

THE EFFECT OF TRANSFER PRICING, CAPITAL INTENSITY AND FOREIGN ACTIVITY ON TAX AVOIDANCE

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Abstract

Tax is one of the main sources of state revenue. However, the realization of tax revenue does not always reach the expected target. There are several factors that become obstacles in tax revenue, one of which is Tax Avoidance. Tax avoidance is a strategy and technique carried out legally and safely for taxpayers because it does not conflict with tax provisions. This study aims to determine the effect of transfer pricing, capital intensity, and foreign activity on tax avoidance in energy sector companies in the oil, gas & coal sub-sector which are listed on the Indonesia Stock Exchange for the period 2017-2021 simultaneously and partially. The sample selection technique used purposive sampling and obtained 10 companies with observations over 5 years, so that 50 samples were observed. The analysis technique used in this research is panel data regression analysis using Eviews 12 software. The results of this study indicate that transfer pricing, capital intensity and foreign activity simultaneously influence tax avoidance. Partially obtained the results that transfer pricing and foreign activity have no significant effect on tax avoidance. While capital intensity has a negative effect on tax avoidance.

Keywords: capital intensity, foreign activity, tax avoidance, transfer pricing

1. INTRODUCTION

The Energy Sector includes companies that sell products and services related to energy extraction which include non-renewable energy (fossil fuels) so that their income is directly affected by world energy commodity prices, such as Oil, Natural Gas, Coal Mining companies, and companies that provide services that support the industry. In addition, this sector also includes companies selling alternative energy products and services.

According to Rahmadini and Ariani (2020) the energy sector is a leading sector that contributes quite a lot to state tax revenues. The large potential of Indonesia's energy sector can increase the desire of companies to reduce the tax burden paid using both legal and illegal means. It was recorded in 2021 that 4,532 out of 8,003 energy industry taxpayers (WP) did not report their annual tax return (SPT), this number does not include the mandatory small-scale mining companies that do not register as taxpayers. Incistaco.com, The Director General of Taxes said the low level of tax compliance in the energy sector among 11 thousand companies holding mining business permits (IUP), only 2 thousand companies were recorded as having a taxpayer identification number (NPWP). This means that there are 9,000 companies that do not have a tax identification number, which means they do not pay their taxes. Therefore, the energy sector has a very large potential loss or potential tax loss.(Citasco, 2018)

Indonesia is a developing country. One of the most important sources of income for a country is taxes. State revenue is used as a fulfillment of state needs and a source of financing as income

for state development. However, this revenue still has the potential to be increased to finance the country's development and operations as one of the steps towards a developed country which requires a large amount of money. According to Sri Mulyani, taxes are the backbone and foundation for a country's economy and have a very important role in creating security, defense and certainty for the country and its citizens. Taxes play a big role in economic growth in our country. To improve the economy and people's welfare, the government sets long-term goals,(Ministry of Finance of the Republic of Indonesia, 2022).

The company's efforts to minimize its tax burden are called tax planning.(Anwar Pohan, 2018). Tax planning that is carried out legally and does not conflict with tax regulations is called tax avoidance, while tax planning that is carried out illegally and contrary to tax regulations is called tax evasion. According to Regina A & Vitarimawatty S (2018), tax avoidance practices usually take advantage of weaknesses in tax law and do not violate tax laws. In addition to providing benefits for the company, tax avoidance can also have a negative effect on the company. This is because tax avoidance can reflect the manager's personal interest by manipulating earnings which results in incorrect information for investors. Thus investors can give a low valuation to the company with existing laws.

