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THE IMPACT OF CORPORATE INCOME TAX AND TAX HOLIDAY POLICY ON DIRECT FOREIGN INVESTMENT IN INDONESIA

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ABSTRACT
Foreign investment has an important influence on a country's economy, it is also considered to be more resilient to crises because investors generally have a long-term perspective when investing in a country. However, the economic crisis in Indonesia caused the inflow of foreign direct investment to experience a drastic decline which led to a slowdown in economic growth in Indonesia. To increase interest in foreign investment in Indonesia again, it is necessary to have an incentive policy in order to attract foreign investors. Therefore, this study aims to examine whether the corporate income tax rate set by the government and the tax holiday policy determine foreign direct investment. Based on purposive sampling, a sample of 38 foreign direct investment inflows from 1981-2018 was obtained. The results show that the corporate income tax rate has a significant negative effect on foreign direct investment, but the tax holiday is not proven to have an effect on foreign direct investment. The results of this study indicate that in determining tax rules and policies, especially corporate income tax rates, it is necessary to consider the interests of foreign investors in order to attract more foreign direct investment to Indonesia.

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1. INTRODUCTION

Investment has an important role in increasing the economic growth of a country. The United Nations Conference on Trade and Development (UNCTAD, 2012) shows that of the many sources of investment, domestic investment still represents the majority of total investment in developing countries, while the role of foreign direct investment is only as a complement. In fact, foreign direct investment can play a different and important role in promoting sustainable growth and development, increasing a country's competitiveness, generating employment, and reducing social and income inequality of its people. In addition, foreign direct investment is considered more resilient to crises, because investors generally have a long-term perspective when investing in a country and have a risk-sharing nature between the recipient country and the investor. Therefore, foreign direct investment provides a stronger stimulus for economic growth than other types of capital flows. Another value added of foreign direct investment is not only in the form of capital flows, but also offers access to new technologies and managerial skills (Fahmi, 2012).

Regarding to the economic crisis in Indonesia 1998, foreign direct investment inflows to decline sharply to reach minus $4,550 million in 2000. Meanwhile, foreign direct investment inflows after the 2008 crisis experienced an increase and reached a peak in 2014 of $25,121 million, but in the following year up to 2018 tended to decline to $20.008 million (WorldBank, 2019). This decline in foreign direct investment inflows will certainly slow down economic growth in Indonesia. Therefore, it is necessary to have incentive policies that can provide legal certainty, ease of licensing, as well as effective economic growth policies so as to attract foreign investors to Indonesia. One of the important incentive policies is related to taxation policies, namely the reduction of corporate income tax rates and tax holidays.

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Tax competition between countries has been increasing day by day with the aim of attracting investment and increasing the inflow of foreign direct investment. To attract foreign direct investment inflows, countries implement several regulations including reducing tax rates (Abdioglu, 2016). Several previous studies (Abdioglu, 2016; Kassahun 2015; San et al 2012; Fahmi, 2012) found that corporate income tax rates have a significant negative effect on foreign direct investment inflows. This means that foreign investors are attracted to invest in countries that have lower tax rates. However, another study (Etim, 2019) was unable to find any effect of corporate income tax rates on foreign direct investment inflows. In addition, the tax holiday policy in PMK Number 150/2018 regulates the ease of facilitation for reducing corporate income taxes. In this new regulation amendment, the government provides 50% and 100% tax reduction facilities for the amount of corporate income tax payable for new investment and taxpayers who wish to expand their business with a minimum value of Rp 100 billion and Rp 500 billion based on the period of granting the reduction. determined income tax. Several studies (Kassahun, 2015; Cleeve, 2008) found that tax holidays have a significant positive effect, where lower tax rates will increase after-tax profits for investors. However, Fahmi (2012) did not find any effect of tax holidays on foreign direct investment in Indonesia.

In the new Order era in Indonesia, which lasted from 1966 to 1998, foreign direct investment was an important driving factor in achieving high economic growth and maintaining sustainable development. Moreover, the presence of foreign direct investment, especially in the manufacturing industry, is a source of technological development, export growth and employment. The manufacturing industry is the only economic sector that has generated the largest value added and the largest contributor to Indonesia's gross domestic product (in Fahmi, 2012). Several previous studies (Abdioglu, 2016; Van Parys 2010; Cleeve, 2008) found that GDP has a significant positive effect on foreign direct investment, where there is an opportunity for better growth in a fast-growing economy.

