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# Evaluation of Tax Policy on Interest and Dividend of IPO

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**Abstract.** This research papers on the evaluation of tax policy interest loan and dividend of the company listed in the Indonesia Stock Exchange consists of five sections. (1). Introduction that describes the problem of conceptual and factual studies that led to the research problems were raised by writer. (2). Literature review presents several theories and key concepts which are used to obtain a theoretical answers and basic understandings to the problem of research. (3). Research method is operationalization of the steps to answer the research problem, data collection and data analyzing. (4). Research finding and discussion of research finding based on research problem rising. (5). Conclusions and suggestions may be given to related parties.

**Key words:** tax policy, tax treatment of interest and dividend, financing decisions

**Abstrak.** Penelitian ini berisi mengenai evaluasi kebijakan kredit pajak bunga dan dividen dari perusahaan yang tercatat di Bursa Efek Indonesia, yang terdiri dari lima bagian. (1). Pendahuluan yang menjelaskan masalah studi konseptual dan faktual yang mengarah ke masalah penelitian yang diangkat oleh penulis. (2). Tinjauan literatur menyajikan beberapa teori dan konsep-konsep kunci yang digunakan untuk mendapatkan jawaban teoritis dan pemahaman dasar terhadap masalah penelitian. (3). Metode penelitian ini adalah operasionalisasi langkah-langkah untuk menjawab masalah penelitian, pengumpulan data dan menganalisa data. (4). Temuan Penelitian dan pembahasan penelitian temuan berdasarkan masalah penelitian meningkat. (5). Kesimpulan dan saran dapat diberikan kepada pihak terkait.

*Kata kunci:* kebijakan pajak, perlakuan pajak terhadap bunga dan Dividen, Keputusan Pendanaan

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## INTRODUCTION

Tax policy has two-fold major functions: first, to be a source of government revenues or serve budgetary function and second function is to regulate or function of regulerend. The budgetary functions of tax is intended as a source of government cash flow and is considered state-treasury, while regulatory function is serving as a tool to achieve certain foals, to achieve that goal then tax policy tool implemented or a tool for development.

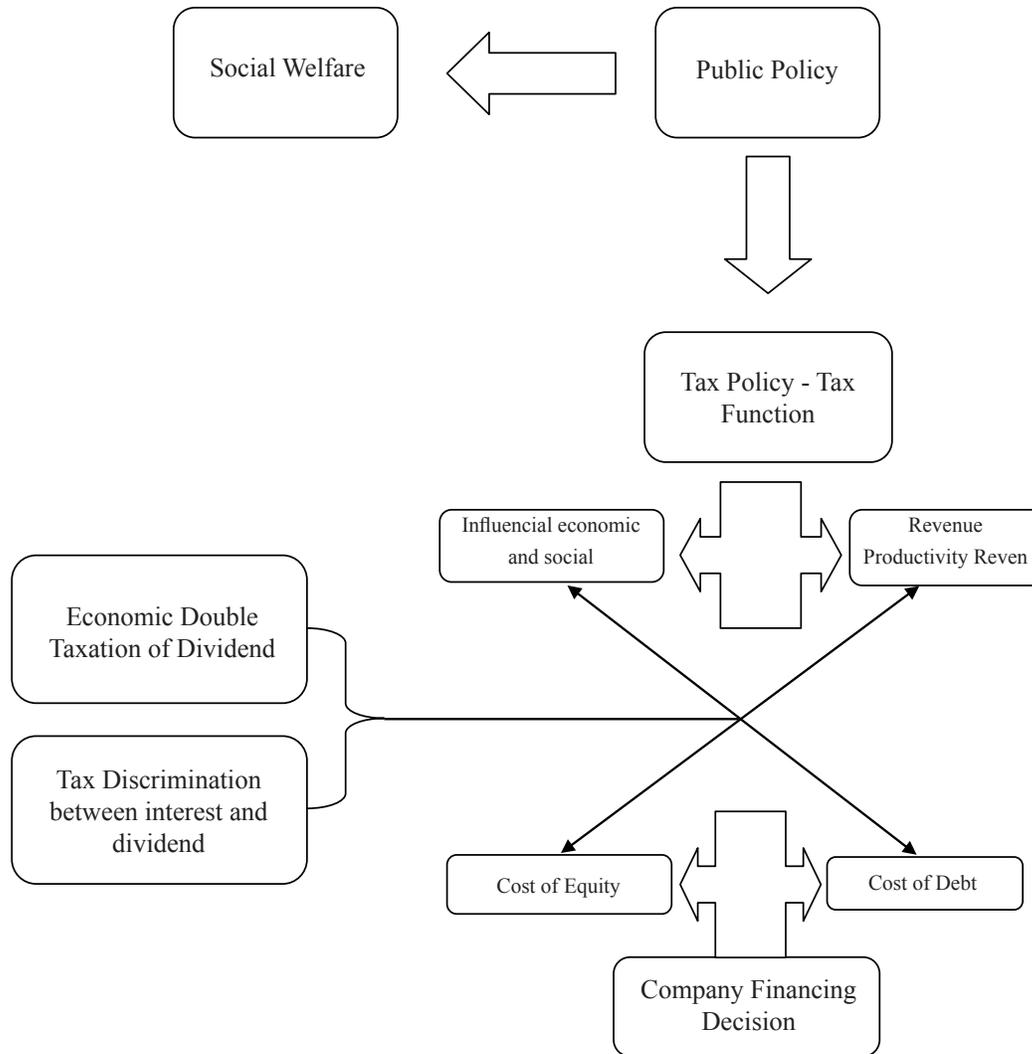
In regard to two main functions of tax, dividend tax or cost of equity and interest rate tax or cost of debt need to be studied and understood more in-depth. According to Article 6 paragraph (1) Income Tax Act of 2000 (Income Tax Act 2000), the interest of loan can be deducted from taxable income of the paying agent, while Article 9 paragraph (1) dividend are not deductible from taxable income of the paying agent. Therefore, it is result that for dividend, there is economic-double taxation and the tax is imposed on the taxpayer twice as profit and distributed as income.

