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BOARD CHARACTERISTICS, INCOME TAX RATE, DEBT COVENANT, AND TRANSFER PRICING: HOW IS FOREIGN OWNERSHIP INVOLVED?

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Abstract

Transfer pricing as a related-party transaction remains a significant concern due to its potential conflict with tax regulations. This study aims to examine the effects of board characteristics, income tax rate, and debt covenants on transfer pricing, with foreign ownership as a moderating variable, while controlling for company size and firm age. The novelty of this study lies in explicitly incorporating foreign ownership as an internal governance mechanism that moderates the interaction between governance, taxation, and financial pressure in shaping transfer pricing behavior. This area remains underexplored in prior empirical studies in Indonesia, thus contributing to the transfer pricing literature by emphasizing the role of foreign ownership as a governance mechanism influencing transfer pricing decisions. This study adopts a quantitative methodology by examining secondary data from 844 non-financial companies listed on the Indonesia Stock Exchange over 2020–2024 (4.220 unit observations). The analysis utilizes panel data regression and moderated regression analysis (MRA). The results indicate that income tax rate and debt covenants have a significant positive effect on transfer pricing, whereas board characteristics show no significant influence. Foreign ownership weakens the effect of debt covenants on transfer pricing but does not moderate other relationships. The findings offer practical insights for policymakers, tax authorities, and multinational firms in strengthening risk-based oversight and governance to manage transfer pricing risks.

Keywords: *Board Characteristics, Debt Covenant, Foreign Ownership, Income Tax Rate, Pricing Practice, Transfer*

1. Introduction

The rapid expansion of cross-border transactions has accelerated economic globalization and increased the activities of multinational enterprises, creating new challenges in taxation, financial reporting, and international regulation (Grediani & Jati,

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2025; Hidayah et al., 2025; Maryanti & Agus Munandar, 2024). As business operations increasingly involve affiliated entities across different tax jurisdictions, transfer pricing has become a major concern in both academic and policy discussions (Duho et al., 2024; Thinh & An, 2023). Transfer pricing refers to pricing arrangements for transactions between related parties. It is legally permitted provided that they comply with the arm's length principle as stipulated in the Regulation of the Minister of Finance of the Republic of Indonesia Number 22/PMK.03/2020. However, information asymmetry and differences in tax rates across jurisdictions provide opportunities for firms to manipulate transfer prices to shift profits and reduce tax liabilities, thereby increasing fiscal risks (Almutairi et al., 2023; Solikhah et al., 2025).

The growing concern over transfer pricing is reflected in global and national evidence. The OECD Statistics recorded 34 Mutual Agreement Procedure (MAP) transfer pricing cases involving Indonesia, an increase from 29 cases in 2022 (OECD, 2023). Moreover, the OECD estimates that Base Erosion and Profit Shifting (BEPS) results in global tax revenue losses of USD 200–240 billion annually. In contrast, the State of Tax Justice (2024) estimates Indonesia loses approximately USD 2.8 billion each year due to corporate tax abuse and profit shifting (Tax Justice Network, 2024). Although the Indonesian government has strengthened transfer pricing regulations through PMK No. 172 of 2023, firms continue to exploit regulatory gaps to minimize tax obligations (Grediani & Jati, 2025). Empirical evidence from Indonesia further illustrates these risks. High-profile cases involving Asian Agri and Toyota Manufacturing Indonesia indicate potential tax revenue losses exceeding Rp1 trillion due to cross-border profit shifting(Pratama, 2020). The magnitude of the loss reflects the high risk of transfer pricing practices in Indonesia, especially in multinational companies with complex ownership structures and business networks. These findings demonstrate that transfer pricing remains a significant issue and highlight the need to identify the factors influencing corporate transfer pricing practices.

Previous studies have examined various determinants of transfer pricing. This study linked transfer pricing to corporate governance mechanisms, taxation, and corporate financial conditions, and tested them simultaneously. Under the political cost hypothesis, board characteristics, including board size and board independence, are expected to enhance monitoring effectiveness and reduce transfer pricing practices. However, previous findings remain inconclusive. Studies have reported positive, negative, and insignificant effects of board size (Duho et al., 2024; Nekhili & Cherif, 2011; Pratama, 2020; Wahab et al., 2011), while evidence on board independence is also inconsistent, with most studies reporting a negative relationship and others finding the opposite (Duho et al., 2024; Santosa et al., 2021; Pratama, 2020; Nekhili & Cherif, 2011; Wahab et al., 2011; ElKelish, 2017).

From a taxation perspective, the income tax rate, proxied by the effective tax rate (ETR), provides an incentive for firms to shift profits to lower tax jurisdictions under the political cost hypothesis. Studies have reported negative, positive, and insignificant effects of the income tax rate on transfer pricing (Ismi Raihan Nadhira & Ardan Gani Asalam, 2024; Merle et al., 2019; Thinh & An, 2023; Devi & Suryarini, 2020; Yulia et al., 2019; Arifin et al., 2020). Meanwhile, from a financial perspective, debt covenants may encourage managers to engage in transfer pricing to maintain financial performance and avoid debt covenant violations, as explained by the debt covenant hypothesis. Hidayah et al. (2025), Sari et al. (2022), Solikhah et al. (2021), dan Supriyati et al. (2021) state that debt covenants have a positive effect on transfer pricing. However, other studies have found a negative association (Priyanti & Suryarini, 2021).