A low inflation rate is considered a sign of internal economic stability in the host country and is expected to increase returns on foreign direct investment. A low inflation rate in a country encourages foreign direct investment, arguing that when the inflation rate is low, the nominal interest rate decreases and consequently the cost of capital is low. Furthermore, the availability of capital with low interest rates allows foreign investors not only to find better partners in the host country but will also maximize their return on investment (Alshamsi et al, 2015). Several studies (Kassahun, 2015; Fahmi, 2012; Klemm, 2011) found that the inflation rate has a significant positive effect on foreign direct investment, arguing that macroeconomic stability is an important factor in foreign direct investment inflows. Meanwhile, Abdioglu's research (2016) failed to find the effect of inflation rate on foreign direct investment.

In addition, trade openness is one thing that attracts foreign investors. Trade openness refers to the degree to which a country or economy conducts international trade with other countries. From a financial development perspective, trade openness means the ability of an economy to obtain funds from other economies, and the willingness to invest excess funds in other countries (in Kassahun, 2015). Several previous studies (Fahmi, 2012; Cleeve, 2008) found that trade openness has a significant positive effect on foreign direct investment, where the open market policy of a government encourages international trade in the form of exports and imports. Meanwhile, other studies (Abdioglu, 2016; Van Parys, 2010) found that trade openness had a significant negative effect on foreign direct investment.

This study aims to examine "Does the corporate income tax rate and tax holiday policy affect foreign direct investment?". In addition, this study also examines the influence of other economic factors (ie gross domestic product, inflation rate, and trade openness) on foreign direct investment.

2. LITERARTURE REVIEW

Hypothesis Development

The theory of tax competition was first introduced by Charles Tieobout in 1956 (in Pinto, 2002) which defines tax competition as something that is desirable and should not be limited in any way because individuals choose the most suitable location based on subjective evaluations of the balance between tax burden and public service offered. In general, tax competition is referred to as reducing the tax burden to improve the economy and welfare of a country by increasing the competitiveness of domestic businesses and/or attracting foreign investment.

To find out if there is tax competition is to look at the tax policies adopted by a country (often the country with the lowest tax rate) that allows the country to gain a competitive advantage in selling its products and services. Tax competition can cause fiscal externalities because the fiscal policies taken by one country can affect the welfare of other countries. The assumption is that every fiscal policy taken is solely based on the protection of its interests and ignores its impact on the residence of other countries. The implications of tax competition are unavoidable in open economies such as the European Union and ASEAN, so that tax competition can be viewed as "a decision-making process in tax matters carried out by the government with rational considerations in response to foreign government tax policies in improving the economy, business and investment. in the country (Steichen, 2002).

Tax competition theory indicates that to attract larger foreign direct investment, corporate income tax should be lower than neighboring countries. The standard theoretical literature on tax competition predicts that higher capital

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mobility can lead to a decrease in the tax burden on investment because there is a reduction in the tax rate on investment. This condition means that the government in determining the tax rate for investment assumes that capital inflows cause capital outflows in a country. To attract capital inflows, each country chooses to take tax cuts. Therefore, the existence of a tax incentive policy in the form of reducing the corporate income tax rate can attract more foreign investment. This is supported by several previous studies (Abdioglu, 2016; Kassahun 2015; Klemm and Van Parys, 2011; Saidu, 2015) which found that the corporate income tax rate had a significant negative effect on foreign direct investment.

H1 : The corporate income tax rate has a negative effect on foreign direct investment

In relation to the theory of tax competition, the eclectic paradigm in the theory of foreign direct investment explains that when the host country can offer foreign investors specific advantages in the form of attractive tax incentive facilities, low labor costs, labor productivity and good quality infrastructure. high will increase the interest of foreign investors to invest in the country. In addition, the tax incentive facility in the form of a tax holiday will attract foreign investors to invest in the country. The results of previous studies (Cleeve, 2008; Kassahun, 2015; and Klemm and Van Parys, 2011) found that tax holidays had a significant positive effect on foreign direct investment.

