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# Tax is a Double-Edged Sword: Transfer Pricing Opens the Door to Tax Avoidance, Moderated by CEO and Foreign Ownership

**Mustafhimatul Ilma**
Universitas Pekalongan,
Indonesia

***Corresponding author:**
Mustafhimatul Ilma, Universitas Pekalongan, Indonesia. ✉mustafhimatul.ilma@gmail.com

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**Abstract**

**Background:** Transfer pricing remains a persistent tax-governance concern because related-party arrangements may shift taxable income across jurisdictions, while governance and ownership characteristics can alter executives' incentives to pursue aggressive tax positions.
**Objective:** The study investigates the relationship between transfer pricing and tax avoidance and evaluates whether CEO narcissism, CEO financial expertise, and foreign ownership change the strength of that relationship among Indonesian energy-sector companies.
**Methods:** The research used a quantitative explanatory approach with 70 firm-year observations obtained through purposive sampling. Secondary financial and corporate-governance information was processed using PLS-SEM in WarpPLS 8.0, and an alternative proxy for tax avoidance was applied as a robustness assessment.
**Results:** Transfer pricing was significantly associated with tax avoidance ($\beta = -0.381$; $p < 0.001$). CEO narcissism ($\beta = -0.186$; $p = 0.018$) and foreign ownership ($\beta = -0.332$; $p < 0.001$) significantly moderated this relationship, whereas the robustness model indicated that the strength of selected effects depends on the tax-avoidance proxy.
**Conclusion:** The findings show that the transfer-pricing–tax-avoidance relationship is contingent on executive and ownership characteristics, supporting the need for risk-based monitoring that jointly considers related-party transactions and corporate-governance attributes.

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## INTRODUCTION

State Revenue Realization data for 2014-2023, published by the Ministry of Finance through the Central Statistics Agency, indicate that tax revenue and non-tax revenue accounted for an average proportion of approximately 80% and 20%, respectively, over the last decade (Keuangan, 2023). This composition indicates that taxes contributed roughly four times as much as non-tax sources to Indonesia's state revenue. Accordingly, the government continues to pursue tax optimization by strengthening and intensifying tax collection. These efforts, however, face several constraints, including the persistence of tax avoidance practices (Harahap et al., 2023; Panjalusman et al., 2018). Data from the 2021 Global Rankings Corporate Tax Haven Index issued by the Tax Justice Network report that Indonesia loses $2,806,311,920 annually to tax haven jurisdictions, equivalent to Rp 43,747,877,152,072, an amount stated to exceed the annual tax revenue nominal in the range of Rp 1 trillion to Rp 2 trillion (Network, 2022). This condition is a serious concern because state financing depends heavily on tax receipts, requiring substantial government measures to recover revenue rights. The policy significance of the issue is further

heightened by the persistence and complexity of cross-border transfer-pricing disputes, which demand considerable time and technical resources from tax authorities in handling related-party cases. Rather than treating a single dispute count as a current global estimate, this study relies on the OECD-related evidence available in the cited literature to demonstrate the continuing enforcement burden.

Globally, the phenomenon of tax avoidance has occurred several times in various countries. One of them was carried out by a Russian company, MedTechnica 1 Ltd. It sold its production to an affiliate at only the production cost and did not record a profit on the transaction to its affiliate. Conversely, the affiliate domiciled in Belarus recorded a higher profit because it purchased products from the affiliate at a lower value. With this scheme, MedTechnica 1 Ltd shifted profits to its affiliate in Belarus which has a tax rate 2% lower than Russia, which is 18% (Bakhram et al., 2021; Salsabilla & Nurdin, 2023).

A similar indication has also been reported in Indonesia. One prominent case concerns alleged tax avoidance by a widely known company. A Global Witness report stated that during 2009-2017, PT Adaro Energy Tbk. reduced its tax obligations through its Singapore-based subsidiary, Coaltrade Service International, by approximately US 14 million per year (Zulaikah & Suryarini, 2023).