Research simultaneously examining governance, taxation, and financial factors with foreign ownership as a moderating variable remains limited. Foreign ownership may strengthen or weaken these relationships because foreign shareholders generally have greater influence over strategic decisions and promote higher governance standards. Although previous studies have established a significant relationship between foreign ownership and transfer pricing (Pratama, 2020; Pujiningsih & Salsabyla, 2022; Santosa et al., 2021; Solikhah et al., 2021; Supriyati et al., 2021; Widiastutik et al., 2024), its moderating role has received limited attention. Accordingly, the novelty of this study lies in incorporating foreign ownership as a moderating variable to explain the interaction between corporate governance, taxation, financial conditions, and transfer pricing. Based on the empirical phenomenon and inconsistent findings in previous studies, this study addresses the research gap by examining the effects of board characteristics, income tax rates, and debt covenants on transfer pricing, as well as the moderating role of foreign ownership in non-financial companies listed on the Indonesia Stock Exchange during 2020–2024. This study is expected to contribute theoretically by clarifying inconsistent findings and practically by providing insights for regulators and companies in developing more effective governance and taxation policies to mitigate transfer pricing practices.

2. Literature Review

2.1 Board Characteristics (Board of Directors) and Transfer Pricing

Based on the political cost hypothesis, companies with high political exposure tend to modify financial reporting policies or accounting practices to avoid public attention and regulatory demands (Duho et al., 2024; Watts & Zimmerman, 1990). In this context, the company must bear monitoring costs, such as hiring auditors, appointing a board of directors, and providing an efficient information system so that the board can effectively assess and supervise managers' actions and behaviors (Duho et al., 2024). Board characteristics, such as board size and board independence, are crucial components in a company's internal oversight system, which helps reduce managerial behaviors, including transfer pricing.

Board size can affect managerial opportunistic actions, depending on the addition of board members, as well as their experience, qualifications, and innovative viewpoints, which can strengthen the company's operations. Regarding transfer pricing, research by Pratama (2020) indicates that board size hurts transfer pricing practices. A larger board size can increase the effectiveness of a company's supervisory system, as a larger board has a greater ability to monitor managers' activities, thereby minimizing transfer pricing practices. In addition, there is an argument that the level of board independence tends to suppress transfer pricing practices (Duho et al., 2024; Nekhili & Cherif, 2011; Pratama, 2020; Wahab et al., 2011). This phenomenon arises because non-executive directors tend to

act independently, thereby limiting the potential for manipulative actions by management. Based on the above analysis, the researcher further formulated the following hypothesis:
H1a: Board size is negatively associated with transfer pricing practices.
H1b: Board independence is negatively associated with transfer pricing practices.

2.2 Income Tax Rate and Transfer Pricing

Referring to the political cost hypothesis, the amount of tax rates imposed in a country is closely tied to government regulations, including rules that require multinational companies to fulfill their tax obligations (Indriaswari & Nita, 2018; Watts & Zimmerman, 1990). This policy will create pressure from the government on companies to pay taxes on an ongoing basis. On the other hand, the higher the company's ability to generate profits, the higher the tax burden it must bear (Yulia et al., 2019). Thus, when a country's income tax rate increases, managers are encouraged to practice transfer pricing by reallocating income from affiliates in high-tax countries to related entities in low-tax jurisdictions (Merle et al., 2019). As a result, the profits of companies in countries with high tax rates will decrease, while the profits of companies in countries with low tax rates will increase (Barker & Brickman, 2017).

Taxes are seen as a form of political cost, so when the ETR increases, companies have a stronger incentive to move profits through transactions between entities within the business group. Thus, the income tax rate proxied by ETR can positively affect transfer pricing decisions. An increase in the ETR is associated with a stronger inclination for firms to adopt transfer pricing strategies as a means of reducing political costs arising from elevated tax obligations. Previous research also supports that high tax pressures encourage companies to be more aggressive in shifting profits through transfer pricing (Devi & Suryarini, 2020; Indriaswari & Nita, 2018; Yulia et al., 2019). Based on the above analysis, the researcher further formulated the following hypothesis:
H2: Income tax rate is positively associated with transfer pricing practices.

2.3 Debt Covenant and Transfer Pricing

Debt covenants are contractual agreements set by lenders that place limitations on borrowers’ activities to protect the value of the credit extended (Hidayah et al., 2025). In relation to this statement, Watts & Zimmerman (1990) stated that the larger the company's loans, the greater the tendency for the company to show good performance, thereby gaining creditors' confidence in the company's ability to repay debts. The debt covenant hypothesis of positive accounting theory suggests that highly leveraged firms are less likely to apply accounting conservatism in their financial reporting (Watts & Zimmerman, 1990).

The debt covenant hypothesis also suggests that a company's high level of debt can put pressure on management to ensure that the company does not violate the terms of the debt agreement made with creditors (Watts & Zimmerman, 1990). Through transfer pricing, managers can shift profits from one entity to another with high debt levels, thereby making their financial position appear stronger. Companies with relatively high debt levels tend to operate closer to the limits specified in debt agreements, which creates additional pressure for managers to keep certain financial indicators from violating the debt agreement (Hidayah et al., 2025). Research conducted by Hidayah et al. (2025), Solikhah et al. (2021), and Supriyati et al. (2021) also found a significant association between debt covenants and transfer pricing practices. Based on the above analysis, the researcher further formulated the following hypothesis:

H3: Debt covenant is positively associated with transfer pricing practices.

