



Research Article



## The Impact of Tax Incentive on Increase Foreign Direct Investment

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**Abstract:** This study examines and describes the effect of applying tax incentives through the tax allowance policy on the growth of direct investment in Indonesia. Legal research is the method of inquiry employed. Legal issues are analyzed using doctrinal research to draw logical conclusions. Legal research enhances the quality of research projects. The application of tax incentives has resulted in an increase in total investment of 187%, and the number of recipients of tax incentives has increased from 69 to 71 and continues to grow annually. Additionally, the incentives have a positive effect on other nations. Several obstacles and barriers exist in its implementation, including inefficiency in the government system, political relations with businesses, and economic stability.

**Keywords:** Tax Incentive; Investment; Tax Allowance;



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## INTRODUCTION

The government views corporations as taxpayers and tax collectors. The government requires tax revenue to finance the execution of various government functions, the provision of public goods such as infrastructure and education, and the improvement of the community's welfare in other ways. Foreign Direct Investment (FDI) refers to the above form of foreign investment. Foreign direct investment (FDI) is an international capital flow in which investors from one country invest in another. Foreign direct investment is typically associated with investments in productive assets by foreign investors. This is in contrast to Foreign Portfolio Investment (PFI), which refers to the flow of capital into countries searching for short- and medium-term financial returns through investments in the stock and bond markets. Many nations disapprove of PFI because it is associated with rapid outflows during times of crisis, destabilizing local financial markets. Over the past two decades, foreign direct investment (FDI) inflows have increased significantly worldwide. Indonesia, as a developing nation, is one of the<sup>1</sup>

Legally, the tax allowance arrangement is specified in Article 3(1) of Law 2/2020, stipulating that the income tax rate will be reduced from 25% to 22% in 2021 and 2022 and 20% in 2023. While Article 3(2) states that eligible local corporations with at least 40% of paid-up shares listed on a capital market are eligible for a 3% income tax rate reduction. In 2023, unlisted companies and local permanent establishments will be required to pay CIT at a rate of 20%, while those with 40% of their shares listed on the

<sup>1</sup> Hadi Sasana and Salman Fathoni, 'Determinant of Foreign Direct Investment Inflows in Asean Countries', *JEJAK*, 12.2 (2019), 253–66 <<https://doi.org/10.15294/jejak.v12i2.18785>>.



capital market will be eligible for a lower rate of 17%. The income tax provides a tax holiday (TH) for industries and pioneering FDI activities in Special Economic Zones. In contrast, a tax allowance (TA) of 30% is available for other FDI, in addition to accelerated depreciation, longer loss carryforwards, and a 10% withholding tax on dividends.<sup>2</sup>

Foreign capital is significant and present in the Indonesian government, but state revenues alone cannot fund the country's development plans. Thus, there must be a better match between government-planned revenue and development expenditures. Therefore, the Indonesian government requires funds from outside its borders. Consequently, the difference in funds from the government's regular budget cannot ensure the continuation of Indonesia's development. Indonesia always relies on international loans or foreign debt to make up for the dearth of development funding sources. Foreign capital is anticipated to impact firm productivity in several ways. Foreign money can replace domestic money and alleviate liquidity constraints if domestic capital access is restricted. It has been demonstrated that foreign investors introduce intangible productive assets such as technological advances, managerial skills, marketing expertise, trade contacts, and a heightened reputation.<sup>3</sup>

The government encourages this investment through its tax allowance policy. One of the policies used to increase the ease of doing business index is the tax allowance. However, this tax exemption is one of many factors that facilitates investment in Indonesia. According to the World Bank's Ease of Doing Business (EoDB) index, paying taxes is one of the ten factors considered in the EoDB ranking. The paying tax index is calculated based on four primary factors: tax payment procedures, time to fulfill tax obligations, tax burden as a percentage of company profits, and index after reporting. With this incentive, investors will receive a tax reduction that benefits the company due to the removal or cutting rate, thereby reducing the proportion of profits subject to taxation<sup>4</sup>.

The implementation of the tax allowance policy itself has generated several disagreements. Implementing the tax exemption has sparked debate in various circles regarding whether the policy will positively impact state revenues or even harm them. In the short term, providing tax incentives such as tax holidays and allowances will reduce corporate income tax, resulting in declining state tax revenue. Implementing the facility-granting period has an effect due to the abuse committed by companies that only pursue the provided investment tax policy and move their investments to other countries after the validity period expires. The government must meet several related parties' expectations in determining tax incentive policies<sup>5</sup>.

