

# “The influence of income tax rate, tunneling incentives, and return on equity on transfer pricing behavior of foreign direct investment enterprises in Vietnam”

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# THE INFLUENCE OF INCOME TAX RATE, TUNNELING INCENTIVES, AND RETURN ON EQUITY ON TRANSFER PRICING BEHAVIOR OF FOREIGN DIRECT INVESTMENT ENTERPRISES IN VIETNAM

## Abstract

The utilization of competitive advantages in international trading has fortuitously put transnational manufacturing enterprises in the position of distorting transfer pricing techniques to maximize profits. The paper aims to explore the influence of the determinants on the transfer pricing behavior of foreign direct investment enterprises in Vietnam. The paper collects primary data from the financial statements of 96 foreign direct investment enterprises in Vietnam over six years from 2016 to 2021. The paper gets a final panel data of 576 observations to be processed by the fixed effects model estimation method using EViews 12. Supporting agency theory and positive accounting theory, the results show that the income tax rate negatively influences transfer pricing behavior, while tunneling incentives and return on equity positively affect transfer pricing behavior. The paper highlights that government agencies should reperform and implement fiscal policies synchronously to be able to monitor transfer pricing behaviors of foreign direct investment enterprises in Vietnam.

## Keywords

tax avoidance, associated transaction, earnings, profit, income, tax rate, bonus

## JEL Classification

M41, H26, K34

## INTRODUCTION

Business conglomerates and transnational enterprises consider transfer pricing behavior (abbreviated as transfer pricing) an essential and urgent issue in the process of economic integration. The international trading transactions of those multinational companies become more complex not only in terms of goods purchase, intangible assets, and sale but also in capital and real estate, especially for tax avoidance affairs. Income tax rates, tunneling incentives, and returns on equity of the enterprises may be adjusted to minimize the tax amount by implementing transfer pricing. Towards foreign direct investment, transfer pricing behavior affects the economic interests of a country receiving the investments due to the decrease in the national budget. It is because foreign direct investment enterprises (abbreviated as foreign enterprises) apply transfer pricing as one of the methods to avoid taxes and increase the return on equity of foreign enterprises, at the same time causing a loss of revenue for the host state budget due to the difference in income tax rates and tunneling incentives. In other words, there is a transfer of profits into lower income tax rates countries and it seems to be unfair for the host country when no tax is col-

lected. Therefore, transfer pricing should be controlled by public policy instruments. The development of tax schemes to strengthen the supervision and monitoring of company tax obligations is considered indispensable.

Studying the determinants of transfer pricing and the impacts of transfer pricing is important and necessary. It suggests practical expedient methods for controlling transfer pricing to minimize the consequences of transfer pricing, reduce negative effects on a large scale, and evenly distribute economic benefits for all related countries. Transfer pricing literature also helps to detect transfer pricing behaviors, and create a fair competitive environment for businesses all over the world. Nowadays, governments of all countries have been making efforts to improve institutions and infrastructure for anti-transfer pricing. However, the management of transfer pricing for foreign enterprises still has many issues to discuss, and need to find appropriate solutions for host countries.

## 1. LITERATURE REVIEW

Transfer pricing represents transactions of subsidiaries that operate in various countries with the parent company. It forms business transactions between companies within a corporation. Transactions can be exchanged between companies to avoid taxes and it is converted in many different forms. Transfer pricing is goods exchanged by units of the same enterprise, or services exchanged between related enterprises in various countries (Li, 2005). The Organization for Economic Cooperation and Development (OECD) acknowledges transfer pricing to be an exchange of transactions defined by groups that are related to each other. It is the view taken by the OECD and is currently used by many organizations and countries around the world as the definition of transfer pricing (OECD, 2020). For multinational enterprises, transfer pricing is essential to confirm that exchanges with foreign affiliates are performed smoothly and departmental operations are tracked (Rugman & Eden, 2017).

Multinational enterprises manipulate the determination of transfer prices with the primary goal of increasing profits and reducing taxes by placing branches in different countries where tax rates or incentives are non-taxable. (Amidu et al., 2011). Baistrocchi and Roxan (2013) argue that transfer pricing is a subjective and intentional activity of multinational corporations and enterprises to minimize the amount of tax payable by pricing products, raw materials, and materials between enterprises in the same group that does not follow the market price to obtain the highest profit. Agreeing with the papers on price manipulation,

Rachmat (2019) considers transfer pricing as a deliberate price adjustment technique that aims to create “real profit, fake loss” to avoid taxes of various countries where enterprises have a special relationship. Arifin et al. (2020) state that transfer pricing used by enterprises is not the same, and enterprises are free to choose alternative accounting processes and methods that can be implemented to reduce costs and increase economic contracts. From another point of view, transfer pricing is performed to increase the profits of enterprises by confirming the prices of goods and services of an organization, enterprises to enterprises in the same group.

In Vietnam, the legal regulations on this issue are not tight, and there is no related legal concept about transfer pricing but only related transactions are mentioned. Recently, Decree 132 in 2020 promulgated tax control for enterprises that have associated exchange with many new and stricter regulations. Decree 132 is considered the most detailed regulatory document on related transactions related to transfer pricing (Vietnam Government, 2020).

Agency theory explains the connection between managers as agents and stockholders as principals and this theory is first developed by Jensen and Meckling (1976). A connection is made by a specific agreement or provision in a contract between the parties, and the principal authorizes the representative to do the requests under the agreement. However, in this relationship, some situations will arise when there are conflicts between the two parties (mandate and agent) related to interests. Indriaswari and Aprilia (2017) argue that for-

own-controlling stockholders can recover investment capital through transfer pricing which can be detrimental to non-controlling stockholders. This theory is implemented to interpret problems of the bonus policy, enterprise size, and profitability ratio of the enterprise because of the impact on economic benefits between related parties.