2.4 Board Characteristics, Foreign Ownership, and Transfer Pricing Practices

The practice of transfer pricing through related-party transactions is one of the tax avoidance strategies commonly employed by multinational companies to shift profits to other entities within the same group in jurisdictions with lower tax rates (Solikhah et al., 2025). The political cost hypothesis explains that companies with high political exposure tend to be cautious in their financial reporting policies to avoid public attention or regulatory pressure (Duho et al., 2024; Watts & Zimmerman, 1990). In this context, board characteristics such as board size and board independence serve as a corporate governance mechanism that oversees the behavior of managers, ensuring they do not act opportunistically for the benefit of individuals or affiliated entities, including the avoidance of detrimental transfer pricing practices (Duho et al., 2024; Jensen & Meckling, 1976). The influence of this board characteristic can be affected by the company's foreign ownership.

Referring to agency theory, foreign shareholders tend to attach importance to transparency, compliance, and stricter management supervision; as a result, foreign ownership can minimize opportunistic behavior from managers, including transfer pricing practices used for tax avoidance (Widiastutik et al., 2024). A higher level of foreign ownership strengthens the influence exerted on management to limit tax avoidance behavior (Maisaroh & Setiawan, 2021). Under these conditions, the role of board supervision and board independence becomes more effective, because foreign shareholders closely supervise managerial decisions related to transfer pricing. Therefore, the researcher further formulated the following hypotheses:

H4a: Foreign ownership strengthens the negative relationship between board size and transfer pricing.

H4b: Foreign ownership strengthens the negative relationship between board independence and transfer pricing.

2.5 Income Tax Rate, Foreign Ownership, and Transfer Pricing Practices

The income tax rate, proxied by ETR, will encourage companies to use transfer pricing as a tax avoidance strategy, as they strive to minimize the tax burden borne in high-tariff countries (Barker & Brickman, 2017; Indriaswari & Nita, 2018; Merle et al., 2019). The increase in ETR will provide incentives for management to engage in profit shifting within the business group (Thinh & An, 2023; Yulia et al., 2019). However, the relationship can be affected by the company's ownership structure. According to agency theory, tax avoidance decisions can give rise to agency problems driven by conflicting objectives between foreign owners and managers, with foreign shareholders typically resisting tax avoidance strategies such as transfer pricing.

Furthermore, Chen et al. (2020) and Solikhah et al. (2025) emphasized that related party transactions act as a channel that connects tax avoidance motives through the transfer pricing mechanism. Management tends to obscure tax avoidance activities by presenting financial reports that lack transparency (Pujiningsih & Salsabyla, 2022). Foreign shareholders will encourage companies to be tax-compliant and recognize that paying taxes is a corporate obligation to fulfill its civic responsibilities. Thus, although a high income tax rate (ETR) encourages profit shifting, the influence will be weaker in companies with high levels of foreign ownership. Based on the above description, the researcher further formulated the following hypothesis:

H5: Foreign ownership moderates the relationship between income tax rate (proxied by ETR) and transfer pricing, such that it weakens the positive effect of income tax rate on transfer pricing practices.

2.6 Debt Covenant, Foreign Ownership, and Transfer Pricing Practices

The debt covenant hypothesis posits that pressure from the debt agreement will encourage managers to maintain a specific financial ratio to avoid violating the terms established with creditors. When a company approaches the limit of a debt covenant violation, managers have an incentive to opt for an income-increasing accounting policy, such as adjusting the transfer price between related entities (Hidayah et al., 2025; Solikhah et al., 2021). However, supervisory mechanisms, such as foreign ownership, can limit managers' tendency to engage in transfer pricing. Foreign shareholders strongly consider the impact of tax avoidance, including the company's reputation, consulting costs, and the potential for legal sanctions that can hinder its operations (Maisaroh & Setiawan, 2021).

Referring to the findings of Widiastutik et al. (2024), foreign ownership prioritizes the company's long-term value over the short-term benefits of transfer pricing. In the context of a debt covenant, company managers approaching the limit of their debt terms are usually encouraged to implement transfer pricing as a strategy to increase the profit reported to creditors, thereby maintaining safe financial ratios. Foreign ownership functions as a corporate governance mechanism that weakens the influence of debt covenants on transfer pricing. Therefore, although debt covenants encourage managers to carry out transfer pricing, the positive effect of DER on transfer pricing is expected to be weaker in companies with high foreign ownership, as foreign investors act as additional controls that limit management's opportunistic behavior and decrease the intensity of profit shifting between entities.

H6: Foreign ownership moderates the relationship between debt covenant and transfer pricing, such that it weakens the positive effect of debt covenant on transfer pricing practices.

Grounded in the theoretical foundations and the conceptual framework previously elaborated, the research design is delineated as follows:

