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The Effect of Ownership Structure on Transfer Pricing Decisions: Evidence from Foreign Direct Investments in Vietnam

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Abstract

Transfer pricing is a matter of concern for countries. It affects the interests of the parties involved in the commercial transaction. Through manipulation of prices in transactions, businesses take advantage of tax rates in a country to adjust profits for economic gain. This affects the fairness and rationality of economic transactions between related parties. The article uses a two-year time series from 2018 to 2019 of 50 foreign direct investment enterprises in Vietnam. The article uses ordinary least squares to test the hypotheses of the research model. The article uses four independent variables related to ownership structure affecting transfer pricing decisions including total ownership, organization ownership, concentration ownership, and area ownership. Research results show that two variables have a positive influence on transfer pricing decisions including total ownership and organization ownership. Organization ownership has a higher degree of influence than total ownership. To be able to control transaction activities related to transfer pricing, Vietnam's state management agencies need to pay attention to perfecting the legal framework based on supplementing and amending regulations related to transfer pricing. Legal regulations need to be regulated based on international common practices to ensure uniformity on a global scale.

Keywords: FDI, Ownership Structure, Transfer Pricing Decisions, Vietnam

JEL Classification Code: E22, G11, G23, O16

1. Introduction

Multinational firms, in general, and foreign direct investment enterprises (FDI), in particular, are becoming increasingly important in economic trade. The determination of transfer pricing based on the selection of transfer pricing methodology has proven difficult for FDI groups operating in various countries. This is one of the worries of countries, particularly developing countries, who need to attract capital for development investment, despite the fact that the legislative framework is inadequate and does not address transfer pricing issues. Multinational corporations, on the other hand, are informed and adaptable in this area. As a result, identifying elements in transfer pricing decisions (TPD) is a criterion for assessing the level, scope, and content of appropriate mechanisms and regulations to promote business transparency and fairness.

In terms of economic development, Vietnam has increased its FDI attraction by enacting a slew of favorable policies. Many countries, particularly developing countries like Vietnam, are concerned about TPD when it comes to attracting capital for development investment from multinational firms, although it has experienced hurdles in this area due to various factors affecting TPD (Tran, 2018). This has an impact on the interests of the persons involved in the TPD economic transaction. Transfer pricing transactions have had an impact on budget revenues and lowered Vietnam's economic benefits. (Nguyen et al., 2018).

In the context of regional and international economic integration, Vietnam has gradually improved its legal regulations. Circular 47.2017 has guided those wishing to

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implement a number of regulations relating to comparative analysis, transfer pricing method selection, information declaration, and transfer pricing document production to determine transfer pricing and to apply the regulations on the exemption from the preparation of documents (Vietnamese Ministry of Finance, 2017). Decree 132.2020, issued recently, specifies the principles, methods, and order for determining the factors that form the associated transaction price; taxpayers' rights and obligations in determining transfer pricing, declaration procedures; and state agencies' responsibilities in tax administration for taxpayers with related transactions.

Associated transactions within the scope of this Decree are transactions of buying, selling, exchanging, renting, leasing, borrowing, lending, transferring, transferring goods and providing services; loans, loans, financial services, financial guarantees, and other financial instruments; buy, sell, exchange, rent, lease, borrow, lend, transfer, transfer tangible assets, intangible assets and agree to buy, sell, use common resources such as assets, capital, labor activities, cost-sharing among related parties, except for business transactions for goods and services subject to the State's price adjustment scope, which comply with the law on prices (Vietnamese Government, 2020). This has helped to improve control over transaction management and administration, as well as to complete the legal framework for connected transactions in transfer pricing.