Positive accounting theory is a general term for any accounting theory that provides descriptive information relevant to the behavior of accountants. Ball and Brown (1968) perform this theory during the same period in the 1960s. Watt and Zimmerman (1979) show that positive accounting aims to develop hypotheses to explain the actual things and phenomena of enterprises. Scott (2015) states that this theory affects managers' predictions about provisions of regulation accounting. The accounting forms used by enterprises are not the same and enterprises have the right to choose replacement forms to reduce costs and increase economic contracts (Arifin et al., 2020). Therefore, positive accounting theory is considered the foundation theory to explain and predict the actual accounting activities of enterprises. This theory aims to explain the accounting rules related to tax rates, incentives, and intangible assets of the enterprises to record and evaluate related economic transactions.

The transfer pricing issue is attracting more and more attention from enterprises, especially those of economic business groups. The trend of developing decentralized governance to ensure close access to the local market and hold information advantages over competitors. Those are the subjects with a centralized structure, making this topic even more attractive to interest groups (Amidu et al., 2019). Although transfer pricing is not a new issue, transfer pricing remains topical and is interesting and researched by some papers. More specifically, the problem of identifying factors that affect transfer pricing has been quite popular recently among academic researchers. Typically, Indriaswari and Aprilia (2017) use binary regression analysis to test the influence of the income tax rate, tunneling incentives, and bonus mechanism on transfer pricing. The sample includes 69 manufacturing enterprises listed in Indonesia between 2012 and 2014. The results indicate that tax rate and tunneling incentives significant-

ly affect transfer pricing but the bonus mechanism does not affect transfer pricing. Susanti and Firmansyah (2018) perform ordinary least squares to check the secondary data of 50 listed companies in the period from 2011 to 2015. The study investigates the influence of tax rates, tunneling incentives, and bonus mechanisms on transfer pricing in Indonesia. The results explore that tax rate and tunneling incentives negatively affect transfer pricing but the bonus mechanism does not impact transfer pricing. Surbakti et al. (2020) explore the transfer pricing of multinational enterprises in the field of food production. The selected sample is listed companies in Indonesia from 2010 to 2018. The model includes only two variables and the regression results by the ordinary least squares. The results that elicit the tax rate and tunneling incentives are positively correlated with transfer pricing. Purnomo et al. (2021) check the impact of tax rates, bonus mechanisms, and tunneling incentives on the transfer pricing of listed manufacturing enterprises in Indonesia from 2017 to 2019. The results of the ordinary least squares method affirm the tax rate does not impact transfer pricing, but the bonus mechanism and tunneling incentives significantly affect transfer pricing.

Several outstanding studies related to other factors such as enterprise size, return on equity, and intangible assets are also done by the papers. Anggraeni and Lutfillah (2019) test the transfer pricing of basic manufacturing and chemical industry enterprises in Indonesia. The paper finds varying degrees of influence among thirteen companies listed on stock exchanges in Indonesia between 2014 and 2017. The ordinary least squares are performed to test. The results indicate tunneling incentives are a factor positively correlated with the transfer pricing of enterprises. On the other hand, Nofryanti and Arsajah (2019) collect information on minimum tax cost, bonus mechanism, foreign ownership ratio, and debt ratio, as well as using some control variables such as enterprise size and profitability of enterprises. To analyze and provide empirical evidence on factors affecting transfer pricing, the selected samples are fourteen listed manufacturing enterprises in Indonesia from 2012 to 2016. The quantitative approach verifies tax minimization significantly affects transfer pricing but bonus mechanism, foreign ownership, and debt proportion do not

affect transfer pricing. Nazihah et al. (2019) conduct an empirical study to check the connection between the tax rate, tunneling incentives, bonuses, and enterprise size with the transfer pricing of enterprises in Indonesia. The sample is collected from 153 Indonesian listed companies in the period 2013 to 2017. The paper performs the ordinary least squares and states that tax rate, bonus mechanism, and enterprise size positively affect transfer pricing and tunneling incentives do not impact transfer pricing. Merle et al. (2019) test the transfer pricing intensity of 40 listed companies in France from 2012 to 2015. The method of using a regression model to test the transfer pricing. The results demonstrate a negatively relate of transfer pricing to intangible assets, and tax rate but enterprise size and financial leverage positively relate to transfer pricing. On the other hand, Arifin et al. (2020) consider the influence of enterprise size, profitability, tax rate, and public sector quality on transfer pricing. The paper focuses on 22 listed companies in Indonesia from 2015 to 2018. By the quantitative method, the result is that enterprise size is positively correlated with transfer pricing, while profitability, tax rate, and quality of the public sector do not affect transfer pricing.

In the context of the development of economic globalization, transfer pricing is not only tax but also considered by other related issues. Wijaya and Widianingsih (2020) measure four factors affecting the transfer pricing of enterprises including tax rate, exchange rate, tunneling incentives, and enterprise size. The selected sample is 19 manufacturing enterprises listed in Indonesia. The study is conducted from 2014 to 2018. The analytical method is a regression model by ordinary least squares. The research finds tax rate, tunneling incentives, and enterprise size significantly affect transfer pricing but the exchange rate does not affect transfer pricing. Rizkya and Isnalita (2020) collect data from non-financial multinational enterprises listed in Indonesia. The sample selects 60 samples from 2014 to 2017. Data are analyzed by ordinary least squares. The results explore that tax rate, profit, and enterprise size are not related to transfer pricing, in contrast, intangible assets find a significant effect on transfer pricing. Nosyk et al. (2023) study 27 European countries in 2022. The paper uses a descriptive method to examine the results. The results show that return on assets and

return on equity have an impact on the transfer pricing of corporations. Kalra and Afzal (2023) test tax avoidance by transfer pricing of corporations in the period 2014–2022. A descriptive analysis was performed to evaluate transfer pricing behavior. The results show that corporations have implemented accounting policies to transfer prices between subsidiaries of the group.

