Do Tax Rates Encourage Profit Shifts By Multinational Companies In Indonesia?

Eko Setiawan

Universitas Indonesia

Email: xcosetiawan2@gmail.com

How to Cite:

ABSTRACT
Due to the COVID-19 pandemic, many companies have experienced a decline in financial performance which has the potential to cause financial difficulties. While the government has provided stimulus to help, there are concerns about increasing tax avoidance efforts and profit-shifting practices with businesses transitioning to digital models. However, there is a view that companies may prefer ethical behavior to safeguard their reputation in the midst of a crisis. This study analyses profit-shifting behaviour by multinational companies in Indonesia before and during the COVID-19 pandemic, focusing primarily on the effect of differences in Indonesia's income tax rates on average rates in countries where the group of companies operates. Descriptive analysis is used in this study to provide an overview and general information about the data obtained in the field which is a research variable and will be used as analysis material to answer research questions. The research sample involved 163 companies listed on the Indonesia Stock Exchange and met certain criteria, such as the calculation of corporate income tax according to the Income Tax Law and the exclusion of certain sectors. Data was analyzed for the period 2017-2022, covering the period before and during the COVID-19 pandemic, as well as changes in tax rates in Indonesia. The results show that the difference in Indonesia's corporate income tax rate with the average tax rate in the country where multinational companies operate has a negative and significant effect on profit before tax.

INTRODUCTION
Multinational companies face different tax regulations between the countries where their operations take place. The laws and regulations governing the tax system may vary between countries. Such differences may include tax rates, tax payments, and tax reporting requirements. This disparity in taxation provisions can create loopholes that companies can exploit to avoid taxes by moving their profits to countries with lower tax rates (Update, 2018).

Profit shifting occurs when a multinational company moves a company's profits from one country to another through intra-group transactions (OECD, 2023a). Multinational corporations shift profits to countries with lower tax rates and large multinationals also exploit the mismatch between the tax system and tax treatment to shrink their tax burden (Johansson et al., 2017). The
wider the global reach of multinational companies, the greater the opportunities that companies can exploit in exploiting regulatory differences in different jurisdictions.

The European Commission’s Joint Research Centre shows estimated fiscal losses incurred due to BEPS practices in the European Union at EUR36 billion, EUR24 billion in Japan, and EUR100.8 billion in the United States each year (Álvarez-Martínez et al., 2022). Indonesia alone is estimated to lose USD4.7 million annually (O’Hare, 2020).

The difference in tax rates provides an incentive to multinational corporations to allocate their accounting profits internationally with the aim of reducing their global corporate tax liability (Lampenius et al., 2021). Multinational companies can benefit from transfer pricing to allocate profits to subsidiaries located in countries with lower tax rates, thereby reducing their global tax liability. Transfer price manipulation through cross-border transactions of intangible assets, such as intellectual property rights, provides multinational corporations with opportunities to allocate profits to low-tax jurisdictions, reduce tax burdens, and maximize financial returns (Choi et al., 2022).

Research (Hebous & Johannesen, 2021), showing that multinational corporations are using their corporate entities located in tax haven countries to sell services to affiliated companies at high prices to erode taxable profits and reduce the tax burden globally. The results of another study of multinational companies in Europe showed that an increase in parent company profits was associated with a significant increase in pretax profits in subsidiaries with low tax rates, compared to their effect on subsidiaries with high tax rates (Dharmapala & Riedel, 2013).

To illustrate, Google took advantage of the lower corporate tax rate in Ireland compared to the United States by transferring ownership of intellectual property related to search technology and advertising to an entity in Ireland. The entity then licenses the technology to other Google affiliates and moves profits to Bermuda through royalty payments. This allows Google to pay lower taxes in Ireland than in the United States. Google also has a similar branch in Singapore for business coverage in Asia (Zucman, 2017). According to OECD (2023b), Ireland’s corporate tax rate of 12.5%, Bermuda’s at 0%, and Singapore’s at 17%, is lower than the United States’ corporate tax rate of 25%.

