

The Influence of Sustainability Reporting, Transfer Pricing, thin Capitalization and Tunneling Incentive on Tax Avoidance in Multinational Manufacturing Sector Companies

Arifatul Khoir^{1*}, Isnani Yuli Andini²

Universitas Wiraraja

Corresponding Author: Isnani Yuli Andini lia@wiraraja.ac.id

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ABSTRACT

Tax avoidance is a legal strategy used by taxpayers to reduce their tax liabilities by exploiting gaps or weaknesses in a country's tax regulations. In Indonesia, this practice is one of the contributing factors to the country's low tax ratio, particularly among multinational corporations. This study aims to examine the influence of sustainability reporting, transfer pricing, thin capitalization, and tunneling incentives on tax avoidance in multinational manufacturing companies listed on the Indonesia Stock Exchange for the 2019–2023 period. Using a quantitative approach and purposive sampling method, 15 companies were selected as samples. The data were obtained from financial statements and sustainability reports and analyzed using EViews 12 software. The results reveal that collectively, all independent variables significantly affect tax avoidance.

INTRODUCTION

Taxation remains a cornerstone of government revenue, playing a critical role in financing national development and delivering public services. Despite its importance, optimizing tax collection poses significant challenges, particularly due to the persistent practice of tax avoidance. Tax avoidance refers to the strategic efforts of taxpayers to legally minimize their tax liabilities by exploiting gaps or ambiguities within tax regulations, without directly breaching the law (Pohan, 2019:28). This practice is especially prevalent among multinational corporations, whose cross-border structures and financial flexibility provide ample opportunities for tax planning.

Indonesia's relatively low tax ratio is often cited as an indication of widespread tax avoidance behavior. This phenomenon undermines the government's ability to collect maximum tax revenue. While tax avoidance is not classified as illegal, Darussalam and Septriadi (2008:72) emphasize that it raises ethical concerns due to its negative impact on equitable public contribution. Understanding the determinants behind such behavior is therefore essential for strengthening the integrity and effectiveness of the national tax system.

Among the suspected drivers of tax avoidance is sustainability reporting, which involves the disclosure of a company's environmental, social, and economic performance. Although such reports are intended to promote transparency and accountability, previous research presents mixed findings. For instance, Hermawan et al. (2019) found no significant link between sustainability reporting and tax avoidance, suggesting that the mere act of disclosing sustainability-related information does not necessarily reduce aggressive tax behavior.

Beyond sustainability disclosures, multinational firms may adopt other tax avoidance strategies, such as transfer pricing the practice of setting intercompany transaction prices between affiliated entities in different tax jurisdictions. This strategy can be exploited to shift profits to countries with lower tax rates (Wahyuni & Islahudin, 2018). Similarly, thin capitalization where companies are financed predominantly through debt rather than equity enables the deduction of interest expenses to lower taxable income. Another factor is tunneling incentive, which describes actions by controlling shareholders to redirect corporate wealth to related parties for personal gain (Rosnani, 2018). The flexibility of multinational enterprises to apply these tactics highlights the urgent need for robust regulation and oversight.

In light of these concerns, this study seeks to answer the following research question: Do sustainability reporting, transfer pricing, thin capitalization, and tunneling incentive influence tax avoidance among multinational manufacturing firms in Indonesia? The objective of this research is to examine the impact of these four variables on tax avoidance, focusing on multinational companies listed on the Indonesia Stock Exchange between 2019 and 2023. The findings are expected to offer insights for both academic discourse and tax authorities, helping to shape more adaptive and equitable tax policies in response to global tax avoidance challenges.