In Vietnam, transfer pricing is of interest to several researchers in recent years. Anh et al. (2018) study the transfer pricing of enterprises in the provinces of Vietnam. The paper performs the ordinary least squares of 180 Vietnamese enterprises in 2016. The results show enterprise size, the number of enterprises associated abroad, the use of tax incentives, and financial leverage have the same direction as transfer pricing but the profitability and intangible assets oppositely affect transfer pricing. Think et al. (2021) use panel data in the period 2018 to 2019. Data are collected from 50 foreign enterprises in Vietnam. The paper uses the ordinary least squares method to check the hypotheses. The results find total ownership and ownership of the organization positively affect transfer pricing.

Most previous studies consider corporations that transfer pricing from subsidiaries in one country to another. It is the transfer of profits to a country with a lower tax rate to avoid corporate tax. It is unfair in business because of transfer pricing. Transfer pricing is performed by many different aspects of enterprises. The purpose of the article is to determine the influence of the determinants on the transfer pricing behavior of foreign enterprises in Vietnam. Through a review of the theoretical basis, the paper finds some fundamental factors affecting the transfer pricing of foreign enterprises such as income tax rate, tunneling incentives, bonus mechanism, enterprise size, intangible assets, and return on equity as follows:

### 1.1. Income tax rate (Rate)

The income tax rate is the ratio of the tax rate that enterprises have to pay. The income tax rate is calculated from the financial information provided by enterprises. Menchaoui et al. (2017) suggest that tax rates are used to evaluate the effectiveness of tax administration in a related group because

intra-group rotation will greatly affect tax rates. The disparity of the tax rates in countries is encouraged multinational enterprises conducting international trade to look for ways to dodge paying excessive taxes. These enterprises will be promoted to implement transfer pricing by transferring the tax obligations of enterprises to enterprises in countries with lower tax rates (Marfuah & Azizah, 2014). Therefore, the benefit of enterprises in high-tax areas converts to low and vice versa, the benefit of enterprises in low-tax areas converts to high (Barker et al., 2017).

The income tax rate is determined by the amount of tax a taxpayer must pay to the government as required by applicable law (Indriaswari & Aprilia, 2017). Companies in countries with higher tax rates will transfer benefits to countries where tax rates are low (Rachmat, 2019). Some studies suggest that tax rate positively impacts transfer pricing (Indriaswari & Aprilia, 2017; Anh et al., 2018; Septiyani et al., 2018; Nofryanti & Arsjah, 2019; Nazihah et al., 2019; Surbakti et al., 2020; Devi & Suryarini, 2020; Depari et al., 2020; Widiasmara & Purwaningsih, 2020). Some other studies consider that tax rates negatively affect transfer pricing (Lo et al., 2010; Susanti & Firmansyah, 2018; Merle et al., 2019). In addition, Sulistyowati and Kananto (2018), Hikmatin and Suryarini (2019), Tjandrakirana and Ermadiani (2019), Widiasmara and Purwaningsih (2020), and Arifin et al. (2020) give the same results that tax rate does not affect transfer pricing.

## 1.2. Tunneling incentives (TUN)

Tunneling incentives are the transformation of financial resources of enterprises for the private gain of the majority stockholders, but the costs incurred from this transformation belong to the minority stockholders (Johnson et al., 2000). If shareholders have large ownership rights in enterprises, then of course shareholders also want large profits or dividends. Therefore, majority stockholders prefer transfer pricing by transferring assets of enterprises for the gain of majority stockholders versus getting dividends to minority stockholders. Tunneling incentives are supported by a percentage of foreign share ownership, the higher the ownership of foreign shares, the higher the ability of enterprises to transfer benefits to different countries to avoid taxes by transfer pricing (Saraswati, 2017).

Tunneling incentives are the act of majority shareholders transferring the benefit of enterprises for the interest of these shareholders, but minority shareholders have to pay the cost (Solikhah et al., 2020). Some papers suggest that tunneling incentives positively relate to transfer pricing (Indriaswari & Aprilia, 2017; Merliyana & Saodah, 2019; Surbakti et al., 2020; Wijaya & Widianingsih, 2020; Baroroh et al., 2021; Purnomo et al., 2021). However, some papers believe that tunneling incentives are negatively correlated with transfer pricing (Lo et al., 2010; Susanti & Firmansyah, 2018). Other studies consider that tunneling incentives do not affect transfer pricing (Nazihah et al., 2019; Widiasmara & Purwaningsih, 2020; Sari et al., 2021).

## 1.3. Bonus mechanism (BONUS)

Bonus mechanisms for the management of foreign enterprises will encourage them to exercise income management in terms of bonuses received. The bonus mechanism performs benefits as a tool of operational performance, and when the management of enterprises is supplemented with bonuses according to the profit target, they strive to obtain the benefit target as much as possible. At this time, the bonus mechanism can also affect enterprises' transfer pricing (Septiyani et al., 2018). Healy (1985) recognizes that managers have information about enterprises' profits and that is an opportunity to implement profit management. Consistent with the bonus scheme, Watts and Zimmermann (1986) suggest that bonuses of managers depend on the enterprises' benefit. To increase welfare, the manager managers can report higher net profit to get a bonus.