<sup>2</sup> Gunadi Gunadi, 'A Little View of The Indonesian Tax System', *Journal of Tax and Business*, 3.1 (2022), 65–71 <<https://doi.org/10.55336/jpb.v3i1.17>>.

<sup>3</sup> Miguel Angel Esquivias and Samuel Kharis Harianto, 'Does Competition and Foreign Investment Spur Industrial Efficiency?: Firm-Level Evidence from Indonesia', *Heliyon*, 6.8 (2020), e04494 <<https://doi.org/10.1016/j.heliyon.2020.e04494>>.

<sup>4</sup> Irwan Aribowo and Deny Irawan, 'Menarik Investasi Ke Indonesia Dengan Tax Holiday', *Jurnal Pajak Dan Keuangan Negara (PKN)*, 2.2 (2021), 135–41 <<https://doi.org/10.31092/jpkn.v2i2.1184>>.

<sup>5</sup> Dahliah Dahliah and Julianty Sidik Tjan, 'Implementation Evaluation Tax Holiday and Tax Allowance Policies on the Growth of Foreign Investment', *Atestasi: Jurnal Ilmiah Akuntansi*, 5.2 (2022), 334–46 <<https://doi.org/10.57178/atestasi.v5i2.393>>.



The domestic investment absorption value in Indonesia is increasing. According to data from the Central Bureau of Statistics, the value of investments realized in 2021 was IDR 447063.6 billion, an increase of IDR 413535.5 billion and a breath of fresh air for Indonesian investment. This is a crucial factor regarding foreign investment or the value granted to Indonesia. Singapore invests US\$3.4 billion, Japan US\$2.3 billion, China US\$2.3 billion, Hong Kong US 1.3 billion, Malaysia US 1 billion, Netherlands US\$738 million, USA US\$631.7 million, South Korea US\$544.4 million, the Virgin Islands US\$385.4 million, and Thailand US\$262.2 million<sup>6</sup>.

The tax allowance policy must be accompanied by several other policies designed to support interests ranging from ease of licensing to tax allowance implementation regulations and other supporting instruments. Regarding the tax allowance, the tax allowance arrangement has existed for a considerable amount of time. They are strengthening the policy through Article 31A of the Income Tax Law No. 7 of 1983 and HPP Law No. 7 of 2021. The problem with applying the tax allowance is that Government Regulation No. 78 of 2019 needs a definition of the commercial start of production (SMB), even though the term is mentioned in the PP without a definition. The current definition of SMB can be found in Minister of Finance Regulation 11/PMK.010/2020. SMB refers to the initial sale or delivery of the production or services of the principal business activity or their use in other production processes. However, since the Minister of Finance Regulation is subordinate to the Government Regulation, the addition of this definition should also be regulated in Government Regulation No. 78/2019. In addition, there are obstacles regarding the purpose of taxpayers eligible for facilities. As required by Article 9 of Government Regulation No. 78 of 2019, the purpose of taxpayers eligible to receive facilities has yet to be spelled out in several additional regulations. According to Government Regulation No. 9/2016 and Government Regulation No. 78/2019, domestic and foreign corporate taxpayers are eligible for tax allowance facilities. However, neither the Head of BKPM Regulation nor the Minister of Industry Regulation includes this definition. Consequently, it is necessary to synchronize the purpose of taxpayers in the Head of BKPM Regulation, the Minister of Industry Regulation, and three unmade ministerial regulations of sector supervisors, namely the Ministry of Public Works and Public Housing, the Ministry of Transportation, and the Ministry of Agriculture<sup>7</sup>.

The existence of these issues motivates research into the issues that arise. The presence of problems stemming from the implementation of tax allowance policies raises new concerns regarding these policies. The tax allowance policy affects attracting more foreign capital investment. Consequently, foreign investment foreign capital can be used for capitalization and additional budgets for social welfare.

## METHOD

This study employs normative legal research methods and a conceptual methodology. The conceptual approach is utilized to comprehend concepts associated with implementing tax incentives to increase domestic taxes via foreign direct investment. This research proposal is descriptive. The primary source of data is

<sup>6</sup> Mahadiansar Mahadiansar and others, 'Realitas Perkembangan Investasi Asing Langsung Di Indonesia Tahun 2019', *Matra Pembaruan*, 5.1 (2021), 65–75 <<https://doi.org/10.21787/mp.5.1.2021.65-75>>.

