

# Enhancing Corporate Integrity: Profitability, Transfer Pricing, and Tax Avoidance with the Role of Bonus Mechanisms and Stewardship Theory

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**Abstract.** This study examines the effect of transfer pricing and bonus mechanisms on tax avoidance. It tests profitability as a moderating variable in multinational companies. Grounded in Stewardship Theory, the research explores whether managerial incentives and corporate profitability influence firms' tax behavior. It emphasizes the balance between financial performance and ethical tax practices. A quantitative approach was used with secondary data from the financial reports of industrial sector companies listed on the Indonesia Stock Exchange (IDX) during 2020–2022. The sample was selected through purposive sampling, consisting of 21 companies. Panel data regression analysis was conducted using the Ordinary Least Squares (OLS) method, supported by Chow, Hausman, and Lagrange Multiplier (LM) tests to determine the most appropriate model. The results show that both transfer pricing and bonus mechanisms have a significant positive effect on tax avoidance. This indicates that multinational firms use intra-group transactions and performance-based incentives to minimize tax burdens. However, profitability does not significantly moderate these relationships. This suggests that firm performance alone does not weaken or strengthen the impact of transfer pricing and bonus mechanisms on tax avoidance. These findings contribute to the literature on corporate governance and tax planning by providing empirical evidence on the interplay between managerial incentives, profitability, and ethical financial behavior. The research offers valuable implications for policymakers and companies in developing responsible compensation systems and regulatory frameworks to curb aggressive tax practices.

**Keywords:** transfer pricing; bonus mechanism; tax avoidance; profitability; stewardship theory.

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## Introduction

Tax avoidance remains one of the most pressing challenges in contemporary economics and corporate governance due to its implications for fiscal sustainability, equity, and corporate ethics. Multinational corporations (MNCs) frequently employ sophisticated tax planning strategies, most prominently transfer pricing, to minimize their global tax burden. By shifting profits to jurisdictions with lower tax rates, firms can reduce taxable income in high-tax regions while maintaining overall profitability. These strategies erode national tax bases, distort competition, and undermine public trust in corporate accountability ((OECD, 2022); (Cobham & Janský, 2020); (Crivelli & Gupta, 2023)).

Recent years have witnessed an escalation in aggressive tax avoidance practices, prompting international initiatives such as the OECD's Base Erosion and Profit Shifting (BEPS) framework, which aims to counteract profit shifting and tax base erosion (OECD, 2022). Transfer pricing remains central to this issue, enabling MNCs to manipulate intra-firm prices to relocate income across borders. This phenomenon not only weakens government revenues but also disadvantages smaller firms that lack comparable tax planning capabilities ((Clausing, 2020); (Johansson & Sørensen, 2023)). Consequently, understanding the organizational and managerial drivers behind such practices is vital for creating more effective tax governance mechanisms.

A growing body of research highlights managerial incentives, particularly bonus mechanisms tied to profitability, as significant internal drivers of corporate tax behavior. When executive compensation is linked to after-tax income, managers are more inclined to engage in tax avoidance to enhance their perceived performance and bonuses ((J. Wang, 2021); (Zhang et al., 2022)). Recent studies reinforce this argument, showing that incentive-based pay structures can shape both the intensity and direction of tax avoidance strategies ((Martínez & Ramírez, 2022); (Chen et al., 2023)). Thus, examining the interaction between managerial incentives and tax behavior remains a critical area of research in understanding firm-level tax aggressiveness.

From a macroeconomic perspective, aggressive tax avoidance undermines fiscal efficiency and reduces governments' ability to fund essential public services and infrastructure (Christensen & Murphy, 2023). For corporations, however, these strategies carry

long-term risks including reputational damage, potential litigation, and the erosion of stakeholder trust ((Chen et al., 2019); (Kovermann & Velte, 2019)). This complex trade-off between short-term financial gains and long-term sustainability underscores the need for deeper insights into the internal determinants of tax avoidance behavior.

This study introduces profitability, measured by Return on Assets (ROA), as a moderating variable to explain how financial performance shapes the relationship between transfer pricing and tax avoidance. The rationale lies in the dual role of profitability: higher profits provide firms with both the capacity and incentive to engage in tax avoidance to preserve earnings, while less profitable firms may lack the resources or motivation to do so ((Hanlon & Heitzman, 2010); (Kovermann & Velte, 2019)). Recent findings, however, remain inconclusive. Some studies report a positive link between profitability and tax avoidance ((Chyz et al., 2023); (Karim et al., 2021)), while others suggest the relationship is context-dependent, influenced by governance quality, regulatory enforcement, and industry structure (Dai & Liu, 2024). This inconsistency highlights the empirical gap in understanding when and how profitability moderates corporate tax behavior.

Despite extensive literature on tax avoidance and transfer pricing, few studies have integrated profitability and managerial incentives within a unified analytical framework. Earlier works ((Gaaya et al., 2017)) explored the link between governance and tax avoidance, yet most recent research isolates variables rather than exploring their interconnected influence. Studies by Martínez & Ramírez (2022), Johansson & Sørensen (2023), and Dai & Liu (2024) emphasize the need for models that capture the interaction between firm performance, internal incentives, and cross-border tax strategies. Thus, the existing literature lacks a comprehensive explanation of how profitability (ROA) moderates the relationship between transfer pricing practices and tax avoidance, particularly in the post-BEPS regulatory environment.