In Indonesia, most tax disputes are about transfer pricing faced by the Directorate General of Taxes is caused by the transfer and utilization of intangible assets and the provision of intra-group services. This amounts to 45% of the total related tax disputes transfer pricing during the period 2017-2019 (Putri et al., 2023). This dispute arises because Different interpretations between tax inspectors and taxpayers in assessing the fairness of the transaction. Ownership of intangible assets such as patents can be used as a primary tool to divert profits Because the valuation is very subjective and it is difficult to determine the fair price (Cooper & Nguyen, 2020).

Since 1980, the world’s average corporate tax rate has consistently decreased. In 1980, the world’s average unweighted corporate tax rate was 40.11%, but in 2022 that average fell to 23.37%, a decrease of 42%. When considering each country’s GDP contribution, the weighted average world corporate tax rate has also decreased from 46.52% in 1980 to 25.43% in 2022. The average reduction in tax rates occurred in all regions of the world (Enache, 2022).

Figure 1. Distribution of Corporate Income Tax Rates in the World in 2022

Source: Processed from Corporate Income Tax Rate Dataset Worldwide (Tax Foundation, 2023)
Quantitatively, as figure 1, there are 70 (32%) countries imposing corporate income tax at rates ranging from 5%-20%, 114 (52%) countries imposing rates ranging from 21%-30%, and only 21 (9%) countries charging rates above 30%. Based on Figure 1.2., during the period from 1980 to 2019, the period before COVID-19, corporate income tax rates in Indonesia were more often above the world average. Meanwhile, higher corporate income tax rates encourage multinationals to divert profits to reduce the taxes they have to pay in the country (Huizinga & Laeven, 2008).

According to (Li & Yan, 2022), COVID-19 has had an impact on the decline in the company’s financial performance through several factors. First, the COVID-19 pandemic caused a significant decrease in demand and investment, which limited the profitability of enterprises and reduced liquidity. Second, the COVID-19 pandemic caused difficulties in the company’s production and operations, thereby increasing operational risks and lowering future performance expectations. Third, the COVID-19 pandemic caused financial market uncertainty, which made investors more conservative in investments and made it difficult for companies already facing financial constraints to obtain external funds.

A decline in the financial performance of most companies can trigger financial distress (Handayati et al., 2022). To mitigate the impact of COVID, the government issued a stimulus to help companies (debtors) who are experiencing difficulties in fulfilling credit or financing payment obligations during the COVID-19 pandemic. The Financial Services Authority (OJK) issued regulation number 11/POJK.03/2020 which provides incentives in the form of relaxation in payment of obligations, loan restructuring, and looser credit risk assessment for debtors affected by COVID-19. Study results (Arhay & Nusantari, 2021) shows that the provision of stimulus to debtors has a positive impact in supporting efforts to recover the Indonesian economy. The stimulus has proven effective in maintaining financial sector stability.

According to (Kobbi-Fakhrakh & Bougacha, 2023), there are two possible behaviors tax avoidance companies due to economic pressures and heightened uncertainty during the COVID-19 pandemic. First, behavior tax avoidance Companies can be described by models' deterrence Economics that focuses on a cost-benefit framework. In crisis situations, taxpayers can undertake tax avoidance strategies as an alternative source of funding to overcome the adverse effects of the crisis, regardless of the risk of being audited by tax authorities. This behavior is reinforced when taxpayers notice a decrease in the level of tax law enforcement during periods of crisis.

Second, a decrease in company revenue during the pandemic can actually cause a decrease in behavior tax avoidance. This can be explained because a decrease in revenue will lead to an increase Risk aversion taxpayer, so they are less motivated to avoid taxes. This view is supported by another opinion that tax avoidance can incur reputational costs and enforcement costs whose value can exceed the benefits obtained (Armstrong et al., 2015; Gallemore et al., 2014). An organization's ethical behavior during times of crisis is very important because it can affect the organization's reputation and public trust in the organization (Potocan & Nedelko, 2021).