The tax discrimination treatment causes the cost of capital for the capital stock tends to be more expensive than a loan. Theoretically in order to enhance corporate

value that is the value of the firm, the firm in implementing its funding policy of financing decision by using more debt as predicated static trade off theory or more using their own capital as predicated pecking order theory.

The Static Trade-Off theory is evolutionary theory or development of Franco Modigliani and Merton Miller theoretical contribution (MM, 1958). This theory assumes that the firm's capital structure is determined by the benefits of tax deduction when debt increases on one side and increased when the agency cost of debt increase on the other side. Assuming a trade-off theory financial management. Intuitively, the trade-off theory predict that in looking for a relationship between the value of corporate capital structure there is a degree of leverage (debt ratio) is optimal. Therefore companies will always try to adjust the level of leverage in the direction so that the optimal level of leverage the company to move on from time to time to the direction of a target to be achieved.

Static trade-off theory assumes that determination of a company's capital structure is determined by the advantaged and disadvantages of each of components that make it up (debt and equity). Three factors to be influential are the first in the presence of taxes. Second, there is likelihood the cost of financial distress (bankruptcy cost).



**Figure 1. Factual Problem**

Source: Researcher Elaboration Toward Factual Problems

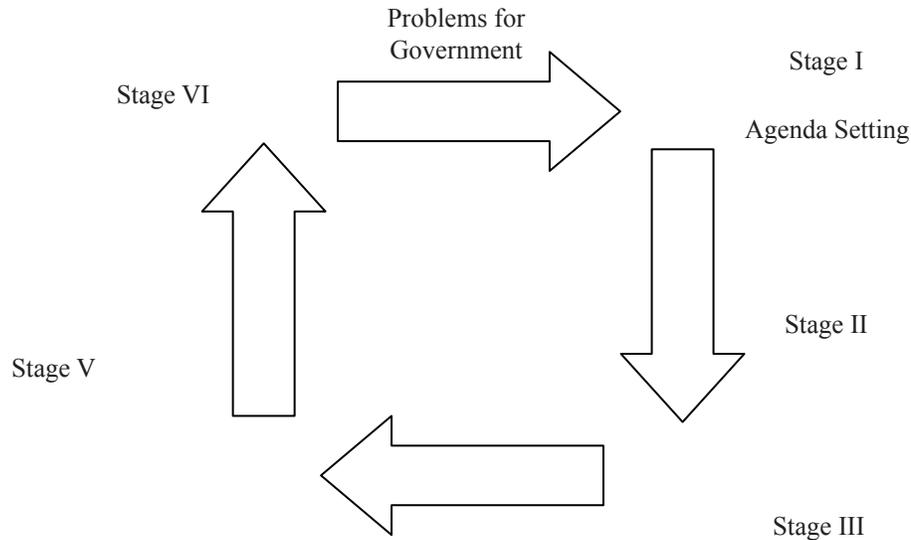
Third, the emergence of agency conflict between owners (principal) and managers (agent). Taxes affect the capital structure as debt interest are treated differently from the dividend. This means that in terms of taxation, debts has an additional advantage for the company in the form of cash flow available for a smaller tax. Thus, the relationship between the company’s tax shields and company value is positive.