Addressing this gap, the present research aims to provide a more nuanced understanding of how internal corporate structures (bonus mechanisms) and financial performance (profitability) jointly drive tax avoidance through transfer pricing. By integrating these dimensions, the study contributes to the literature in three ways. First, it extends existing models of tax avoidance by incorporating

profitability as a moderator, addressing a neglected theoretical linkage. Second, it provides empirical evidence from a recent global context (2020–2025), responding to calls for updated analyses that reflect evolving international tax dynamics. Third, it offers policy and managerial insights into designing incentive systems and regulatory mechanisms that balance profit maximization with ethical and sustainable tax practices.

Ultimately, this research contributes to the broader debate on building a fair and efficient international tax system. For policymakers, it highlights the importance of incentive-compatible regulation to curb harmful tax avoidance. For corporate leaders, it emphasizes how performance-based compensation structures and profitability goals can be aligned with ethical governance. In doing so, this study enhances the understanding of how internal managerial and financial dynamics shape external tax outcomes, offering both theoretical and practical contributions to modern tax research.

### *Theoretical Review and Hypothesis Development*

#### *Stewardship Theory*

Stewardship Theory provides an alternative to the traditional Agency Theory by emphasizing managers' intrinsic motivation to act in the organization's best interests rather than purely pursuing personal gain. Under this view, managers, when empowered and trusted, are "stewards" who prioritize the long-term sustainability and integrity of the firm over short-term performance metrics (Davis et al., 1997; Hernandez, 2012). Stewardship-oriented managers value firm reputation, ethical behavior, and organizational continuity, aligning their actions with the company's strategic vision rather than short-term personal incentives.

In the context of transfer pricing and tax avoidance, Stewardship Theory helps explain why some managers, despite having opportunities for tax manipulation, refrain from aggressive tax strategies that could damage the firm's long-term credibility. When profitability is high, stewardship-oriented managers may perceive less pressure to engage in tax avoidance because financial performance is already satisfactory. Conversely, in less profitable firms, the pressure to meet financial targets may weaken stewardship tendencies, prompting managers to adopt more opportunistic, short-term behaviors such as manipulating transfer prices to reduce taxes.

Malmendier et al. (2019) found that stewardship-oriented leaders are less likely to engage in aggressive tax avoidance, even when such actions could yield short-term benefits. Similarly, Laguir et al., (2015) and Chen et al., (2020) showed that firms with stewardship-based governance and ethical leadership frameworks exhibit more responsible tax behaviors, emphasizing reputation and compliance over short-term profit maximization.

Thus, Stewardship Theory provides the moral and behavioral foundation for understanding how profitability moderates the relationships between transfer pricing, bonus mechanisms, and tax avoidance, particularly by weakening opportunistic tendencies in financially healthy firms.

#### *The Effect of Transfer Pricing on Tax Avoidance*

Transfer pricing refers to the pricing of transactions such as goods, services, and intangibles between related entities within multinational corporations (MNCs). While legitimate for internal cost allocation, transfer pricing can also be strategically used to shift profits to low-tax jurisdictions, reducing the firm's global tax liability (Dowd et al. 2017).

Theoretically, when firms operate in countries with different corporate tax rates, managers have an incentive to manipulate internal prices to reallocate profits to countries with minimal tax burdens. This behavior is consistent with profit-shifting models Clausing (2020) and has been empirically validated by De Simone et al., (2020), who found that MNCs systematically exploit transfer pricing differences to minimize overall tax expenses.

From a Stewardship Theory perspective, however, such behavior reflects a deviation from stewardship motives, prioritizing immediate gains over corporate integrity. Stewardship-oriented managers would avoid manipulative pricing that could harm the firm's reputation or lead to regulatory sanctions. Therefore, while the general economic expectation is that transfer pricing increases tax avoidance, stewardship-driven governance could moderate or weaken this relationship.

H<sub>1</sub>: Transfer pricing has a positive effect on tax avoidance.

#### *The Effect of Bonus Mechanisms on Tax Avoidance*

Bonus mechanisms are incentive systems designed to align managerial effort with corporate objectives, typically linking compensation to financial indicators

such as profitability, earnings per share, or return on equity. While these mechanisms can enhance motivation and accountability, they can also encourage short-term performance orientation, prompting managers to adopt aggressive tax strategies to inflate net profits ((Kuo et al., 2019); (Bae & Kwon, 2021)).

Empirical evidence supports this behavioral pattern: performance-based bonuses correlate with increased tax avoidance in multiple settings (Huang et al., 2020). Executives under pressure to meet earnings targets may exploit tax loopholes, engage in aggressive transfer pricing, or defer tax liabilities to report higher after-tax profits. This pattern aligns with Agency Theory, where self-interest dominates, but contradicts Stewardship Theory, which emphasizes collective long-term welfare.

Within the stewardship framework, such opportunism signals a breakdown of stewardship behavior, particularly when bonus systems prioritize short-term metrics. Thus, while the bonus mechanism positively affects tax avoidance behavior, stewardship-oriented governance could mitigate this impact by embedding ethical constraints and emphasizing long-term success.

H<sub>2</sub>: Bonus mechanisms have a positive effect on tax avoidance.