During COVID-19, companies have had to adjust their business strategies, one of which is changing business models from traditional to digital (Olarewaju & Ajeyalemi, 2023). Digital technology allows companies to automate business processes, reduce production costs, and improve operational efficiency. In addition, digital technology also allows companies to collect and analyze customer data, so as to improve the quality of products and services offered. With digital technology, companies can also expand their market reach by utilizing digital platforms such as social media and e-commerce (Warner & Wäger, 2019). Meanwhile, in addition to increasing market power, the use of technology can also be used to do profit shifting through sales with digital platforms and increased payments for the use of intangible assets (Ghauri et al., 2021). By selling through a subsidiary’s digital platform in a low-tax country, more profit is made there, rather than in the country where the actual sale takes place.

A reduction in the corporate tax rate has the potential to reduce the incentive for companies to shift profits to countries with lower rates (Huizinga & Laeven, 2008), however, the crisis caused by the COVID-19 pandemic is expected to increase tax avoidance behavior and the
emergence of profit shifting opportunities through increased use of digital platforms. Meanwhile, there is another view that states that taxpayers are not motivated to avoid taxes because increased Risk Aversion and risk reputational cost thus encouraging companies to tend to behave ethically during times of crisis. Therefore, this study aims to analyze whether the reduction in tax rates in Indonesia is related to profit shifting practices during the COVID-19 pandemic.

This research is a development of research that has previously been carried out by Purba & Tran (2018) and (Gill et al., 2022). The results of Purba & Tran's (2018) research, found inconsistent behavior of Indonesian multinational companies in profit shifting activities, where in one period the company carried out profit shifting activities but in another period the company stopped shifting profits. Therefore, this study will look at the impact of tax rate reduction policies in Indonesia during the COVID-19 pandemic on reported profit before tax. In addition, this study builds on research that has been conducted by (Gill et al., 2022), in the context of different locations. This study chose Indonesia as the research location with several fundamental differences. First, Indonesia applies a lower corporate income tax rate than India. Second, Indonesia as a destination country for foreign investment tends to be part of the global supply chain, so it risks following tax avoidance schemes from multinational parent companies (Darussalam et al., 2022).

This study analyses profit-shifting behaviour by multinational companies in Indonesia before and during the COVID-19 pandemic, focusing primarily on the effect of differences in Indonesia's income tax rates on average rates in countries where the group of companies operates. The specific objective is to assess whether the difference affects taxable profit reported in Indonesia and whether during the pandemic the tax rate has had a positive impact on profit before tax. For academics, this research has the potential to enrich understanding of international taxation, especially in developing countries such as Indonesia, as well as provide insight into the dynamics of the influence of tax rates during the pandemic crisis.

METHODS

Descriptive analysis is used in this study to provide an overview and general information about the data obtained in the field which is a research variable and will be used as analysis material to answer research questions. This study examines the profit-shifting behavior by multinational companies in Indonesia that are subsidiaries of overseas parents or vice versa, defined based on (Johansson et al., 2017). The research sample involved 163 companies listed on the Indonesia Stock Exchange and met certain criteria, such as the calculation of corporate income tax according to the Income Tax Law and the exclusion of certain sectors. Data was analyzed for the period 2017-2022, covering the period before and during the COVID-19 pandemic, as well as changes in tax rates in Indonesia.

This study operationalizes the variables clearly. The dependent variable is profitability, measured by the ratio of total profit, while the independent variable is the difference in Indonesia's income tax rate with the unweighted average rate of the rate in the multinational group country. In addition, there are other control variables such as company size, position within the group, and patent ownership. Data analysis involves descriptive tests, selection of the best regression model, and tests of classical assumptions such as normality, multicollinearity, autocorrelation, and heteroscedasticity to ensure the validity of the regression model used.