<sup>7</sup> Anies Said Basalamah, 'Tax Allowance , Mengapa Tidak Berjalan?', *Kajian Ekonomi Dan Keuangan*, 2.3 (2018), 195–209 <<https://doi.org/10.31685/kek.v2i3.323>>.



secondary information derived from a literature review<sup>8</sup>. Using qualitative descriptive analysis, the collected data is examined. The research also depended on laws and regulations about Tax Allowance di Indonesia. Other approaches, such as historical and statutory, were also employed in gathering accurate data. The researchers did a qualitative data analysis with interpretation techniques of legal documents during the literature study, thus analytically and critically presenting the results.

## RESULT AND DISCUSSION

### *Execution of the Tax Allowance Policy to Increase Indonesia's Foreign Capital*

The government's tax allowance policy significantly impacts Indonesia's tax revenue. The tax credit aims to increase direct investment activities domestically and internationally. Tax exemptions are anticipated to promote economic growth, equitable development, and accelerated development in particular business fields and regions. Corporate tax incentive arrangements must accompany the implementation of tax allowances. Regarding the corporate tax itself, it has also been explained that to attract foreign investors, the corporate income tax must be lower than in other countries. This indicates that the government considers capital inflows that result in capital outflows when determining tax rates. Each nation may choose to reduce tax rates to attract FDI. Therefore, it is anticipated that a tax incentive policy in the form of a reduction in the corporate income tax rate will attract more foreign investment. The corporate income tax rate significantly negatively impacts foreign direct investment.<sup>9</sup>

Government-mandated tax absorption must be distinct from the factors determining foreign direct investment. Foreign direct investment (FDI) inflows have a positive relationship with market size, trade openness, infrastructure, and research and development. In contrast to the estimation results, alternative results for the effect of the inflation rate and human resources on FDI inflows have the opposite sign. According to the character and significance of market size, trade openness, and infrastructure for foreign direct investment, foreign investors are interested in increasing their regional investments during the study period despite a lower human capital base and a higher inflation rate. The lower production costs in ASEAN can explain this compared to other regions, which attract foreign investors. Despite this, inflation hurt FDI. Moreover, I discovered a negative correlation between human capital and FDI inflows. Although some studies (with different measurements) support this result, most studies demonstrate a positive effect between human capital and FDI. Regarding the relationship between economic growth and FDI, we can examine the case of Libya, which shares with Indonesia the same FDI pull factor, namely its mineral resources. The relationship between the economic growth rate in Libya and several independent variables (foreign investment, labor, inflation rate in the Libyan economy) indicates that FDI and human resources account for approximately 61% of changes in the economic growth rate (delivery). A 1% increase in foreign direct investment increases GDP by 0.215 percent

<sup>8</sup> Pradeep Mallekyl Devadasan, 'Legal Research- Descriptive Analysis on Doctrinal Methodology', *International Journal of Management, Technology, and Social Sciences (IJMTS)*, 2.December 2019 (2022), 10 <<https://doi.org/10.47992/IJMTS.2581.6012.0075>>.

<sup>9</sup> Muhammad Ikhsan, S Bella, and Ivan Yudianto, 'The Impact of Tax Incentives on Foreign Direct Investment: The Case of Tax Holiday and Corporate Income Tax Rates in Indonesia', *Journal of Accounting Auditing and Business*, 4.2 (2021), 2021 <<http://jurnal.unpad.ac.id/jaab>>.





(economic growth rate). Generalized line estimation provides the most accurate estimate of natural economic growth in Libya<sup>10</sup>.

Regarding the regulation and implementation of the tax allowance in Indonesia, Minister of Finance Regulation Number 11/PMK.010/2020 specifies the following: to domestic corporate taxpayers who invest for primary business purposes. Both new investment and expansion of existing businesses in, initially, the Specific Business Fields listed in Appendix I of Government Regulation No. 78 of 2019 are eligible for tax credits. And second, specific business fields and regions, as detailed in Appendix II of Government Regulation 78 of 2019 concerning Income Tax Facilities for Investment in Certain Business Fields and Certain Regions, can be granted Income Tax Facilities if they meet specific criteria and requirements. Minister of Finance Regulation No. 11/PMK.010/2020 also regulates the imposition of income tax on dividends paid to foreign taxpayers who do not have permanent establishments in Indonesia at a rate of 10% (ten percent) or a lower rate by the applicable double tax avoidance agreement. In addition, Minister of Finance Regulation Number 11/PMK.010/2020 governs the compensation of losses more significant than five but less than ten years old<sup>11</sup>.