#### *The Effect of Transfer Pricing on Tax Avoidance with Profitability as a Moderating Variable*

Profitability, often measured by return on assets (ROA), reflects a firm's overall performance and financial strength. It can moderate how aggressively firms engage in tax avoidance through transfer pricing. When profitability is high, managers, especially stewardship-driven ones, have less incentive to take reputational or legal risks for marginal tax savings. In contrast, when profitability declines, managers may experience greater pressure to manipulate transfer pricing to boost after-tax profits ((Chen, Huang, et al., 2021); (Li & Ma, 2019); (Bennet & O'Connell, 2021)).

From the Stewardship Theory perspective, profitability serves as a contextual buffer: high profitability reinforces stewardship behaviors by reducing opportunistic pressure, thereby weakening the positive relationship between transfer pricing and tax avoidance. Conversely, low profitability amplifies short-term managerial motivations, strengthening this relationship. Empirical evidence supports this moderating effect: firms with lower profitability tend to adopt more aggressive transfer

pricing tactics to offset weak financial performance ((Li & Ma, 2019); (Chen, Lin, et al., 2021)).

H<sub>3</sub>: Profitability weakens the positive effect of transfer pricing on tax avoidance.

#### *The Effect of Bonus Mechanisms on Tax Avoidance with Profitability as a Moderating Variable*

The relationship between bonus mechanisms and tax avoidance can also be contingent on a firm's profitability level. When firms are highly profitable, stewardship-oriented managers may resist the pressure to manipulate tax outcomes because the organization already meets financial expectations. In this case, profitability reinforces ethical behavior and reduces opportunistic tax strategies (Zhang et al., 2022). Conversely, in firms with lower profitability, the drive to meet performance-based bonus targets may encourage managers to engage in aggressive tax planning, undermining stewardship principles.

Thus, profitability moderates the relationship between bonus mechanisms and tax avoidance by influencing the balance between stewardship and opportunism. High profitability fosters stewardship behaviors and diminishes the need for aggressive tax planning, weakening the positive relationship between bonuses and tax avoidance. Low profitability, however, intensifies financial pressure, strengthening that relationship.

H<sub>4</sub>: Profitability weakens the positive effect of bonus mechanisms on tax avoidance.

### **Research Methods**

A quantitative research design will be employed to investigate the relationship between bonus mechanisms, tax avoidance, and profitability. This study will utilize a cross-sectional design, which is chosen for its ability to collect data at a single point across multiple firms, providing a snapshot of the current state of these variables.

The type of data used in this research is secondary data, which can be obtained from records, books, and magazines in the form of published financial statements of companies, government reports, articles, theoretical books, magazines, and others (Sujarweni 2022). The data sources for this study consist of secondary data in the form of financial reports obtained from the official website of the Indonesia Stock Exchange ([www.idx.co.id](http://www.idx.co.id)) and other sources related to the research.

The sampling technique used in this research is purposive sampling. Purposive sampling is a sample

selection technique based on specific considerations or criteria (Sujarweni 2022). The following are the criteria used in sample selection:

1. The companies under study are those operating in the industrial sector, specifically those listed on the Indonesia Stock Exchange (IDX) as of 2022, chosen for their relevance to the research. The companies did not incur losses during the period from 2020 to 2022.
2. The companies published annual financial reports from 2020 to 2022.

Based on the above criteria, out of 63 companies in the industrial sector listed on the Indonesia Stock Exchange (IDX) as of 2023, 21 companies can be used as samples in this study.

### *Operationalization of Variables*

The operationalization of variables in this study ensures measurable, reliable, and comparable indicators that accurately capture each construct's conceptual meaning. The variables include transfer pricing, bonus mechanisms, tax avoidance, and profitability (as a moderating variable). Each variable and its measurement are described as follows:

#### *1. Transfer Pricing (Independent Variable)*

Transfer pricing refers to the pricing policies applied in transactions between related entities within a multinational corporation. It is often proxied by the Related Party Transaction Ratio (RPTR), which reflects the extent to which a company engages in intra-group transactions relative to its total sales. The measurement is adapted from prior empirical studies ((De Simone et al., 2020; (Garcia-Bernardo & Jansky, 2021)):

$$\text{Transfer Pricing (TP)} = \frac{\text{Related Party Transactions}}{\text{Total Sales}}$$

A higher ratio indicates a greater degree of intra-company pricing activity, which may be associated with a higher likelihood of transfer pricing being used for tax minimization purposes. This measurement allows for cross-firm comparison while capturing the intensity of transfer pricing practices.

#### *2. Bonus Mechanism (Independent Variable)*

The bonus mechanism represents managerial incentives linked to firm performance. This variable is operationalized through the proportion of performance-based compensation to total executive

compensation, following approaches used by Kuo et al., (2019) and (Zhang & Zhang, 2020):

$$\text{Bonus Mechanism (BM)} = \frac{\text{Performance-based Bonuses}}{\text{Total Executive Compensation}}$$

A higher ratio indicates stronger performance-related incentives. This measure reflects the extent to which executives' compensation depends on achieving specific performance targets, which may influence their engagement in tax avoidance practices.

#### *3. Tax Avoidance (Dependent Variable)*

Tax avoidance is assessed using the Effective Tax Rate (ETR), which indicates the proportion of income paid in taxes relative to pre-tax earnings. The ETR serves as a reliable proxy for the level of tax avoidance because lower effective tax rates generally reflect more aggressive tax minimization strategies ((Chen et al., 2021); (Li & Ma, 2019)):

$$\text{ETR} = \frac{\text{Total Tax Expense}}{\text{Pre-Tax Accounting Income}}$$

To better capture tax avoidance behavior, this study also employs an adjusted measure of tax avoidance (TA), where lower ETR values indicate higher tax avoidance:

$$\text{Tax Avoidance (TA)} = 1 - \text{ETR}$$

This transformation simplifies interpretation, as higher TA values directly reflect more extensive tax avoidance.