RESULTS

Descriptive Statistics

| Table 1. Descriptive Statistical Summary of PROFIT, TAXDIFF, and SIZE Variables |
|-----------------|-----|-------|------|-------|-------|---------|---------|
| Variable        | N   | Mean  | Median| SD    | Minimum| Maximum | Skewness |
| PROFIT          | 978 | 0.0639| 0.0542| 0.1254| -0.3583| 0.5610  | 0.4840   |
| TAXDIFF         | 978 | 0.0277| 0.0250| 0.0364| -0.0550| 0.1250  | 0.7140   |
| SIZE            | 978 | 29.4211| 29.4788| 1.7040| 24.4629| 33.6550| -0.1750  |
Note: PROFIT is profitability as measured by the ratio of profit before tax to total assets, TAXDIFF is the difference in Indonesia’s Corporate Income Tax rate with the average tax rate in all countries where multinational companies operate, SIZE is the size of the company measured by total assets.

Source: processed by author

Table 1. is a statistical descriptive of numerical variables that have been adjusted. The average PROFIT value of 6.39% shows that the average sample company earns profits on its business operations in Indonesia, even though there are companies that have suffered losses of up to 35.83% of their total assets. Nevertheless, more companies gained than lost as the median value was positive at 5.42%. According to table 4.2., it is known that during the COVID-19 pandemic, the average sample company experienced a decrease in profit by 0.53% but based on the paired t-test results, the decrease was not significant, so it can be said that on average the company earned the same profit in the period before and during COVID-19.

Table 2. is a statistical descriptive of numerical variables that have been adjusted. The average PROFIT value of 6.39% shows that the average sample company earns profits on its business operations in Indonesia, even though there are companies that have suffered losses of up to 35.83% of their total assets. Nevertheless, more companies gained than lost as the median value was positive at 5.42%. According to table 4.2., it is known that during the COVID-19 pandemic, the average sample company experienced a decrease in profit by 0.53% but based on the paired t-test results, the decrease was not significant, so it can be said that on average the company earned the same profit in the period before and during COVID-19.

Table 2. Comparison of PROFIT, TAXDIFF, and SIZE Variables in the Period Before and During the COVID-19 Pandemic

<table>
<thead>
<tr>
<th>Variable</th>
<th>N = 489</th>
<th>N = 489</th>
<th>Mean</th>
<th>S.D.</th>
<th>Mean</th>
<th>S.D.</th>
<th>Mean Diff</th>
<th>t-stat</th>
</tr>
</thead>
<tbody>
<tr>
<td>PROFIT</td>
<td>0.0666</td>
<td>0.1249</td>
<td>0.0613</td>
<td>0.1260</td>
<td>-0.0053</td>
<td>-0.9159</td>
<td></td>
<td></td>
</tr>
<tr>
<td>TAXDIFF</td>
<td>0.0389</td>
<td>0.0352</td>
<td>0.0166</td>
<td>0.0342</td>
<td>-0.0223</td>
<td>72.9083*</td>
<td></td>
<td></td>
</tr>
<tr>
<td>SIZE</td>
<td>29.3330</td>
<td>1.6932</td>
<td>29.5091</td>
<td>1.7118</td>
<td>0.1761</td>
<td>10.2893*</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Note: PROFIT is profitability as measured by the ratio of profit before tax to total assets, TAXDIFF is the difference in Indonesia’s Corporate Income Tax rate with the average tax rate in all countries where multinational companies operate, SIZE is the size of the company measured by total assets. * represents statistical significance at the level of 5%

Source: Reprocessed STATA output

Figure 1. shows that on average multinationals experienced the deepest decline in profits in 2020, at the beginning of the COVID-19 pandemic, but began to increase in 2021 even exceeding profits in the pre-COVID-19 period. This is in accordance with the results of the study (Devi et al., 2020) and (Handayati et al., 2022) which stated that in general the company experienced a decline in revenue during COVID-19 but some companies still generate good profitability and are far from the risk of financial difficulties. Further, according to (Olarewaju & Ajeyalemi, 2023), companies must be able to respond to uncertainty due to COVID-19 with their dynamic capabilities. From figure 1. It is also seen that multinational companies can adapt well and generate increased profits.

Indonesia’s corporate income tax rate is still relatively high compared to the average tax rate imposed on multinational company groups. This is reflected in the average TAXDIFF value of 2.77%, which shows a positive difference between Indonesia’s corporate tax rate and the average tax rate imposed on multinational group companies. Although there are some companies that consider Indonesia’s tax rate to be lower to 5.5%, the majority of sample companies view the domestic corporate tax rate as still higher. This is indicated by a positive median TAXDIFF value of 2.5%.