In 2018, 69 taxpayers utilized the tax allowance facility, illustrating the relationship between the tax allowance policy and the increase in domestic revenue. In 2019, 71 additional taxpayers were eligible for the tax allowance. The total investment value of PP No. 78 of 2019 has increased by 187% from Rp. 63.2 trillion to Rp. 181.6 trillion. Thus, the enacted PP No. 78 of 2019 produced effective results and positively impacted investment in Indonesia. This increase has a positive effect on Indonesian investment. Additionally, this increase in investment has a positive impact on the economy of Indonesia. From 2016 to 2019, Indonesia's tax revenue continued to increase. The tax revenue of Indonesia in 2016 was Rp1,105.99 trillion; in 2017, it was Rp1,151.08 trillion; in 2018, it was Rp1,313.35 trillion; and in 2019, it was Rp1,545.3 trillion. This tax allowance incentive policy contributes to Indonesia's tax revenue growth.<sup>12</sup>

The increase in foreign investment is not solely intended to boost Indonesia's profits. Tax exemptions are also designed to encourage domestic R&D. The Tax Allowance policy breathes new life into domestic research. The tax allowance policy is essential for a developing nation because innovation is required to boost the economy. Research and development is a proven method for enhancing the U.S. economy because it positively and significantly impacts GDP over the long term but does not affect GDP in the short term. In addition, it has been demonstrated that R&D activities have a spillover effect, meaning that a state's investment in R&D will affect other states. Notably, a state's additional tax incentives for R&D may vary from those of other U.S. states. Given the

<sup>10</sup> Mustafa El. Hamoudi and Nagmi Aimer, 'The Impact of Foreign Direct Investment on Economic Growth in Libya', *International Journal of English Literature and Social Sciences*, 2.6 (2017), 144–54 <<https://doi.org/10.22161/ijels.2.6.22>>.

<sup>11</sup> Reni Marlina and others, 'Identification of Tax Allowance Policies and Mechanisms in Indonesia', *ITQAN: Journal of Islamic Economics, Management, and Finance*, 2.1 (2023), 10–17 <<https://doi.org/10.57053/itqan.v2i1.16>>.

<sup>12</sup> Amin Isnanto, Istiqomah Istiqomah, and Suharno Suharno, 'Faktor-Faktor Yang Mempengaruhi Penerimaan Pajak Penghasilan Dalam APBN', *Jurnal Ilmiah Universitas Batanghari Jambi*, 21.2 (2021), 832 <<https://doi.org/10.33087/jiubj.v21i2.1436>>.



authority to regulate, each state member can understand what the state needs and how to support R&D activities in each state.<sup>13</sup>

Research and development are essential to a nation's economic health and growth. It contributes to the country's competitiveness in terms of productivity and standard of living. Although it was once considered ineffective in promoting economic growth, it is now believed to have a significant impact. Still, there is no direct relationship between R&D spending and economic growth. In addition, research and development does not immediately impact the economy; instead, it is a long-term investment in a nation's competitiveness vis-à-vis other countries. This demonstrates that a one trillion dollar increase in R&D investment will increase economic growth by 0.61 percent. Several countries, particularly Indonesia, are developing R&D (research and development) assets. A company invests in research and development to produce a product that is superior to its predecessor (the new product) and can also improve the quality of the older product. There is a positive and significant relationship between the volume of e-commerce transactions and economic growth on the scale of e-commerce. Some of the benefits of e-commerce can result in economies of scale that reduce production costs and stimulate economic expansion. E-commerce, as a symbol of technological advancement, is a concept that can aid economic actors in optimizing the production process and output. E-commerce platforms solve problems associated with the marketing process and costs that arise, such as rental costs and product diversification. All the advantages of e-commerce will have an indirect effect on economic growth.<sup>14</sup>

Regarding the tax allowance policy, it affects businesses and contributes to an increase in investment. The increase is reflected in the fact that, during periods of stability, the average firm's investment increases in response to tax incentives. Nevertheless, the effect during periods characterized by adverse first-moment shocks and positive second-moment shocks depends on the underlying economic conditions and the degree to which firms are exposed to uncertainty. Consequently, the distribution of firms in the economy is an essential factor for the government to consider when evaluating the suitability of tax allowance measures to stimulate investment during recessions. Tax allowance policies and other incentives must be regarded because incentives must be administered with care during COVID-19 and amidst economic unpredictability. Tax incentives substantially positively affect average investment under conditions of low uncertainty. Under high-tension conditions, however, the story is different: the response is highly heterogeneous, with firms shielded from high tension responding well to the policy and firms exposed to high delay reacting poorly. This implies that periods of stability offer significant policy opportunities to encourage investment and that the effect of stimulus in a crisis depends on firms' exposure to uncertainty<sup>15</sup>.

