

TAX RATES AND ADOPTION OF IFRS ON FOREIGN DIRECT INVESTMENT in ASEAN ECONOMIC COMMUNITY COUNTRIES

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Abstract

This study aimed to get empirical evidence of the effect of tax rates and the adoption of IFRS to Foreign Direct Investment (FDI). The study also attempts to identify whether a country needs to adopt IFRS fully, convergence IFRS or not using IFRS able to increase FDI. Otherwise to detect Tax rates from Asean Economic Community Countries can affected FDI. This study uses a quantitative descriptive approach. The sample consisted of 54 observations of each variable that consists of information 9 countries of the ASEAN Economic Community (AEC) during the years 2011 to 2016. The proposed model was tested using multiple regression analysis through partial t test, as well as simultaneous test F. The results showed the tax rate in a country negatively affect FDI and the adoption of IFRS by a country has a positive effect on FDI, while simultaneously tax rates and the adoption of IFRS have a significant effect on FDI. This study extends the theoretical concept of tax rates and the level of IFRS adoption, even though previous research has been done before in developing countries, and there is no research that focuses on AEC countries. Previous research used a simple score of 2 to 3 score levels in AEC scoring the level of IFRS adoption in each sample country so that it was not accurately. This Research is using five (5) levels of scores taken from the IASB namely full adoption, adapted, pieceAECI, referenced, and not adoption at all.

Keywords: Tax Rate, Adoption of IFRS, Foreign Direct Investment, IASB

1. INTRODUCTION

Many factors influence investor interest, one of which is the amount of tax rates imposed by a country's government that will be used as an investment destination. According to Quere et al (2001, p.3) Volume and location of FDI are influenced by tax policy, a high tax rate will reduce

the *after-tax return (after tax return)*. Realizing this, the competing countries compiled a combination of policies in the field of taxation that were expected to increase the attractiveness of the country in the eyes of investors. Until now there have been various research results regarding the relationship between tax rates and FDI in the empirical literature. Marbun &

Martani (2015), Quere, Fontagne & Resvil (2003), and De Mooij & Everdeen (2005) found a negative influence between tax rates and FDI, while Slemrod (1991) found that tax rates did not significantly influence FDI inflows.

The amount of tax rates and the application of international accounting standards (IFRS) in a country are some of the added values for a country in promoting its territory as an FDI target in the eyes of foreign investors, including countries registered in the AEC. The AEC is designed so that ASEAN's competitiveness increases and it can compete with China and India to attract foreign investment. Foreign investment in this region is needed to increase employment and improve welfare. Based on the background above, this study will examine the effect of tax rates and IFRS adoption on *Foreign Direct Investment* (FDI) in

countries registered in the Asean Economic Community (AEC) in 2011-2016.

The difference in this research with previous research is in terms of AECsuring the level of IFRS adoption. Most previous studies divided the AECsurement of IFRS adoption into two to three levels of scoring. This research will use more detailed AECsurements of the level of ad options IFRS using lima level scores are taken from the level of adoption of IFRS by the *International Accounting the Standard Board* (IASB), namely: *Full Adoption*, *Adapted*, *pieceAECI*, *Referenced*, and *Not adoption at all*. In addition, the object of research used by previous researchers was developing countries in Asia, while this study focused more on countries registered in the Asean Economic Community (AEC).

2. LITERATURE REVIEW

2.1 Tax Rates

According to Luqman (2016, chap.2) the tax rate is a rules or percentage based on the law that can be used to calculate and / or find the amount of tax that must be paid, paid for, and / or collected by the taxpayer. The Treasury of Australian Government (2006, chap.5) states, to compare the tax burden that must be borne by companies between countries can be used several AECsures including *tax to GDP ratio*, *statutory tax rate* (STR), *effective corporate tax*, *effective tax rate* (ETR), *average tax rate*, *effective marginal tax rate*, *effective average tax rate* (EATR). In this study using the *effective average tax rate* (EATR), the average effective tax rate in a country, is the percentage tax burden on total income (Marbun & Martan, 2015).

Research on the effect of tax rates on FDI has been carried out by researchers, including De Mooij and Enderveen (2005), Harini Ekowati (2008), Querre, Fontage, Revil (2011), and Martani and Marbun (2015). They found a negative impact on tax rates on FDI. On the other hand, some researchers find the tax rate does not have a significant impact on FDI, one of which is the research conducted by Slemrod (1991). In terms of the tax rate does not significantly influence investors' decisions to invest, namely when the portion of the tax that becomes state revenue is reduced, but foreign investment entering the country does not grow. This is a *trade off* that should not be experienced by the government.

2.2 Adoption of IFRS

IFRS *Foundation* (2017) states IFRS is a globally recognized standard for the preparation of financial statements by

business entities. The use of a high-quality set of standards by companies around the world increases the comparability and transparency of financial information and reduces the costs of preparing financial statements. If standards are applied strictly and consistently, capital market players receive high-quality information and can make better decisions. Thus, the market allocates funds more efficiently and companies can achieve lower capital costs.