Figure 2. Average Graph of PROFIT and TAXDIFF Variables for the 2017-2022 Period

Figure 2. Average Graph of PROFIT and TAXDIFF Variables for the 2017-2022 Period

Source: Processed by the author
Table 2. shows that on average, TAXDIFF has decreased by 2.23% and this decrease has a significant difference compared to the period before the COVID pandemic. Figure 4.1 clarify the condition. If observed every year, the TAXDIFF variable experienced a sharp decrease in 2020 due to a decrease in the Corporate Income Tax rate in Indonesia, however, in 2021 and 2022, the value of TAXDIFF increased. This is because some countries also lower their corporate tax rates. For example, Tunisia lowered their tax rate by 10% and Chile lowered its corporate tax rate to 15% in 2021 (Enache, 2022). Some countries in the Asian Region have also lowered tax rates. Myanmar lowered the corporate tax rate by 3% and Bangladesh lowered the corporate tax rate by 2.5% in 2022. Nevertheless, there are several countries that have increased their corporate tax rates such as Argentina increasing the corporate tax rate by 5% in 2021 and Turkey which increased the rate to 3% in 2022. Corporate tax rates undergo dynamic changes in accordance with the authority of local government authorities. This relatively high corporate tax rate has the potential to encourage multinational companies to shift profits to other tax jurisdictions at lower rates, in order to minimize the tax paid overall.

Table 3. Descriptive Statistical Summary of PATENT, HQ, and OP Variables

<table>
<thead>
<tr>
<th>Variable</th>
<th>Dummy</th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>PATENT</td>
<td>0</td>
<td>744</td>
<td>76.07%</td>
</tr>
<tr>
<td></td>
<td>1</td>
<td>234</td>
<td>23.93%</td>
</tr>
<tr>
<td>HQ</td>
<td>0</td>
<td>690</td>
<td>70.55%</td>
</tr>
<tr>
<td></td>
<td>1</td>
<td>288</td>
<td>29.45%</td>
</tr>
<tr>
<td>ON</td>
<td>0</td>
<td>438</td>
<td>44.79%</td>
</tr>
<tr>
<td></td>
<td>1</td>
<td>540</td>
<td>55.21%</td>
</tr>
</tbody>
</table>

Note: PATENT is patent ownership, HQ is the company’s status as the ultimate parent, OP is the company’s status as an intermediary parent

Source: processed by author

Patents can be used as a means of making profit transfers through payment of rewards for the use of intangible assets. As of table 2., there are 23.93% of sample companies that have patents. That is, almost a quarter of those sample companies have a higher incentive to engage in profit-shifting practices, because they can set transfer prices on royalties and rewards for the use of their patents to affiliated entities.

A small percentage of the sample companies in this study (29.45%) are ultimate parents and have full authority in making overall strategic decisions on all entities in the multinational group. The remaining 55.21% of sample companies have the status of intermediary parents who...
act as intermediary entities with limited authority to certain subsidiaries under their control. Intermediary parents generally only implement the direction and strategic decisions of the ultimate parent. While the other 15.34% are direct subsidiaries that are fully controlled by both the ultimate parent and intermediary parent without having strategic decision-making authority. This full subsidiary basically only carries out instructions from its parent company.

Analisis Data Panel
a. Regression Estimation Model Selection

The results of the Hausman test show that the Fixed Effect Model is the most appropriate estimation model for panel data in this study, as shown in Appendix 2 on the results of the model selection test.

b. Classical Assumption Test

The test results showed no multicollinearity problems in the regression model used, characterized by the absence of a correlation coefficient above 0.8 or a VIF value above 10. Nevertheless, the test results Wooldridge Test (Drukker, 2003) and Modified Wald Test (Greene, 2000) indicates that there are problems with autocorrelation and heterokedasticity. The test results can be seen in appendix 2. Therefore, Panel Corrected Standard Errors (PCSE) was chosen as the handling method due to heteroscedasticity, and first-order serial correlation. In addition, PCSE is an appropriate estimator because the cross-sectional dimension (163 companies) is larger than the time dimension (6 years) (Minh Ha et al., 2021; Neves et al., 2019).