Tax-motivated profit shifting remains an important issue for policymakers and researchers internationally. Within multinational corporations (MNCs), much of the discussion centers on transfer pricing (Bond & Gresik, 2020; Duho et al., 2022; Rathke et al., 2020). In recent years, transfer-pricing disputes have attracted substantial attention from both tax authorities and multinational firms because of their contentious character and the difficulty, complexity, and cost of resolving them. OECD statistics reported in the cited literature indicate that transfer-pricing cases handled through the mutual agreement procedure (MAP) require an average of 35 months to resolve, illustrating that these disputes generally take longer than non-transfer-pricing cases. The volume of such cases has also increased. OECD statistics further show that disputes between treaty partners, most of which involve transfer-pricing matters, rose from 3,328 cases in 2010 to 6,478 cases in 2020, with further increases anticipated (Candra, 2023). The central research gap is the inconsistency of prior findings regarding the direct transfer-pricing-tax-avoidance relationship and the limited evidence simultaneously examining CEO narcissism, CEO financial expertise, and foreign ownership as distinct boundary conditions within a single moderation framework.

Prior studies examining the effect of transfer pricing on tax avoidance have reached differing conclusions. These inconsistent findings suggest that additional factors may alter the strength or direction of the relationship between transfer pricing and tax avoidance. Baron & Kenny (1986) and Rajakumar et al. (2024) argue that when the relationship between an independent and dependent variable is weak or inconsistent, a moderating variable may be involved. On this basis, the present study considers CEO narcissism, CEO financial expertise, and foreign ownership as potential moderators of the transfer-pricing-tax-avoidance relationship. The novelty is therefore not limited to adding moderating variables, but lies in combining upper-echelons characteristics and ownership structure within one explanatory framework. CEO narcissism represents dispositional risk orientation, CEO financial expertise reflects the capacity to interpret and use complex financial-tax information, and foreign ownership captures an external governance and internationalization channel. Examining these mechanisms jointly helps explain why comparable transfer-pricing arrangements may be associated with different tax outcomes.

## METHOD

This study adopted a quantitative explanatory design to examine directional relationships among observed firm-level variables and to assess whether specified moderating factors altered the strength of the relationship between transfer pricing and tax avoidance.

The population comprised companies in the oil, gas, coal, and alternative-energy sectors classified as energy-sector firms under the Indonesia Stock Exchange Industrial Classification of 2022. The study employed purposive sampling and obtained a final sample of 70 observations. The energy sector was selected because firms in this sector commonly operate through capital-intensive, cross-border, and related-party arrangements, making transfer-pricing exposure and

tax-planning incentives directly relevant to the research question. The purposive-sampling criteria included classification as an energy-sector firm on the IDX; availability of annual reports and financial statements for the observation period; availability of the information required to construct all study variables; and sufficient disclosure to identify the relevant transfer-pricing and ownership measures.

This study used a quantitative explanatory research design and secondary panel data derived from published annual reports and financial statements. The design was explanatory because the analysis tested hypothesized relationships and moderation effects rather than merely describing company characteristics.

Data were collected through documentation by identifying and compiling information from published annual financial statements and company annual reports. The study obtained these data from the official Indonesia Stock Exchange (IDX) website, www.idx.co.id, and from company websites when particular reports were unavailable on the IDX platform (IDX-IC., 2022). Data processing and analysis were conducted using Partial Least Squares Structural Equation Modeling (PLS-SEM) with WarpPLS 8.0. A robustness test was conducted by replacing the primary tax-avoidance proxy, the current effective tax rate, with the cash effective tax rate. PLS-SEM in WarpPLS 8.0 was selected because the research model included several interaction terms and was designed to estimate direct and moderating effects simultaneously, while accommodating potentially non-normal secondary-data distributions and supporting prediction-oriented model evaluation. The use of the cash effective tax rate in the robustness analysis provided an additional assessment of whether the conclusions depended on the primary proxy for tax avoidance.