The bonus mechanism is a part of the bonus amount given by enterprise owners or stockholders who are assessed as having good achievements every year and when enterprises generate profits. Profit-based bonus mechanism will cause directors to adjust profits and even perform actions to regulate earnings to increase the bonus received (Indriaswari & Aprilia, 2017). Some studies by Sulistyowati and Kananto (2018), and Merliyana and Saodah (2019) suggest that the bonus mechanism negatively affects transfer pricing. Indriaswari and Aprilia (2017), Susanti and Firmansyah (2018), Nofryanti and Arsjah (2019),

Hikmatin and Suryarini (2019), Widiasmara and Purwaningsih (2020), Solikhah et al. (2021), Baroroh et al. (2021), and Purnomo et al. (2021) again find that bonus mechanism does not affect transfer pricing. Some authors argue that the larger the bonus mechanism, the more foreign enterprises tend to implement transfer pricing (Lo et al., 2010; Nazihah et al., 2019).

#### 1.4. Enterprise size (SIZE)

Enterprise size can classify the scales of enterprises in many different ways such as total assets, stock market value, and others. Brigham and Huston (2010) also comment that enterprise size is expressed by total assets, revenue, profit, tax expenses, and other expenses. International transfer pricing is performed by corporations through strategies adapted to the business situation of each company in different countries. At the same time, Jacob (1996) also expresses the same opinion when analyzing the impact of enterprise size on earnings mobility and proves that small enterprises are less sensitive to such transfers.

Enterprise size is a value that represents the scale of enterprises, and high asset value shows more prospects in the long run. Studies show that enterprise size has no relationship with transfer pricing (Septiyani et al., 2018; Hikmatin & Suryarini, 2019; Rizkya & Isnalita, 2020; Sari et al., 2021). Although previous studies provide mixed results on the impact of enterprise scales on transfer pricing, most of the findings of previous studies indicated that enterprise size is positively related to transfer pricing (Sulistiyowati & Kananto, 2018; Anh et al., 2018; Nazihah et al., 2019; Merle et al., 2019; Wijaya & Widianingsih, 2020; Arifin et al., 2020).

#### 1.5. Intangible assets (INTAN)

Intangible assets are immaterial assets and have no physical form. Intangible assets are invisible and cannot be held. Intangible assets include patents, copyrights, trademarks, goodwill, and franchises. The problem is the transfer of intangible assets between companies to avoid taxes. Intangible assets are transferred between companies in the group such as intellectual property as well as research and development costs (Grubert, 2003). Intangible

assets have completely different characteristics, so it is difficult to price them in the financial market. The valuation of intangible assets is subjective to the appraisal companies. The valuation is done by the transfer and receipt of the value of intangible assets usually performed by associated enterprises (Dyrenge et al., 2008).

Intangible assets are defined as non-physically existing. Intangible assets are difficult to evaluate because of the lack of financial markets to value them (Richardson et al., 2013). Many studies suggest that intangible assets positively affect transfer pricing, including Widiasmara and Purwaningsih (2020), Depari et al. (2020), and Rizkya and Isnalita (2020). Contrary to the results of the above studies, Anh et al. (2018) and Merle et al. (2019) conclude that intangible assets negatively affect transfer pricing.

#### 1.6. Return on equity (ROE)

Return on equity is an important indicator for potential investors, it measures the ability of enterprises to use capital effectively. If this ratio is low, the profits of enterprises show a higher capacity, and profit changes will arise and there is doubt that enterprises are involved in the implementation of transfer pricing (Bava & Trana, 2015). Profit is also the driving force for enterprises to carry out production and business activities (Abdullah et al., 2019; Majid et al., 2019). Holtzman and Nagel (2014) argue that earnings demonstrate the potential of enterprises to gain profits by doing business. Enterprises with higher pre-tax profits can avoid more taxes than enterprises with lower pre-tax profits (Rego, 2003). Besides, enterprises with higher profits can participate in the implementation of transfer pricing.

Return on equity is one of the measures of the operational efficiency of enterprises. Return on equity indicates the ability of enterprises to gain earnings for a while from sales, assets owned, and equity (Anisyah, 2018). Baroroh et al. (2021) suggest that return on equity enhances the influence of tax costs to transfer pricing but return on equity does not control for the influence of bonus mechanism and tunneling incentives to transfer pricing. On the other hand, Rizkya and Isnalita (2020) find that return on equity is not related to transfer pricing.

Transfer pricing is considered in many ways. Enterprises take various forms to avoid home country income taxes. Transfer pricing is important to ensure fairness in the interests of a developing country like Vietnam. Based on the synthesis from previous studies related to transfer pricing, the paper proposes some hypotheses of the model, specifically:

*H1: The income tax rate affects transfer pricing to avoid taxes on foreign enterprises in Vietnam.*

*H2: Tunneling incentives influence transfer pricing to avoid taxes on foreign enterprises in Vietnam.*

*H3: The bonus mechanism is related to transfer pricing to avoid taxes on foreign enterprises in Vietnam.*

*H4: Enterprise size interacts with transfer pricing to avoid taxes on foreign enterprises in Vietnam.*

*H5: Intangible assets support to transfer price to avoid taxes on foreign enterprises in Vietnam.*

*H6: Return on equity is inversely proportional to transfer price to avoid taxes on foreign enterprises in Vietnam.*

## 2. METHODOLOGY

The paper uses quantitative methods to quantify the influence of transfer pricing of foreign enterprises in Vietnam. EViews 12 software is used to analyze the method of ordinary least squares, fixed and random effects model.

