. Lastly, Debt Covenant has a positive and significant effect on Transfer Pricing, suggesting that a higher debt covenant correlates with increased transfer pricing conducted by the company.

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