## RESULTS AND DISCUSSION

### Results

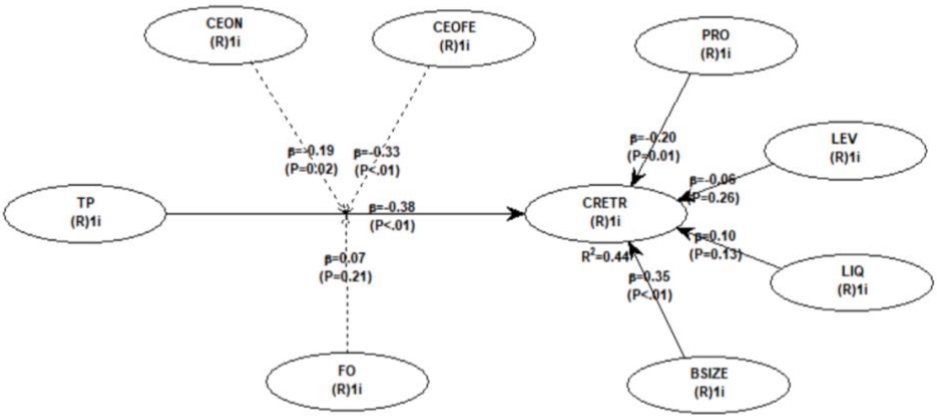



**Figure 1.** Hypothesis Test

**Table 1**
*Hypothesis Test*

| Variable | *Path Coefficients* | *P-Values* | *Rule of Thumb* | *Notes* |
|---|---|---|---|---|
| TP_CRETR | -0.381 | P < 0.001 | P < 0.05 | Accepted |
| CEON*TP | -0.186 | P = 0.018 | P < 0.05 | Accepted |
| CEOFE*TP | -0.332 | P < 0.001 | P < 0.05 | Accepted |
| FO*TP | 0.071 | P = 0.207 | P < 0.05 | Rejected |
| PRO | -0.200 | P = 0.012 | P < 0.05 | Sig |
| LEV | -0.056 | P = 0.259 | P < 0.05 | Not sig |
| LIQ | 0.097 | P = 0.131 | P < 0.05 | Not sig |
| BSIZE | 0.348 | P < 0.001 | P < 0.05 | Sig |

The effect of transfer pricing on tax avoidance was tested using current effective tax rate as the tax-avoidance measure and an index-score ratio as the transfer-pricing measure. Under the current effective tax rate proxy, a lower value indicates a stronger indication of tax avoidance,

whereas a higher transfer-pricing index score represents more extensive transfer-pricing activity. Hypothesis 1 (H1) proposes that transfer pricing positively affects tax avoidance. Because the two proxies move in opposite numerical directions, an increase in transfer pricing combined with a stronger indication of tax avoidance is expected to produce a negative coefficient in the software output. Accordingly, the negative sign is consistent with the interpretation of the current effective tax rate proxy: the lower the tax-avoidance proxy value, the stronger the indication that the company is avoiding tax. The estimated path coefficient is -0.381; therefore, H1 is accepted on the basis of the opposite directional coding of the transfer-pricing and tax-avoidance measures.

The moderating effect of CEO narcissism on the relationship between transfer pricing and tax avoidance was then examined. CEO narcissism was measured on an ordinal scale, with higher scores representing higher levels of narcissism. Hypothesis 2a (H2a) states that CEO narcissism strengthens the relationship between transfer pricing and tax avoidance. The interaction between CEO narcissism and transfer pricing produced a path coefficient of -0.186. Because this direction is consistent with the main transfer-pricing model under the current effective tax rate coding, CEO narcissism is interpreted as strengthening the relationship between transfer pricing and tax avoidance. H2a is therefore accepted.

The study also tested whether CEO financial expertise moderates the relationship between transfer pricing and tax avoidance. CEO financial expertise was measured as a dummy variable: a value of 1 was assigned when the CEO held a finance degree or had career experience in finance, and 0 otherwise. Hypothesis 2b (H2b) proposes that CEO financial expertise strengthens the transfer-pricing-tax-avoidance relationship. The interaction term between CEO financial expertise and transfer pricing yielded a path coefficient of -0.332. This coefficient follows the direction of the main transfer-pricing model under the proxy coding used in the study. CEO financial expertise is therefore interpreted as strengthening the relationship between transfer pricing and tax avoidance, and H2b is accepted.

Testing was conducted on the foreign ownership variable to test its influence on the relationship between transfer pricing and tax avoidance. A ratio was used to measure the level of foreign ownership of a company. The higher the value obtained, the greater the indication of foreign ownership of a company. The hypothesis (H3) developed in this study is that foreign ownership strengthens the relationship between transfer pricing and tax avoidance. The path coefficient of the interaction of foreign ownership with transfer pricing shows a positive value of 0.071. The significance level of this relationship is P = 0.207, meaning that the effect of this relationship is not significant because P > 0.05, which means that the influence of this variable on the relationship between transfer pricing and tax avoidance occurs by chance rather than due to a specific cause.