c. Regression Results

<table>
<thead>
<tr>
<th>Variable</th>
<th>PROFIT (All Periods) (1)</th>
<th>PROFIT (COVID Interaction) (2)</th>
</tr>
</thead>
<tbody>
<tr>
<td>TAXDIFF</td>
<td>-0.2600 * (-2.44)</td>
<td>-0.3410 * (-2.79)</td>
</tr>
<tr>
<td>TAXDIFF*DUMCOV</td>
<td></td>
<td>0.0274 (-0.17)</td>
</tr>
<tr>
<td>DUMCOV</td>
<td></td>
<td>-0.0156 (-1.51)</td>
</tr>
<tr>
<td>SIZE</td>
<td>0.0124 * (7.20)</td>
<td>0.0128 * (7.58)</td>
</tr>
<tr>
<td>PATENT</td>
<td>0.0148 * (2.63)</td>
<td>0.0135 * (2.41)</td>
</tr>
<tr>
<td>HQ</td>
<td>-0.0019 (-0.29)</td>
<td>-0.0023 (-0.34)</td>
</tr>
<tr>
<td>ON</td>
<td>0.0188 * (2.95)</td>
<td>0.0188 * (2.96)</td>
</tr>
<tr>
<td>Constant</td>
<td>-0.3070 * (-6.34)</td>
<td>-0.3090 * (-6.65)</td>
</tr>
<tr>
<td>Year</td>
<td>Included</td>
<td>Included</td>
</tr>
<tr>
<td>Industry</td>
<td>Included</td>
<td>Included</td>
</tr>
<tr>
<td>Observations</td>
<td>978</td>
<td>978</td>
</tr>
<tr>
<td>R-squared</td>
<td>0.0432</td>
<td>0.0463</td>
</tr>
<tr>
<td>Wald chi2</td>
<td>216.10</td>
<td>452.20</td>
</tr>
<tr>
<td>Prob &gt; chi2</td>
<td>0.0000</td>
<td>0.0000</td>
</tr>
</tbody>
</table>

Note: PROFIT is profitability as measured by the ratio of profit before tax to total assets, TAXDIFF is the difference in Indonesian Corporate Income Tax rates with the average tax rate in all countries where multinational companies operate, SIZE is the size of the company measured by total assets, PATENT is patent ownership, HQ is the company’s status as the ultimate parent, OP is the company’s status as an intermediary parent, DUMCOV is the COVID-19 dummy, and TAXDIFF*DUMCOV is the effect of COVID-19 interaction with different tax rates. * represents statistical significance at the level of 5%.

Source: Reprocessed STATA output
d. Hypothesis Testing

The regression results in Table 3 column 1, without the interaction of COVID-19 show that differences in tax rates have a negative and significant effect on reported profit before tax. After including the COVID-19 interaction in column 2, there was no change in the effect of variable tax rate differences on pre-tax profit, either before or during the pandemic. In other words, the difference in Indonesia's corporate income tax rate with the average tax rate in all countries where multinational companies operate continues to negatively affect the profit before tax reported by multinational companies in Indonesia during the COVID-19 period, the same as before the pandemic.

Analysis of Research Results

The effect of different tax rates on profit before tax.

The results of this study are in line with the findings of previous research that has been conducted by (Johansson et al., 2017), (Heckemeyer & Overesch, 2017) and (Zhou et al., 2018) which concludes that differences in tax rates between countries have a negative impact on reported pretax profits. (Heckemeyer & Overesch, 2017) indicates that a decrease in the difference in tax rates has an effect on the increase in reported profit before tax. (Johansson et al., 2017) indicates that an increase in the difference in tax rates will decrease the amount of pretax profit reported to a country. (Zhou et al., 2018) indicates that a decrease in the parent company's tax rate leads to an increase in the difference in tax rates and decreases the profit reported in Indonesia. This shows the tendency of multinational companies to take advantage of different tax rates to reduce the amount of tax paid globally. However, the results of this study are not consistent with research conducted by (Gill et al., 2022), which looks at multinational companies in India.