On the contrary, another theory known to be the pecking order theory proposed by Stewart Myers and Nicholas Majluf (1984) stated that funding decision follows hierarchy in which the source of funding come from within the company or internal financing over precedence funding sources from outside the company or external financing, while the company’s using of external funding, the loans (debt) take precedence over funding with additional capital from new shareholders (equity).

Improvement of MM’s assumption (1958) there are no transactions cost raises the pecking-order theory

Hypothesis. This theory states that fixed transaction fee had to be paid. Therefore, the maximization of value is done by minimizing the cost of transaction. Company’s capital structure was an accumulation of past financial needs. Theory postulates that the financing of investment, there is sequences began funding such as the use of internal financing of accumulated operating profit last period. In case insufficient funding was sought, the company will be choosing from the least-expensive issuing instrument costs. For example, the issuance of debt or the issuance of the relatively expensive cost of issuance of convertible bonds. Last among least is the issuance of shares (equity). Shares is considered relatively expensive cost of issuance for a more complex procedure and requires the company issued several types of costs that cannot be avoided.

The existence of discriminatory tax treatment of investment funds between the cost of borrowing and the dividend could be expected to encourage practice of thin capitalization, which is funding a debt greater than equity.



**Figure 2. Policy-Cycle Picture**  
 Source: Lester and Stewart (2000)

Thus, it will result in failure of the government policy to encourage companies to become more financially healthy, and ultimately the loss of potential tax revenue as a result of debt-tax shields.

With the burden of loans that are too huge for the company, the debt-tax shields through a policy of raising loans (thin capitalization) in addition to debt-tax shields, utilizing discriminatory from tax treatment of interest and dividend can also be used to get around to reduce the tax burden from the highest layers to lower layer, especially for companies with profitability or profitable company.

In fact, this study takes the object of the companies listed in the Indonesia Stock Exchange, where capital markets are concerned with the activities of public offering and trading of securities. Institutions related to capital markets including public companies that issue debt securities as well as equity securities traded for individual and institutional investors. There are also professional bodies supporting capital markets such as notary, legal consulting, Public accounting firms, custodian central affects, and clearing securities underwriters.

In accordance to the capital markets, the investment can be realized in the form of capital market activities are well-order, fair and efficient as well as protecting the interest of investors and the public. Two main functions of capital market are: first, capital market means funding for companies to obtain funds from the public. Second, capital market can be increased economic growth through investment financing that is cheap.

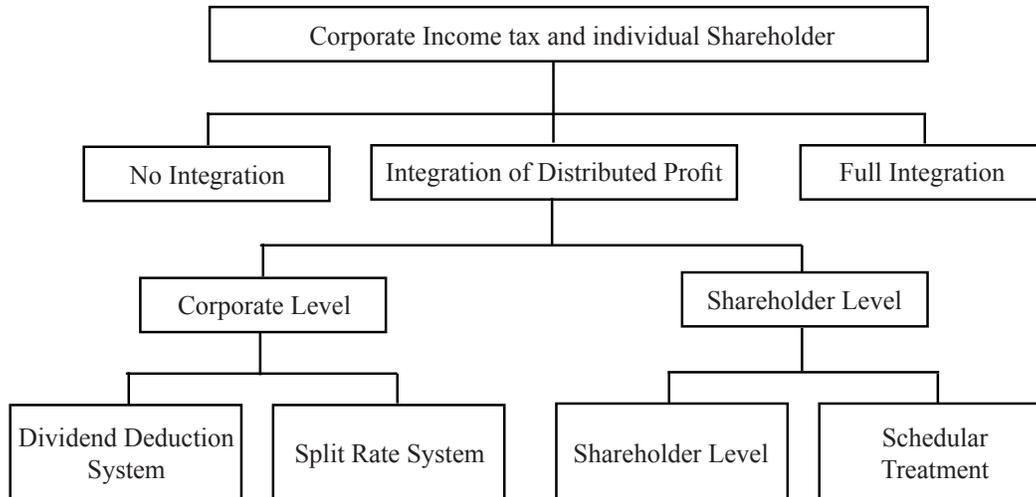
For each decision, companies always have to pay attention to the benefits of various alternative decisions. The funding decision may be through issuance of shares,