#### *4. Profitability (Moderating Variable)*

Profitability is measured using the Return on Assets (ROA) ratio, which captures a firm's ability to generate earnings relative to its asset base. This measure is widely used in corporate finance and taxation studies ((Bennet & O'Connell, 2021); Mohammad & Noor, 2020)):

$$\text{ROA} = \frac{\text{Net Income}}{\text{Total Assets}}$$

Higher profitability (ROA) reflects stronger financial performance, which may moderate the relationship between transfer pricing, bonus mechanisms, and tax avoidance. In line with Stewardship Theory, it is expected that higher profitability weakens the positive relationship between managerial incentives and tax avoidance, as

profitable firms prioritize long-term sustainability and ethical governance over short-term tax benefits.

Data analysis will involve descriptive statistics to summarize the sample characteristics, correlation analysis to examine relationships between variables, and multiple regression analysis to test the effects of transfer pricing and bonus mechanisms on tax avoidance, with profitability as a moderator. Interaction terms will be created to evaluate the moderating effect, with additional robustness checks to ensure the validity of the results.

## Results and Discussion

### Results

#### Descriptive Statistics

The results of the descriptive analysis are summarized in Table 1 below.

Table 1.  
Descriptive statistics

Variable	Min	Max	Mean	Std Deviation
Transfer Pricing (X1)	0.000000	0.985739	0.133502	0.261039
Bonus Mechanism (X2)	0.018640	156.7139	5.486829	22.21477
Tax Avoidance (Y)	-	0.936774	0.211728	0.339873
Profitability (Z)	2.160841			
	0.000407	0.363620	0.079912	0.066455

Table 1 presents the descriptive statistics for the study variables, including transfer pricing (X1), bonus mechanism (X2), tax avoidance (Y), and profitability (Z). Transfer pricing (X1) has a minimum value of 0.000000 and a maximum of 0.985739, with an average of 0.133502 and a standard deviation of 0.261039, indicating significant variability among firms. The bonus mechanism (X2) data appear incomplete, but tax avoidance (Y) exhibits a wide range, with a minimum value of -2.160841 and a maximum of 156.7139, suggesting extreme variations in tax strategies across firms. The mean tax avoidance value is 0.936774, with a standard deviation of 5.486829, indicating substantial dispersion. Profitability (Z) has a minimum of 0.000407 and a maximum of 0.363620, with an average of 0.079912 and a standard deviation of 0.066455, suggesting that while some firms have higher profitability, most fall within a relatively

narrow range. The results highlight significant variations in tax avoidance strategies, transfer pricing practices, and profitability levels across the sample firms.

#### Choosing the Panel Data Regression Model

The model used in this study is panel data regression, which tests the model specifications and the suitability of theories with reality. Ordinary least squares model (OLS) or common effect model (CEM), Hausman Test (Fixed Effect, Random Effect).

Table 2.  
Chow Test Results

Effects Test	Statistic	d.f	Prob.
Cross-section F	1.135462	(20.40)	0.3555
Cross-section Chi-square	28.326639	20	0.1019

The study employs panel data regression, which allows for testing model specifications and assessing the alignment between theoretical expectations and real-world data. To determine the most suitable model, the Chow Test is conducted to compare the Common Effect Model (CEM) and the Fixed Effect Model (FEM). Table 2 presents the Chow Test results, where the Cross-section F statistic is 1.135462 with a probability value (Prob.) of 0.3555, and the Cross-section Chi-square statistic is 28.326639 with a probability value of 0.1019. Since both probability values are greater than 0.05, the null hypothesis is not rejected, indicating that the Common Effect Model (CEM) is more appropriate than the Fixed Effect Model (FEM) for this study. This result suggests that firm-specific effects do not significantly impact the model, and a pooled regression approach is more suitable.

Table 3.  
Hausman Test Results

Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	1.294250	2	0.5235

The Hausman Test is conducted to determine whether the Fixed Effect Model (FEM) or the Random Effect Model (REM) is more appropriate for this study. Table 3 presents the Hausman Test results, where the Chi-Square statistic is 1.294250, with 2 degrees of freedom and a probability value (Prob.) of 0.5235. Since the probability value is greater than

0.05, the null hypothesis is not rejected, indicating that the Random Effect Model (REM) is more suitable than the Fixed Effect Model (FEM) for this study. This result suggests that individual firm effects are best treated as random rather than fixed, making the REM approach more efficient in capturing variations across firms.

Table 4.  
Lagrange Multiplier (LM) Test Results

	Test Hypothesis		
	Cross-Section	Time	Both
Breusch-Pagan	0.029733 (0.8631)	0.118993 (0.7301)	0.148726 (0.6998)

The Lagrange Multiplier (LM) Test, specifically the Breusch-Pagan LM Test, is conducted to determine whether the Random Effect Model (REM) is more appropriate than the Common Effect Model (CEM). Table 4 presents the LM Test results, where the Cross-Section statistic is 0.029733 with a probability value (Prob.) of 0.8631, the Time statistic is 0.118993 with a probability value of 0.7301, and the Both statistic is 0.148726 with a probability value of 0.6998. Since all probability values are greater than 0.05, the null hypothesis is not rejected, indicating that the Common Effect Model (CEM) is more suitable than the Random Effect Model (REM). This result suggests that there is no significant variation across firms or over time, making a pooled regression model the most appropriate choice for this study.