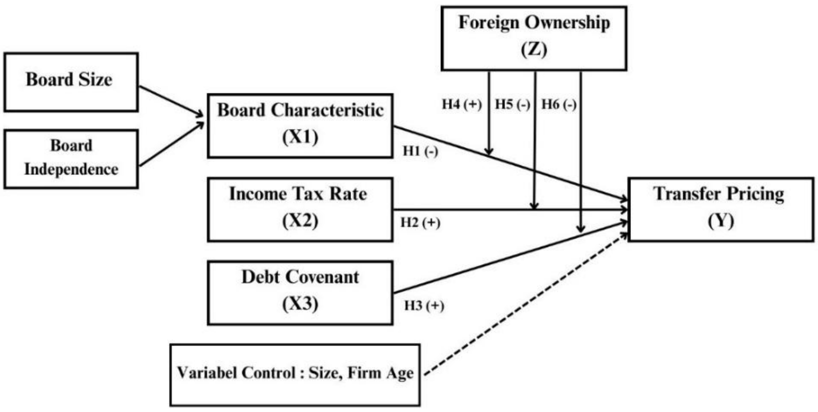

Figure 1. Research Model

3. Research Methods

This study employs a quantitative approach using a population research method, in which the entire population is used as the sample (Wahyudin, 2015). The population consists of all companies listed on the Indonesia Stock Exchange (IDX) during 2020–2024. Of the 954 listed companies, 110 financial firms were excluded because non-financial companies were selected to avoid bias arising from sector-specific regulations in the financial industry, which have distinct characteristics in terms of leverage, capital structure, and taxation. Accordingly, the final sample comprised 844 non-financial companies, resulting in 4,220 firm-year observations. Secondary data were obtained from annual reports available on the IDX website (www.idx.co.id) and the Refinitiv database. With extensive data coverage, this study addresses the limitations of prior research that relied on smaller samples, such as Hidayah et al. (2025) and Pratama (2020), which focused only on manufacturing firms with limited sample sizes, thereby offering a more comprehensive depiction of transfer pricing practices in Indonesia.

The variables examined consist of board size, board independence, income tax rate, and debt covenant as independent variables; foreign ownership as the moderating variable; and transfer pricing as the dependent variable. Company size and firm age are incorporated as control variables to mitigate potential estimation bias, supported by prior empirical evidence demonstrating their relevance to transfer pricing behavior (Duho et al., 2024; ElKelish, 2017; Haryadi et al., 2025; Pratama, 2020; Solikhah et al., 2025). Operational definitions and measurements are detailed in **Table 1.**

Table 1. Operational Definition and Variable Measurement

Variables	Definition	Measurement
Dependent Variable		
TPI (Transfer Pricing)	The price paid between two or more companies for delivering goods or services to another company that has a special relationship (Devita & Sholikhah, 2021).	TPI/Transfer Pricing Intensity (the ratio of the number of receivables of related parties divided by total receivables).
Independent Variable		
BSIZE (Board Size)	The number of directors on the board (Duho et al., 2024).	Natural logarithm of board size
BIND (Board Independence)	Board members who are free from financial, ownership, management, or family ties with the company or controlling shareholders (Duho et al., 2024).	Ratio of independent directors to total board size
ETR (Income Tax Rate)	The level of income tax that the company bears from pre-tax profits (Thinh & An, 2023).	Effective tax rate yang dihitung dari jumlah income tax expense dibagi profit before tax
DEBT (Debt Covenant)	An agreement between creditors and debtors that sets a certain financial ratio to maintain the company's compliance and solvency (Sari et al.,	The ratio of total liabilities to total equity

	2022).	
Moderation Variable		
FO (Foreign Ownership)	The proportion of a firm's issued shares held by external parties, either individuals, institutions, or legal entities with foreign status (Santosa et al., 2022).	Ratio of total shares owned by foreign to total outstanding shares
Control Variable		
SIZE (Company Size)	Scale the company based on total assets and sales or the average of both.	Natural logarithm of total assets
FIRM_AGE (Firm Age)	The length of the company's establishment from the year of establishment (IPO) to the year of research (Duho et al., 2024).	The year of establishment

Source: Data processed by the Author, 2025

This study applies descriptive statistics and moderated regression analysis (MRA) using interaction terms as the primary data analysis methods. This study applied winsorization to all variables by limiting the scores to the 1st and 99th percentiles to minimize the influence of outliers in the regression model (Solikhah et al., 2025). The data processing is then carried out using EViews 12 software. The regression model used is as follows.

Model 1

$$TPI_{i,t} = a_0 - \beta_1 BSIZE_{i,t} - \beta_2 BIND_{i,t} + \beta_3 ETR_{i,t} + \beta_4 DEBT_{i,t} + \beta_5 SIZE_{i,t} + \beta_6 AGE_{i,t} + \varepsilon_{i,t}$$

Model 2

$$TPI_{i,t} = a_0 - \beta_1 BSIZE_{i,t} - \beta_2 BIND_{i,t} + \beta_3 ETR_{i,t} + \beta_4 DEBT_{i,t} - \beta_5 FO_{i,t} + \beta_5 SIZE_{i,t} + \beta_6 AGE_{i,t} + \varepsilon_{i,t}$$

Model 3

$$TPI_{i,t} = a_0 - \beta_1 BSIZE_{i,t} - \beta_2 BIND_{i,t} + \beta_3 ETR_{i,t} + \beta_4 DEBT_{i,t} - \beta_5 FO_{i,t} + \beta_6 BSIZE_{i,t}{}^{*} FO_{i,t} + \beta_7 BIND_{i,t}{}^{*} FO_{i,t} - \beta_8 ETR_{i,t}{}^{*} FO_{i,t} - \beta_9 DEBT_{i,t}{}^{*} FO_{i,t} + \beta_{10} SIZE_{i,t} + \beta_{11} AGE_{i,t} + \varepsilon_{i,t}$$

4. Results and Discussion

4.1 Result

4.1.1 Descriptive Statistics

The descriptive statistical analysis provides a general depiction of the data by presenting key summary measures, including the mean, maximum, minimum, and standard deviation for each variable. Descriptive statistical results for dependent, independent, moderation, and control variables are shown in **Table 2.**

Table 2. Descriptive Statistic

Variable	N	Min	Max	Mean	Std. Dev.
Transfer Pricing	4.220	0.5197	1.0786	0.7229	0.2023
Board Size	4.220	0.6931	2.7080	0.7568	0.2615
Board Independence	4.220	0.0105	0.9883	0.0380	0.1257