through a loan, may even be combination funding through loans and the issuance of shares. Important factors examine whether existing tax policy became the basis of the company's management in making decisions. Figure one present to share the factual problem in this study.

In this regard, researcher are interested to raise the taxation study on interest and dividend of the company listed in Indonesia Stock Exchange (hereinafter referred to as BEI). In addition, the researcher are intended to analyze the funding decisions by companies listed in the Stock Exchange. Researcher also want to analyze the tax implications rising as a result of corporate financing decisions of public choice.

This research papers on the evaluation of tax policy interest loan and dividend of the company listed in the Indonesia Stock Exchange consists of five sections; (1). Introduction that describes the problem of conceptual and factual studies that led to the research problems were raised by writer; (2). Literature review presents several theories and key concepts which are used to obtain a theoretical answers and basic understandings to the problem of research; (3). Research method is operationalization of the steps to answer the research problem, data collection and data analyzing; (4). Research finding and discussion of research finding based on research problem rising; (5). Conclusions and suggestions may be given to related parties.

The emergence of public issues are starting point in order to the governments make policy decisions. The public issues problem arises because of the imbalance between demand factors and the availability of facilities. In formulating a policy, the sequence needs to be followed



**Figure 3. Relationship Corporate Tax and Shareholder of Company**

Source: Clossen (1993)

from the formulation of the problem and end with the termination of the policy. Lester and Stewart (2000) set six steps in the policy stages. At the stages agenda-setting, policy-makers will gather public issues. After knowing problems that have been collected, analyzed and followed by the preparation of policy making.

The next cycle is implement this policy in the community and is followed by evaluating, by analyzing the result of the evaluation, then made adjustments or changes to improve this policy. The final step of the cycle is to end the policy-making because the goal has been reached. Furthermore, Lester and Stewart describe the Policy Cycle as follows:

Dividend treatment under the tax laws as benefit was received by the shareholders and it should be treated as taxable income. Although dividend is the element of profit that had been taxed as income dividend to shareholders at the individual or entity with certain conditions imposed income tax again, and thus potential for double taxation is going to be inevitable. Double taxation tend to be less attractive to investors. Investors tend do not to ariset up the company, because the double taxation imposed, or management tend not to distribute dividend, but the profits are reinvested to other projects.

The relationship between corporate tax and shareholder of the company (individual shareholders) can be illustrated by the following illustrations below:

The first relationship is considered can not be integrated at all (no integration) or so-called classical system. No integration or classical system assumes that the corporate income tax and personal income tax is different so does not need to be integrated. The second relationship is the integration of distributed profits means profits are divided into two kinds that are for

corporate and for share holder. Thus, implied only once that dividend can be deducted against taxable income that more equal treatment so the interest expense that is allowed as a deduction from income. Such second relationship is known as the dividend deduction system.

Another approach is the way of split rate system, which is taxed to reduce impression of giving two times the tax rate on dividend deduction lower than the rate of profit is not shared. For the stockholders, in order to lightening the tax burden on dividend made by the way of imputation (imputation system), where shareholders can potentially receive a tax burden.

Mc. Lure (1979) asserts that imputation system is the method to minimizing tax burden of payment on corporate profits, corporate profits may be credited to the shareholder. If fully credited, it is called full imputation, if only partially known by the partial imputation. In terms of taxation in Indonesia in accordance with the Act (Act) No.71983 and amended several time and last amended by the Act No. 362008 is embracing the classical system, where the corporation is considered separate authority with few exceptions, if the corporate shareholder have ownership the lowest 25 percent of the paid-up capital, therefore dividend are not taxed.

