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Analysis of Financial Distress on Tax Avoidance Mediated by Transfer Pricing

Dewi Sartika
Master of Accounting Program
Universitas Bina Darma, Palembang, Indonesia
dewi.sartika@binadarma.ac.id

Muji Gunarto
Master of Management Program
Universitas Bina Darma, Palembang, Indonesia
mgunarto@binadarma.ac.id

Feliantika Wijayanti
Student of Accounting Program
Universitas Bina Darma, Palembang, Indonesia
feliantikawijayanti@gmail.com

Sukurniati
Student of Accounting Program
Universitas Bina Darma, Palembang, Indonesia
sukurniati517@gmail.com

Yolan Saparingga
Student of Accounting Program
Universitas Bina Darma, Palembang, Indonesia
yolansaparingga2908@gmail.com

Abstract

The purpose of this study is to test and analyze the effect of financial distress on tax avoidance mediated by transfer pricing in manufacturing companies listed on the Indonesia Stock Exchange in 2020-2022. This study uses a descriptive method with a quantitative approach. The number of samples taken in this study was 48 companies. The sampling technique was carried out with a nonprobability sampling approach, namely the purpose sampling method. The findings of this study are transfer pricing is not able to mediate the effect of financial distress on tax avoidance; transfer pricing affects tax avoidance, and financial distress affects tax avoidance. This research implies that it is expected to contribute and refer to further research on the analysis of financial distress on tax avoidance mediated by transfer pricing.

Keywords
Tax Avoidance, Transfer Pricing, Financial Distress

1. Introduction

In this era of increasingly rapid economic growth, the government is required to meet and finance all state expenditures to create people's welfare by utilizing state revenues. The taxation sector is the sector that supports the state and is the main sector for the state and society to achieve better welfare (Harahap et al., 2023). One of the biggest sources of state revenue is taxes. Tax is one of the most important sources of state financial income. With the increase in state revenue from the tax sector, the government always strives to improve the existing taxation system so that it continues to run in a better direction (Handoyo et al., 2022).

Tax avoidance is a legal action that aims to minimize the tax burden by exploiting loopholes or adopting unintended interpretations of tax laws (O'Hare, 2019). Tax avoidance can affect the revenue of the government's taxation department, and tax avoidance is a natural consequence of any tax policy taken by the Directorate General of Taxes. The number of companies that try to find policy loopholes to save taxes (Silaban & Siagian, 2020). Tax avoidance is not a violation of tax law because taxpayers' efforts to reduce, avoid, or minimize tax obligations are carried out in a manner permitted by tax law. Tax avoidance in this study is measured using the Effective Tax Rate (ETR) ratio, which is the income tax expense divided by the pre-tax income of a company (Alfina et al., 2018).

Pada umumnya perusahaan cenderung untuk meminimalkan jumlah pajak terutang, yang dapat dilakukan melalui tindakan penggelapan pajak atau penghindaran pajak yang mengurangi nilai pajak (Claudianita et al., 2023). Kemungkinan terjadinya penghindaran pajak juga disebabkan karena pemerintah Indonesia menerapkan sistem *self assessment* dalam sistem pemungutan pajaknya. Wajib pajak memiliki kebebasan penuh untuk menghitung, membayar pajak, dan melaporkan kewajiban perpajakannya. Penerapan pajak ini seakan memberikan kesempatan kepada wajib pajak untuk melakukan tindakan penghindaran pajak dengan cara mengurangi laba perusahaan sehingga mengurangi jumlah pajak yang terutang (Stawati, 2020)

The phenomenon behind this research is based on a case reported by the Tax Justice Network stating that Indonesia is estimated to lose USD 4.86 billion per year or equivalent to IDR 68.7 trillion (IDR exchange rate against the US dollar is IDR 14,149 per US dollar). 14,149 per US dollar) due to tax evasion. In a headline titled The State of Tax Justice 2020: Tax Justice in the COVID-19 Era, Tax Justice News reported that with a total of IDR 68.7 trillion, the losses incurred due to tax evasion by business actors in Indonesia. The amount of losses incurred reached 4.78 billion USD or equivalent to 67.6 trillion rupiah. Meanwhile, the rest came from individual taxpayers amounting to USD 78.83 million or equivalent to IDR 1.1 trillion. In addition, multinational companies transfer their profits to the state, which is considered a financial utopia. This is done with the intention of not reporting the actual profits earned in the country where the company is located. Therefore, business entities that engage in this activity have to pay lower taxes than they should.