2. Literature Review

The concept of transfer pricing is viewed from many different perspectives. Al-Eryani et al. (1990) stated transfer pricing is the expression of the values of transactions between subsidiaries operating in different countries. However, there is also another opinion that transfer pricing is for goods and services transferred between units or profit centers within the same company, as well as for goods and services transferred between companies relevant in different countries (Li, 2005). There is a consensus view that transfer pricing is a transfer determined by the value of tangible or intangible fixed assets, goods, services, raw materials, know-how, and technology, etc. from the parent company to subsidiaries or affiliates (Aranoff, 2000; Dogan et al., 2013). The Organization for Economic Co-operation and Development considers that transfer pricing is the transfer in transactions that are determined by groups that are related to each other (OECD, 2020).

TPD is the use of price manipulation in transactions to take advantage of lower tax rates in one nation to transfer earnings to a country with lower tax rates (Anggraeni & Lutfillah, 2019). TPD is the systematic manipulation of prices within a group to manipulate one party's profits and increase the other party's profit (Baroroha et al., 2021). This has resulted in a loss for one party to evade taxes or obligations in a country (Depari et al., 2020). The main characteristic of transfer pricing is that it is used to increase the autonomy of each unit in the group; it provides a means to evaluate and compare the performance of different units within the group; it is used to motivate managers to maximize revenue and profit; and it is a tool for maintaining and achieving a competitive advantage (Dogan et al., 2013).

Multinational companies' transfer pricing methods are usually specialized methods based on a comparable uncontrolled price method; resale price method; cost-plus method; profit-split method; and other methods such as market-based and nonmarket-based, cost-based, market price, linear programming, negotiation, profit-sharing basis (OECD, 2020). As a result, Vietnam, as a developing country, must evaluate and identify significant concerns to assess the scope, content, methods, and strategies of transfer pricing to develop appropriate solutions. Appropriately adjusting mechanisms and regulations leads to the legal framework being perfected to maintain fairness and rationality in business.

According to public interest theory, government regulation is the instrument for overcoming the disadvantages of imperfect competition, unbalanced market operation, missing markets, and undesirable market results. Regulation can improve the allocation by facilitating, maintaining, or imitating market operation. The exchange of goods and production factors in markets assumes the definition, allocation, and assertion of individual property rights and freedom to contract. Public interest theory is a part of welfare economics and emphasizes that regulation should maximize social welfare and that regulation is the result of a cost/benefit analysis done to determine if the cost to improve the operation of the market outweighs the amount of increased social welfare (Godfrey et al., 2003). Beaver (1998) argued that social interest theory is formed based on encouraging legislators to regulate the common interests of society among stakeholders. In general, the theory of regulation suggested that regulation must be based on the goal of protecting social interests, but this process can lose its neutrality due to the influence of different parties.

TPD has been the subject of a number of previous studies. The majority of the studies used qualitative methods to investigate issues related to TPD, such as identifying factors affecting transfer pricing in multinational companies, factors affecting transfer pricing, and method of transfer pricing selection used as a strategic tool by multinational corporations to minimize taxes (Dogan et al., 2013), as well as to maximize the profits of their subsidiaries operating in countries with lower tax rate (Fraedrich & Bateman, 1996).

In general, the factors affecting TPD include four factors that are legal, political and social, external, and internal economic. Legal factors include the tax laws of the country in which the parent company operates; taxes, customs laws, and prices of the countries in which the subsidiaries operate; government intervention (price and quantity restrictions); shares of members of domestic companies; some principles of tax authorities; accounting standards on financial statements; anti-dumping and antitrust laws of the country in which the group operates. Political and social factors related to the risk of national confiscation and disenfranchisement of operating corporations; the ability to connect with the government of the country in which the corporation operates; policies of racial discrimination in the country in which the corporation operates; civil war in the country in which the corporation operates; religious conflicts in the country in which the corporation operates; political instability of the country in which the corporation operates; human rights violations in the countries in which the group operates. For external economic factors include exchange rate fluctuations and controls; limit the transfer of profits and money; price control; import restrictions and quotas; inflation rates in the countries in which the group operates. For internal economic factors such as the group's market share; market structure of the countries in which the group operates; competitiveness of corporations; performance and evaluation criteria for corporations (Lin & Chang, 2009; Dogan et al., 2013).