According to the Tax Justice Network report, Indonesia is expected to face losses of US\$ 4.86 billion per year or the equivalent of IDR 68.7 trillion (the rupiah exchange rate is IDR 14,149 per US dollar) due to tax evasion. In an editorial entitled The State of Tax Justice 2020: Tax Justice in the time of COVID-19, the Tax Justice News reported that a total of IDR 68.7 trillion, the loss was caused by corporate taxpayers committing tax evasion in Indonesia? The amount of losses caused reached US\$ 4.78 billion or the equivalent of Rp. 67.6 trillion. Meanwhile, the rest came from individual taxpayers with a total of US\$ 78.83 million or the equivalent of Rp. 1.1 trillion.(Fatima, 2020)

Lots companies that seek to minimize the tax burden. One that has been detected as committing tax evasion in Indonesia is a mining company listed on the Indonesia Stock Exchange (IDX), namely PT Adaro Energy (ADRO). Based on an examination by the Directorate General of Taxes (DGT), it is known that from 2009 to 2017 the coal company carried out transfer pricing in an effort to reduce the tax burden through Coaltrade Services International, which is its subsidiary in Singapore. PT Adaro Energy (ADRO) implemented a strategy that made tax payments less than what had to be paid in Indonesia, namely only US\$ 125 million or Rp. 1.75 trillion. This results in reduced taxable income. In implementing tax avoidance,(Sugianto, 2019).

2. BASIC THEORY AND METHODOLOGY

2.1 Basic theory

2.1.1 Agency Theory (Agency Theory)

Agency theory was pioneered by Jensen and Meckling in 1976, this theory is related to the contractual relationship between members of a company and the organization. The most commonly used models in this theory are the principal (superiors) and agents (subordinates),

and are viewed from a behavioral and structural perspective. The principal delegates decision-making responsibility to the agent. In relation to the practice of tax revenue, the company in this case is called the agent is a party that contributes to tax revenue, but the government in this case is called the principal has a different goal from the company where the government aims to maximize tax revenue, while the company aims to minimize the smallest possible burden where the company considers tax as one of the burdens that needs to be minimized. The existence of these different interests can lead to agency conflicts because companies are considered to be able to make decisions that benefit their interests but are detrimental to the government.

2.1.2 Tax Avoidance

Tax avoidance is a tax avoidance effort that is carried out legally and safely without conflicting with tax regulations, tax avoidance is carried out through methods and techniques that lead to the use of weaknesses (gray areas) contained in tax laws and regulations in order to minimize the amount of tax payable. Measurements used in this study are:

$$CETR = \frac{\text{Cash taxes paid}}{\text{Total pre tax accounting income}}$$

2.1.3 Transfer Pricing

Organization For Economic *Co-operation And Development*(OECD) defines transfer pricing as a price determined in transactions between group members in a multinational company, where the specified transfer price can deviate from the fair market price as long as it is appropriate for the group. In this study, transfer pricing is proxied using a dummy variable with the following criteria:

Score 1: If the company sells to parties who have special relationships abroad.

Score 0: If the company has no relations or does not sell to parties who have special relations abroad.

2.1.4 Capital Intensity

According to Nugraha & Mulyani (2019) Capital intensity is an investment activity carried out by a company in the form of fixed assets to increase profit. Fixed assets are elements of assets with great value in the company's statement of financial position (balance sheet). Fixed assets will be deducted from income so that in tax avoidance the depreciation expense will be deducted from taxes. The capital intensity formula is as follows:

$$CAP = \frac{\text{Total Asset Tetap Bersih}}{\text{Total Asset}}$$

2.1.5 Foreign Activities

Foreign Activities is an overseas activity utilized by a company to expand its operational development (Zamani, 2022). According to (Rego, 2018), companies that carry out foreign

activities have the opportunity to reduce income tax by way of income shifting in countries that have low tax rates. The foreign activity formula is as follows:

$$\text{Foreign Activity} = \frac{\text{Total Foreign Sales}}{\text{Total Global Sales}}$$

2.2 Framework

2.2.1 Effect of Transfer Pricing on Tax Avoidance

Transfer pricing can be expressed as the selling price between companies to minimize taxes incurred on the sale of goods and services. According to Pohan (2018: 196-197) transfer pricing is a calculated price for the delivery of other intangible goods or services from one company to another company that has a special relationship under conditions based on the principle of fair market prices.