Based on previous studies, there are several factors that can affect tax avoidance in manufacturing companies. These determining factors include transfer pricing and financial distress.

In general, transfer pricing is carried out by multinational industries such as the exchange of goods and services with various industries at high prices, either mark up or mark down (Harahap et al., 2023). However, transfer pricing is not an illegal practice even though it violates ethical principles (Wijaya & Hidayat, 2021). In addition, research on transfer pricing shows mixed results. Research conducted by (Dharmawan et al., 2017) shows that transfer pricing has a significant effect on tax avoidance, while the research conducted by (Harahap et al., 2023; Panjalusman et al., 2018) shows that transfer pricing has no effect on tax avoidance.

Financial distress is defined as an early clue before a company goes bankrupt (Purnamawati, 2021). Financial distress is caused by a lack of capital caused by improper use of capital resources, insufficient deposits, and inefficient management in managing all activities. Previous research shows that tax avoidance is significantly influenced by financial distress factors in research (Purnamawati, 2021). Whereas in the research conducted by (Cita & Supadmi, 2019) shows that financial distress has a negative effect on tax avoidance.

This study examines and analyzes the effect of financial distress on tax avoidance mediated by transfer pricing in manufacturing companies listed on the Indonesia Stock Exchange in 2020-2022. Researchers chose manufacturing companies because they make the largest contribution to national GDP and are an important source of income. the largest contributor to national GDP and the highest contributor as a taxpayer. the highest contribution as a taxpayer.

2. Literature Review

2.1 Research Variables

Tax Avoidance (TA)

Tax avoidance is an effort to minimize the amount of tax payable, where taxpayers use loopholes in existing tax rules, in carrying out their tax management (Sinduarta & Hapsari, 2021). Tax avoidance is carried out by utilizing the arrangements in the tax aspect to the maximum, namely on the exemptions and depreciation that are permitted and not regulated in the legislation and the weaknesses that exist in the related tax regulations (Purnamawati, 2021).

$$\text{ETR} = \frac{Tax\ Expense}{Net\ Income\ Before\ Takes}$$

Transfer Pricing (TP)

Transfer pricing is a transfer pricing policy on selling prices (goods, services, and intangible assets) to subsidiaries and to related parties located in Indonesia or in other countries. In manufacturing companies, transfer pricing is used as a strategy to avoid taxation. The function of transfer pricing in tax management, as a strategy in minimizing the amount of tax that must be paid (Setyorini & Nurhayati, 2022). According to (Fazwa & Islahuddin, 2022), transfer pricing is determined through the amount of trade receivables to related parties and total receivables per period.

$$\text{TP} = \frac{Accounts\ receivable\ from\ related\ parties}{Total\ Accounts\ Receivable} \times 100$$

Financial Distress (FD)

Financial distress is a company's financial condition that experiences a stage of decline before the company experiences bankruptcy (Hutauruk et al., 2021). The company's inability to fulfill obligations such as paying off debt in the short term and solvency is an indication of financial distress. Companies experience financial distress when they experience negative profit margins for several years (Purnamawati, 2021). Financial distress is viewed from cash inflows that do not meet daily operating costs. Another opinion states that financial incapacity is a state of entity experiencing financial difficulties which is the beginning of bankruptcy (Ningsih & Noviari, 2022).

$$\text{FD} = \frac{Operating\ Cash\ Flow}{Total\ Average\ Liabilities}$$

2.2 Hypothesis Building

Effect of Financial Distress on Transfer Pricing

Transfer Pricing is a product or service exchange transaction that occurs between two different entities within a group of companies (K Tampubolon dan Z Al Farizi, 2018). Transfer Pricing is a company policy in determining the price of a transaction between related parties. Tax avoidance is often done by multinational companies using transfer pricing. According to (Rifai & Atiningsih, 2019) transfer pricing is a special selling price set in an interdepartmental exchange to capture the revenue of the sales department and the cost of the purchasing department.
H1: Financial Distress affects Transfer Pricing.