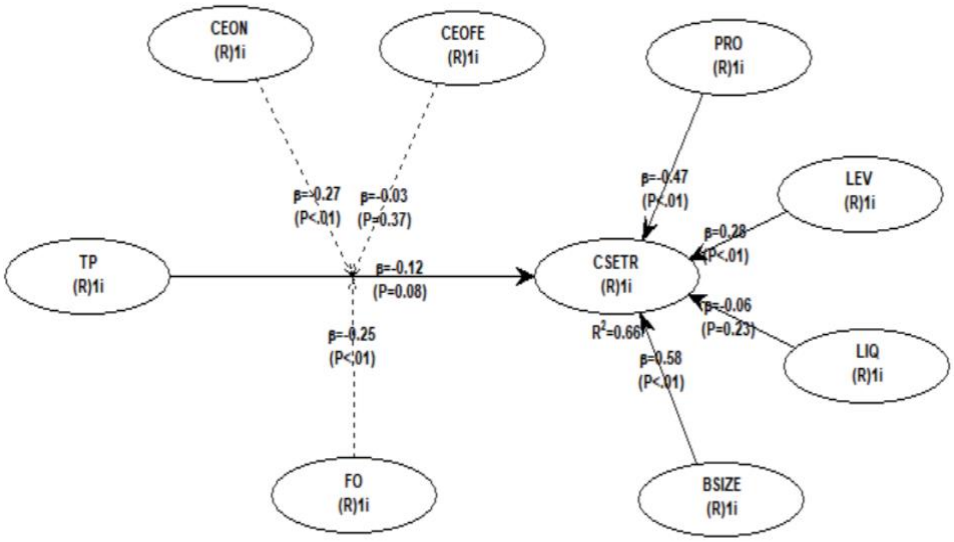



**Figure 2.** Hypothesis Test

**Table 2**
*Hypothesis Test*

| Variable | *Path Coefficients* | *P-Values* | *Rule of Thumb* | *Notes* |
|---|---|---|---|---|
| TP | -0.124 | P = 0.078 | P < 0.05 | Rejected |
| CEON*TP | -0.272 | P = 0.001 | P < 0.05 | Accepted |
| CEOFE*TP | -0.029 | P = 0.368 | P < 0.05 | Rejected |
| FO*TP | -0.254 | P = 0.002 | P < 0.05 | Accepted |
| PRO | -0.475 | P < 0.001 | P < 0.05 | Sig |
| LEV | 0.281 | P < 0.001 | P < 0.05 | Sig |
| LIQ | -0.064 | P = 0.232 | P < 0.05 | Not sig |
| BSIZE | 0.579 | P < 0.001 | P < 0.05 | Sig |

The robustness analysis replaced the tax-avoidance proxy from current effective tax rate with cash effective tax rate to assess whether the study's findings remained stable under an alternative measurement. The model produced an R-Square value of 0.657, indicating that 65.7% of the variation in tax avoidance is explained by the variables included in the research model, while 34.3% is attributable to variables outside the model. Transfer pricing produced a path coefficient of -0.124 with P = 0.078; because the effect is not significant at P < 0.05, H1 is rejected and this result is considered not robust. The interaction between CEO narcissism and transfer pricing yielded a coefficient of -0.272 with P = 0.001; the effect is significant at P < 0.05, so H2a is accepted and the result is considered robust. The CEO financial expertise-transfer pricing interaction produced a coefficient of -0.029 with P = 0.368; because it is not significant at P < 0.05, H2b is rejected and the result is considered not robust. The foreign ownership-transfer pricing interaction yielded a coefficient of -0.254 with P = 0.002; the effect is significant at P < 0.05, so H3 is accepted and the result is considered robust.

**Discussion**

The relationship is statistically significant at P < 0.001, which is below the 0.05 threshold. The transfer-pricing effect size is 18.1%, indicating a moderate practical contribution of the transfer-pricing variable. The acceptance of H1 is consistent with findings reported by Amidu et al. (2019), Bartelsman and Beetsma (2003), Jansky et al. (2013), Sikka and Willmott (2010), Taylor & Richardson (2012) and Nebie and Cheng (2023) which document that manipulation of transfer prices can facilitate tax avoidance. The results are therefore interpreted as consistent with stewardship theory, under which a steward is expected to act in the interests of stakeholders because contributing to collective organizational objectives may also generate personal benefits (Davis et al., 1997; Donaldson & Davis, 1989, 1991; Steinfeld, 2023).