The paper chooses data for the six years from 2016 to 2021 because it is the time when the financial reports of foreign enterprises in Vietnam are fully available. The sample is collected from the financial reports of 96 foreign enterprises in Vietnam, corresponding to 576 observations and these are enterprises with the above manufacturing industry code out of a total of foreign enterprises in Vietnam. The paper only focuses on foreign enter-

prises in Vietnam that are related to production activities because these enterprises are related to information about importing materials, machinery, and equipment and having payment transactions with foreign enterprises and stakeholders.

The paper inherits the variables in the models of Susanti and Firmansyah (2018) and Rizkya and Isnalita (2020) and is combined with the opinions of some experts of the Vietnamese tax agency. The paper considers building a research model with variables suitable to the characteristics and conditions of Vietnam. The research is structured as follows:

$$TPT = \beta_0 + \beta_1 \cdot RATE + \beta_2 \cdot TUN + \beta_3 \cdot BONUS + \beta_4 \cdot SIZE + \beta_5 \cdot INTAN + \beta_6 \cdot ROE, \quad (1)$$

where *TPT* – transfer pricing, *RATE* – income tax rate, *TUN* – tunneling incentives, *BONUS* – bonus mechanism, *SIZE* – enterprise size, *INTAN* – intangible assets, and *ROE* – return on equity.

To measure the transfer pricing, the paper has inherited the scale of Khotimah (2018). The formula is presented as receivables from related party transactions divided by total accounts receivable.

The income tax is payable and it is considered a mandatory payment to the state in which the company or organization is subject to enforcement by law (Wijaya & Widianingsih, 2020). The tax variable in the paper is determined using the effective tax rate (Richardson et al., 2013; Jaafar & Thornton, 2015; Alfandia, 2018). The income tax rate is measured as corporate income expenses divided by profit before tax.

The tunneling incentives performed in this study represent the existence as well as the extent of tunneling incentives exercised by controlling stockholders. This index is measured by the total receivables of a group and then compared with the total assets held by foreign enterprises (Nurazi et al., 2015; Tang, 2016). The measurement formula determines that receivables by related party transactions are divided by total assets.

The bonus mechanism is calculated by the number of bonuses that enterprise owners or stockholders

give to members each year. The bonus mechanism is determined by the ratio of earnings achieved in year  $t$  to the earnings in year  $t-1$  (Indriaswari & Aprilia, 2017). The measurement formula of the bonus mechanism is that profit after corporate income tax year  $t$  divided by profit after corporate income tax year  $t-1$ .

Enterprise size is measured in terms of equity, sales, or assets (Riyanto, 2008). Sharing this view, Sulistyowati and Kananto (2018) argue that enterprise size is expressed as total assets, total sales, or capitalization. The larger the total assets, the more enterprise size, and the more invested capital. In this paper, enterprise size uses asset assessment criteria and converting to natural logarithms (Hartono, 2014; Waworuntu & Hadisaputra, 2016; Sulistyowati & Kananto, 2018; Aryotama & Firmansyah, 2019; Firmansyah & Yunidar, 2020). The formula for enterprise size is presented by  $\ln(\text{Total assets})$ .

Intangible assets are difficult to evaluate and bring clear advantages for enterprises to make transfer payments. The problematic evaluation of enterprises' assets such as royalties expressed as total assets, and total parent sales, is difficult to determine under the fair price (Richardson et al., 2013). Similar to Firmansyah and Yunidar (2020), intangible assets are defined that total intangible assets divided by total assets.

Return on equity is measured by the success of profits and is expressed through the ability to use capital effectively. Therefore, the profit of enterprises can be determined by taking the profit earned in a period against the number of owners, total assets, or total sales (Munawir, 2014). According to Khasanah (2015), return on equity is determined by profit after income tax divided by total equity, the paper also measures according to the above formula.

### 3. RESULTS

The data of Table 1 elicit the average transfer pricing is 0.38, the maximum is 0.99 but the minimum is 0.00. The standard deviation of transfer pricing is relatively high which affirms that there is a disparity between foreign enterprises in Vietnam. All independent variables have average levels consistent with the situation of foreign enterprises in Vietnam. The income tax rate has a mean of 0.13, a maximum of 0.93, and a minimum of  $-0.18$ . The mean of tunneling incentives is 0.09, the maximum is 0.73 and the minimum is 0.00. For the bonus mechanism, the mean is 0.98, where the maximum is 6.04, and the minimum is  $-3.91$ . For enterprise size, the mean is 1.70, the maximum is 3.10 and the minimum is 0.03. Intangible assets have an average of 0.01, the minimum is 0.00, and the maximum is 0.09. Return on equity has an average of 0.11, the minimum is  $-3.04$ , and the maximum is 4.10. Most of the independent variables have a relative standard deviation.

The purpose of the correlation matrix analysis is to check the correlation between the transfer pricing and the independent variables in the model. The results of the correlation matrix in Table 2 explore that the autocorrelation coefficients between transfer pricing and the independent variables are all less than 0.8. It can be remarked that the model has no multicollinearity (Rogerson, 2001). The results show that the variable has a good linear correlation between 0.210648 and 0.607426. The correlation coefficients of variables including income tax rate, bonus mechanism, and intangible assets related to the transfer pricing. The variables of tunneling incentives, enterprise size, and return on equity positively relate to transfer pricing.