LITERATURE REVIEW

Agency Theory

According to Jensen and Meckling (1976), agency theory describes the relationship between a company's owner (the principal) and its manager (the agent), who is entrusted with the authority to manage the company's resources. However, conflicts of interest frequently arise, as agents often prioritize their personal interests over maximizing the principal's wealth. This issue is exacerbated by the information asymmetry between owners and managers, which increases the likelihood of opportunistic behavior (Grossman & Hart, 1983; Jensen & Smith, 1985). Agency conflicts become more pronounced when ownership is dispersed among many shareholders, while control remains concentrated in the hands of managers (Subagiastra et al., 2017). In the realm of taxation, significant tax burdens may incentivize managers to adopt tax minimization strategies to enhance financial performance, often through the manipulation of financial disclosures (Teza et al., 2018). In practice, managers may engage in tax avoidance to satisfy shareholder expectations, utilizing methods such as transfer pricing, thin capitalization, and tunneling incentives to reduce tax liabilities and boost company profitability.

Legitimacy Theory

Legitimacy theory underscores the necessity of gaining societal approval for a company's existence and operations as a prerequisite for its continued survival. As outlined by Dowling and Pfeffer (1975), firms operate within a broader social framework shaped by prevailing norms and values, making responsiveness to public expectations essential for maintaining legitimacy (Ghozali & Chariri, 2007). This legitimacy is grounded in the notion of a social contractan implicit agreement whereby a company earns the right to access public resources in exchange for fulfilling its social obligations (O'Donovan, 2002). When a business is perceived as misaligned with societal values, its right to operate may come under scrutiny. Consequently, aligning corporate activities with societal interests through initiatives that benefit both the environment and the community becomes imperative (Deegan, 2002).

To secure and sustain legitimacy, organizations must exhibit social accountability, often demonstrated through the disclosure of sustainability practices. Sustainability reporting serves as a critical communication tool between corporations and stakeholders, showcasing that business values and actions are consistent with societal expectations (Nokiyanti et al., 2023). Corporate Social Responsibility (CSR) initiatives represent tangible evidence of a company's dedication to social and environmental concerns and are frequently employed as strategies to build public trust and enhance corporate reputation (Gray et al., 1995). Therefore, sustainability disclosures function not only as a reflection of ethical compliance but also as a strategic mechanism for attaining stakeholder recognition and societal legitimacy.

METHODOLOGY

This study adopts a quantitative approach, focusing on 15 multinational manufacturing firms listed on the Indonesia Stock Exchange (IDX) during the 2019–2023 period. The sample was selected using purposive sampling techniques (Sugiyono, 2017). The research relies on secondary data, primarily drawn from the companies’ annual and sustainability reports. The independent variables examined include sustainability reporting, transfer pricing, thin capitalization, and tunneling incentives, while tax avoidance serves as the dependent variable. Each variable was measured using indicators adapted from prior research, such as GRI 11 standards for sustainability reporting (Nokiyanti et al., 2023), the affiliated sales gap method for transfer pricing (Teza et al., 2018), the debt-to-equity ratio for thin capitalization (Subagiastra et al., 2017), and ultimate ownership structure for tunneling incentives (Hutagaol et al., 2022). The data were analyzed using multiple linear regression with the assistance of EViews 12 software.

RESEARCH RESULT

Panel Data Regression Analysis

Chow Test

The Chow test in this study is employed to compare the common effect and fixed effect models in order to identify the most appropriate panel data regression model. Model selection is guided by the cross-section F-probability value: if the p-value exceeds 0.05, the common effect model is considered more suitable; conversely, if the p-value is below 0.05, the fixed effect model is selected and subsequently followed by the Hausman test for further validation.

Table 1. Chow Test Result

Redundant Fixed Effects Tests
Equation: Untitled
Test cross-section fixed effects

Effects Test	Statistic	d.f.	Prob.
Cross-section F	2.876089	(8,32)	0.0157
Cross-section Chi-square	24.379005	8	0.0020

Source: Eviews 12 Output (2025)

As shown in Table 1, the result of the Chow test yields a cross-section F-probability value of 0.0020, which is below the 0.05 threshold. Therefore, the fixed effect model is deemed the most appropriate for this analysis.