<sup>13</sup> Irwanto Irwanto and Meilani Meilan, 'Comparative Study of Tax Incentives in Indonesia, Malaysia, and the United States of America to Support Research and Development', *Journal of Accounting and Management Innovation*, 6.1 (2022) <<https://doi.org/http://dx.doi.org/10.19166/jam.v6i2.538>>.

<sup>14</sup> Gebrella Nadia Sumahir, Heru Wahyudi, and Tiara Nirmala, 'Pengaruh Investasi Research And Development (R&D), Karyawan Perusahaan E-Commerce, Dan Volume Transaksi Terhadap Pertumbuhan Ekonomi Di Indonesia 2010q1 – 2020q4', *E-Journal Field of Economics, Business and Entrepreneurship*, 1.1 (2022), 22–32 <<https://doi.org/10.23960/efebe.v1i1.12>>.

<sup>15</sup> Irem Gucer and Maciej Albinowski, 'Investment Responses to Tax Policy under Uncertainty', *Journal of Financial Economics*, 141.3 (2021), 1147–70 <<https://doi.org/10.1016/j.jfineco.2021.04.032>>.



The application of tax incentives and tax collection to support infrastructure refers to China's application of tax incentives. We must comprehend the impact of tax incentives on corporate profitability to understand tax incentives' role in the domestic economy. Here, profitability refers to ROA (return on assets). ETR consistently has a statistically and economically significant negative impact on corporate ROA. Specifically, a 1% decrease in ETR following the reform results in a 1.7% increase in ROA. Third, ETR influences ROA via two channels. We prove that a low ETR can increase a company's ROA by encouraging FAI and lowering FAI costs. A reduction in external financing constraints as a result of a lower ETR is an additional significant channel. Lastly, reforms reduce ETR for domestic companies regardless of ownership, firm size, financial constraints, or industry competition. However, the effect of ETR on ROA is contingent on several variables. The results indicate that ETR can be weakened if the state-owned enterprise is relatively large, has a low SA index, and operates in an industry with less competition<sup>16</sup>.

Implementing the tax allowance policy must be accompanied by a rise in foreign investment by domestic corporations. This tax absorption through approach can also be overcome by encouraging taxation in Indonesia via means other than FDI alone. The increase in tariff may affect the increase in taxes collected by the country due to the significant flow that determines the positive relationship between domestic and foreign investment, which is primarily influenced by tax planning and profit-shifting opportunities, as well as greater access to financing capital. In response to tax incentives, multinational corporations strategically locate their affiliates. Therefore, international expansion is correlated with increased access to financing capital and enables multinationals to allocate money more efficiently through internal capital markets. Internal debt is a standard method for profit shifting and more efficient capital allocation, so these two channels are closely interconnected. Multinational corporations can take advantage of tax differences between nations, giving them an edge over domestic competitors<sup>17</sup>.

The implementation of the tax allowance policy is fully linked to an increase in foreign funding, which affects increasing state revenue, and to long-term investments in domestic research and development to improve technology transfer, which will have a long-term impact on increasing state revenue in Indonesia through Foreign Direct Investment (FDI)

### ***Adopting Tax Allowance to Increase Foreign Investment in Indonesia: Limitations and Obstacles.***

The implementation of the tax allowance policy needs to be improved. In Indonesia, the problem is that taxation has varying effects. The relationship between tax incentives and FDI is negative, which contradicts the hypothesis. However, the impact of the income tax rate is consistent with the theory that the lower the income tax rate, the greater the FDI flows. In addition, the results indicate that FDI will increase if other variables, such as high-quality institutions and macroeconomic stability, support it. Lastly, tax incentives are negatively correlated with FDI, indicating that the government must

<sup>16</sup> Hongsheng Fang, Yunqing Su, and Weijun Lu, 'Tax Incentive and Corporate Financial Performance: Evidence from Income Tax Revenue Sharing Reform in China', *Journal of Asian Economics*, 81 (2022), 101505 <<https://doi.org/10.1016/j.asieco.2022.101505>>.