Previous research had used quantitative methodologies to investigate the factors that influence TPD. Various connected factors are taken into account when doing quantitative research. Several authors are interested in a study on ownership structure. Septiyani et al. (2018), for example, looked into the factors that influence TPD. The model was tested using a quantitative method. The data was Indonesian multinational companies from 2015 to 2016. The results showed that tax minimization has a positive impact on TPD but firm size, foreign ownership, the reward mechanism, and the exchange rate do not affect TPD. Sulistyowati and Kananto (2018) looked at how taxes affect TPD. The research sample is 30 Indonesian manufacturing companies for the period 2012–2015. Foreign ownership, leverage, and business size all have a positive impact on TPD, according to the findings. Taxes and bonuses are not significant to TPD. Nofryanti and Arsjah (2019) did an empirical analysis related to the variables affecting TPD. The sample included 14 listed Indonesian companies for the period 2012–2016. The research results showed that tax significantly affects TPD while bonus scheme, foreign ownership ratio, and debt ratio have no effect on TPD.

Hikmatin and Suryarini (2019) evaluated the effects of variables such as taxes, bonuses, foreign ownership, and firm size on TPD. The article surveyed 20 Indonesian manufacturing companies from 2014–2016. The article used the ordinary least square (OLS) to test. The results showed that foreign ownership has a significant effect on TPD but variables including tax, bonus, and company size have no significant effect on TPD. Depari et al. (2020) examined how tax expenses and foreign ownership affected TPD. To test, the research used OLS. In the years 2017–2019, a sample of 30 Indonesian manufacturing enterprises was taken. The findings suggested that tax costs and intangible assets have an impact on TPD, but that ownership has no effect. The influence of share ownership concentration and firm operation complexity on TPD was investigated by Liana et al. (2020). From 2017 to 2018, the research sample includes 116 Indonesian publicly traded enterprises. Multiple linear regression was used in the study. The findings demonstrated that while share ownership concentration has no influence on TPD, the complexity of a company's operations has a significant positive impact.

Some studies are concerned with transfer pricing, while others are concerned with transfer pricing strategy or technical difficulties. Seetharaman et al. (2016) looked into how multinational corporations influenced transfer pricing strategy decisions. The article used qualitative methods through synthesis and analysis of descriptive statistical data. The findings revealed that transfer pricing regulations have an impact on management's operational and financial condition. Abeysekera and Jebeile (2019) surveyed 25 Australian university students to acquire a better understanding of the topic of transfer pricing. The article used the descriptive statistics method. According to the findings, respondents struggled with detailed transfer price accounting techniques.

Previous Vietnamese studies on transfer pricing have not been widely publicized due to data availability issues. Previous research on this topic, such as Tran (2018), has identified various factors that influence multinational corporations' transfer prices. The article used a qualitative method based on an overview of transfer pricing, identifying methods and causes of transfer pricing. In general, four factors influence transfer pricing: legal, political, and social, as well as economic, both foreign and internal. Nguyen et al. (2018) investigated the factors that influence transfer pricing in the valuation of 180 Vietnamese enterprises. The hypothesis was tested using OLS. The findings revealed that six factors, including firm size, intangible assets, and financial leverage, influence transfer pricing in Vietnamese businesses. The factors of ownership structure to TPD of Vietnamese FDI have not been discussed in previous Vietnamese research.

3. Research Design

The article used OLS to test the research model. The article used information from Vietnamese FDI's financial statements for two years 2018–2019. The research sample includes 50 FDIs. The selected FDI is informative enough for data to be guaranteed.

Based on the expert opinion of the Vietnamese tax department, the article inherited the model of some previous authors related to ownership structure to consider the factors of ownership structure affecting FDI in Vietnam. Therefore, the multivariable regression model was designed as follows:

$$\text{PRICE} = \beta_0 + \beta_1 \times \text{TOTAL} + \beta_2 \times \text{ORGAN} + \beta_3 \times \text{CONCE} + \beta_4 \times \text{AREAS} + \varepsilon$$

The variables of the model are measured, specifically as follows:

The dependent variable is PRICE (transfer pricing): Related party receivables/Total receivables.