#### *The Effect of Transfer Pricing and Tax Avoidance*

Table 5.  
Panel Least Squares

Variable	Coefficient	Std Error	t-Statistics	Prob.
C	0.134839	0.043559	3.095588	0.0030
X1	0.575936	0.149508	3.852213	0.0003

Table 5 presents the Panel Least Squares (PLS) regression results for examining the effect of transfer pricing (X1) on tax avoidance. The constant term (C) has a coefficient of 0.134839 with a standard error of 0.043559, yielding a t-statistic of 3.095588 and a probability value (Prob.) of 0.0030, indicating statistical significance at the 1% level.

For the independent variable transfer pricing (X1), the coefficient is 0.575936, suggesting a positive relationship with tax avoidance. The standard error is 0.149508, and the t-statistic is 3.852213, with a probability value of 0.0003, which is highly significant at the 1% level. These results imply that

firms engaging in transfer pricing strategies are more likely to reduce their tax liabilities through tax avoidance practices. The significance of transfer pricing highlights its role as a key mechanism used by companies to manage tax expenses, aligning with previous research on corporate tax strategies. Thus, H1 is Accepted.

#### *The Effect of Bonus Mechanism and Tax Avoidance*

Table 6 presents the Panel Least Squares (PLS) regression results for examining the effect of the bonus mechanism (X2) on tax avoidance. The constant term (C) has a coefficient of 0.178228 with a standard error of 0.040792, yielding a t-statistic of 4.369242 and a probability value (Prob.) of 0.0000, indicating high statistical significance at the 1% level.

Table 6.  
Panel Least Squares

Variable	Coefficient	Std Error	t-Statistics	Prob.
C	0.178228	0.040792	4.369242	0.0000
X2	0.006105	0.001796	3.399182	0.0012

For the independent variable bonus mechanism (X2), the coefficient is 0.006105, suggesting a positive relationship with tax avoidance. The standard error is 0.001796, and the t-statistic is 3.399182, with a probability value of 0.0012, which is also significant at the 1% level. These results indicate that firms with higher performance-based compensation structures are more likely to engage in tax avoidance practices. This finding aligns with previous studies that suggest executive incentives may influence corporate tax strategies, as managers seek to maximize after-tax profits to increase their compensation. Then, H2 is Accepted.

#### *The Effect of Transfer Pricing on Tax Avoidance with Profitability as a Moderator Variable*

Table 7  
Panel Least Squares 1

Variable	Coefficient	Std Error	t-Statistics	Prob.
C	-0.062901	0.075825	-	0.4101
X1	-0.353197	0.331370	0.829557	0.2908
Z	4.026697	1.301640	-	0.0030
			1.065870	
			3.093555	

Table 8  
Panel Least Squares 2

Variable	Coefficient	Std Error	t-Statistics	Prob.
C	-0.057921	0.079898	-	0.4714
X1	-0.447342	0.552301	0.724931	0.4212
Z	3.983439	1.327588	-	0.0039
X1Z	0.422498	1.973878	0.809960	0.8313
			3.000508	
			0.214045	

Panel Least Squares 1 (Table 7)

Table 7 presents the Panel Least Squares (PLS) regression results examining the relationship between transfer pricing (X1) and tax avoidance (Y), incorporating profitability (Z) as a moderator. The constant term (C) has a coefficient of -0.062901, with a standard error of 0.075825, yielding a t-statistic of -0.829557 and a probability value (Prob.) of 0.4101, indicating that it is not statistically significant.

For the independent variable transfer pricing (X1), the coefficient is -0.353197, with a standard error of 0.331370 and a t-statistic of -1.065870, with a probability value of 0.2908, suggesting that transfer pricing alone does not have a significant direct effect on tax avoidance.

However, profitability (Z) shows a significant positive effect on tax avoidance, with a coefficient of 4.026697, a t-statistic of 3.093555, and a probability value of 0.0030, indicating a strong impact at the 1% significance level. This suggests that firms with higher profitability tend to engage more in tax avoidance strategies.

Panel Least Squares 2 (Table 8)

Table 8 further examines the moderating role of profitability (Z) in the relationship between transfer pricing (X1) and tax avoidance (Y) by including an interaction term (X1Z).

- The coefficient for transfer pricing (X1) is -0.447342, with a probability value of 0.4212, indicating that transfer pricing alone does not significantly impact tax avoidance.
- The coefficient for profitability (Z) remains significant, at 3.983439, with a probability value of 0.0039, confirming its positive influence on tax avoidance.
- The interaction term X1Z, which represents the moderating effect, has a coefficient of 0.422498, but its probability value is 0.8313, indicating that profitability does not significantly moderate the effect of transfer pricing on tax avoidance.

The findings suggest that profitability has a direct and significant positive effect on tax avoidance, meaning that firms with higher profitability are more likely to engage in tax avoidance. However, transfer pricing alone does not have a significant impact on tax avoidance, and the interaction between transfer pricing and profitability does not produce a statistically significant moderating effect. This implies that while profitable firms engage in tax avoidance, they may not necessarily use transfer pricing as a primary mechanism for tax avoidance strategies. Thus, H3 is Rejected.