Income Tax Rate	4.220	0.8114	1.0400	0.8966	0.0669
Debt Covenant	4.220	0.8460	1.1298	0.9791	0.0625
Foreign Ownership	4.220	0.4297	1.0000	0.6842	0.2322
Size	4.220	22.8785	32.3590	27.6230	2.1984
Firm Age	4.220	0.0000	39.0000	11.0111	11.5450

Source: Data processed by the Author, 2025

The transfer pricing variable shows a low value of 0.5197 and a high value of 1.0786. The average value of 0.7229 and the standard deviation of 0.2023 indicate that transfer pricing practices between companies in the sample vary widely. The board size variable ranges from 0.6931 to 2.7080, with a mean of 0.7568 and a standard deviation of 0.2615, suggesting generally uniform board structures, although several firms maintain larger boards. Board independence ranges from 0.0105 to 0.9883, while the low mean of 0.0380 and standard deviation of 0.1257 reflect considerable variation in the adoption of independent directors. The income tax rate ranges from 0.8114 to 1.0400, with a mean of 0.897 and a relatively small standard deviation of 0.067, indicating limited disparity in firms' effective tax rates. Debt covenant, proxied by DER, ranges from 0.8460 to 1.1298, and its mean of 0.9791 with a standard deviation of 0.0625 suggests relatively uniform leverage conditions. Foreign ownership ranges from 0.4297 to 1.0000, with a mean of 0.6842 and a standard deviation of 0.2322, indicating high yet diverse levels of external ownership. Firm size varies substantially (22.8785–32.3590), while firm age ranges from 0 to 39 years with an average of 11 years, reflecting diverse organizational scales and maturity.

4.1.2 Inferential Statistics

Before hypothesis testing, several procedures are conducted to determine the most suitable panel data model (CEM, FEM, REM). Model selection involves the Chow test, Hausman test, and Lagrange Multiplier test. The results identifying the best model are presented in Table 3.

Table 3. Model Selection Test Results

	Estimation Model	Prob	α	Selected Model
Chow Test	CEM-FEM	0.0000	0.05	FEM
Hausman Test	FEM-REM	0.0004	0.05	FEM

Source: Data processed by the Author, 2025

The Chow test results in Table 3 show a cross-section F probability of 0.0000, which is below the 5% significance level (α = 0.05), indicating that the Fixed Effect Model (FEM) is more appropriate than the Random Effect Model (REM). The Hausman test was then conducted to determine the better model between FEM and REM. Table 3 reports a cross-section F value of 0.0004, also below the 5% level, confirming FEM as the most suitable model for TPI. The Lagrange test is unnecessary because the best model has been identified.

According to Wahyudin (2015), the use of regression-based analysis tools still requires several additional tests, commonly called classical assumption tests. The classical assumption tests used in this study are normality tests, multicollinearity tests, and heteroscedasticity tests. This study relies on the Central Limit Theorem (CLT) to address the normality assumption, as the theorem explains that the distribution of the sample mean converges toward normality when the number of observations is adequately large, independent of the population's initial distribution (Tacq, 2010). Referring to the CLT (Tacq, 2010), data can be considered normally distributed if the sample size is ≥ 30. Napitupulu et al. (2021) also state that an observation data count of ≥ 30 analysis units can disregard the normality requirement in panel data regression. The total observation units in this study are 4,220, which means this study meets the criteria and can be assumed to be normally distributed.

Multicollinearity testing is conducted to determine the presence of high correlation among independent variables in the regression model (Wahyudin, 2015). The test is carried out by assessing the correlation coefficients between the independent variables. According to Napitupulu et al. (2021) and Wahyudin (2015), A multicollinearity problem arises if the correlation between any two explanatory variables exceeds 0,90. Based on the results in Table 4, there are no correlation values that surpass this threshold, so this research model is free from multicollinearity symptoms and can be interpreted well without the need for additional adjustments.

Table 4. Multicollinearity Test Result

	BSIZE	BIND	ETR	DEBT	FO	SIZE	FIRM_AGE
BSIZE	1.0000	0.7305	0.1298	0.0883	0.2268	0.4107	0.2447
BIND	0.7305	1.0000	0.1215	0.0983	0.1717	0.3505	0.2084
ETR	0.1298	0.1215	1.0000	0.2086	0.1093	0.2540	0.0036
DEBT	0.0883	0.0983	0.2086	1.0000	0.0936	0.3557	0.0572
FO	0.2268	0.1717	0.1093	0.0936	1.0000	0.4693	0.4126
SIZE	0.4107	0.3505	0.2540	0.3557	0.4693	1.0000	0.4413
FIRM_AGE	0.2447	0.2084	0.0036	0.0572	0.4126	0.4413	1.0000

Source: Data processed by the Author, 2025

The heteroscedasticity test examines whether residual variance across units is constant or variable. A proper regression model fulfills the homoscedasticity assumption, indicating no heteroscedasticity (Wahyudin, 2015). Residual plots are commonly used to detect this symptom, as the distribution pattern reflects changes in variance (Napitupulu et al., 2021). Referring to Napitupulu et al. (2021), residuals within ±500 indicate no heteroscedasticity. Based on Figure 2, the residual values fall well below this threshold, confirming constant variance.