The independent variables include TOTAL (total ownership): Dummy variable (if FDI has 100% it is 1, otherwise 0); ORGAN (Organization ownership): Dummy variable (if FDI with organization ownership, it is 1, otherwise 0); CONCE (Concentration ownership): Dummy variable (if FDI has ownership concentration of more than 50%, then it is 1, otherwise 0); AREAS (Area ownership): Dummy variable (if FDI owned by Asia, it is 1, otherwise 0).

4. Results

According to Table 1 results, the average level of PRICE is 0.316, with a maximum of 0.865 and a low of 0.000. The PRICE standard deviation is relatively high, indicating that there are significant differences in FDI-related transactions. Meanwhile, the standard deviation of the independent variables in the model is small. CONCE has a higher average of 0.921, TOTAL has an average of 0.814, ORGAN has an average of 0.683, and finally, AREAS has an average of 0.749.

Table 2 shows that the correlation coefficients of the variables range from 0.284 to 0.476 in relative terms. Furthermore, the correlation coefficient between the variables indicates that these variables with the dependent variable have a significance level of less than 5%. It ensures that the data is statistically significant.

The results of Table 3 show that the adjusted *R* square is 0.607. It shows that 60.7% variance/change in PRICE is explained by the independent variables. This ratio is quite consistent in statistics.

Table 1: Descriptive Statistics

Variables	*N*	Minimum	Maximum	Mean	Std. Deviation
PRICE	100	0.000	0.865	0.316	0.297
TOTAL	100	0	1	0.814	0.015
ORGAN	100	0	1	0.683	0.026
CONCE	100	0	1	0.921	0.018
AREAS	100	0	1	0.749	0.045

Table 2: Correlations

Variable		Price	Total	Organ	Conce	Areas
PRICE	Pearson Correlation	1	0.467	0.391	0.284	0.301
	Sig. (2-tailed)		0.000	0.001	0.000	0.000
	N	100	100	100	100	100

Table 3: Model Summary

Model	*R*	*R* Square	Adjusted *R* Square	Std. Error of the Estimate
PRICE	0.741	0.668	0.607	1.637

The test used to evaluate the linear relationship between the dependent and independent variables is *F*-Test in Anova. Accordingly, the hypothesis of the fit of the overall linear regression model, ia as below:

H0: *β_i = 0: The variables included in the model do not affect PRICE.*

H1: *β_i # 0: The variables included in the model have an effect on PRICE.*

From Table 4, the results show the sig value is 0.000 and it is less than 5% significance level so the H0 hypothesis is rejected. Therefore, the regression model with the above independent variables affects PRICE. Accordingly, the data of the model is evaluated to ensure statistical relevance.

The above test results showing that the model's data ensure statistical validity, and the regression test for the model is based on four independent variables.

According to Table 5, the model's regression analysis revealed that two variables, TOTAL, and ORGAN, have a positive impact on PRICE. The results reveal that the model's variance inflation factor (VIF) is minimal, indicating that there is no collinearity. The regression model's specific results are as follows:

$$PRICE = 0.126 + 0.114 \times TOTAL + 0.367 \times ORGAN$$

5. Discussion and Policy Recommendations

This study's findings are in line with those of Sulistyowati and Kananto (2018), as well as Hikmatin and Suryarini (2019). It's comparable to Tran (2018) that there are legal issues with transaction regulations and methods for assessing transfer pricing of multinational companies, including FDI. TOTAL and ORGAN have a positive effect on TPD, according to the findings. ORGAN has a stronger influence than TOTAL among these two variables.