After analyzing the correlation matrix between the variables, the paper conducts three regres-

**Table 1.** Descriptive statistics

Source: Data compiled by EViews 12.

| Variables    | TPT      | RATE        | TUN      | BONUS       | SIZE     | INTAN    | ROE         |
|--------------|----------|-------------|----------|-------------|----------|----------|-------------|
| Mean         | 0.384446 | 0.130486    | 0.092584 | 0.986541    | 1.702445 | 0.012874 | 0.113845    |
| Median       | 0.240371 | 0.134217    | 0.038637 | 0.982063    | 1.763401 | 0.001046 | 0.098224    |
| Maximum      | 0.998402 | 0.934682    | 0.730487 | 6.041878    | 3.104568 | 0.098723 | 4.106827    |
| Minimum      | 0.000000 | $-0.187704$ | 0.000000 | $-3.908443$ | 0.036802 | 0.000000 | $-3.047501$ |
| Std. Dev.    | 0.314722 | 0.124693    | 0.119746 | 1.568227    | 0.546334 | 0.054068 | 0.560891    |
| Observations | 576      | 576         | 576      | 576         | 576      | 576      | 576         |

**Table 2.** Correlation coefficient matrix

Source: Data compiled by EViews 12.

| Probability | TPT       | RATE      | TUN       | BONUS     | SIZE      | INTAN     | ROE      |
|-------------|-----------|-----------|-----------|-----------|-----------|-----------|----------|
| TPT         | 1.000000  |           |           |           |           |           |          |
| RATE        | -0.263704 | 1.000000  |           |           |           |           |          |
| TUN         | 0.441812  | -0.210648 | 1.000000  |           |           |           |          |
| BONUS       | -0.259014 | 0.301672  | 0.330481  | 1.000000  |           |           |          |
| SIZE        | 0.240752  | 0.540786  | 0.271685  | 0.501497  | 1.000000  |           |          |
| INTAN       | -0.306471 | 0.394180  | -0.607426 | -0.240177 | -0.216384 | 1.000000  |          |
| ROE         | 0.410522  | 0.264837  | 0.3041782 | -0.230432 | -0.415237 | -0.214473 | 1.000000 |

sion models, including the ordinary least squares (OLS), fixed effects model (FEM), and random effects model (REM).

### 3.1. The regression results of ordinary least squares (OLS)

According to the results in Table 3, the regression results verify that the independent variables are all statistically significant except intangible assets. Income tax rate, bonus mechanism, and enterprise size, negatively influence and impact the transfer pricing, while tunneling incentives and return on equity have a negative influence and impact on the transfer pricing. The probability level p-value of the variables is 0.00, so these factors influence the transfer pricing. The adjusted R-squared coefficient of 0.7046 shows that 70.46% of the variation in transfer pricing is interpreted by the independent variables. The probability level p-value of the pair of hypotheses is less than 0.01, the regression

model is consistent with the statistics. Specifically, the model is defined as follows:

$$TPT = 0.390472 - 0.350974 \cdot RATE + 3.046802 \cdot TUN - 0.105762 \cdot BONUS - 0.128304 \cdot SIZE + 0.148712 \cdot ROE. \quad (2)$$

### 3.2. The regression results of the fixed effects model (FEM)

According to the regression results presented in Table 4, tunneling incentives and return on equity have statistical significance with the p-value probability level less than 0.05, positively correlated to the transfer pricing. When setting the income tax rate, enterprise size is statistically significant and negatively correlated with transfer pricing. Bonus mechanism and intangible assets are not statistically significant. The adjusted R-squared coefficient is 0.8274, showing that the independent variables interpret 82.74% of the variation of the

**Table 3.** Regression results of ordinary least squares (OLS)

Source: Data compiled by EViews 12

| Variable           | Coefficient | Std. Error         | t-Statistic | Prob.    |
|--------------------|-------------|--------------------|-------------|----------|
| C                  | 0.390472    | 0.010488           | 4.841227    | 0.0000   |
| RATE               | -0.350974   | 0.015621           | -3.842901   | 0.0000   |
| TUN                | 3.046802    | 0.021792           | 6.904361    | 0.0000   |
| BONUS              | -0.105762   | 0.010483           | -4.607783   | 0.0000   |
| SIZE               | -0.128304   | 0.014882           | -5.118029   | 0.0000   |
| INTAN              | -0.930466   | 0.120781           | -0.960274   | 0.4581   |
| ROE                | 0.148712    | 0.012873           | 3.970216    | 0.0000   |
| R-squared          | 0.704162    |                    |             |          |
| Adjusted R-squared | 0.704581    |                    |             |          |
| F-statistic        | 2904.502    | Durbin-Watson stat |             | 2.604581 |
| Prob (F-statistic) | 0.000000    |                    |             |          |

**Table 4.** Regression results of fixed effects model (FEM)

Source: Data compiled by EViews 12.

| Variable           | Coefficient | Std. Error | t-Statistic        | Prob.    |
|--------------------|-------------|------------|--------------------|----------|
| C                  | 0.816732    | 0.054176   | 3.041607           | 0.0000   |
| RATE               | -0.190487   | 0.104675   | -2.028411          | 0.0000   |
| TUN                | 2.104508    | 0.010945   | 4.708116           | 0.0000   |
| BONUS              | -0.107642   | 0.041285   | -0.544812          | 0.9016   |
| SIZE               | -0.704881   | 0.302847   | -0.460811          | 0.3802   |
| INTAN              | 1.277504    | 0.084462   | 0.804632           | 0.5246   |
| ROE                | 1.129482    | 0.204816   | 5.904617           | 0.0000   |
| R-squared          | 0.860417    |            |                    |          |
| Adjusted R-squared | 0.827403    |            |                    |          |
| F-statistic        | 20.1608     |            | Durbin-Watson stat | 2.901463 |
| Prob(F-statistic)  | 0.000000    |            |                    |          |

**Table 5.** Results of F-test

Source: Data compiled by EViews 12.

| Effects Test             | Statistic  | d.f.   | Prob.  |
|--------------------------|------------|--------|--------|
| Cross-section F          | 5.041752   | 72,038 | 0.0000 |
| Cross-section Chi-square | 309.178903 | 95     | 0.0000 |

transfer pricing. The probability level p-value of the pair of hypotheses is less than 0.01, the model is consistent with the statistics. The result of the fixed effects model is:

$$TPT = 0.816732 - 0.190487 \cdot RATE + 2.104508 \cdot TUN + 1.129482 \cdot ROE. \quad (3)$$

The paper uses F-test to choose appropriately between the ordinary least squares (OLS) and the fixed effects model (FEM). Based on Table 5, the F-test results find that Prob is 0.000 and less than 0.05. With the collected data, it explores that the fixed effects model (FEM) is appropriate.