Furthermore, (Ftouhi & Ghardallou, 2020) argue that multinational companies transfer profits to geographical areas because there are differences in the application of tax rates between countries as an alternative to international tax planning strategies. The international tax optimization mechanism can have an impact on shifting part of profits from one country to another that imposes lower taxes, through manipulation of transfer prices. Moreover (Johansson et al., 2017) Convey two other channels that can be utilized, namely allocating ownership of intangible goods, assets and risks in low-tax countries to divert profits from high-tax countries and manipulating debt locations.

Descriptive statistical analysis shows that corporate income tax rates in Indonesia tend to be higher, resulting in positive tax rate differences. This situation shows that Indonesia has risks related to profit shifting practices. This becomes more complex considering that most companies operating in Indonesia do not have the authority to make strategic decisions, they only carry out policies that have been set by the head office. In this context, differences in tax rates between countries remain the main driving factor for multinational companies operating in Indonesia to divert profits. They tend to exploit rate gaps to maximize after-tax profits, with strategies to minimize tax payments globally (Armstrong et al., 2015; Omar & Zolkafli, 2015) (OECD, 2023). As an attractive investment destination for multinational corporations, Indonesia is often part of global supply chains. The existence of Indonesia as a global production and distribution chain makes this country vulnerable to various tax avoidance schemes commonly carried out by multinational companies including profit shifting practices.

Indonesia's corporate income tax rate of 22% is currently lower than developed countries such as the United States, France, Canada, and Germany. However, there are a number of jurisdictions with lower tariffs than Indonesia such as the United Arab Emirates, Hong Kong, Singapore, Brunei Darussalam, and Vietnam. For multinational companies based in high-rate countries, Indonesia's tax rates are relatively competitive when compared to company operations in other jurisdictions. If multinational companies view Indonesia's tax rate as most favorable, they are encouraged to allocate and move profits to Indonesia. Conversely, if they are considered less competitive, they will take advantage of lower rates in other countries. The findings of this study
indicate that amid the downward trend in global tax rates, differences in tax rates between jurisdictions still provide incentives for multinational companies to divert profits to minimize tax payments globally.

The effect of tax rate differences on pre-tax profits during the COVID-19 pandemic

The interaction of the variables TAXDIFF and DUMCOV has no significant effect on the dependent variable PROFIT. The effect of the difference in tax rates on reported pretax profit did not differ significantly between observations and periods during and before the COVID-19 pandemic. This shows that during the COVID-19 pandemic, the difference in tax rates still has a negative and significant effect on profit before tax reported in Indonesia. These results do not support the second hypothesis that a reduction in tax rates during the pandemic should have had a positive impact on decreasing reported pretax profits. On the contrary, these empirical findings show that the policy of reducing tax rates in 2020 which narrowed the difference in tax rates can actually be followed by an increase in profit reporting before tax of multinational companies in Indonesia even though companies experienced a decline in profitability due to the COVID-19 pandemic.

Descriptive statistical data shows that on average, the profitability of companies between before and after COVID did not differ significantly. This shows that the company's profitability has not decreased significantly while tax avoidance behavior has decreased and tax compliance has increased. Therefore, the reduction in tax rates has a positive impact on the profit before tax reported in Indonesia. The positive impact on reported profits from reduced tax rates during the pandemic also indicates that although multinational companies have experienced a decline in profitability, taxpayers are more compliant in carrying out tax obligations and do not engage in tax avoidance including the transfer of profits to other countries’ jurisdictions. The reduction in tax rates has succeeded in lowering the incentive of companies to divert profits from business operations in Indonesia. This result is in line with the opinion of (Brondolo, 2009) who states that a recession can improve tax compliance. First, the increase in risk aversion behavior causes companies to be reluctant to take the risk of engaging in tax avoidance when experiencing a decrease in revenue. Second, declining revenues and lowering tax rates during the COVID pandemic kept marginal tax rates lower and provided less incentive not to report income. In addition, concerns over reputational loss may also influence executive management's decision not to engage in tax avoidance during periods of crisis (Athira & Ramesh, 2023) Because it can have an impact on decreasing company value, decreasing customer trust, and can even lead to lawsuits (Wang et al., 2021).