Transfer pricing can be used by companies to carry out tax avoidance by setting transfer prices with the aim of transferring company profits to related parties in countries with low tax rates, so that company profits will be taxed in the country the related parties are located, the company will sell goods or services to relation companies that are abroad at unreasonable prices, with the aim that these companies can minimize the profits they earn, so that the reported profits are small. So it can be concluded that transfer pricing has a positive effect on tax avoidance.

This is in accordance with research related to transfer pricing conducted by Amidu et al., (2019) which shows that transfer pricing has a positive effect on tax avoidance because companies become more aggressive in transferring price abuse which leads to higher tax avoidance with the introduction of transfer pricing interactions.

2.2.2 Effect of Capital Intensity on Tax Avoidance

Capital intensity or capital intensity is defined as a form of the ratio of investment activities carried out in a company. The existence of capital intensity shows the company's investment presented in the form of fixed assets or capital intensity in the form of machinery, equipment, and property to its total assets. (Anindyka et al., 2018). In PSAK 16 fixed assets are tangible assets, so these fixed assets generate depreciation expense every year with respect to their economic life.

When the depreciation expense is higher, the company's burden is also higher, then the taxable income will be lower and the tax will be lower. Companies that have high fixed asset values will incur high depreciation or depreciation costs, so that tax avoidance will increase. This is one way for companies to avoid taxes by increasing capital intensity or fixed assets as much as possible.

A temporary conclusion can be obtained that capital intensity will become a depreciation expense that is owned to reduce income in calculating taxes resulting in tax avoidance practices. Therefore, it can be concluded that the existence of capital intensity has a positive effect on tax avoidance which is in line with the research conducted by Suciarti et al., (2020) And Rosdiana (2018).

2.2.3 Effect of Foreign Activity on Tax Avoidance

According to Rego (2018), companies that have foreign activity have the opportunity to reduce income tax by carrying out income shifting towards countries that have low tax rates. In foreign activities, research in developed countries shows that companies that have foreign activities report a much lower taxable income.

CETR variations in Australia and shows that foreign activity has a significant negative sign (Harris & Feeny, 2003). This indicates that when companies have high foreign activity, the tendency for companies to try to do tax avoidance is low. Harris & Feeny (2019) argues that it is evidence that companies may use foreign activity to reduce tax payments in their countries. Especially in ASEAN, the tax rate in Indonesia (25%) can be said to be quite high compared to Singapore (17%), Thailand (20%), and even Vietnam (20%). This description gives an indication that it is possible for companies to take advantage of foreign activity to reduce tax payments in Indonesia.

It can be concluded that the presence of foreign activity has a positive effect on tax avoidance in line with research conducted by Fazliza M. Kasim and Natrah (2019) and Hansson et al., (2018).

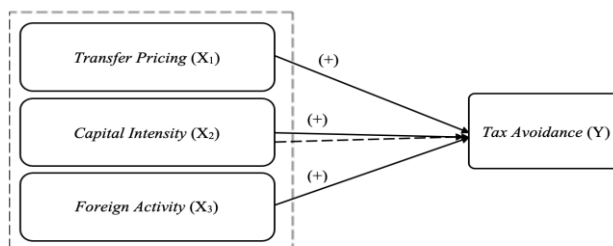


Figure 2.1: Framework

2.3 Research Hypothesis

Based on the formulation of the problem and the framework supported by the relevant theory, the hypotheses in this study are as follows:

1. Transfer pricing, capital intensity and foreign activity simultaneously affect tax avoidance.
2. Transfer pricing partially has a positive effect on tax avoidance.
3. Capital intensity partially has a positive effect on tax avoidance.
4. Foreign activities partially has a positive effect on tax avoidance.