The relationship between IFRS and FDI adoption has been widely investigated. A number of studies have shown that the transition to the international accounting framework has led to an increase in FDI flows, especially in developing countries, including Gordon, et al (2012), Martani & Marbun (2015), and Marquez-Ramos (2011), and Catalina Florentina (2017). But on the contrary, Efobi & Nnadi (2015) and Lasmin (2012) who did not find a positive relationship between IFRS and FDI adoption.

2.3 Foreign Direct Investment

Foreign Direct Investment (FDI) is an investment activity carried out by a company or entity in a country to companies in other countries (World Bank Group, nd). Almost all state governments want to attract FDI into their countries, because FDI is considered to be able to generate new businesses, produce new technologies and more generally, encourage economic growth and employment. FDI can also positively influence domestic income through spillover effects such as the introduction of new technology and

increasing human resources. With this potential advantage, policy makers constantly re-examine their tax regulations to attract FDI.

3. RESEARCH METHOD

this study provides an overview of the conditions of Tax Rates, Adoption of IFRS and *Foreign Direct Investment* (FDI) in countries registered in the ASEAN Economic Community (AEC) in 2011-2016.

3.1. Data Collection Techniques

The data used are secondary data collected through literature, e-mail, and search on Internet sites in the form of a report *Paying Taxes data* released by Pwc (*World Bank group*) to obtain the data Tsensible tax years 2011-2016. *IFRS by country* report by Pwc and *IFRS-Jurisdiction profile* by *IFRS Foundation* to obtain data on IFRS Adoption for 2011-2016. While data from the *Foreign Direct Investment* in 2011-2016 was obtained from *Foreign direct investment, net inflows (% of GDP)* released by the *World Bank*

3.2. Operational Definitions of Variables

To find out how the calculation of each of the variables examined in this study, the following is a table of variables that can explain the operationalization of variables.

3.3. Sample Collection Techniques

The population in this study were all countries registered in the ASEAN Economic Community (AEC). The selection of samples in this study used purposive sampling with

criteria: (i) Southeast Asian countries registered in the ASEAN Economic Community, (ii) Consistently having the data needed during 2011-2016, and (iii) The sample countries must have stock exchanges.

3.4. Data Analysis Techniques

The multiple regression method chosen because it is based on the number of independent variables more than one variable. The following are the formulas used in the Multiple Regression method:

$$Y = \alpha + \beta_1.TP + \beta_2.IFRS + \epsilon$$

Information :

Y = Foreign Direct Investment (FDI)
 TP = Tax Rates
 IFRS = Adoption of IFRS
 α = Constant
 ϵ = Error

4. RESULTS AND DISCUSSION

4.1. Results

Table 1
 Descriptive statistics

| Variable | N | Minimum | Maximum | Mean | STDEV |
|--------------------|----|---------|---------|------|--------|
| TAX rates | 54 | 0.18 | 0.45 | 0.31 | 0.0810 |
| ADOPTION OF IFRS | 54 | 0.00 | 4.00 | 2.59 | 1.4077 |
| FDI INFLOW | 54 | 0.00 | 0.24 | 0.06 | 0.0614 |
| Valid N (listwise) | 54 | | | | |

Source: Results of SPSS version 22

Based on the results of calculations from table 1.2 the ratio of FDI INFLOW in each country averages 0.0630 or 6.3% with a minimum value of 0.00 or 0.44%, namely the State of Indonesia in 2016, which is the smallest value of Indonesian FDI since 2004. While the maximum value FDI amounted to 0.24 or 24.01%, namely the State of Singapore in 2014. Singapore is the country with the highest FDI inflows in Southeast Asia during the research year, 2011-2016. The minimum value of the Tax Rate ratio is 0.18 or 18%, namely the Singapore

State tax rate in 2013, while the maximum value is 0.45 or 45%, which is the Philippine State tax rate in 2011. The minimum IFRS Adoption ratio is 0.00 which is countries that have not adopted IFRS at all (not Adoption at all) namely Cambodia, Indonesia and Malaysia in 2011. The maximum value of IFRS Adoption is 4, which is the country that adopts all IFRS products and translates the word adoption, including Cambodia and Malaysia in 2012-2016, as well as Singapore and Myanmar in 2011-2016.