As an illustration, Giti Holdings Ltd is the parent company of PT Gajah Tunggal Tbk (GJTL). Giti Holdings Ltd operates in Singapore, Indonesia and China and has 23 subsidiaries in all three countries. Singapore's state tax rate of 17% and China's at 25% has not changed since 2017. Meanwhile, Indonesia lowered the Corporate Income Tax rate in 2020 to 22% from the previous 25%.

Table 5. Company TAXDIFF Calculation Illustration Example

<table>
<thead>
<tr>
<th>Year</th>
<th>Corporate Tax Rate (CTR)</th>
<th>Unweighted Average CTR</th>
<th>AXDIFF</th>
<th>PROFIT</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>China</td>
<td>Indonesia</td>
<td>Singapore</td>
<td></td>
</tr>
<tr>
<td>2017</td>
<td>25</td>
<td>25</td>
<td>17</td>
<td>22.33</td>
</tr>
<tr>
<td>2018</td>
<td>25</td>
<td>25</td>
<td>17</td>
<td>22.33</td>
</tr>
<tr>
<td>2019</td>
<td>25</td>
<td>25</td>
<td>17</td>
<td>22.33</td>
</tr>
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<td>2020</td>
<td>25</td>
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<td>2021</td>
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<td>2022</td>
<td>25</td>
<td>22</td>
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<td>21.33</td>
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</tbody>
</table>

Source: processed by author
According to the calculation in table 5, it is known that there is a decrease in the difference in tax rates between Indonesia and the average tax rate in the three countries where Giti Holdings Ltd. operates. This difference decreased from 2.67% in the pre-COVID-19 period to 0.67% in the COVID-19 period. This research found that the decrease in the difference in tax rates had a positive effect on the increase in profits reported by companies. This can be justified if in ceteris paribus conditions, meaning that all variables that affect the company's profits are constant. However, in reality this is unlikely to happen. This condition certainly cannot be interpreted that an increase in company profitability is always caused by a decrease in tax rates. This is because many factors affect the profitability of a company and are dynamic, such as internal company factors, market conditions, and macroeconomic factors (Johansson et al., 2017).

However, at least the results of this study indicate that changes in tax rates (increases or decreases) can provide incentives for multinational companies to transfer profits between tax jurisdictions to countries that provide the lowest tax rates. In addition, reported increases or decreases in profits do not necessarily reflect profit transfer practices. In the example of Giti Holdings Ltd’s case, for example, during the pandemic the average profit reported by the company was 0.73%, decreasing compared to the pre-pandemic period of 0.86%, while the difference in tax rates between Indonesia and the average tax rate in the three countries where Giti Holdings Ltd operates is getting smaller. Such conditions also cannot be concluded that there is a transfer of profits. Therefore, further research needs to be done on this profit shifting behavior. This research only focuses on tax rates that can encourage profit shifting behavior.

CONCLUSION

This study analyzes profit-shifting behavior by multinational companies in Indonesia before and during the COVID-19 pandemic. The results show that the difference in Indonesia’s corporate income tax rate with the average tax rate in the country where multinational companies operate has a negative and significant effect on profit before tax. The findings are in line with some previous studies, but differ from studies looking at multinational companies in India. During the pandemic, the negative effect of tax rates on profits remained significant, demonstrating the compliance of multinational companies in Indonesia with tax obligations.

While this study provides valuable insights, there are limitations worth noting. The main focus of the study is on corporate tax rates, while there are other factors such as taxation systems and preferential tax policies that can affect profit shifts. For example, preferential policies in other countries such as the Netherlands may encourage international companies to take advantage of incentives such as low tax rates for patent ownership. For a more in-depth and accurate analysis, further research is recommended to consider these factors and compare effective tax rates in various countries in one group of companies.

REFERENCES