Prior literature identifies transfer pricing as an important mechanism through which multinational enterprises may shift profits across jurisdictions to reduce their overall tax liabilities, potentially eroding tax revenues in higher-tax countries (Amidu et al., 2019; Grubert & Mutti, 1991; Taylor & Richardson, 2012; Nebie & Cheng, 2023). Previous studies also highlight the role of tax-haven jurisdictions in facilitating international tax avoidance and influencing multinational enterprises' tax burdens (Choi et al., 2026; Dyreng & Lindsey, 2009). Nevertheless, not all transfer-pricing transactions between affiliated multinational entities constitute tax avoidance, as such transactions may reflect legitimate business activities conducted in accordance with the arm's length principle. Accordingly, this study focuses specifically on transfer-pricing arrangements involving affiliates located in tax-haven jurisdictions that are used to shift profits and reduce tax liabilities.

With consistent and continuous results, it becomes a fact that grey areas and tax havens are indeed the masterminds behind the creation of this relationship of actions. Legal weaknesses continue to be exploited to achieve goals not intended by lawmakers (Sitorus et al., 2022). Thus, the results of this test prove the truth of one of the three characteristics of tax avoidance mentioned by the Organisation for Economic Co-operation and Development (OECD) (Moshenets et al., 2025; Spitz, 1983). This is because tax haven jurisdictions offer various benefits to non-residents and foreign companies. These benefits include laws specifically designed to attract investment, strict confidentiality to protect investor privacy, and low taxes to maximize their profits (Hearson & Brooks, 2010; Otusanya et al., 2023). By transferring income to tax haven

territories, maximum profit and minimum tax will be created. So in fact, transfer pricing is indeed carried out based on tax avoidance.

The transfer-pricing effect on tax avoidance produced a path coefficient of -0.381. Given the opposite numerical directions of the transfer-pricing measure and the current effective tax rate proxy, this coefficient is interpreted as supporting hypothesis 1 (H1). The relationship is statistically significant at $P < 0.001$, below the 0.05 threshold, and the transfer-pricing effect size is 18.1%, indicating a moderate practical contribution. The acceptance of H1 is consistent with Amidu et al. (2019), Syarif and Koerniawan (2025), Bartelsman and Beetsma (2003), Jansky et al. (2013), Sikka & Willmott (2010), Taylor and Richardson (2012), which document that transfer-price manipulation can facilitate tax avoidance. The finding is also interpreted as consistent with stewardship theory, in which a steward is motivated to serve stakeholder interests because contributing to collective organizational goals may simultaneously produce personal benefits (Davis et al., 1997; Donaldson & Davis, 1989, 1991; Steinfeld, 2023).

The significance level of this relationship is $P = 0.018$, meaning that the influence of this relationship is very significant because $P < 0.05$, which means that the influence of this variable on the relationship between transfer pricing and tax avoidance does not occur by chance but rather due to a specific cause. The effect size arising from the inclusion of this variable in the relationship between transfer pricing and tax avoidance is 7.8%, which means that although there is a contribution from the CEO narcissism variable, it is still considered weak in practical terms. Thus, the research results show a concept in line with upper echelons theory, where the characteristics of the upper echelon play an important role in determining the success of a company, because these characteristics not only influence the decision-making process of an upper echelon but also shape the company culture in long-term performance (Bekos et al., 2023).

The hypothesis is accepted, so the researcher's argument is proven correct that when finding tax loopholes, narcissistic CEOs act opportunistically by moving company profits to low-tax countries, as a way to enrich themselves. In line with previous research showing that CEOs with narcissistic personalities tend to abuse the authority they have to achieve personal goals, including committing unethical and illegal acts (Ashforth, 1994; Higgs, 2009; Higgs et al., 2026; Kellerman, 2004; Lipman-Blumen, 2005).

The results of this study also prove the correctness of the argument by Nevicka et al. (2011) and Barkhoda et al. (2026) which shows that narcissistic individuals tend to perform better in situations that promise large financial gains. Lunbeck (2020), Salehi et al. (2021) and Xu (2024) also argue that a narcissistic person tends to ignore social values in decision-making. Therefore, because the results of this study are also in line with these critical views, empirical evidence is found that the presence of a narcissistic CEO in top management will strengthen the potential for opportunistic actions in making cross-path decisions to achieve greater income by manipulating transfer prices.

The transfer-pricing effect on tax avoidance produced a path coefficient of -0.381. Given the opposite numerical directions of the transfer-pricing measure and the current effective tax rate proxy, this coefficient is interpreted as supporting hypothesis 1 (H1). The relationship is statistically significant at $P < 0.001$, below the 0.05 threshold, and the transfer-pricing effect size is 18.1%, indicating a moderate practical contribution. The acceptance of H1 is consistent with Amidu et al. (2019), Syarif and Koerniawan (2025), Bartelsman and Beetsma (2003), Jansky et al. (2013), Sikka and Willmott (2010), and Taylor and Richardson (2012), which document that transfer-price manipulation can facilitate tax avoidance. The finding is also interpreted as consistent with stewardship theory, in which a steward is motivated to serve stakeholder interests because contributing to collective organizational goals may simultaneously produce personal benefits (Davis et al., 1997; Donaldson & Davis, 1989, 1991; Steinfeld, 2023).