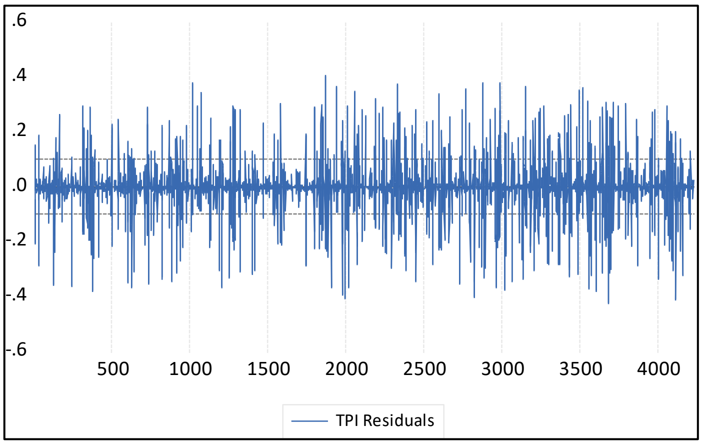

Figure 2. Residual Plot of Heteroscedasticity Test
Source: Data processed by the Author, 2025

Hypotheses are subsequently examined after the most suitable regression model has been determined and the classical assumption test has been applied. This study utilizes the t-test to examine the individual impact of each explanatory variable on the outcome variable. Table 5 presents the results of the t-test and MRA test for all independent variables and the moderation of the dependent variable (transfer pricing). Based on the results of the analysis using the Fixed Effect Model (FEM) with EViews 12 software, the regression and moderation equations in this study are as follows:

Model 1

$$TPI_{i,t} = 0{,}1636 + 0{,}0078BSIZE_{i,t} - 0{,}0188BIND_{i,t} + 0{,}0673ETR_{i,t} + 0{,}0975DEBT_{i,t} + 0{,}0144SIZE_{i,t} - 0{,}0001AGE_{i,t} + \varepsilon_{i,t}$$

Model 2

$$TPI_{i,t} = 0{,}1641 + 0{,}0082BSIZE_{i,t} - 0{,}0193BIND_{i,t} + 0{,}0680ETR_{i,t} + 0{,}0936DEBT_{i,t} - 0{,}0182FO_{i,t} + 0{,}0149SIZE_{i,t} + 0{,}0001AGE_{i,t} + \varepsilon_{i,t}$$

Model 3

$$TPI_{i,t} = -0{,}0599 - 0{,}0580BSIZE_{i,t} - 0{,}0040BIND_{i,t} + 0{,}2090ETR_{i,t} + 0{,}2924DEBT_{i,t} + 0{,}4675FO_{i,t} + 0{,}0741BSIZE_{i,t}{}^{*}FO_{i,t} - 0{,}0089BIND_{i,t}{}^{*}FO_{i,t} - 0{,}2126ETR_{i,t}{}^{*}FO_{i,t} - 0{,}3543DEBT_{i,t}{}^{*}FO_{i,t} + 0{,}0129SIZE_{i,t} + 0{,}0003AGE_{i,t} + \varepsilon_{i,t}$$

Table 5. Model Estimation Results with FO as a Moderating Variable

Variable	Model 1		Model 2		Model 3	
	β	Sig	β	Sig	β	Sig
Constanta	0.1636	0.0129	0.1641	0.0126	-0.0599	0.6832
BSIZE	0.0078	0.6962	0.0082	0.6838	-0.0580	0.6517
BIND	-0.0188	0.5342	-0.0193	0.5243	-0.0040	0.9807
ETR	0.0673	0.0501	0.0680	0.0480	0.2090	0.0425
DEBT	0.0975	0.0192	0.0936	0.0250	0.2924	0.0071
FO	-	-	-0.0182	0.3077	0.4675	0.0339
BSIZE*FO	-	-	-	-	0.0741	0.5971
BIND*FO	-	-	-	-	-0.0089	0.9610
ETR*FO	-	-	-	-	-0.2126	0.1310
DEBT*FO	-	-	-	-	-0.3543	0.0369

SIZE	0.0144	0.0000	0.0149	0.0000	0.0129	0.0000
FIRM_AGE	-0.0001	0.9134	0.0001	0.9284	0.0003	0.7948
R-square	0.8062	-	0.8063	-	0.8067	-
Adj. R-square	0.7574	-	0.7574	-	0.7577	-
F Test	0.0000	-	0.0000	-	0.0000	-

Source: Data processed by the Author, 2025

The panel data and moderation regression results in Table 5 indicate that board characteristics comprising board size (BSIZE) and board independence (BIND) do not significantly influence transfer pricing, leading to the rejection of H1a and H1b. The income tax rate (ETR) exerts a significant positive effect on transfer pricing (β = 0.0680; Sig = 0.0480 < α = 0.05), supporting H2, while the debt covenant (DEBT) also shows a significant positive effect (β = 0.0936; Sig = 0.0250 < α = 0.05), confirming H3. The moderation analysis in Model 3 demonstrates that foreign ownership (FO) does not moderate the effects of board characteristics and ETR, thereby rejecting H4a, H4b, and H5, although FO weakens the influence of DEBT on transfer pricing (β = -0.3543; Sig = 0.0369 < α = 0.05), resulting in H6 being accepted.

Based on Table 5, the adjusted R-squared value of 0.7577 indicates that the independent variables account for 75.77 percent of the variation in transfer pricing. In comparison, 24.23 percent is explained by factors outside the model. All regression and moderation equations exhibit good model fit, as shown by F-test p-values of 0.0000. Therefore, the combined effect of the independent variables is statistically significant. The control variable company size (SIZE) has a significant positive effect in Model 1 (β = 0.0144), Model 2 (β = 0.0149), and Model 3 (β = 0.0129), whereas firm age is not significant in any model.