### 3.3. The regression results of the random effects model (REM)

According to Table 6, tunneling incentives and return on equity have statistical significance with a p-value probability level of less than 0.05 and positively correlated with the transfer pricing. The income tax rate is statistically significant and negatively correlated with transfer pricing. Bonus mechanism, enterprise size, and intangible assets are not statistically significant. The explanatory level of the model is 0.7141, showing that the adjusted R-squared coefficient affects 71.41% of the transfer pricing. The probability level p-value of

the pair of hypotheses testing the fit of the regression function is less than 0.01, the model is consistent with the statistics. The regression equation is as follows:

$$TPT = 0.945762 - 0.605841 \cdot RATE + 2.014823 \cdot TUN - 0.481273 \cdot BONUS + 0.146580 \cdot ROE. \quad (4)$$

The Hausman test supports comparing the fixed effects model (FEM) and the random effects model (REM) to choose a suitable model. The results of the Hausman test are presented in Table 7 showing that the p-value is 0.000 and is smaller than 0.05. Thus, the fixed effects model (FEM) is more suitable for the data of the paper. Through the regression results of the three models, and the test results to choose the research model, the fixed effects model (FEM) is the most suitable.

The phenomenon of multicollinearity in the quantitative model is represented by the variance inflation factor (VIF). In the experimental study, when the variance inflation factor (VIF) is less than 3, then the model is considered to be free of multicollinearity (Rogerson, 2001). The results of Table 8 affirm that the variance inflation factor (VIF) of the model's variables is all less than 3, so the model has no multicollinearity phenomenon.

**Table 6.** Regression analysis of the random effects model

Source: Data compiled by EViews 12.

| Variable           | Coefficient | Std. Error         | t-Statistic | Prob.    |
|--------------------|-------------|--------------------|-------------|----------|
| C                  | 0.945762    | 0.051287           | 3.894016    | 0.0000   |
| RATE               | -0.605841   | 0.104932           | -5.041882   | 0.0000   |
| TUN                | 2.014823    | 0.024188           | 3.774189    | 0.0000   |
| BONUS              | -0.481273   | 0.001672           | -0.126943   | 0.5806   |
| SIZE               | -0.127834   | 0.054183           | -0.804556   | 0.2086   |
| INTAN              | -0.304759   | 0.002047           | -0.762441   | 0.4071   |
| ROE                | 0.146580    | 0.054971           | 4.190285    | 0.0000   |
| R-squared          | 0.725146    |                    |             |          |
| Adjusted R-squared | 0.714063    |                    |             |          |
| F-statistic        | 26.0472     |                    |             |          |
| Prob(F-statistic)  | 0.000000    |                    |             |          |
|                    |             | Durbin-Watson stat |             | 2.518704 |

**Table 7.** Results of the Hausman test

Source: Data compiled by EViews 12.

| Test Summary         | Chi-Sq. Statistic | Chi-Sq. d.f. | Prob.  |
|----------------------|-------------------|--------------|--------|
| Cross-section random | 11.162034         | 6            | 0.0000 |

**Table 8.** Multicollinearity

Source: Data compiled by EViews 12.

| Variables | VIF      |
|-----------|----------|
| RATE      | 1.160247 |
| TUN       | 1.224813 |
| BONUS     | 1.402741 |
| SIZE      | 1.517482 |
| INTAN     | 1.104786 |

The information in Table 9 demonstrates that three out of six hypotheses including H1, H2, and H6 are accepted.

**Table 9.** Hypotheses testing results

Source: Data compiled by EViews 12.

| Hypotheses                | Results              |
|---------------------------|----------------------|
| H1 (Income tax rate)      | Supported (negative) |
| H2 (Tunneling incentives) | Supported (positive) |
| H3 (Bonus mechanism)      | Not supported        |
| H4 (Enterprise size)      | Not supported        |
| H5 (Intangible assets)    | Not supported        |
| H6 (Return on equity)     | Supported (positive) |

## 4. DISCUSSION

The study explores the fixed effects model (FEM) as the most perfect. The income tax rate, tunneling incentives, and return on equity are statistically significant. The paper determines the influence of transfer pricing of foreign enterprises in Vietnam.

The research is similar to Susanti and Firmansyah (2018) showing that tax rates negatively affect transfer pricing. The other two variables are tunneling incentives and return on equity, which indicate a positive influence on transfer pricing. It is different from Susanti and Firmansyah (2018), and Rizkya and Isnalita (2020) because the economic conditions and legal regulations of Vietnam are different from those of other countries. The result is also consistent with the explanations of variables related to the underlying assumptions of agency and positive accounting theory.

The income tax rate affirms a negative relationship with transfer pricing. The results are consistent with previous studies by Lo et al. (2010), Susanti and Firmansyah (2018), and Merle et al. (2019). It explains that with low tax rates, foreign enterprises tend to realize high transfer pricing. The positive accounting theory is performed to interpret that foreign enterprises implement transfer pricing to minimize the cost of foreign enterprises in the form of payable taxes. The result is consistent with the context of Vietnam over time. Enterprises in the early stages, although enjoying preferential tax rates and privileges of Vietnam, often take advantage of opportunities to carry out behavior about the transfer pricing because they are not interested in the early stages, and have not been strictly controlled by the state. Shortly, Vietnam state agencies should care for foreign enterprises,

especially in the early stages of the establishment process. State agencies always create favorable conditions for the initial stage of the formation of foreign enterprises. However, state agencies always have to monitor and ensure compliance with tax regulations.