<sup>17</sup> Stefan Goldbach and others, 'The Effect of Investing Abroad on Investment at Home: On the Role of Technology, Tax Savings, and Internal Capital Markets', *Journal of International Economics*, 116 (2019), 58–73 <<https://doi.org/10.1016/j.jinteco.2018.10.001>>.



evaluate the structure of tax incentives and the mechanism or procedure for their implementation, particularly concerning the most recent tax bill (the Omnibus Tax Law), which still offers tax holidays and tax allowances. This may result in an effective and efficient implementation of tax policy<sup>18</sup>. These issues have become an impediment that the government must address.

There are additional issues with the tax allowance policy. Tax exemptions and tax allowances have indeed been effectively implemented—however, more than these incentives are needed to generate the required level of investment. Since 2016, seven projects have received tax allowances, and nine projects have received tax exemptions, with a total investment of IDR63.2 trillion (\$4.5 billion) or an average annual investment of IDR16 trillion (\$1.1 billion). Although impressive, this level of investment falls short of the \$4 billion annually required over the next decade based on current goals<sup>19</sup>. This makes the tax allowance policy objective even less ambitious than boosting future investment.

Deficiencies caused by the absence of climate The government's primary focus is on enhancing the investment climate Beginning with the Online Single Submission (OSS) system and extending to the provision of various tax incentives, including tax holidays and tax allowances. Due to its high investment barriers, Indonesia still needs to compete with other ASEAN nations to attract foreign investors. This is evident thus far in the bureaucratic process and licensing system, particularly in land settlement matters. Indonesia is already attractive to investors. However, investors frequently need help with attempting to realize their investment. Therefore, there must be coordination between the central and local governments and improvements to land governance, labor policies, and the licensing system. Frequently, land acquisition and licensing issues present obstacles. Even though licensing through the OSS system is currently simplified, many obstacles still need to be overcome in its implementation, as evidenced by the actual state of affairs. "The inconsistency of government policies in facilitating the entry of investment is a factor of equal importance." Therefore, more is needed to deregulate and incentivize; the obstacles of policy inconsistency must be eliminated by enhancing central and regional coordination<sup>20</sup>.

Indirectly, tax avoidance impedes the implementation of tax absorption and the provision of tax incentives. This is shown by the link between the rise in tax evasion and the use of tax incentives, where the government's goal of tax intensity can make a company more productive and competitive. Nonetheless, corporations exploit the tax code as a loophole to avoid taxes. There is sufficient corporate fraud for the company to avoid paying taxes: the greater a firm's leverage, the greater its tax avoidance. Power

<sup>18</sup> Galu Bernie Aprian and Ferry Irawan, 'The Impact of Tax Incentives and IFRS Adoption on Foreign Direct Investment in ASEAN Countries', *International Journal of Innovation, Creativity and Change*, 5.2 (2019), 1195–1212  
<<https://doi.org/http://dx.doi.org/10.24198/jaab.v4i1.30629>>  
<<https://doi.org/http://dx.doi.org/10.24198/jaab.v4i1.30629>>.

<sup>19</sup> *Renewable Energy Tariffs and Incentives in Indonesia*: (Manila, Philippines, September 2020)  
<<https://doi.org/10.22617/TCS200254>>.

<sup>20</sup> Guntur Eko Saputro, 'Implementation of Economic Policy Facing The China American Trade War In The Framework of Nirmilitary Defense', *International Journal of Social Science and Human Research*, 04.12 (2021), 3709–16 <<https://doi.org/10.47191/ijsshr/v4-i12-36>>.





has a statistically significant effect on tax avoidance; when a company adds debt to obtain substantial tax incentives, it is said to avoid taxes: the more meaningful a corporation's leverage, the greater its tax avoidance<sup>21</sup>.

Political connections positively and significantly affect effects on tax avoidance practices are also obstacles to implementing tax allowances, indicating a link between companies with political connections and their tax avoidance activities. This result demonstrates that companies with political connections can avoid paying taxes due to their unique relationship with the government. The Big Four KAP, generally of high quality, has yet to be able to detect and minimize tax avoidance. Internal management decision-making is the only factor influencing the company's decision to engage in tax avoidance<sup>22</sup>.