In general financing need scan be full filled from two sources, the first source comes from their own capital or loans from financial institutions, like banks loan or the public investor in term of bond. In every company there is always the element of funding costs. The cost basically means how much sacrifices can be made to find out alternative funding for the company and this sacrifice can be measured by monetary value. When company esuse alternative financing through loans, it appears the cost of interest namely interest expense with certain amount of

**Table 1. Previous Research Findings**

Study	Research Question	Method of study	Research findings and its implication
Baskin (1989)	<ol style="list-style-type: none"> <li>1. Was firm financing decision more optimizing its cash-flow occurred (peaking order hypothesis)?</li> <li>2. Was investment opportunity effect the firm financing decision??</li> <li>3. How the impact of dividend before period to current deb?</li> </ol>	Multiple regression	<ol style="list-style-type: none"> <li>1. Firm its own capital (free cash flow) which one of the source is profit.</li> <li>2. The relation between profit and debt is negative, due to here are not optimal capital structure (static trade off hypothesis) not proven</li> <li>3. The relation between past dividend and current debt is positive, so if there was dividend payment before, current condition would need more cash funded possibly by debt</li> </ol>
Homaifar, Zeit, Benkato (1994)	<ol style="list-style-type: none"> <li>1. Homaifar Zeit Benkato extended Bradley Jarrel and Kim (BJK, 1984) and Titman-Wessels (1988). BJK run regression to understand tax effect -as hypothesis's DeAngelo and Masulis (1980)-proxy variable Non Debt Tax-Shields (NDTS). Regression is performed by firm specific debt to value ration and NDTS</li> <li>2. The study identified capital structure determinant that estimated based on long run steady state equilibrium. The new estimate predicted more robust than short-run contemporaneous relationship</li> </ol>	<p>Multiple regression with panel data</p> <p>Autoregressive Distributed Lag Model</p>	<ol style="list-style-type: none"> <li>1. Several firm specific and economic condition impact to debt ratio: corporate tax rate correlate positive with debt, NDTS negative, size positive, capital market condition negative, interest rate positive and earning volatility still question marks</li> <li>1. By using autoregressive Distributed Lag would be estimated long term coefficient to short term coefficient. The estimation result are: corporate tax rate positive significant, NTDS negative not significant, growth negative meaning pecking order hypotesis proven, capital market condition negative (capital market product is substitute to debt), inflation rate is positive not significant and earning volatility negative significant</li> </ol>
Nainggolan (2009)	<ol style="list-style-type: none"> <li>1. Had tax determinant effect toward long term debt growth and total debt of public company in Thailand, South Korea, Indonesia (combine) and each countries and aggregate industry sector?</li> <li>2. Had tax determinant effect toward long term debt growth and total debt of public company in Thailand, South Korea, Indonesia in regard to using debt tax-shield in order to tax burden combination 3 countries, each countries and aggregate industry sector?</li> <li>3. Had relaxation of MM's basic assumption consist of information symmetry, the same interest between manager maximizing the value of the firm contribute to better result toward tax determinant empirical test to long term debt growth.</li> </ol>	Multiple regression with Panel Data	<ol style="list-style-type: none"> <li>1. Tax determinant factor proxy with Marginal Tax Rate (MTR) effected long term debt growth in combination panel data. In the country result, tax determinant factor only impact for South Korean companies. In industry sector result indicate, tax determinant factor effect South Korean and Thailand's manufacturing industry. For the constuction sector, tax determinant factor significant for combination 3 countries, however the result not significant in each countries. In other sectors, tax determinant factors not significant.</li> <li>2. Bussiness profitability is not fostering debt in order to get tax shield (debt will reduce tax payment), while profitability is proxy by profit margin. For the company in every countries, high profitability and all industry sector had internal source of fund as postulated by pecking order theory</li> <li>3. By using variable Effective Tax rate (ETR) as proxy tax determinant factor, the empirical result showed tax factor not effect to debt growth each countries and each sectors. By using control variable agency problem and signaling hypothesis indicate different contribution in each countries and each sector in order to indicate the dynamic of dependent variable</li> </ol>

money owed to the owner of the funds.

For the funding side, compensate on for the owner of the fund (surplus funders) is the dividend. Damodaran (1997) defines dividend to be “ as any cash returned by a business to its owner”. Dividend payment will be obtained for the stakeholders, there for edividend is not just cash dividend, but can also be a stock dividend.