H2 : Tax holiday has a positive effect on foreign direct investment

3. RESEARCH METHODS

This study focuses on the number of foreign direct investment inflows in Indonesia from 1981 to 2018 to examine the effect of corporate income tax rates and tax holidays on foreign direct investment. The data collection technique used in this research is document analysis with observation techniques. The data used are entirely secondary data, namely data on foreign direct investment inflows, gross domestic product, inflation, and trade openness used obtained from the World Bank, as well as corporate income tax rates and tax holiday provisions obtained from taxfoundation.org. By using non-probability sampling, 38 samples of foreign direct investment inflows were obtained during the period 1981 to 2018.

To test the hypothesis about the effect of corporate income tax rates and tax holidays on foreign direct investment, regression analysis is used as follows

$$\mathbf{FDI = \beta_0 + \beta_1 Rate + \beta_2 Holiday(Dummy) + \varepsilon}$$

Where: FDI = (new investment inflows – disinvestments) / Gross Domestic Product (in US$); Rate = Corporate income tax rate based on tax law, Holiday = dummy variable, 0 if there is no provision for tax holiday and 1 if there is provision for tax holiday

As an additional analysis, other economic factors (gross domestic product growth, inflation and trade openness) that affect the flow of foreign direct investment are added in the regression analysis above as follows:

$$\mathbf{FDI = \beta_0 + \beta_1 GDP\ Growth + \beta_2 Inflation + \beta_3 Openness + \beta_4 Rate + \beta_5 Holiday(Dummy) + \varepsilon}$$

Where: GDP Growth = gross domestic product growth; Inflation = inflation rate (consumer price index), Openness = (Exports + Imports) / GDP

4. RESULTS AND DISCUSSION

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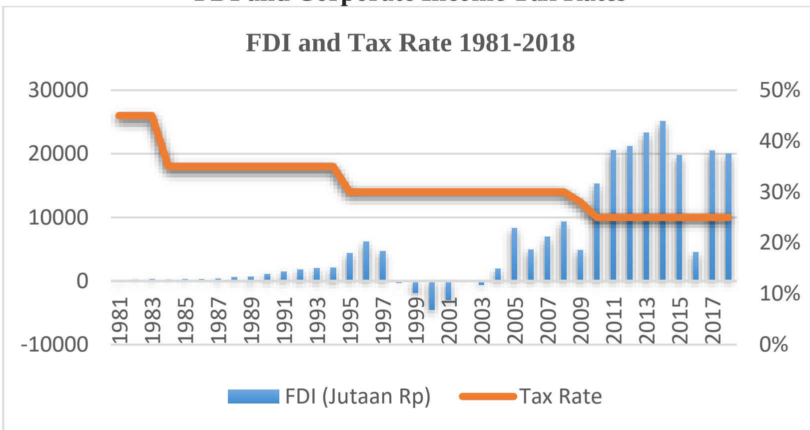
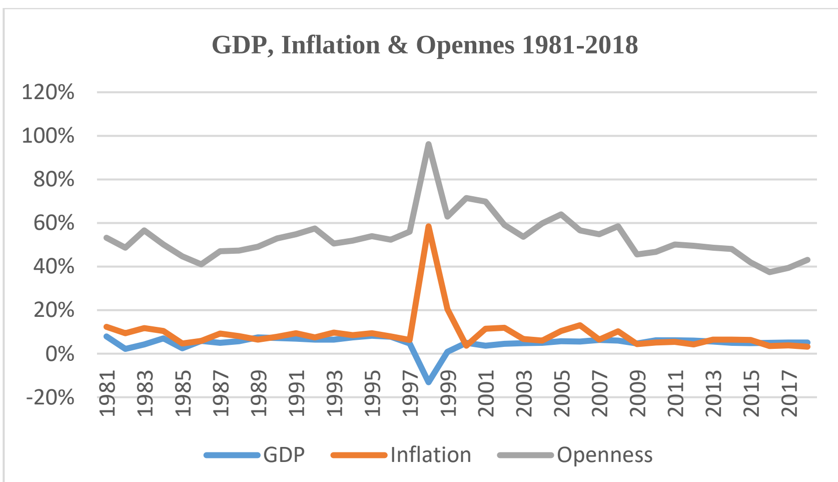
The results of data analysis on foreign direct investment (FDI) and corporate tax rates are illustrated in the following diagram.