Because organizational ownership (ORGAN) is owned by the organization, it is often affected by TPD. This means that businesses will be able to conduct related interest transactions such as buying and selling, as well as exchanging goods, services, and assets. It will be more difficult for a corporation that is personally owned to do so than it will be for a company that is owned by an institution. Particularly with 100% direct ownership of a company (TOTAL), it is an ownership structure that is completely controlled by a company and is not affected by related owners. As a result, these businesses are more likely to implement TPD. It also demonstrates that when a company owns a large number of related parties, it is difficult to reach a consensus on TPD.

To effectively control TPD, Vietnamese state management agencies need to pay attention to the legal framework to create consistency and synchronization. Accordingly, Vietnamese state management agencies should pay attention to specific issues related to:

- Law against transfer pricing should be studied and implemented soon. The provisions of this law need to clarify the scope of application and objects of transfer pricing, as well as transaction principles, requirements when disclosing information,

Table 4: ANOVA

Model		Sum of Squares	df	Mean Square	*F*	Sig.
PRICE	Regression	0.016	4	0.018	11.728	0.000
	Residual	0.208	95	0.001		
	Total	0.277	99			

Table 5: Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients	*t*	Sig.	Collinearity Statistics	
		B	Std. Error	Beta			Tolerance	VIF
1	(Constant)	0.126	0.018		2.084	0.000		
	TOTAL	0.114	0.012	0.028	2.741	0.000	0.921	1.094
	ORGAN	0.367	0.018	0.031	3.016	0.000	0.960	1.084
	CONCE	0.484	0.022	0.045	0.492	0.527	0.927	1.091
	AREAS	0.012	0.001	0.007	0.803	0.403	0.918	1.098

regulations on sanctions, and penalties for acts of transfer pricing of companies.

- The current Tax Administration Law needs to be reviewed to supplement a number of regulations on the characteristics and complexity of transfer pricing activities, method of determining the fair value or market value. Prohibited acts in tax administration are acts of colluding, hooking up, and covering up between taxpayers and tax administration officials and tax administration agencies to transfer prices and evade taxes. State agencies should direct and guide functional agencies to strengthen the appraisal of investment projects to prevent transfer pricing and avoid taxes.
- The government's decree (Decree 132.2020) should be based on regulations in accordance with international practices to be adjusted to suit the actual situation of Vietnam. According to this Decree, it is necessary to pay attention to the principle of transfer pricing transactions. Accordingly, taxpayers with related-party transactions must exclude factors that reduce tax obligations influenced by the related-party relationship. This must be done to declare and determine tax obligations for equivalent related-party transactions with independent transactions with the same conditions. In addition, the tax authority manages, examines, and inspects the associated transaction prices of taxpayers according to the principle of independent transactions and the nature of operations and transactions. This determines the tax liability corresponding to the value of the transaction generated from the nature of transactions, production, and business activities of taxpayers. The regulation not to recognize related party transactions that do not follow the principle of independent transactions reduces the tax liability of enterprises to the state budget and adjusts the price of such related transactions to properly determine the tax liability according to the regulations.
- The Ministry of Finance's circular (Circular 47.2017) requires analysis and comparison, as well as the selection of an independent comparator for comparing and determining the price of related-party transactions. As a result, the nature of related party transactions is determined and compared between legal contracts or documents, related parties' transaction agreements, and the actual execution. The basis for adjusting the tax rate, profit rate, and profit distribution ratio of taxpayers to establish corporate income tax liability is the standard independent transaction value range.

6. Conclusion

Procedures, methods, and techniques have made transfer pricing a challenge in international organizations in general and FDI in particular. It stems from legal loopholes that allow for the conduct of activities relating to this problem. With the need to attract investment for economic development, Vietnam, like any other developing country, faces issues in maintaining a fair and transparent business environment. According to the findings, two factors influence the TPD of Vietnamese FDI: total ownership and organizational ownership. It is one of the bases for determining the scope, content, strategies, and procedures used by companies in transfer pricing in accordance with international conventions. This is the basis for making appropriate adjustments to procedures and policies to enable multinational companies to reduce and prevent transfer pricing in general, and FDI in particular.

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