The theory of financing decisions become primary literature of this study is leading to the most important theory of capital structure: Static trade-off theory and Pecking-order theory. The two- theory developed from the classic research of Modigliani-Miller. Franco Modigliani and Merton Miller (MM) concluded that value of the firm is not affected by the capital structure of the firm. Basically, MM assumed the value of a company is not determined from the capital structure- combination of debt and stock-rather than firm's asset. Thus, maximization of the firm value is determined by firm's investment decision that will generate cash-flow for the company, instead of the method of financing investments.

MM have underlying theory on the assumption that capital market is perfect or perfect capital market, thus several number of conditions have to be full filled. The assumptions-use dare difficult to be full filled in reality and therefore become a fundamental source of critics. At the same time developing other theories are rooted in relaxation of the assumption of perfect markets and so on.

Static trade-off theory assumes that determinant of the firm's capital structure is determined by the advantages and disadvantages of each of the components essential for company's capital structure-debt and equity. Relationships postulated between the company and the tax shield is positive according to static theory. But the other side of the coin, presence of the debt for the company will be incurring the bankruptcy or financial distress costs.

Financial Distress Cost arises when a company has debt in its capital composition. This cost consists of two parts: first the bankruptcy administration cost is including attorneys fees that the management time used for administering this financial distress process. Second, the cost is not visible in the form of loss investment opportunities. Given the risk of bankruptcy, the company will change its investment policy. This will directly result in changes to the future-plan investment will have an impact on the company's decline in value.

The trade-off theory states that there is a need for an optimal composition of the balance between the advantages of use of debt and bankruptcy risks rising in line with the creation of debt. Studies that using the trade-off theory, among others: McKie-Mason (1990) and Graham (1996).

Pecking-order theory was first introduced by Myers

(1984), this theory is built on several assumptions and empirical evidences about the company's financial activities as follows: first, the company's dividend policy is sticky means not easy to go up or down. Managers are always trying to keep the dividend per share has not changed despite temporary fluctuations in corporate profits. Second, firms prefer internal sources of funds that is retained earnings and depreciation as compared with external funding varying from debt to equity.

Third, if you have to use external funding sources, the company will choose the safest (low-risk) securities. Fourth, when need for substantial external funding is critical, the company will select the securities issued by the following sequence: the most secure debt, higher-risk debt, convertible securities, preferred stock and the last common stock. Pecking order models put more emphasis on the motivation of manager rather than the principles of market valuation (Arifin, 2005). The pecking order theory was motivated several studies such as Baskin (1989) and Myers and Majluf (1984).

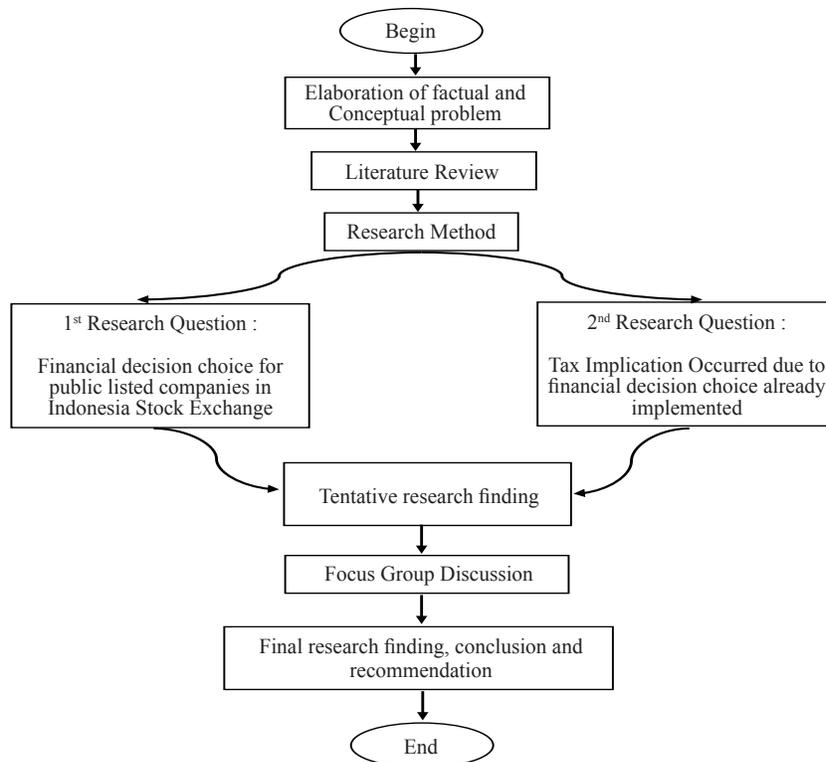
The Paragraph below is a detailed elaboration on the previous studies about financing decisions of public companies in the form of a summary table of previous research. Previous studies include a summary description of the first, the research questions and the researcher proposed, secondly, the methods used to answer there search question. Thirdly, the results or research findings and implications of research findings.