Table 2

Normality Test Results , Multicollinearity, Autocorrelation, Heteroscedasticity, T Test, F Test, and Determination Coefficient

| Variable | VIF | Sig. Abs Ut | t-statistics | Sig. |
|-------------------|------------|--------------------|----------------------|-------------|
| Lag_TP | 1,06 | 0.19 | -6,382 | 0,00 |
| Lag_IFRS | 1,0 | 0.62 | 2,300 | 0.02 |
| <i>Asymp. Sig</i> | | | | |
| <i>(2-tailed)</i> | 0.08 | | | |
| <i>Durbin</i> | | | | |
| <i>Watson</i> | 1,84 | | | |
| <i>R-squared</i> | 0.49 | | <i>Sig. Prob (F)</i> | 0,00 |
| <i>Adjusted</i> | | | | |
| <i>R-squared</i> | 0.47 | | <i>Observations</i> | 53 |

Based on the results of the classic assumption test, it was found that the data experienced autocorrelation problems. So to overcome this problem, the orcutt cochrane test was used to transform data(Transform Lag) , so that the amount of data is reduced by 1 (one) to 53 data that is free from autocorrelation problems and can be used to carry out further analysis.

Table 1.3 In addition, the data used juga free from problems of autocorrelation and heteroscedasticity with proceeds amounting to 1.843 D Watson urbine so classified as dU criteria $d < 4 - dU$ ($1.6359 < 1.843 < 2.3641$), the conclusion is that there is no positive or negative autocorrelation between residuals in the regression model used and the Sig. Abs Ut from the Glejser test results (for testing heteroscedasticity problems) the Lag_TP variable is 0.199 and the Lag_IFRS variable is 0.620. This AECNs that the probability significance value of all variables is above the confidence level of 5% (0.05), so that based on G hozali (2013) it can be concluded that the regression model used in this study is

free from the symptoms of heteroscedasticity.

The t-test results on the Tax Rate variable give the results of t-statistics = -6,382, sig = 0,000 indicating that the Tax Rate has a negative and significant effect on Foreign Direct Investment (FDI), which AECNs that a tax rate reduction in a country will increase Foreign Direct Investment (FDI) in the country. This negative correlation is in line with the results of research by Marbun & Martani (2015) which is the main reference of this study, Agnes Benassy Quere, Lionel Fontagne, and Amina L. Vesv (2003), De Mooij and Enderven (2005), and Slemrod (1991). Marbun & Martani (2015) state that the determination of effective tax rates that are quite low can significantly increase FDI inflows in the country. This result is also in accordance with the paradigm built by Dunning (2006), known as the abbreviation OLI (Ownership advantage - Location Advantage - Internalization advantage). The OLI paradigm provides a framework for explaining the rationalization of a company making

direct investment (FDI) as an option for its investment activities. In terms of location advantage, investors will be motivated to invest in locations or countries that provide high profits. This aspect of taxation is one of the benchmarks used in the selection of location advantage, by providing incentives in the form of a reduction in tax rates will provide the return on investment is higher so that the tax aspect may influence the decision of foreign investors who want to invest.

The t-test results on the IFRS Adoption variable give the results of t-statistics = 2.300, sig = 0.026 indicating that the adoption of IFRS has a positive and significant effect on Foreign Direct Investment (FDI), AECning that the increase in the IFRS Adoption rate in a country will increase Foreign Direct Investment (FDI) in the country. The results of this study support Lawrence A. Gordon's research, Martin P. Loeb, Wenjie Zhu (2012), and Laura Márquez-Ramos (2011). Where it is stated that the Adoption of IFRS variable affects Foreign Direct Investment (FDI). However, it is different from research from Uchenna Efobi and Mathias Nnadi (2015) and Damian Lasmin (2012) who say the opposite that IFRS does not affect FDI in developing countries. IFRS implementation can improve financial transparency and comparability, reduce information costs because of the lack of asymmetric information obtained by investors. The decision of a country in adopting IFRS as an accounting reporting standard in its country will increase Foreign Direct Investment (FDI), because foreign

investors will prefer to invest in countries that can provide relevant and transparent information for the continuity of their investments.

N value Prob Sig. Prob (F) as big as 0,0000 explained that based on statistical testing using a confidence level of up to 99%, by value adjusted R-squared is 0.472 so it can be concluded that the overall independent variable has an effect of 47.2% on the dependent variable, namely FDI inflows, while other factors not used in this study have an effect of 52.8% on FDI.

5. CONCLUSION

Based on the test results, the researchers concluded several research results, including:

Tax rates have a negative effect on Foreign Direct Investment (FDI) in countries registered in the ASEAN Economic Community (AEC) in 2011-2016. This AECns that a country with a low tax rate is seen as a location advantage, so foreign investors prefer AEC countries that have low tax rates in making decisions on their FDI flows.

The adoption of IFRS has a positive effect on Foreign Direct Investment (FDI) in countries registered in the ASEAN Economic Community (AEC) in 2011-2016. This AEC that foreign investors prefer AEC countries that implement IFRS as their financial reporting standard as the location of their investments. This is because IFRS can increase transparency, comparability, and reduce asymmetric information from financial reports which are the main tools of investors in making investment decisions.

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