Effect of Transfer Pricing on Tax Avoidance

Transfer pricing is a system used by businesses to reduce their tax burden, either by trading with special parties (related party transactions), by transferring profits to a group of companies that suffer losses, or by trading with companies in tax-free countries. Most companies engage in tax avoidance by manipulating transfer prices. Similar to (Amidu et al., 2019; Herianti & Chairina, 2019; Marwa & Wahyudi, 2018) found that the more transfer pricing practices that are applied, the more companies avoid taxes that should be their obligations.
H2: Transfer Pricing affects Tax Avoidance

Effect of Finacial Distress on Tax Avoidance

Financial distress is defined as an early clue before a company goes bankrupt (Purnamawati, 2021). Financial distress is caused by a lack of capital caused by inappropriate use of capital resources, insufficient deposits, and inefficient management in managing all activities. This is what Brondolo inscribed in (Cita & Supadmi, 2019)When the company is suspected of experiencing financial distress or difficulty in funding, the entity seeks to practice tax avoidance to

minimize tax payments borne. Previous research shows that tax avoidance is significantly influenced by financial distress factors in research (Purnamawati, 2021)
H3: Financial Distress affects Tax Avoidance

2.3 Framework

Based on the description above, the framework can be described as follows in Figure 1:

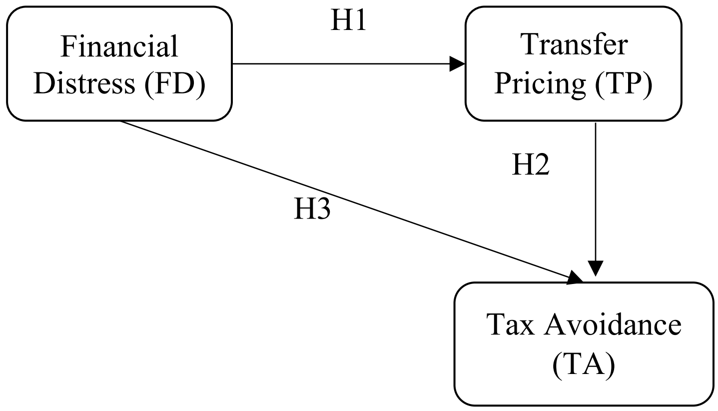

Figure 1. Conceptual Framework

3. Research Methodology

The object of this study is to analyze the effect of financial distress on tax avoidance mediated by transfer pricing. This type of research is a descriptive method with a quantitative approach. The population in this study were manufacturing companies listed on the Indonesia Stock Exchange 2020-2022 with a total sample of 48 companies. The sampling technique in this study was carried out with a nonprobability sampling approach, namely the purpose sampling method. The data analysis technique used is multiple linear analysis using SPSS 23 software. Data collection techniques using secondary data of manufacturing companies listed on the Indonesia Stock Exchange.

4. Results and Discussion

4.1 Descriptive Statistics Test

Variable description in the study was conducted on transfer pricing, financial distress, and tax avoidance variables. The descriptive statistical test results of this study are presented in Table 1 below.

Table 1. Descriptive Analysis

Variables	N	Minimum	Maximum	Mean	Std. Deviation
Tax Avoidance (TA)	48	.047	2.901	.31799	.431993
Transfer Pricing (TP)	48	.185	1.029	.90648	.191767
Financial Distress (FD)	48	.002	4.499	.48490	.800719

Source: Data processed, 2024

Based on Table 1, the results of the analysis using descriptive statistics, the value of tax avoidance has a standard deviation of 0.431993, a minimum of 0.047 owned by the FOOD company (PT Sentra Food Indonesia Tbk.) in 2022, a maximum value of 2.901 owned by KAEF (Kimia Farma Tbk.) in 2022. The Transfer Pricing variable has a standard deviation of 0.191767, transfer pricing shows a minimum value of 0.185 owned by the HMSP company (HM Sampoerna Tbk) in 2021, the COCO Company (PT Wahana Interfood Nusantara Tbk.) in 2022 has a maximum value of 1,029.The Financial Distress variable has a standard deviation of 0.800719, the ALTO Company (Tri Banyan Tirta Tbk) in 2020 shows a minimum value of 0.002, the maximum value of 4,499 is owned by the WIIM company (Wismilak Inti Makmur Tbk) in 2021.