Hausman Test

The Hausman test is applied to assess and compare the fixed effect and random effect models to determine the most suitable panel data regression model. Model selection hinges on the probability value of the cross-section random effect: if the p-value exceeds 0.05, the random effect model is preferred; however, if it falls below 0.05, the fixed effect model is considered more appropriate.

Table 2. Hausman Test Result

Correlated Random Effects - Hausman Test
 Equation: Untitled
 Test cross-section random effects

Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	9.170534	4	0.0570

Source: Eviews 12 Output (2025)

The results of the Hausman test presented in Table 2 indicate a probability value of 0.0570, which exceeds the 0.05 threshold. Accordingly, the random effect model is considered the most appropriate choice for this analysis.

Lagrange Multiplier Test

The Lagrange Multiplier (LM) test is employed to determine the more suitable model between the common effect and random effect approaches in panel data estimation. Model selection is based on the Breusch-Pagan cross-section value: if the p-value is greater than 0.05, the common effect model is preferred; if it is less than 0.05, the random effect model is selected.

Table 3. Lagrange Multiplier Test

Null (no rand. effect) Alternative	Cross-section One-sided	Period One-sided	Both
Breusch-Pagan	1.042144 (0.3073)	0.673403 (0.4119)	1.715547 (0.1903)
Honda	1.020855 (0.1537)	-0.820611 (0.7941)	0.141593 (0.4437)
King-Wu	1.020855 (0.1537)	-0.820611 (0.7941)	-0.080636 (0.5321)
GHM	-- --	-- --	1.042144 (0.3021)

Source: Eviews 12 Output (2025)

Based on the Lagrange Multiplier test results in Table 3, the Breusch-Pagan value is 0.3073, which exceeds the 0.05 threshold. Therefore, the common effect model is identified as the most appropriate regression model for this study.

Panel Data Regression Analysis

Drawing on the results of the Chow, Hausman, and Lagrange Multiplier tests, the common effect model is deemed the most appropriate panel data regression approach for this study, as the data across cross-sections and time periods exhibit a relatively uniform pattern.

Table 4 Panel Data Regression Common Effect Model Result

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.181959	0.042563	4.275081	0.0001
X1	0.030065	0.098667	0.304717	0.7622
X2	-0.163174	0.046770	-3.488859	0.0012
X3	0.231207	0.064633	3.577219	0.0009
X4	-0.168961	0.057039	-2.962226	0.0051
R-squared	0.331268	Mean dependent var		0.255757
Adjusted R-squared	0.264395	S.D. dependent var		0.091747
S.E. of regression	0.078689	Akaike info criterion		-2.142185
Sum squared resid	0.247679	Schwarz criterion		-1.941445
Log likelihood	53.19916	Hannan-Quinn criter.		-2.067351
F-statistic	4.953680	Durbin-Watson stat		1.513661
Prob(F-statistic)	0.002439			

Source: Eviews 12 Output (2025)

Based on the test results presented in Table 4, the panel data regression model is formulated as follows:

$$Y = 0,1819 + 0,0301X1 - 0,1632X2 + 0,2312X3 - 0,1690X4 + e$$

Where,

- Y = tax avoidance.
- X1 = sustainability reporting.
- X2 = transfer pricing.
- X3 = thin capitalization.
- X4 = tunneling incentive.

When all independent variables are held constant, the baseline value of tax avoidance is 0.1819. Sustainability reporting (X₁) and thin capitalization (X₃) exhibit a positive influence on tax avoidance, whereas transfer pricing (X₂) and tunneling incentive (X₄) demonstrate a negative relationship. A one-unit change in any of these variables will either increase or decrease the level of tax avoidance in line with the direction of its respective coefficient, assuming other variables remain unchanged.

T Test

The t-test is conducted to assess the partial effect of each independent variable on the dependent variable. A probability value below 0.05 indicates a statistically significant influence, while a value above 0.05 suggests that the independent variable does not have a meaningful impact on the dependent variable.