What are Differences in this study with previous research in related to the theoretical background used, the time of the study, and research's implication. First, it was related to the theoretical background of this study uses the theoretical basis of Baskin (1989) that incorporated the paradigm of financing pecking order theory.

Second, this research time period lasts much longer approximately 8 years of observations from 2000 to 2007, quite different than the Nainggolan study using shorter study period (2000-2005) but Nainggolan's study using a cross-country research study in Thailand, South Korea, and Indonesia. Third, the differentiation of research implication of this study more focused on the stakeholders in making tax policy, among others: are the Directorate General of Tax and Capital Market Supervisory Agency-Financial Institution.

## RESEARCH METHODS

The researcher use mix method approach to answer the research problem. The mixed method combines qualitative and quantitative approaches. Two approaches were undertaken to answer the research questions that are not fully be answered with one of two approaches, and



**Figure 4. Research-Schemachart**  
 Source: Research Adaptation from Previous Studies

indeed the practical research problem, it is often difficult to completely distinguish the two approaches.

Green, Caracelli, Graham (1989), ascitedin Cresswell (1994), mentions five goals combined approach of quantitative and qualitative, amongothers: (i). Triangulation aims to find a convergence of research, findings, (ii). Complementary that will become complement other dimensions of the phenomenon of new research findings emerge. (iii). Development between the methods of research will foster implementation of other research methods. (iv). Initiation which result conflict and new ideas popping upon the series. (v). Expansion where the combined method and the scope and depth of study are full-filed.

In order to get a complete and comprehensive information of the research object,the researcher will use numerical data from the companies financial statements for the period 2000-2007, data or graphics from a variety of publishing the official report of the Indonesia Stock Exchange and data from companies publication or other relevant sources.

Necessary data in the study that include: (i). Primary data in this study is the amount of corporate debt, total equity, net profit, total assets it possesses, the level of corporate profits, interest expense, income taxes and others. (ii). Secondary data in the form of rules of law,

decrees and regulations which are in the hierarchy below. Apart from numerical-data collection, researcher also conducted focus group discussions (FGD) involving a variety of key informant as speakers consisted of: managers of securities companies, tax consultants, tax and financial management academician and last but not least, the Directorate General of Taxation.

Focus group discussions aimed to obtain a comprehensive picture of research topics mainly related for strengthening and the triangulation of the quantitative findings that have been made. So this study varied in terms of getting useful results reinforce the prevailing theory of policy funding decisions policies: static trade-off or pecking order

In order to analyze how the choice of public company regarding to their funding decision and understand financial decision which is more influentialby using their own capitalnamely free cash flow hypothesis or use more debt in their financial decisions, the research uses Baskin’s model (1989). This study uses variable income with additional debt and other explanatory variables adapted to the findings of a studyin Indonesia’ scapital structure, in example Chandra’s study (2007). In order to test the pecking order and static trade-off can use multivariate regression equation (1) follows (Asnawi and Wijaya, 2006):

**Table 2. Summary of Research Findings**

Variable	Leverage	Debt	R2
Earning	-16.228*	-15,882*	0.506(Leverage)
Size	22.911*	21,199*	
Profitability	-7.489*	-6,489*	0.512 (Debt)
<i>Interpretation</i>			
Leverage/Debt Earning	(-) significant	Packing order hypothesis that can explain financial decision of public listed company	
Leverage/Debt Size			
Leverage/Debt	(+) significant		
Profitability	(-) significant		
Leverage/Debt Growth			
Opportunity	(-) significant	Growth opportunity would be financed with company own capital	