#### *The Effect of Bonus Mechanism on Tax Avoidance with Profitability as a Moderator Variable*

Table 8

Panel Least Squares 1				
Variable	Coefficient	Std Error	t-Statistics	Prob.
C	-0.001901	0.065242	-0.029137	0.9769
X2	0.000578	0.002329	0.248284	0.8048
Z	2.633596	0.778569	3.382611	0.0013

Table 9

Panel Least Squares 2				
Variable	Coefficient	Std Error	t-Statistics	Prob.
C	-0.001777	0.065350	-0.027188	0.9784
X2	0.010607	0.011440	0.927154	0.3576
Z	2.467041	0.801734	3.077131	0.0032
X2Z	-0.028702	0.032054	-0.895422	0.3742

Panel Least Squares 1 (Table 8)

Table 8 presents the Panel Least Squares (PLS) regression results examining the effect of the bonus mechanism (X2) on tax avoidance (Y) while considering profitability (Z) as a potential moderator.

- The constant term (C) has a coefficient of -0.001901, with a standard error of 0.065242, a t-statistic of -0.029137, and a probability value (Prob.) of 0.9769, indicating that it is not statistically significant.
- The bonus mechanism (X2) has a coefficient of 0.000578, with a standard error of 0.002329, a t-statistic of 0.248284, and a probability value of 0.8048, showing that the direct effect of the bonus mechanism on tax avoidance is not significant.
- However, profitability (Z) has a significant positive effect on tax avoidance, with a coefficient of 2.633596, a t-statistic of 3.382611, and a probability value of 0.0013, indicating strong significance at the 1% level. This suggests that more profitable firms are more likely to engage in tax avoidance strategies.



*Panel Least Squares 2 (Table 9)*

Table 9 extends the analysis by incorporating the interaction term (X2Z) to test whether profitability moderates the effect of the bonus mechanism on tax avoidance.

- a. The bonus mechanism (X2) now has a coefficient of 0.010607, with a probability value of 0.3576, indicating that it still does not have a significant direct effect on tax avoidance.
- b. Profitability (Z) remains significant, with a coefficient of 2.467041, a t-statistic of 3.077131, and a probability value of 0.0032, confirming its strong influence on tax avoidance.
- c. The interaction term (X2Z) has a coefficient of -0.028702, with a probability value of 0.3742, indicating that profitability does not significantly moderate the effect of the bonus mechanism on tax avoidance.

The findings suggest that profitability has a direct and significant positive effect on tax avoidance, implying that more profitable firms are more likely to engage in tax avoidance practices. However, the bonus mechanism does not have a significant direct effect on tax avoidance, meaning that incentive-based compensation alone does not necessarily drive firms to engage in tax avoidance strategies. Additionally, profitability does not significantly moderate the relationship between the bonus mechanism and tax avoidance, indicating that even in highly profitable firms, executive bonuses do not necessarily influence tax avoidance behavior. Then, H4 Rejected.

## Discussion

### *The Effect of Transfer Pricing and Tax Avoidance*

The results of this study indicate that transfer pricing has a significant and positive effect on tax avoidance among multinational corporations (MNCs). This suggests that firms actively utilize intra-group transactions to shift profits from high-tax to low-tax jurisdictions, thereby reducing their overall tax liabilities. Such findings highlight that transfer pricing functions not merely as an operational pricing strategy but as a deliberate tool in international tax planning and profit-shifting schemes.

This result aligns with a growing body of empirical research supporting the positive association between transfer pricing and tax avoidance. Taylor et al. (2018) demonstrated that multinational firms with

complex international supply chains strategically manipulate transfer prices to exploit differences in tax regimes. Similarly, Sari & Martani (2020) found that Indonesian firms with higher levels of intangible assets and intercompany transactions are more likely to use transfer pricing for tax minimization. De Simone et al., (2020) also confirmed that multinational firms actively engage in profit shifting through transfer pricing mechanisms, especially when operating in jurisdictions with significant tax rate differentials. Garcia-Bernardo and Jansky (2021) further showed that global MNCs exploit intra-firm financial flows to allocate profits in tax havens, reinforcing the central role of transfer pricing in international tax avoidance. More recently, Tang & Firth (2022) found that firms with aggressive transfer pricing policies achieved lower effective tax rates, supporting the view that transfer pricing remains one of the primary methods for corporate tax avoidance.

In addition, Nguyen et al., (2023) provided evidence that the extent of transfer pricing manipulation increases with firm size and international exposure, emphasizing that large MNCs use internal pricing adjustments as part of tax optimization strategies. Collectively, these studies validate the finding that transfer pricing serves as a powerful mechanism for reducing global tax burdens.

However, other empirical findings suggest that the relationship between transfer pricing and tax avoidance is not universally positive and may depend on corporate governance quality, regulatory environment, and ethical orientation. For instance, Hanlon and Heitzman (2021) argued that strong governance frameworks and tax transparency regulations reduce the opportunistic use of transfer pricing. Mulyani et al., (2020) found that firms with robust ethical cultures and stewardship-oriented leadership exhibit lower levels of tax avoidance, even when transfer pricing opportunities exist. Kim & Zhang (2021) reported that the enforcement of OECD's BEPS (Base Erosion and Profit Shifting) guidelines significantly mitigates profit-shifting behavior in multinational enterprises. Similarly, Wang & Ho (2022) observed that firms adopting integrated reporting and ESG disclosure practices demonstrate weaker relationships between transfer pricing intensity and tax avoidance. Lee et al. (2023) also highlighted that companies operating in jurisdictions with strong tax compliance environments show no significant link between transfer pricing and tax avoidance, suggesting that regulatory oversight can effectively deter misuse.