4.2 Classical Assumption Test

Normality Test

The results of the normality test with the Kolmogorov-Smirnov test technique carried out on the SPSS 23 software show that the Sig value is 0.052> 0.05. The results of this test indicate that the data analyzed is normally distributed and the distribution of data in the data group is normal.

Multicollinearity Test

The multicollinearity test results conducted on SPSS 23 software, the multicollinearity test results show that transfer pricing has a tolerance value of 0.929 and VIF of 1.076, financial distress has a tolerance value of 0.929 and VIF of 1.076. Where if the tolerance is above 0.1 and the VIF value is not more than 10, the data shows no multicollinearity.

Heteroskedasticity Test

The heteroscedasticity test in this study can be seen in the scatterplot graph. Based on Figure 2, it can be seen that the data does not occur heteroscedasticity because it spreads without forming a clear pattern and the dots spread above and below 0 on the Y axis so it can be concluded that there is no heteroscedasticity.

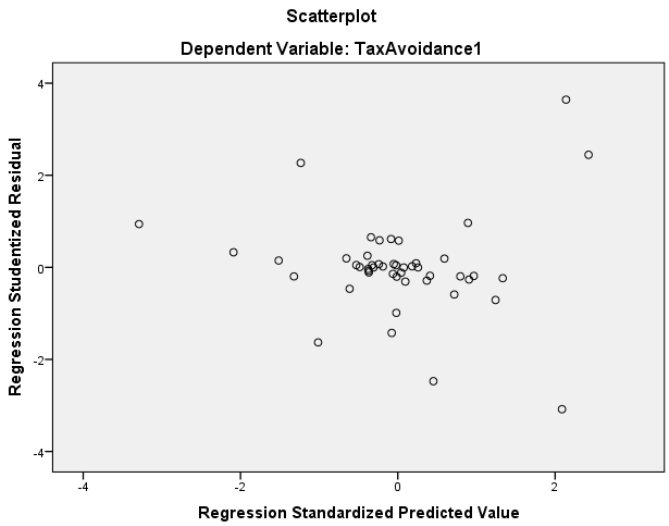

Figure 2. Scatterplot Graph

Autocorrelation Test

The results of the autocorrelation test conducted on SPSS 23 software, it can be concluded that the DW test value is 1.884. This value when compared to the table value using a confidence degree of 5% (0.05) with a sample size (n) of 48 and an independent variable (k) of 3, then in the Durbin-Watson table the du value will be 1.6708 and the dl value is 1.4064. So that the dw value is greater than the dl value (0 > d > dl), namely 0 > 1.884 > 1.4064, it can be interpreted that there are no symptoms of autocorrelation.

4.3 Regression Analysis

Path Analysis

Path Analysis of the Effect of Financial Distress (FD) on Transfer Pricing (TP)

The effect of other variables on transfer pricing (e_1) can be determined as follows:

$e_1 = \sqrt{1 - r2}$

$e_1 = \sqrt{1 - 0,124}$

$e_1 = 0,9359$

The value of e_1 the path coefficient of other variables on TP is equal to 0,9359.

Path Analysis of the Effect of Transfer Pricing (TP) and Financial Distress (FD) on Tax Avoidance (TA)

This path analysis is carried out to determine the effect of independent variables, mediating variables on the dependent variable, namely the effect of TP and FD on TA, it can be determined in the following way:

It is known that the R Square is 0.149 (r2) The effect on tax avoidance (e_2) then the calculation can be done in the following way:

$e_2 = \sqrt{1 - r2}$

$e_2 = \sqrt{1 - 0{,}149}$
$e_2 = 0{,}9224$

Then the e_2 value of the path coefficient of all variables on tax avoidance (TA) is 0.922, so the substructure 2 path equation is as follows:

Y = α+β1. TP - β2. FD - β3

Description:

ETR = Tax Avoidance
TP = Transfer Pricing
FD = Financial Distress
α = Constant
β1-6 = Independent variable regression coefficient
e = Error