FDI and Corporate Income Tax Rates



The figure above shows that the highest corporate income tax rate was 45% during 1981-1983, then reduced to 35% during 1984-1994, and decreased again to 30% during 1995-2008. Since then, the income tax rate has finally been 25% until now. The reduction in tax rates has resulted in increased inflows of foreign direct investment into Indonesia. For policies or regulations regarding tax holidays, Indonesia has not consistently implemented them. It is known that regulations or provisions regarding tax holidays only existed since 1996, but these regulations disappeared or were no longer known from 2000-2006 and reappeared in 2007. This is related to other factors, namely the growth rate of gross domestic product (GDP). inflation rate and trade openness are presented in the following graph.



The highest inflation occurred in 1998, at that time there was an economic crisis that started from the crisis in Thailand and spread to neighboring countries, including Indonesia. Data from the Central Statistics Agency also shows that the economy, which still recorded a positive growth of 3.4 percent in the third quarter of 1997, changed to zero percent in the last quarter of 1997. The figure continued to shrink sharply to a contraction of 7.9 percent in the first quarter of 1998, a contraction of 16, 5 percent in the second quarter of 1998, and continued to contract 17.9 percent in the third quarter of 1998. Likewise, the inflation rate up to August 1998 had reached 54.54 percent, with the inflation rate in February reaching 12.67 percent. On the other hand, the export sector which was expected to be a savior in the midst of a crisis, turned out to be just as slumped or unable to take advantage of the momentum of the depreciation of the rupiah. The downturn in the business world due to debt burdens has led to heavy dependence on imported components, difficulties in trade financing, and intense competition in the global market. During the period January-June 1998, oil and gas exports fell by around 34.1 percent compared to the same period in 1997, while non-oil and gas exports only grew 5.36 percent (https://news.detik.com/memori-krisis-moneter-19971998).

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After the 1998 monetary crisis, Indonesian governments have taken prudent financial measures to ensure that a similar crisis does not recur. Monitoring of banking sector liquidity is now more stringent and transparent, 'hot money' is handled more carefully (eg by limiting short-term debt), and the government debt-to-GDP ratio is lower (about 25 percent and shows a downward trend) compared to most developed economies. When the 2008 crisis hit, Indonesia was again hit by a large outflow of capital but was able to guarantee a stable economy due to good economic fundamentals. Even during the 2008-2009 crisis Indonesia showed strong growth with GDP growth of 4.6 percent mainly supported by domestic consumption (https://www.indonesia-investments.com/). The following is presented descriptive statistical research data for the years 1981-2018

Table 1. Descriptive statistics

Variabel	N	Minimum	Maximum	Mean	Std. Deviasi
FDI (in millions)	38	-4.550	25.121	5.875	8.359
Rate	38	0,25	0,45	0,3139	0,05465
Holiday	38	0	1	0,29	0,46
GDP	38	-0,13127	0,0822	0,0502957	0,03404988
Inflation	38	0,03198	0,58451	0,0928243	0,08869733
Openness	38	0,37421	0,96186	0,5327971	0,1042934

The results of model testing and research hypotheses are presented in table below.

Table 2. Summary of Model 1

Model	Prediction	Coefficient	t	Sig
Rate	-	-0,607	-4,1728	0,000
Holiday	+	0,101	0,693	0,493
Sig. F	0,000			
R.Square	0,438			
Adj. R. Square	0,406			
Dependend Variable : FDI				