Table 5. T Test Result

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.181959	0.042563	4.275081	0.0001
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F-statistic	4.953680	Durbin-Watson stat		1.513661
Prob(F-statistic)	0.002439			

Source: Eviews 12 Output (2025)

The t-test results in Table 5 indicate that Sustainability Reporting (X_1) has no significant effect on Tax Avoidance, as reflected by its probability value of 0.7622, which exceeds the 0.05 threshold. In contrast, Transfer Pricing (X_2), Thin Capitalization (X_3), and Tunneling Incentive (X_4) show a statistically significant influence on Tax Avoidance, with respective probability values of 0.0012, 0.0009, and 0.0051 all falling below the 0.05 significance level.

F Test

Based on the F-test results shown in Table 5, the probability value of the F-statistic is 0.002439, which is below the 0.05 significance level ($0.002439 < 0.05$). This indicates that, collectively, the variables Sustainability Reporting, Transfer Pricing, Thin Capitalization, and Tunneling Incentive have a significant influence on Tax Avoidance.

Coefficient of Determination Test

The coefficient of determination test results in Table 5 show an adjusted R-squared value of 0.264, or 26.4%. This indicates that 26.4% of the variation in tax avoidance can be explained by the variables sustainability reporting, transfer pricing, thin capitalization, and tunneling incentive, while the remaining 73.6% is influenced by factors not included in the model. Furthermore, the model's standard error of 0.0786 is lower than the standard deviation of the dependent variable, which is 0.0917 suggesting that the regression model is valid and reliable for predictive purposes.

DISCUSSION

The Influence of Sustainability Reporting on Tax Avoidance

The t-test results in this study reveal that sustainability reporting does not have a statistically significant impact on tax avoidance, as indicated by a probability value of 0.7622 well above the 0.05 significance threshold. This leads to the rejection of the first hypothesis (H1), as the statistical evidence (t-statistic = 0.304717) fails to support the initial assumption that sustainability reporting influences tax avoidance. This finding suggests that multinational firms in the manufacturing sector do not utilize sustainability reporting as a manipulative tool for tax minimization. Instead, they appear to use it as a platform to enhance corporate image, secure public legitimacy, and foster stronger relationships with stakeholders (Iriyadi et al., 2024). Sustainability reporting thus serves as a means of demonstrating corporate social accountability rather than as a fiscal strategy for reducing tax liabilities. It also reflects a deeper commitment to environmental and social responsibility, prioritizing long-term sustainability over short-term financial gains.

Legitimacy theory posits that companies seek societal approval by aligning their operations with prevailing social norms and values (Jao & Holly, 2022). In this context, sustainability reporting plays a pivotal role in shaping public perception and enhancing corporate reputation. As such, companies that prioritize public trust and brand integrity may deliberately avoid tax avoidance practices that could undermine their established legitimacy (Amalia, 2019).

The findings of this research are consistent with those of Iriyadi et al. (2024), who also found no significant relationship between sustainability reporting and tax avoidance. However, these results differ from those reported by Amanda Wulansari & Pohan (2024) and Kulsum et al. (2023), who observed a significant influence. Such discrepancies may be attributed to variations in industry sectors, research periods, and specific characteristics of the companies analyzed.

The Influence of Transfer Pricing on Tax Avoidance

The t-test results indicate that transfer pricing has a significant effect on tax avoidance, as shown by a probability value of 0.0012 well below the 0.05 significance level. The t-statistic of -3.488859 further confirms that the second hypothesis (H2) is accepted. These findings support the researcher's initial assumption that transfer pricing is utilized by companies as a legal strategy to reduce their tax burden. Transfer pricing refers to the pricing arrangements of transactions between related entities, particularly within multinational corporate groups. This mechanism is commonly employed to shift profits to low-tax jurisdictions, thereby minimizing the overall tax liability (Wulandari & Oktaviani, 2023). Such practices are enabled by complex multinational structures that allow companies to adjust intra-group pricing with considerable flexibility (Iriyadi et al., 2024). Firms often exploit tax rate differences across countries to enhance their tax efficiency (Hidayat et al., 2024).