Influences

The results of path analysis show that financial distress (FD) can have a direct effect on tax avoidance (TA) and can also have an indirect effect through transfer pricing (TP) as intervening:

The Effect of Financial Distress (FD) on Tax Avoidance (TA):

Direct Effect (p1) = -0,107
Indirect Effect (p2×p3) = (0,072 × -0,307) = -0,0221
Total Effect (p1+(p2×p3)) = -0,107 + -0,0221= -0,1291

The results using the Sobel Test, taking into account the magnitude of the standard error value of the indirect effect, namely:

Se1 $= \sqrt{1-r2} = \sqrt{1-0{,}124} = 0{,}935$
Se2 $= \sqrt{1-r2}\ \sqrt{1-0{,}149} = 0{,}922$
p2p3 = p2 × p3 = 0,935 × 0,922 = 0,862
Sp2p3 $= \sqrt{(TPp2^{2}\cdot Se2^{2)}) + (FDp3^{2}\cdot Se1^{2)}) + (S1^{2}\cdot Se2^{2)})}$
$= \sqrt{(-0{,}307^{2}.\ 0{,}922^{2}) + (-0{,}107^{2}.0{,}935^{\ 2)}) + (\ 0{,}935^{2}.\ 0{,}922^{\ 2})}$
$= \sqrt{0{,}080 + 0{,}0099 + 0{,}7430}$
$= \sqrt{0{,}8329} = 0{,}9126$

Next, determine the t value as presented in the calculation below:

$$t = \frac{p2p3p4}{Sp2p3p4} = \frac{p2p3p4}{Sp2p3p4} = \frac{-0{,}1291}{0{,}9126} = -0{,}3188$$

The results present the t value compared to the t table value, if the t table value, if the t value> table value, it can be concluded that there is a mediating influence. The calculation result presents the t value smaller than the t table with a significance level of 0.05 with a value of -0.3188 < 1.684. Thus it can be concluded that the transfer pricing variable is not able to mediate the effect of financial distress on tax avoidance..

4.4 F-Test

The F test or model feasibility test aims to determine whether the independent variables have a joint influence on the dependent variable.

Table 2. F-Test

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	3.150	2	1.575	12.610	.000b
	Residual	5.621	45	.125		
	Total	8.771	47			

Source: Secondary data processed using SPSS 23

Based on Table 2, it can be seen that this equation model has a sig value of 0.000 <0.05, which means that the independent variables simultaneously or together affect the dependent variable, so it can be concluded that this model is feasible to use or fit.

4.5 R^2 Test

The R^2 test aims to measure the extent to which the model's ability to explain variations in independent variables. Based on the results of the R^2 test conducted on SPSS 23, it shows that the Adjusted R Square value of 0.331 means that 33.1% of tax avoidance variations can be explained by financial distress variables with transfer pricing. The remaining 66.9% is influenced by other variables not included in this study.

4.6 Partial Test (T Test)

Table 3. Partial Test (T Test)

Model		Unstandardized Coefficients		Standardized Coefficients		
		B	Std. Error	Beta	t	Sig.
1	(Constant)	.096	.072		1.330	.190
	Transfer Pricing (TP)	-.307	.116	-.328	-2.652	.011
	Finansial Distress (FD)	-.107	.031	-.422	-3.406	.001
a. Dependent Variable: Tax Avoidance (Y)						

Source: Secondary data processed using SPSS 23

Based on table 3, it can be concluded as follows:

H1: Transfer Pricing Is Not Able to Mediate the Effect of Financial Distress on Tax Avoidance

The first hypothesis has been tested on the path test where the calculation results present the t value smaller than the t table with a significance level of 0.05 with a value of -0.3188 < 1.684. Thus it can be concluded that the transfer pricing variable is not able to mediate the effect of financial distress on tax avoidance, so the second hypothesis is rejected. This shows that the greater the company experiencing financial distress does not encourage the company to perform transfer pricing actions.