This moderating relationship is statistically significant at $P < 0.001$, below the 0.05 threshold. The inclusion of CEO financial expertise in the transfer-pricing-tax-avoidance relationship produces an effect size of 15.1%, indicating a moderate practical contribution. The finding is interpreted as consistent with upper echelons theory, which emphasizes that characteristics of top executives can materially shape organizational success because they affect both managerial decision-making and the organizational culture underlying long-term performance (Bekos et al., 2023).

Because the hypothesis is accepted, the findings support the argument that CEOs with

financial expertise may view tax avoidance as a strategic option in the context of alternative investments. Such CEOs can manage this option by weighing potential returns against the associated risks. Their stronger financial knowledge may help them formulate strategies for navigating regulatory gaps, while their leadership authority allows accounting knowledge to inform corporate financial policies aligned with business interests. These capabilities provide greater scope to identify legally available tax-saving approaches (Amernic & Craig, 2010; Azevedo & Nakao, 2024).

The findings are also consistent with the argument of Custodio and Metzger (2014) and Rossignoli et al. (2025), who show that CEOs with financial expertise tend to be more active in managing corporate finances and may lead firms with relatively high debt levels. Such circumstances can create incentives to seek tax-optimization strategies. Gallemore & Labro (2015) and Liu et al. (2026) likewise argue that CEOs with financial expertise are more likely to influence corporate tax policies. In line with these views, the present evidence suggests that a high level of CEO financial expertise within top management can strengthen the potential for cross-jurisdictional decisions aimed at increasing income through the manipulation of transfer prices.

The transfer-pricing effect on tax avoidance produced a path coefficient of -0.381. Given the opposite numerical directions of the transfer-pricing measure and the current effective tax rate proxy, this coefficient is interpreted as supporting hypothesis 1 (H1). The relationship is statistically significant at $P < 0.001$, below the 0.05 threshold, and the transfer-pricing effect size is 18.1%, indicating a moderate practical contribution. The acceptance of H1 is consistent with Amidu et al. (2019), Syarif and Koerniawan (2025), Bartelsman and Beetsma (2003), Jansky et al. (2013), Sikka and Willmott (2010), and Taylor and Richardson (2012) and Nebie and Cheng (2023), which document that transfer-price manipulation can facilitate tax avoidance. The finding is also interpreted as consistent with stewardship theory, in which a steward is motivated to serve stakeholder interests because contributing to collective organizational goals may simultaneously produce personal benefits (Davis et al., 1997; Donaldson & Davis, 1989, 1991; Steinfeld, 2023).

The hypothesis is rejected, so the researcher's argument is not proven correct. Multinational companies with ownership structures that are highly distributed among many investors, both domestic and foreign, tend to have stricter oversight of tax accounting practices. This reduces the opportunity for international cash flow manipulation. Bad experiences in using transfer pricing schemes in the past may have made foreign shareholders more cautious in implementing active tax strategies in the present.

## CONCLUSION

The findings indicate a significant association between transfer pricing and tax avoidance, while CEO narcissism and CEO financial expertise significantly moderate this relationship in the main model. The moderating effect of foreign ownership is not supported consistently across model specifications. These results suggest that the tax implications of related-party pricing are partly conditional on characteristics of top executives, offering one explanation for the mixed findings reported in earlier studies.

From a theoretical perspective, the study broadens transfer-pricing research by incorporating upper-echelons characteristics and ownership structure as separate boundary conditions. In practical terms, tax authorities may consider executive characteristics, exposure to related-party transactions, and ownership structure within risk-based monitoring, while companies can strengthen governance over transfer-pricing decisions and related documentation. Future studies should examine wider sectoral coverage, longer panel periods, and alternative measures of tax avoidance to assess the stability of the identified moderation effects.

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## AUTHOR CONTRIBUTION STATEMENT

Mustafhimatul Ilma was responsible for conceptualization, research design, methodological development, data collection, data analysis, interpretation of the findings,

manuscript preparation, and approval of the final submitted version. The author assumes full responsibility for the accuracy, content, and integrity of the research.

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