2.4 Research methodology

In this study, the population used is the energy sector companies in the oil, gas & coal sub-sector which are listed on the Indonesia Stock Exchange (IDX) for the 2017-2021 period. The sampling technique used in this study was purposive sampling and obtained 10 mining companies with a research period of 5 years. The analytical method used is a panel data

regression model and descriptive statistical analysis. The analytical method in this study uses the panel data regression method which can be described as follows.

$$Y = \alpha + \beta_1 TP + \beta_2 CI + \beta_3 FA + \varepsilon$$

Information:

Y : Tax Avoidance

α : Constant

β : Regression coefficient of each independent variable

TP : Transfer Pricing

CI : Capital Intensity

FA : Foreign Activities

ε : Error term

3. DISCUSSION

3.1 Descriptive Statistical Analysis

In this study there are 2 descriptive statistics, namely nominal scale and ratio scale. Following are the results of descriptive statistical tests of nominal scale variables as follows:

Table 1: Transfer Pricing Descriptive Statistical Results

Information	Number of Companies					Total
	2017	2018	2019	2020	2021	
Perform Transfer Pricing	3	4	5	5	5	22 (44%)
Not Performing Transfer Pricing	7	6	5	5	5	28 (56%)

Source: Data that has been processed by the author, (2023)

Table 1 shows that the descriptive statistical results of the transfer pricing variable in energy sector companies in the oil, gas & coal sub-sector listed on the Indonesia Stock Exchange in 2017-2021 were measured using a dummy variable, that out of 50 samples, there were 22 (44%) samples that carry out transfer pricing, while there are 28 (56%) samples that do not have overseas relations or do not carry out transfer pricing with related parties abroad.

In this study, the variables using the ratio scale, namely capital intensity, foreign activity and tax avoidance, will be analyzed using the maximum, minimum, average and standard deviation values. Following are the results of ratio scale descriptive statistics:

Table 2: Results of Ratio Scale Descriptive Statistical Test

	Tax Avoidance	Capital Intensity	Foreign Activities
Means	0.277383	0.187128	0.762981
Maximum	0.688063	0.326878	0.995080
Minimum	0.028892	0.031078	0.228002
Standard Deviation	0.180601	0.078775	0.228247

Source: Data processed using Eviews 12, (2023)

Based on table 2, it shows that the average value of the tax avoidance variable as measured using the Cash Effective Tax Rate (CETR) in oil, gas and coal sub-sector energy sector companies listed on the Indonesia Stock Exchange (IDX) in 2017- 2022 is 0.277383, while the standard deviation value is smaller, namely 0.180601, which indicates that the tax avoidance variable data is grouped or does not vary. The maximum value of tax avoidance is 0.688063. Meanwhile, the minimum tax avoidance value is 0.028892.

The independent variable capital intensity has an average value of 0.187128 while the standard deviation value is smaller, namely 0.078775. Which shows that the capital intensity variable data is grouped or does not vary. The maximum value of capital intensity is 0.326878. Meanwhile, the minimum capital intensity value is 0.031078.

The foreign activity independent variable has an average value of 0.762981, while the standard deviation value is smaller, namely 0.228247. which shows that the foreign activity variable data is grouped or not varied. The maximum value of foreign activity is 0.995080. Meanwhile, the minimum foreign activity value is 0.228002.

3.2 Test Classic Assumption

3.2.1 Test Multicollinearity

The following are the results of the multicollinearity test using Eviews 12 Software:

Table 3: Multicollinearity Test Results

	Transfer Pricing	Capital Intensity	Foreign Activities
Transfer Pricing	1	-0.162	0.317
Capital Intensity	-0.162	1	-0.570
Foreign Activities	0.317	-0.570	1

Source: Data processed using Eviews 12, (2023)

Based on table 3, it shows that all independent variables have no correlation coefficient greater than 0.9. It can be concluded that the independent variables in this study do not have symptoms of multicollinearity.