H2: Transfer Pricing Affects Tax Avoidance

The second hypothesis states that transfer pricing affects tax avoidance. Table 3 shows that -0.307 as the regression coefficient value and obtained a P-value of 0.011 <0.05. This result shows that. The value of regression coefficient 1 of -0.307 indicates the relationship between TP and ETR. The test results show that transfer pricing affects tax avoidance, so the first hypothesis is accepted. This shows that companies with high transfer pricing variables conduct more transactions than companies with low transfer pricing variables. This provides an opportunity for these companies to conduct improper transactions to minimize their tax burden. The results of this study are in line with research conducted by (Dharmawan et al., 2017; Harahap et al., 2023; Panjalusman et al., 2018; Wijaya & Hidayat, 2021) which states that transfer pricing affects tax avoidance.

H3: Financial Distress Affects Tax Avoidance

The third hypothesis states that financial distress affects tax avoidance. Table 3 shows that -0.107 as the regression coefficient value and obtained a P-value of 0.001 <0.05. This result shows that financial distress has a negative effect on ETR. The coefficient value of -0.107 indicates a negative relationship between financial distress and ETR. The test results that financial distress affects tax avoidance, so the third hypothesis is accepted. This shows that companies that experience financial or financial difficulties will encourage companies to try to do tax avoidance to minimize the tax payments borne. The results of this study are in line with the research conducted by (Cita & Supadmi, 2019; Purnamawati, 2021) which states that financial distress affects tax avoidance.

5. Conclusions and Recommendations

Based on the results of the analysis and discussion that has been done, it can be concluded that the greater the company experiencing financial distress, it does not encourage the company to perform the act of transfer princing, so that transfer pricing is not able to mediate the effect of financial distress on tax avoidance. The company with high transfer pricing variable conducts more transactions than the company with low transfer pricing variable, it provides an opportunity for the company to conduct improper transactions to minimize its tax burden so that transfer pricing affects tax avoidance. Companies that experience great financial difficulties will encourage companies to do tax avoidance, so that financial distress variables affect tax avoidance.

The results of this study also have implications for regulators, in this case the Directorate General of Taxes should periodically review existing tax regulations so as to narrow the gap for tax avoidance by taxpayers.In addition, the Indonesia Stock Exchange should further expand the completeness of financial reports, so that the data required is more accurate.

This research has been prepared correctly and in accordance with scientific procedures, but still has limitations that can be used as a reference for further research in order to obtain better results. The limitations of this study are that it only covers a limited research period of 3 years and the research object is only in the manufacturing sector listed on the Indonesia Stock Exchange. For future researchers, they can expand the period and number of research objects. In addition, it can add other independent variables related to Tax Avoidance such as Good Corporate Governance, sales growth and others.

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Biographies

Dewi Sartika is a lecturer at the Faculty of Social Humanities at Bina Darma University, Palembang. Her associate degree was obtained from the Department of State and Regional Finance, Universitas Andalas, Padang in 2005. The bachelor degree was obtained from the Department of Accounting, Universitas Muhammadiyah Palembang in 2009. The master of economics degree was obtained from Andalas University, Padang in 2014 and the doctoral degree was obtained from the Doctor of Economics (Accounting) program at Andalas University, Padang in 2022. And got the accounting profession at Andalas University, Padang in 2018. Her current position is Head of Accounting StudyProgram, Bina Darma University. She has also participated in national and international scientific seminars and also made various articles that have been published in journal

Muji Gunarto is Assoc. Prof. at the Faculty of Social Sciences and Humanities, Bina Darma University, Palembang, Indonesia. His current position is Functional Head of Management. His undergraduate degree was obtained from the Faculty of Statistics, Padjajaran University, Bandung, Indonesia. The Master of Science degree was obtained from Sriwijaya University, Palembang, Indonesia. The Doctoral degree is obtained from the Doctoral Program, University of Education Indonesia. Several books and scientific works have been published in Scorpus and Sinta-indexed journals.

Feliantika Wijayanti is an undergraduate student at Bina Darma University majoring in Accounting. This is paper her first step in her research journey which is expected to be further developed in the pursuit of knowledge.

Sukur Niati is an undergraduate student at Bina Darma University majoring in Accounting. This is paper her first step in her research journey which is expected to be further developed in the pursuit of knowledge.

Yolan Saparingga is an undergraduate student at Bina Darma University majoring in Accounting. This is paper her first step in her research journey which is expected to be further developed in the pursuit of knowledge.