From a theoretical perspective, these findings generate an important dialogue between Stewardship Theory and Agency Theory. While Stewardship Theory posits that managers act as custodians of long-term corporate interests, focusing on ethical conduct and sustainable value creation, the significant positive effect of transfer pricing on tax avoidance observed in this study reveals managerial behavior that aligns more closely with Agency Theory. In this context, managers may prioritize short-term financial performance and shareholder wealth maximization over ethical and societal considerations. This opportunistic behavior, especially when tied to performance incentives, contradicts the stewardship assumption of intrinsic managerial motivation toward corporate and social well-being.

Nonetheless, the evidence from stewardship-oriented firms Mulyani et al., (2020); Wang & Ho (2022)) indicates that ethical leadership and long-term orientation can weaken the association between transfer pricing and tax avoidance. Hence, while transfer pricing remains a legitimate and strategic business tool, its ethical application depends on internal governance quality, regulatory scrutiny, and managerial values.

#### *The Effect of Bonus Mechanism and Tax Avoidance*

The results of this study show that the bonus mechanism has a significant and positive effect on tax avoidance. This implies that when a larger portion of managerial compensation is tied to performance-based bonuses, managers may be more inclined to engage in aggressive tax strategies to boost reported profits and, consequently, their rewards. This behavior reflects a short-term focus on financial performance metrics, which can lead to ethical risks and undermine long-term corporate sustainability.

This finding aligns with prior research. Noviani & Ratnadi, (2020) found that managers with performance-based compensation are more likely to adopt tax avoidance strategies to maximize bonuses. Similarly, Kurniasih & Sari, (2021) highlighted that incentive structures directly influence managerial decisions related to financial reporting and tax planning. These studies support the idea that bonus-driven managerial incentives can create pressure to reduce tax expenses, often through mechanisms that exploit regulatory loopholes rather than through genuine operational efficiency.

While Stewardship Theory emphasizes that managers act as trustworthy stewards of the company's resources and goals, the influence of bonus mechanisms on tax avoidance reveals a deviation from this ideal. When personal gain becomes the dominant motivator, managers may act in ways that prioritize short-term personal or shareholder benefits over ethical and sustainable corporate governance. This underscores the importance of designing balanced incentive systems that align with both financial and ethical performance, and of implementing strong oversight to discourage aggressive tax strategies.

#### *The Effect of Transfer Pricing on Tax Avoidance with Profitability as a Moderator Variable*

The results of this study confirm that transfer pricing has a significant positive effect on tax avoidance, supporting the notion that multinational corporations (MNCs) strategically use intra-group pricing mechanisms to shift profits to low-tax jurisdictions. However, when profitability (measured by ROA) was introduced as a moderating variable, the analysis revealed no significant moderating effect on the relationship between transfer pricing and tax avoidance. This finding indicates that the degree of profitability does not meaningfully alter how transfer pricing influences tax avoidance behavior among MNCs.

This result contrasts with some prior studies that proposed profitability as a potential factor that could weaken or strengthen the association between transfer pricing and tax avoidance. For instance, Chen, Lin, et al., (2021) and Li & Ma (2019) found that firms with lower profitability are more likely to use aggressive transfer pricing to manage tax burdens, whereas more profitable firms tend to adopt more conservative tax positions to protect their reputation and long-term value. Conversely, Bennet & O'Connell (2021) and Zhang et al., (2022) reported mixed results, suggesting that the moderating role of profitability may be context-dependent, varying with regulatory environments and governance quality.

The absence of a significant moderating effect in this study suggests that profitability alone may not be a decisive factor in determining how firms use transfer pricing for tax purposes. Instead, other organizational and institutional factors such as corporate governance mechanisms, managerial incentives, or the level of international tax

enforcement may exert stronger influences on firms' tax avoidance behavior. This finding aligns with Nguyen et al., (2023), who observed that while profitability affects firms' financial flexibility, it does not necessarily dictate their tax planning aggressiveness. Similarly, Wang & Ho (2022) found that ethical leadership and environmental, social, and governance (ESG) pressures play more prominent roles in moderating tax behavior than profitability metrics alone.

From a theoretical perspective, this outcome is consistent with Stewardship Theory, which posits that managers in profitable firms prioritize long-term organizational stability and compliance rather than short-term tax minimization. The lack of moderation effect implies that even when firms are more profitable, managerial decisions regarding transfer pricing remain guided by broader governance and ethical frameworks rather than financial performance pressures. This stands in contrast to Agency Theory, which would predict that managers in high-profit firms have stronger incentives to exploit transfer pricing opportunities for personal or shareholder gain.

This moderation effect is supported by previous studies. Puspita & Martani, (2019) found that highly profitable firms tend to exhibit better compliance with tax regulations, as they have reputational concerns and are subject to more rigorous audits. Similarly Herawaty & Nurcahyo, (2020) demonstrated that firms with strong financial performance are less likely to aggressively avoid taxes through transfer pricing, as the potential risks (legal sanctions, reputational damage) outweigh the financial benefits. This suggests that profitability can serve as an internal control, discouraging excessive use of transfer pricing for tax evasion purposes.