4.2 Discussion

4.2.1 Board Characteristic (Board of Directors) and Transfer Pricing

The results of the study showed that board characteristics did not have a significant effect on transfer pricing practices, so the H1a and H1b hypotheses were rejected. In a developing country such as Indonesia, strategic decisions related to taxes are largely under management's control, thus limiting the effectiveness of board oversight. This insignificance is supported by previous empirical evidence and the institutional conditions of corporate governance in Indonesia, where public companies generally have a high concentration of ownership and a dominant controlling shareholder, thus substantively limiting board independence (Claessens et al., 2000). This study's results are congruent with previous research in Indonesia, such as Pandapotan et al. (2023). Wahab et al. (2011) support this, and ElKelish (2017) shows that board independence is often purely formal due to social and relational relationships with management, which undermines the effectiveness of supervision over related party transactions.

However, the empirical evidence in this study differs from Duho et al. (2024), which demonstrates that board size and non-executive director representation are associated with transfer pricing practices. This difference can be explained by the object of the research, which results in differences in the institutional environment and corporate governance, where Duho et al. (2024) conducted their research in developed countries with stronger investor protection and more dispersed ownership structures, allowing board characteristics to function more effectively compared to the corporate governance context in Indonesia. As a result, board characteristics may not function similarly in Indonesia. While not supportive of H1a and H1b, these findings provide important insights that formal governance mechanisms, such as board size and independence, are not necessarily effective in limiting transfer pricing practices in Indonesia without the support of a more balanced ownership structure and substantive strengthening of the board's supervisory role.

4.2.2 Income Tax Rate and Transfer Pricing

The hypothesis testing results indicate that the income tax rate, as measured by ETR, has a positive and statistically significant effect on transfer pricing practice, thereby supporting hypothesis H2. This evidence indicates that higher corporate income tax pressure motivates managers to adopt transfer pricing strategies. The empirical results correspond with the political cost hypothesis, which contends that pressures arising from governmental policies, including tax obligations, encourage firms to adjust reported earnings to reduce political burdens such as taxation (Watts & Zimmerman, 1990). Companies facing substantial fiscal pressure tend to shift income to jurisdictions offering more favorable tax regimes to reduce tax liabilities. This practice is generally carried out by reducing selling prices, thereby lowering reported profits or generating losses, which consequently decreases the tax payable to the state.

These findings align with the empirical results of Devi & Suryarini (2020), Indriaswari & Nita (2018), and Yulia et al. (2019), who demonstrated that taxes positively affect transfer pricing decisions. However, the results differ from those of Arifin et al. (2020) and Rizkya & Isnalita (2020), who found that taxes do not significantly influence transfer pricing practices. This discrepancy may arise because firms in those studies conducted related-party transactions in compliance with tax regulations, limiting incentives for aggressive transfer pricing. Overall, this finding emphasizes that taxation remains the primary economic incentive underlying transfer pricing behavior. The significant effect of the income tax rate indicates that managerial decisions regarding related-party transactions are strongly tax-driven rather than purely operational, reinforcing the view that transfer pricing functions as a strategic response to fiscal pressure. Accordingly, tax authorities should strengthen oversight of such transactions, while firms are encouraged to enhance compliance and transparency in their transfer pricing policies to mitigate legal and reputational risks.

4.2.3 Debt Covenant and Transfer Pricing

The results displayed in Table 5 reveal that the debt covenant proxy (DER) is positively and significantly associated with transfer pricing behavior, supporting hypothesis H3. These findings provide empirical evidence that when the company's debt level is high, the company will be closer to the limit of the provisions in the debt covenant, as a result of which the company is more likely to adopt transfer pricing strategies as a means to maintain certain financial conditions so that there is no violation of the debt covenant. From a theoretical perspective, the findings support the debt covenant hypothesis, which posits that when a company has high leverage, its financial statements are less likely to reflect accounting conservatism (Watts & Zimmerman, 1990). The results of this study support the research of Hidayah et al. (2025), Solikhah et al. (2021), and Supriyati et al. (2021), who found that stronger debt covenant pressures are positively related to transfer pricing practices.

The significant effect of leverage suggests that managerial decisions regarding related-party transactions are driven more by the need to maintain compliance with debt agreements and financial stability than by operational considerations alone. In this context, transfer pricing functions as a strategic financial adjustment mechanism to avoid debt covenant violations. This study contributes by providing empirical evidence that transfer pricing is influenced not only by tax motives but also by internal financial pressures related to firms' financing structures and contractual obligations. Accordingly, tax authorities should intensify scrutiny of highly leveraged firms, creditors should design debt contracts that mitigate earnings management incentives, and corporate managers should balance financing strategies with tax compliance and sound corporate governance.

4.2.4 Board Characteristics, Foreign Ownership, and Transfer Pricing Practices

The results of the study showed that foreign ownership was not able to moderate the influence of board characteristics on transfer pricing practices, so the H4a and H4b hypotheses were rejected. This insignificance suggests that the presence of foreign shareholders is not necessarily followed by increased involvement in the company's internal oversight. In the corporate governance environment in Indonesia, foreign ownership is generally passive and not involved in strategic decision-making, as well as oriented towards portfolio investment, so foreign shareholders tend to rely on existing governance mechanisms without actively strengthening the board's role in overseeing strategic decisions such as transfer pricing (Ferreira & Matos, 2008; Haryadi et al., 2025). In addition, limited understanding of domestic regulations and the complexity of intra-group transactions cause foreign shareholders not to exercise their control rights, which affects the effectiveness of the board's supervision of related party transactions (Hidayah et al., 2025).