The government implements a tax treaty to avoid some of these obstacles. The current tax treaty does not affect the amount of investment entering Indonesia. The stable amount of incoming investment during the year the tax treaty was ratified and implemented is evidence of this. Country-specific factors determine the amount of tax revenue collected. The stability of the host country will impact foreign direct investment. The level of incoming investment is proportional to the strength of the economy. Reducing tax avoidance and transfer pricing cases is an advantage of tax treaty implementation because the approved tax treaty contains rules or articles on exchanging information (Eol). The government can use the existence of Eol in the tax treaty to investigate potential avoidance. In addition, Eol can prevent "double non-taxation," which occurs when income is not taxed in two countries. The time test in each country also influences the non-taxation of a person in both countries<sup>23</sup>.

Regarding tax evasion, the government can learn from the United Kingdom. Since 2016, all large companies in the United Kingdom must make public a board-approved tax strategy statement consistent with their overall business strategy. Large corporations voluntarily published their designs in various formats before the statutory mandate. The Indonesian government can reduce tax avoidance by implementing the following process: first, an approach to risk management and governance arrangements; second, an attitude toward tax planning; third, the level of risk that the group is willing to accept; and fourth, an approach to its relationship with HMRC<sup>24</sup>.

Only some companies that make things in Indonesia and are listed on the Indonesia Stock Exchange avoid paying taxes. The companies in the sample are typically compliant taxpayers who do not engage in tax avoidance. This study successfully demonstrated that executive traits motivate companies to engage in bolder tax avoidance. Several lines of evidence indicate that family ownership does not encourage companies to engage in

<sup>21</sup> Henny Henny, 'Pengaruh Manajemen Laba Dan Karakteristik Perusahaan Terhadap Tax Avoidance', *Jurnal Muara Ilmu Ekonomi Dan Bisnis*, 3.1 (2019), 36 <<https://doi.org/10.24912/jmieb.v3i1.4021>>.

<sup>22</sup> Diah Amalia and Steven Ferdiansyah, 'Does Political Connection, Executive Character, and Audit Quality Affect the Tax Avoidance Practice? Evidence in Indonesia', *Sebelas Maret Business Review*, 4.2 (2019), 93 <<https://doi.org/10.20961/smb.r.v4i2.35905>>.

<sup>23</sup> Faqih Aji and Ferry Irawan, 'Studi Komparatif Aplikasi Tax Treaty Indonesia-Tiongkok Dan Indonesia-Singapura', *Educoretax*, 1.3 (2021), 174–87 <<https://doi.org/10.54957/educoretax.v1i3.26>>.

<sup>24</sup> Lynne Oats and Penelope Tuck, 'Corporate Tax Avoidance: Is Tax Transparency the Solution?', *Accounting and Business Research*, 49.5 (2019), 565–83 <<https://doi.org/10.1080/00014788.2019.1611726>>.



tax evasion. This study also needs to provide proof that the existence of political connections as a multiplier of executive traits and family ownership increases tax avoidance further. Companies with political connections do not engage in tax avoidance—Given that most sample companies comply with tax regulations. If sample companies are found to have violated tax laws, they are exempt from sanctions and fines. The sample companies also consider the possibility of losses if tax avoidance is proven<sup>25</sup>.

There are still many gaps in applying the Tax Allowance policy, which is one of the obstacles associated with the procedure. Using tax avoidance behavior to avoid paying taxes, despite receiving incentives, is the root cause of the problems that arise—Political connections to support tax avoidance. The government can use these obstacles as evaluation material for immediate problem resolution. In addition, the government can implement several solutions through international tax treaties. It can increase the transparency of tax payment schemes by companies that reflect the application of British policies. The government can utilize this as a future policy solution.

## CONCLUSION

Implementation of the tax allowance policy in Indonesia has a positive effect on state revenues. The tax allowance positively correlates with Indonesia's state revenue when other tax incentive arrangements are considered. With the implementation of regional regulations and the tightening of the system and process for obtaining Tax Allowance, Tax Allowance can function optimally. Despite this, tax exemption in Indonesia has a positive effect. There must be policies and solutions to overcome obstacles to the tax allowance's implementation. Tax avoidance and a lack of implementation arrangements are obstacles that arise during the performance of the tax allowance. This may result in a suboptimal performance of the tax allowance. Tax transparency with the system implemented in the United Kingdom and tax treaty policies between nations can be used to minimize tax abuse and avoidance.

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