Taxation in Indonesia its impact on foreign direct investment : a comporative study with that in China, Thailand and Vietnam

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Abstrak

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Foreign Investment is believed can accelerate economic growth especially Foreign Direct Investment. FDI has benefit to host country among others in:

- Improvement current balance due to capital inflow in foreign currency for initial activities and export proceeds (if any).

- Reduction of unemployment rate

- Increasing economic activities due to more people has more income.

- Bringing an international market access to local business.

- Increasing demand for domestic sources when raw material for production is supplied from local market.

On the other hand it will cost host country in inter-alia:

- Weakening current balance in the long run if profit repatriated is generated from domestic market.

- Diminishing local business that similar to what FDI business activities.
Survey of Foreign Direct Investment flow in 1998 states that Asia Pacific still a favorable place. Growing areas such as Latin America, East Europe will become a though competitor to Asia Pacific. Most of them remain unchanged their investment value in Asia Pacific even some will expand their investment. It is believed could initiate a faster economic growth for Asia countries (see: UNCTAD & ICC survey 1998 & Asian Development Outlook 1999 and ADO 2000).

Indonesia is among Asia Pacific country, which currently needs FDI. Since 1980 the trend shows a steadily increasing, but financial crisis started 1997 has totally change the trend. Now everybody believed that FDI could help to restore and accelerate economic growth.

From investor point of view, taxation in host country is part of their consideration before arriving to invest or not decision. Tax is a direct deduction to cashflow generated and repatriated to parent company.

Return from their investment is partly depends on taxation. Suppose MNC can make the sanie level of profit from operation, a heavier tax burden in one country could alter investment place to another country, which offered a lesser tax burden. Tax burden in this case is consisting of Corporate or Enterprise Tax and Dividend Tax.

Tax burden is heavily depends on tax rate applied and incentives offered related to that rate. There are some criteria used before granting an incentive. Those criteria could be become an instrument to achieve fiscal policy target. 1f one country has a certain target of unemployment rate, then labor-intensive FDI will get an incentive, because by attracting more labor-intensive FDI then unemployment rate could be reduced.

Another item in taxation considered, as the most important issue in cross-country operation is transfer pricing (see: Ernst & Young survey 1999). UnavailabilitY of transfer pricing detail regulations and capable persons to implement those regulations could lead investment into a higher level uncertainty. There are opportunities to generate more profits from investment on one hand and threat to be treated unfairly -means additional charge to investment return-on the other hand.

In brief, from investor point of view they need as low as possible tax rate or maximum tax incentives to minimize reduction to their return of investment, and a higher certainty in transfer pricing regulations and practices due to their cross border operation. Indonesian taxation in said above points shows a condition that is not conducive to attract EDI. We only apply one rate for corporate and dividend tax. It makes tax burden so general and applied to all kind of investment or business. There is no specific incentive available to attract FD1. Indonesian tax rate is not the highest but having applied possible incentive could be utilized, tax burden in Indonesia is the highest. It?s beóause there is no incentive to reduce tax burden. By doing this it seems that government of Indonesia will collect as much as possible tax regardless multiplier effect of investment. Incentive given will reduce government revenue in the short-term, but in the long run along with increasing economic activities, total revenue will be higher.

China has estabLished a detail transfer pricing regulations and personnel. Thailand is preparing those. Study says transfer pricing still occuffed in China. Indonesia has not yet had those and has a high tax rate. It will push investor to do transfer pricing due to a high tax rate that they try to avoid. Government will not collect an optimum tax because transfer pricing makes profit in host country minimum and corporate tax accordingly.