This study aligns with agency theory, which highlights the conflict of interest between principals (owners) and agents (managers). Managers, acting on behalf of shareholders, may pursue strategies that boost company profits, such as transfer pricing, as a form of tax avoidance (Elishang et al., 2024). However, such behavior may expose the firm to reputational risk or regulatory penalties, thereby posing a threat to shareholder value. In this context, transfer pricing can be interpreted as an opportunistic action consistent with agency theory (Hidayat et al., 2024). The findings are consistent with those of Hidayat et al. (2024) and Adiguna & Ritonga (2024), who also found that transfer pricing significantly affects tax avoidance in Indonesia's manufacturing sector. Real-world cases, such as the tax controversies involving Philip Morris in Thailand and Heineken in Vietnam, further underscore the global relevance of transfer pricing practices (DDTCNews, 2020). Nonetheless, contrasting evidence comes from Suherman & Murtanto (2024), who found no significant relationship between transfer pricing and tax avoidance within the mining and energy sectors.

The Influence of Thin Capitalization on Tax Avoidance

The results of the t-test in this study demonstrate that thin capitalization has a statistically significant impact on tax avoidance. This is evidenced by a probability value of 0.0009 well below the 0.05 significance level and a t-statistic of 3.577219. These findings validate the third hypothesis (H3), confirming that thin capitalization influences tax avoidance behavior. Thin capitalization refers to a financing strategy where a company relies more heavily on debt than on equity. Multinational corporations often employ this method to lower taxable income by leveraging interest expenses, which are typically deductible under many tax regulations (Sarif, 2022; Julianti & Ruslim, 2023). By adopting high-debt structures, companies can effectively shift profits to jurisdictions with lower tax rates, particularly when subsidiaries are located in tax havens. In response, regulations such as Indonesia's PMK No. 169/PMK.010/2015 and Article 18(1) of the Income Tax Law have been introduced to curb such practices (DDTC News, 2023).

These findings are aligned with agency theory, which explores the conflict of interest between principals (shareholders) and agents (managers). Managers, acting as agents, may strategically use debt-heavy capital structures to reduce the company's tax obligations and enhance reported profits despite potential long-term risks for shareholders (Mayanisa & Fridayana, 2019). The information asymmetry between principals and agents creates room for tax avoidance through thin capitalization techniques. This study supports prior research by Widiani & Trisnawati (2024) and Ramadhan (2023), both of which found a significant relationship between thin capitalization and tax avoidance, particularly in public and manufacturing firms. However, contrasting results were reported by Mafidah & Budiwitjaksono (2024) and Elishang et al. (2024), who found no significant effect in sectors such as property and consumer goods manufacturing.

The Influence of Tunneling Incentive on Tax Avoidance

The t-test results indicate that tunneling incentive significantly affects tax avoidance, as evidenced by a probability value of 0.0051 below the 0.05 significance threshold and a t-statistic of 2.962226. Consequently, the fourth hypothesis (H4) is accepted. This finding supports the initial assumption that tunneling incentive plays a role in shaping corporate tax avoidance behavior. Tunneling incentive refers to actions taken by controlling shareholders to transfer company assets or earnings for personal gain, often at the expense of minority shareholders (Isnain et al., 2022). Such actions can lead to lower reported net income, thereby reducing taxable income. Tunneling may take various forms, including below-market transactions, unjustified asset transfers, or the removal of company obligations practices that benefit majority stakeholders while harming the company and its minority investors (Gamasti & Supatmi, 2023).