Table 2 shows sig.F (0.000), meaning that the corporate income tax rate and tax holiday can explain the inflow of foreign direct investment by 43.8% (R square value), and the remaining 40.6% is explained by other factors. Based on the t-test, the corporate income tax rate has a sig value of 0.000 (coefficient of -0.607), which indicates that the corporate income tax rate has a significant negative effect on foreign direct investment inflows. The higher the corporate income tax rate, the lower the inflow of foreign direct investment. This result is in accordance with the theory of tax competition, where the determination of a lower tax rate in a country compared to neighboring countries can attract foreign direct investment. The standard theoretical literature on tax competition predicts that higher capital mobility can lead to a decrease in the tax burden on investment because there is a reduction in the tax rate on investment. This condition means that the government in determining the tax rate for investment assumes that capital inflows cause capital outflows in a country. To attract capital inflows, each country chooses to take tax cuts. The results are consistent with the proposed hypothesis and support previous studies (Abdioglu, 2016; Kassahun. 2015; Klemm and Van Parys, 2011; Saidu, 2015) which proves that corporate income tax rates have a negative effect on foreign direct investment.

The tax holiday has a sig value of 0.439 indicating that the tax holiday is not proven to have an effect on foreign direct investment inflows. Other factors (GDP, inflation and trade openness) which also affect the inflows of foreign direct investment are added as control variables. By using the control variables, the results of the regression analysis are presented as follows.

Table 3. Summary of Model 2

Model	Prediction	Coefficient	t	Sig
Rate	-	-0,604	-4,278	0,000
Holiday	+	0,102	0,717	0,478
GDP	+/-	0,122	0,514	0,611
Inflation	+/-	0,237	0,824	0,416
Openness	+/-	-0,46	-2,44	0,020
Sig. F	0,000			
R.Square	0,574			
Adj. R. Square	0,507			

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Dependend Variable : FDI

Table 3 shows sig. F of 0.000, indicating the corporate income tax rate, tax holiday, gross domestic product, inflation, and trade openness can explain changes in foreign direct investment inflows of 57.4% (R square). Based on the t-test, consistent with the results in model 1, it shows that the corporate income tax rate has a significant negative effect on foreign direct investment inflows, while tax holidays are not proven to affect foreign direct investment inflows. For the control variable, only trade openness (ie exports and imports) has an effect on foreign direct investment inflows.

Based on the results, there is not enough evidence that the tax holiday has an effect on foreign direct investment inflows. This result is inconsistent with the research hypothesis and previous studies (Cleeve, 2008; Kassahun, 2015; and Klemm and Van Parys, 2011) which found that tax holidays have a positive effect on foreign direct investment. This also does not support the location hypothesis in the eclectic theory which states that countries that have specific advantages by providing tax incentive facilities in the form of tax holidays can attract foreign investors. This means that the provision of tax incentive facilities (tax holidays) will only have a stronger correlation if there is an improvement in the basic business climate such as infrastructure, governance, high political and economic stability, and so on. Moreover, several improvements are needed in the tax holiday policy that can provide rules that are as clear as possible and easily understood by various parties so as to reduce uncertainty. But this result is consistent with several previous studies (Etim, 2019; Fahmi, 2012) which failed to find sufficient evidence that tax holidays have an effect on foreign direct investment inflows. In addition, only trade openness (exports and imports) has a significant effect on foreign direct investment cash inflows, while gross domestic product and inflation rate which averages 9% per year are not proven to have an effect on foreign direct investment inflows.

5. CONCLUSIONS

Based on the results described above, it can be concluded that the corporate income tax rate has a negative effect on inflows of foreign direct investment, while the tax holiday policy is not proven to have an effect on inflows of foreign direct investment. In addition, trade openness (exports and imports) has an effect on inflows of foreign direct investment, while gross domestic product and inflation rate have no effect.

implication of the results is that in determining the rules and policies to increase foreign direct investment, it is necessary to consider more emphasis on tax policy. In addition, a better export and import policy may also be needed to increase the interest of foreign investors to invest in Indonesia. This study only focuses on foreign investment inflows as measured by the amount of new investment inflows minus disinvestments, so it is recommended for further research using other measurements, such as foreign direct stock investment inflows (FDI Stock Inflow). In addition, this study only observes the effect of corporate income tax rates and tax holiday policies, it is recommended to include other tax policies, such as investment allowances, investment tax credits, or interest tax reductions paid, so that the results of the research are expected to strengthen the tax model that explains foreign direct investment.

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