Tunneling incentives have the same effect and influence as transfer pricing. It implies that the larger the implicit interest, the more transfer pricing tends to be implemented in foreign enterprises. Research by Indriaswari and Aprilia (2017), Merliyana and Saodah (2019), Surbakti et al. (2020), Wijaya and Widianingsih (2020), Solikhah et al. (2021), Baroroh et al. (2021), and Purnomo et al. (2021) also have similar results. According to agency theory, foreign controlling shareholders will seek to maximize profits from ownership by regulating the management of related party transactions. The result is compatible with the current situation in Vietnam. The more foreign enterprises have transactions with many related parties, the related parties are the opportunities, and the conditions for performing the transaction. In the future, Vietnam state agencies should pay attention to exchange and purchase transactions between foreign enterprises and related parties. Through commercial transactions, foreign enterprises can raise input prices and reduce output prices. Therefore, state agencies always have to control transactions between related parties of foreign enterprises to comply with tax regulations.

Return on equity has the same effect as transfer pricing. The research is consistent with a previous study by Sari et al. (2021). The agency theory also shows that enterprises with effective business operations and high profitability are high-profit enterprises. It is consistent with the practical context of Vietnam. Owners of the enterprises tend to authorize the directors of enterprises to perform the act of transferring profits to the company abroad to reduce tax payable in Vietnam. Shortly, Vietnam state agencies need to pay attention to the economic efficiency of foreign enterprises. When foreign enterprises operate effectively, profit is an influential criterion in adjusting to reduce payable tax. Therefore, state agencies must always control arising transactions related to reasonable income and expenses so that foreign enterprises can properly enforce tax regulations.

The paper proposes several policies to support the Vietnamese state in strengthening the control of transfer pricing of foreign enterprises in Vietnam. It is one of the important issues and not only a small challenge but also many opportunities for provinces in the process of international economic integration with countries in the region and the world. In addition to the above issues, to strengthen the control of transfer pricing of foreign enterprises in Vietnam, tax authorities need to carry out the issues synchronously in different aspects.

The state management agency of Vietnam should organize tax policy training seminars, and dialogue with enterprises to remove difficulties and obstacles in tax administrative policies and procedures of enterprises. State agencies should carry out propaganda on enterprises' sense of compliance with legal regulations, and improve their sense of compliance with issued tax laws and policies.

Vietnamese government must strengthen sanctions and impose sanctions and strictly handle enterprises that violate tax laws in the field of transfer pricing. Along with fines, enterprises may also suffer from reputational damage in the market and be included in the tax agency's list of high-risk enterprises in terms of transfer pricing, leading to more periodic tax audits. Moreover, if enterprises have repeated violations, their business licenses will be revoked.

Vietnamese government agencies should establish a division in charge of controlling transfer prices of the tax department. In addition, it is necessary to strengthen the application of information technology in managing data about enterprises' actual transactions and coordinate with relevant authorities in the process of organizing and controlling the transfer pricing such as the state audit, security department, customs department, etc. Furthermore, state agencies should strengthen cooperation and information exchange with international organizations and governments. It is the basis for completing the database for tax administration for foreign enterprises in Vietnam.

Vietnamese tax authorities need to improve the responsibility and obligations of the investor as the obligation to the state budget. Regulations

need to be fully complied with to ensure the obligations of enterprises for tax payment. It significantly contributes to the economic development achievements of the host country. In addition, tax authorities should improve professional qualifications for the contingent of civil servants performing the task of monitoring, inspecting, and inspecting transfer pricing of enterprises in Vietnam. On the part of tax officials, it is necessary to regularly update knowledge and expertise through specialized classes, periodical training on transfer pricing, and summarizing

and sharing experiences from enterprises with transfer pricing. In addition, tax officials and employees need to equip themselves with information technology knowledge to apply information technology for professional work and improve their capacity to exploit databases from the system of the tax data warehouse to serve the inspection and examination. It is the fundamental tool for tax authorities to control transfer pricing to avoid tax on foreign enterprises in Vietnam.

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## CONCLUSION

International trading makes more sense for developing countries to attract foreign investments. However, facing the transfer pricing behavior of foreign enterprises is the other side of the coin in international economic integration. The purpose of this paper is to test the determinants of the transfer pricing behavior for foreign enterprises in Vietnam. The paper uses the fixed effects model estimating methods to accept three of the six hypotheses. The findings show that tunneling incentives and return on equity positively affect transfer pricing behavior, while the impact of the income tax rate on transfer pricing behavior is significantly negative. The paper confirms that there are transfer pricing practices during the research period in foreign direct investment firms. Accordingly, the Vietnamese state agencies should review and revise tax policies, set up an appropriate legal framework, and consistent and synchronous incentives. Tax authorities should develop a set of conducting criteria from internal industry data as well as international organizations, and governments to improve the database serving the tax administration for foreign enterprises. Tax authorities also need to call for the responsibilities of foreign firms such as submitting contributions to the state budget, complying with national regulations, or otherwise strengthening sanctions for those that violate the transfer pricing law. Future research can conduct replication studies for firms in other industries such as real estate, construction, or power and gas, which are the leading sectors for foreign direct investment in Vietnam.

## AUTHOR CONTRIBUTIONS

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Formal analysis: Tran Quoc Thinh, Nguyen Thi Hai An.  
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