This result is consistent with agency theory, which explains the conflict of interest between majority and minority shareholders. Those with dominant control may leverage their authority to engage in tax avoidance through tunneling strategies, prioritizing private gain over corporate accountability (Nokiyanti et al., 2023). Such practices compromise shareholder equity and undermine overall corporate governance. These findings are in line with studies by Ratnandari & Achyani (2023) and Putri & Evana (2024), who found that tunneling incentive has a notable impact on tax avoidance. However, differing results have been reported in other research. For instance, Retnowati & Muchlish (2024) and Waluyo et al. (2023) found no significant relationship between tunneling and tax avoidance, particularly in sectors such as property and non-cyclical consumer goods, which may operate under distinct ownership structures and governance models.

Joint Influence of Sustainability Reporting, Transfer Pricing, Thin Capitalization and Tunneling Incentive on Tax Avoidance

The F-test results reveal that the variables sustainability reporting, transfer pricing, thin capitalization, and tunneling incentive collectively have a statistically significant effect on corporate tax avoidance. This conclusion is supported by the F-statistic probability value of 0.002439, which falls below the 0.05 significance threshold ($0.002439 < 0.05$). Accordingly, the fifth hypothesis (H5) is accepted, confirming that these four independent variables jointly contribute to corporate tax minimization practices. Sustainability reporting is often leveraged by firms not only to maintain public legitimacy and enhance corporate image but also as a tax planning tool particularly when sustainability-related expenditures qualify as deductible expenses. Transfer pricing facilitates the shifting of profits to jurisdictions with lower tax rates. Thin capitalization enables firms to reduce taxable income by increasing interest-bearing debt, while tunneling incentive involves the transfer of profits or assets by controlling shareholders for personal benefit, consequently lowering reported taxable profits.

These findings align with both agency theory and legitimacy theory. Agency theory underscores the potential for conflicts of interest between managers and shareholders, often resulting in aggressive tax strategies such as transfer pricing and debt-based financing to maximize post-tax profits. On the other hand, legitimacy theory suggests that sustainability disclosures are used to meet societal expectations and bolster corporate reputation, although their impact on actual tax liabilities may vary depending on implementation. This study's conclusions are consistent with research by Putri & Evana (2024), which examined mining firms listed on the Indonesia Stock Exchange from 2018 to 2022. Their findings similarly indicated that transfer pricing, tunneling incentives, thin capitalization, and capital intensity exerted a simultaneous influence on tax avoidance behavior. These results further reinforce the idea that the combination of such strategies plays a pivotal role in shaping corporate tax planning practices.

CONCLUSIONS AND RECOMMENDATIONS

The study reveals that sustainability reporting does not significantly influence tax avoidance. This outcome suggests that companies primarily employ sustainability disclosures as a means to enhance their corporate image and gain public approval, rather than using them as mechanisms for reducing tax liabilities. In contrast, the variables of transfer pricing, thin capitalization, and tunneling incentive are found to have a meaningful impact on tax avoidance. Transfer pricing enables profit shifting between affiliated entities to jurisdictions with more favorable tax regimes. Thin capitalization allows firms to lower taxable income by recognizing interest expenses on debt. Meanwhile, tunneling incentive reflects the behavior of controlling shareholders who divert company profits for personal benefit, thereby reducing the tax base. Collectively, these three strategies serve as tools for corporations to minimize their tax obligations, while sustainability reporting appears to be more aligned with reputation management and corporate social responsibility efforts rather than aggressive tax planning.

ADVANCED RESEARCH

Future researchers are encouraged to broaden the scope of their sample beyond the manufacturing sector by including firms from various industries, in order to gain a more comprehensive understanding of tax avoidance practices. Additionally, it is advisable to incorporate alternative data sources beyond financial statements published by the Indonesia Stock Exchange such as industry publications and business media to enrich the analysis. Lastly, the adoption of more advanced methodologies, such as a mixed-methods approach, is recommended to provide a deeper and more holistic insight into corporate tax avoidance behavior.

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