The results of this study are in line with Haryadi et al. (2025) and Hidayah et al. (2025), who show that foreign shareholders do not always act to maximize personal interests through transfer pricing, considering that the company's decisions must still obtain board approval. Limited board oversight effectiveness and the relatively passive role of foreign ownership in Indonesia explain the absence of a moderating effect on the relationship between board characteristics and transfer pricing practices. Nevertheless, this study contributes to the literature by emphasizing the context-dependent nature of foreign ownership as a monitoring mechanism, particularly in institutional environments characterized by regulatory complexity and evolving enforcement. The results imply that regulators and tax authorities should not rely on foreign ownership as an indirect governance tool. In contrast, foreign investors are encouraged to adopt more active governance engagement to enhance the effectiveness of foreign ownership in constraining transfer pricing practices.

4.2.5 Income Tax Rate, Foreign Ownership, and Transfer Pricing Practices

The test results showed that foreign ownership was unable to moderate the influence of the income tax rate (ETR) on transfer pricing practices, so the H5 hypothesis was rejected. In the ownership structure of public companies in Indonesia, foreign ownership is often in the position of minority shareholders. It does not always reflect effective control due to the dominance of domestic shareholders. Decisions related to cross-border tax strategies are generally seen as operational policies that are sensitive to regulatory and reputational risks, so foreign shareholders tend to be more cautious and not actively involved in the supervision and determination of transfer pricing policies (Claessens et al., 2000; Hidayah et al., 2025). In contrast to domestic shareholders, foreign shareholders face cross-border risk exposure, including the risk of multiple taxes, international disputes, and the involvement of tax authorities in their home countries.

This finding is in line with Hidayah et al. (2025), who found that foreign ownership is not directly involved in decision-making related to transfer pricing or related party transactions. Foreign ownership is ineffective in limiting aggressive transfer pricing and does not reduce the impact of tax rates in Indonesian companies due to suboptimal supervisory mechanisms. The finding contributes to the literature by highlighting that foreign ownership's role in tax oversight is limited and context-dependent, particularly when cross-border risks and minority positions constrain active involvement. Practically, companies should strengthen internal controls over related-party transactions and responses to ETR. At the same time, regulators and tax authorities should focus on substance-based oversight, and foreign investors are encouraged to enhance their understanding and involvement in tax policies. Hence, their ownership remains relevant in strategic decision-making affected by tax rates.

4.2.6 Debt Covenant, Foreign Ownership, and Transfer Pricing Practices

Referring to the hypothesis testing carried out, it is shown that foreign ownership can moderate the positive influence of debt covenants on transfer pricing, thereby supporting the acceptance of hypothesis H6. This study presents empirical evidence indicating that, although companies with high debt levels experience accounting pressure from debt covenants and tend to engage in transfer pricing practices, the existence of foreign shareholders actually reduces the tendency for such opportunistic behavior. These findings align with agency theory, which suggests that foreign ownership can serve as a more effective supervisory mechanism, as foreign investors possess strong skills, international experience, and incentives to mitigate opportunistic behavior, including transfer pricing (Widiastutik et al., 2024).

This is in line with the research of Maisaroh & Setiawan (2021) and Widiastutik et al. (2024), which states that foreign shareholders highly consider the impact of tax avoidance, including consulting fees, company reputation, and legal sanctions, and tend to be long-term oriented and more sensitive to compliance risks. This study contributes to the literature by providing empirical evidence that foreign ownership weakens the positive effect of debt covenants on transfer pricing. Practically, companies with high leverage should strengthen the role of foreign shareholders in corporate governance, while regulators may consider foreign ownership as a relevant factor in transfer pricing risk assessments. For investors, foreign ownership serves as a positive signal of stronger monitoring and lower agency risk.

5. Conclusions

This study concludes that taxation factors and contractual pressures influence transfer pricing practices in non-financial companies in Indonesia, while not all corporate governance mechanisms function effectively in limiting it. Empirically, income tax rate and debt covenant have a positive effect on transfer pricing, while board characteristics have no significant effect. In addition, foreign ownership can moderate the influence of debt covenants, but not on other determinants. Theoretically, these findings expand the political cost hypothesis that tax burdens drive transfer pricing and support the debt covenant hypothesis related to opportunistic incentives due to debt contract pressures. The insignificance of board characteristics indicates the weak role of board oversight of political costs. Support for agency theory is also seen through the role of foreign ownership in suppressing agency conflicts and transfer pricing tendencies through increased supervision and governance standards. However, its role is contextual and not universal. Practically, firms must manage transfer pricing carefully to mitigate legal and reputational risks, and regulators should strengthen oversight of related-party transactions, especially in companies with high levels of debt and foreign ownership.

This research has several limitations. First, the study covers only non-financial companies in Indonesia, so the findings cannot be generalized to the financial sector, which has different regulatory characteristics. Second, transfer pricing measurement is based on annual report data, so it has not fully captured undisclosed practices. Third, this study has not considered changes in tax regulations that could affect transfer pricing behavior. Based on these limitations, further research is recommended to involve financial sector companies or conduct cross-sector and cross-country comparisons to understand the influence of differences in tax regulations on transfer pricing. In addition, a qualitative approach can be considered to uncover transfer pricing practices that are not disclosed in the annual report. Future studies are also expected to examine the impact of regulatory changes on transfer pricing practices.

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