From the perspective of Stewardship Theory, profitable firms may reflect stronger management accountability and ethical commitment, where decision-makers act in the long-term interest of the organization. This aligns with the idea that managers in profitable companies are more likely to act as stewards rather than opportunists, avoiding risky tax strategies that could harm the firm's integrity or public image. Therefore, profitability acts as a moderating force, mitigating the potential misuse of transfer pricing in tax avoidance practices and reinforcing ethical corporate behavior.

*The Effect of Bonus Mechanism on Tax Avoidance with Profitability as a Moderator Variable*

The findings of this study indicate that the bonus mechanism has a significant positive effect on tax avoidance. This suggests that managers whose compensation is tied to performance-based incentives tend to engage in tax planning strategies that reduce the firm's tax burden, potentially to enhance reported net income and meet bonus-related performance targets. Such behavior highlights a possible misalignment between corporate governance objectives and managerial incentives, where short-term personal gains may take precedence over ethical or long-term organizational considerations. This result aligns with previous studies such as Kuo et al., (2019), Bae & Kwon (2021), and Huang et al., (2020), which found that performance-linked compensation structures often lead to greater levels of tax aggressiveness.

However, when profitability (measured by ROA) was introduced as a moderating variable, the results revealed no significant moderating effect on the relationship between bonus mechanisms and tax avoidance. This indicates that a firm's level of profitability does not meaningfully alter how managerial bonus incentives influence tax behavior. In other words, regardless of whether firms are highly profitable or less profitable, performance-based bonuses continue to encourage similar patterns of tax avoidance behavior among managers.

This finding diverges from some prior empirical research suggesting that profitability could dampen aggressive tax behavior. For instance, Sari & Martani (2020) and Gunawan & Utami (2020) found that profitable firms tend to adopt more conservative tax positions due to reputational concerns and increased public scrutiny. Conversely, other recent studies, such as Chen, Huang, et al., (2021), Zhang et al., (2022), and Nguyen et al., (2023), report that profitability does not consistently influence the strength of the relationship between executive incentives and tax avoidance, particularly in environments where corporate governance mechanisms or regulatory oversight are weak. This mixed evidence underscores that profitability alone may not sufficiently explain variations in tax avoidance behaviors driven by managerial compensation structures.

From a Stewardship Theory perspective, the absence of a moderating effect suggests that profitability does not necessarily transform managerial motivations. Even in profitable firms, managers may continue to pursue tax avoidance strategies if their performance rewards are strongly tied to after-tax earnings. This aligns with the idea

that when incentive structures emphasize short-term performance, stewardship behavior is weakened, and managerial decision-making may still reflect agency-driven motives. Hence, the results of this study imply that profitability, as a measure of financial success, is not a sufficient deterrent to bonus-driven tax avoidance practices. Instead, reinforcing stewardship-oriented governance through ethical leadership, transparency, and accountability may be more effective in curbing such behavior.

## Conclusion

This study concludes that the bonus mechanism significantly influences tax avoidance, demonstrating that performance-based compensation structures can motivate managers to engage in tax-reducing strategies to enhance reported profits and achieve bonus-related targets. This finding supports prior evidence by Kuo et al., (2019), Huang et al., (2020), and Bae & Kwon (2021), which shows that performance-linked incentives often drive aggressive financial behaviors, including tax avoidance. These results underscore the importance of designing compensation systems that balance performance motivation with ethical financial management.

However, the analysis revealed that profitability does not significantly moderate the relationship between bonus mechanisms and tax avoidance. This suggests that a firm's level of profitability does not materially alter how managerial incentives influence tax behavior. Whether firms are highly profitable or not, managers appear to respond similarly to bonus-driven incentives when making tax-related decisions. This finding aligns with studies by Chen, Huang, et al., (2021) and Nguyen et al., (2023), which also reported that profitability does not consistently mitigate the influence of executive bonuses on tax avoidance behavior.

From a Stewardship Theory perspective, the absence of a moderating effect implies that profitability alone is insufficient to strengthen stewardship-oriented behavior among managers. Even in profitable firms, managers may continue to pursue tax avoidance if incentive systems emphasize short-term financial performance. This indicates that stewardship behavior is more likely to emerge in environments with ethical leadership, transparent governance structures, and long-term value orientation rather than being solely driven by financial success. The findings thus highlight the importance of integrating stewardship values into

corporate governance and executive compensation frameworks.

Practically, this research offers valuable implications for policymakers and corporate leaders. Firms should restructure bonus mechanisms to align managerial incentives with responsible tax practices and long-term organizational sustainability. Strengthening corporate governance, ethical oversight, and disclosure transparency can reduce the tendency for bonus-driven tax avoidance. Furthermore, regulators could encourage the incorporation of non-financial performance indicators such as corporate social responsibility (CSR) or compliance metrics into executive compensation packages to promote integrity and accountability.

For future research, scholars are encouraged to expand the model by introducing additional moderating variables, such as corporate social responsibility, audit quality, or ownership structure, as suggested by Gunawan & Utami (2020) and Zhang et al., (2022). Comparative studies across different industries or regulatory settings could also deepen understanding of how contextual factors influence the link between incentive structures and tax behavior. By doing so, future studies can offer a more comprehensive perspective on how governance mechanisms and organizational culture interact to shape ethical tax practices.

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