3.2.2 Heteroscedasticity Test

Following are the results of the Heteroskedasticity test using Eviews 12 Software:

Table 4: Heteroscedasticity Test Results

Variables	coefficient	std. Error	t-Statistics	Prob.
C	0.045456	0.209128	0.217358	0.8292
TP	0.020588	0.056407	0.364997	0.7173
CI	0.438534	0.298755	1.467874	0.1511
FA	-0.011103	0.256691	-0.043254	0.9657

Source: Data processed using Eviews 12, (2023)

Based on table 4, it shows that the probability value of the transfer pricing variable, capital intensity and foreign activity has a probability value of > 0.05 , so it can be concluded that in this study there was no heteroscedasticity.

3.3 Panel Data Regression Analysis

Based on the test results of the predetermined model, namely the Chow test and the Hausman test which have a significance value of < 0.05 . Then the appropriate model in this study is the fixed effect. The table below shows the results of the fixed effect model test using the Eviews 12 software:

Table 5: Fixed Effect Model Testing Results

Dependent Variable: Y				
Method: Panel Least Squares				
Date: 04/11/23 Time: 21:35				
Sample: 2017 2021				
Period included: 5				
Cross-sections included: 10				
Total panel (unbalanced) observations: 48				
Variables	coefficient	std. Error	t-Statistics	Prob.
C	-0.133524	0.430972	-0.309822	0.7585
TP	0.212339	0.116243	1.826680	0.0763
CI	2.389285	0.615674	3.880762	0.0004
FA	-0.183786	0.528990	-0.347428	0.7304
Effects Specification				
Cross-section fixed (dummy variables)				
Root MSE	0.131357	R-squared	0.453340	
Mean dependent var	0.269315	Adjusted R-squared	0.265913	
SD dependent var	0.179541	SE of regression	0.153829	
Akaike info criterion	-0.680137	Sum squared residue	0.828218	
Schwarz criterion	-0.173353	Likelihood logs	29.32328	
Hannan-Quinn criter.	-0.488622	F-statistics	2.418759	
Durbin-Watson stat	2.348344	Prob(F-statistic)	0.020874	

Source: Data processed using Eviews 12, (2023)

Based on the selected regression model, namely the fixed effect model, the panel data regression equation can be obtained, as follows:

$$Y = (0.133524) + 0.212339 TP + 2.389285 CI - 0.183786 FA + e$$

Information:

Y : *Tax Avoidance (CETR)*

TP : *Transfer Pricing*

CI : *Capital Intensity*

FA : *Foreign Activities*

e : *Error*

Because CETR and Tax Avoidance are inversely proportional, when a constant is positive it will cause tax avoidance to be negative and vice versa if the constant is negative then tax avoidance is positive.

3.4 Hypothesis test

3.4.1 Coefficient of Determination (R²)

Based on table 5, it can be seen that the Adjusted R-Square in this research model is 0.265913 or 26%. Thus it can be concluded that transfer pricing, capital intensity and foreign activity are able to explain the dependent variable, namely tax avoidance in energy sector companies in the oil, gas & coal sub-sector which are listed on the Indonesia Stock Exchange in 2017-2021 as measured by Cash Effective The tax rate (CETR) is 0.380963 or 26%, while the remaining 74% is explained by variables outside this study.

3.4.2 Simultaneous Test (Test F)

Based on table 4, it is known that the prob value (F-statistic) is 0.020874 < 0.05, which means that transfer pricing, capital intensity and foreign activity variables simultaneously affect tax avoidance in energy sector companies in the oil, gas & coal sub-sector listed on the Indonesia Stock Exchange in 2017-2021.

3.4.3 Test Partial (t test)

1. The probability value (t-statistic) of transfer pricing is 0.0763 > 0.05, it can be concluded that transfer pricing has no partial effect on tax avoidance.
2. The probability value (t-statistic) of capital intensity is 0.0004 < 0.05, CETR is inversely proportional to tax avoidance, where the lower the CETR value, the higher tax avoidance so that it can be concluded that capital intensity has a partial negative effect on tax avoidance.
3. The probability value (t-statistic) of foreign activity is 0.7304 > 0.05, it can be concluded that foreign activity partially has no effect on tax avoidance.

3.5 Discussion of Research Results

3.5.1 Effect of Transfer Pricing on Tax Avoidance

Based on the test results from the panel data regression analysis in table 5 it shows that transfer pricing has a regression coefficient value of 0.212339 and a probability value of 0.0763. This value indicates that the probability of transfer pricing is greater than the significance level of 0.05, so it can be concluded that transfer pricing partially has no significant effect on tax avoidance. Thus it can be concluded that the results are not in accordance with the hypothesis in the research framework.

This is because the Minister of Finance of the Republic of Indonesia issued Regulation No. 1 of 2016 No. 213/PMK.03/2016 in which taxpayers are required to make TP Doc (transfer pricing documentation), namely types of documents and/or additional information that must be kept by taxpayers transactions with related parties and the procedures for managing them. Therefore, with strict and firm control from the Ministry of Finance and the Directorate General of Taxes, it is rather difficult for a company to carry out tax avoidance through transfer pricing practices. The results of this study are in line with research conducted by Panjalusman et al. (2018) And Napitupulu et al. (2020) states that transfer pricing has no significant effect on tax avoidance.

3.5.2 Effect of Capital Intensity on Tax Avoidance

Based on the test results from the panel data regression analysis in table 5 shows that capital intensity has a regression coefficient value of 2.389285 and a probability value of 0.0004, this value is below the significance level of 0.05, CETR is inversely proportional to tax avoidance, where the lower the CETR value the higher the tax avoidance so that it can be concluded that capital intensity partially has a negative effect on tax avoidance.

Fixed assets owned by the company can be used to assist the company in carrying out its business activities, the greater the fixed assets owned can help the company to run its business better so that it can increase profits and fulfill its tax obligations without having to do tax avoidance. So that the greater the capital intensity or the intensity of fixed assets owned by the company, the less tax avoidance activities the company has. The results of this study are in line with research conducted by Primary, Aziz (2022) and Cahyani et al., (2021) which states that capital intensity has a negative effect on tax avoidance.

3.5.3 Effect of Foreign Activity on Tax Avoidance

Based on the test results from the panel data regression analysis in table 5 shows that foreign activity has a regression coefficient value of -0.183786 and a foreign activity probability value of 0.7304, this value is above the 0.05 significance level, so it can be concluded that foreign activity partially has no effect against tax avoidance.

These results indicate that multinational companies or companies that have overseas operations do not transfer high tax potential in one country to another country that has lower tax potential. Multinational companies establish many subsidiaries in countries according to their production market share only to improve marketing strategies and to increase company revenues, the

establishment of subsidiary companies is to strengthen import-export trade alliances in various countries and strengthen the company's global base. It is also suspected that the establishment of foreign operations was not used as an opportunity to use tax planning (tax management) to reduce payments. The results of this study are in line with research that has been conducted by Dewi & Teak (2019) And Ratna Ayu (2021) which states that foreign activity has no effect on tax avoidance.

4. CONCLUSION

Based on the results of the tests that have been carried out in this study on oil, gas & coal sub-sector energy sector companies listed on the Indonesia Stock Exchange in 2017-2021 it shows that transfer pricing variables, capital intensity and foreign activity effect simultaneously on tax avoidance. Partially, *transfer pricing* and *foreign activities* does not affect tax avoidance, meanwhile *capital intensity* negative effect on tax avoidance.

Based on the results of the study, the coefficient of determination obtained by transfer pricing, capital intensity and foreign activity variables only explains the dependent variable of 26% of tax avoidance, while the remaining 74% is explained by variables outside the study. Future researchers are expected to examine variables and proxies or other indicators outside of this study in order to be able to explain tax avoidance in more depth.

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