\*statistically significant by 95% confidence level

**Table 3. Summary of Tentative Research Findings**

No.	Research Question	Tentative Findings
1	Financial decision choice for public listed companies in Indonesia Stock Exchange	<ol style="list-style-type: none"> <li>Based on multiple regression, the result stated that financing decision choice for public listed companies in Indonesia Stock Exchange tend to follow the pecking order hypothesis, meaning company is more prefer using its own profit accumulation to operate their business operation</li> <li>Interest Loans treatment for the company (corporation since the tax ordinance of 1925 up to Law No. 7 of 1983 on Income Tax, as several times amended the latest by Law No. 36/2008, interest on the loan is treated as expenses (cost) and interest are deductible in calculating taxable profits. This provision applies in general, both listed companies or non listed companies.</li> </ol>
2	Tax implication occurred due to financial decision choice already implemented	<ol style="list-style-type: none"> <li>For companies which having loans and placements on deposits, with deposit amount equal to or greater than the loan, the interest loan do not recognized as an expense. If the deposit is less than the amount of the loan, the interest cost is recognized in proportion.</li> <li>Dividend treatment such a component of income for the recipient had expressly stipulated in Law No. 7 of 1983 on Income Tax which has been several times, the last amended by the Law No. 36/2008. Dividend payment for the company had also been stipulated in the Act since the ordinance Corporate Tax and Income tax Act are applicable.</li> <li>There was no difference in the treatment of dividend paid to companies listed or non-listed which the dividend is not charged, so dividend should not be deducted in calculating taxable income.</li> </ol>

• leverage  $t_{i,t} = \alpha + \beta \text{ earning}_{i,t} + \beta X_1 + \dots + \beta X_n + \varepsilon$

Statistical-hypothesis:

$H_0$  = The earning do not increase leverage (pecking order hypothesis :  $\beta \leq 0$ )

$H_a$  = The earning increase leverage (static trade — off hypothesis :  $\beta > 0$ )

$Leverage_{i,t}$  = Ratio of debt plus debt and working capital firm-i for the fiscal year t,

$Earning_{i,t}$  = Profits for firm-i infiscal year t

The other independent variable is determined based on previous empirical research findings include: (X1) Firm Size, (X2) Profitability, (X3) Growth Opportunity.

In addition to the multivariate regression equation (1), researcher used a multivariate regression (2) as follows (Asnawi and Wijaya, 2006):

$Debt_{i,t} = \alpha + \beta Earning_{i,t} + \beta X_1 + \dots + \beta X_n + \varepsilon$

Statistical-hypothesis:

$H_0$  =The earning reduce firm-debt (pecking order hypothesis:

$H_a$  =The earning do not reduce firm-debt (static trade-off hypothesis:

$Debt_{i,t}$  = firm-i’s total debt for the fiscal year t

$Earning_{i,t}$  = profit earned firm-i’s in fiscal year t

X1- Xn = the other independent variable is determined based on empirical findings of previous studies include: (X1) Firm Size, (X1) Profitability, (Xa) Growth Opportunity

In this study, the population is a publiclisted company of the Indonesia Stock Exchange between 2000 to 2007. The research sample are 109 public listed companies with the following criteria: (1). Companies finance its operation by funding mechanism not used its retained

earnings during the period 2000-2007. (2). Companies had never delisting from the Indonesia Stock Exchange. (3). Companies had a complete financial statement compiled in Indonesian Capital Market Directory (ICMD) to the verification has been made to the issuer's financial statements to the Indonesia Stock Exchange and Bapepam-LK. (4). Companies included in the category of eight sectors of the Indonesia Stock Exchange industry classification, exclude the financial sector

Based on the criteria above and using specified sampling method, researcher had obtained sample of 109 public companies. Meanwhile, to conduct the research will be explained through several stages in this research-schema chart.

## RESULT AND DISCUSSION

Based on secondary data findings consists of the relevant regulations on tax policy of loan interest and dividend starting 1925 in the era of company tax ordinance up to Law Number 7 Year 1983 on Income Tax which has been amended several times and latest by Law Number 38 Year 2008. Treatment of interest is consistently regarded as a burden that can reduce the cost of implicitly for the period 1925 to 1983. The loan interest is explicitly stated that one element of cost can be deducted in calculating taxable income for the period 1984 to present.

Cash dividend was made by any company whether listed or unlisted companies, so that participation in capital markets had become indifference. Cash dividend is not considered a cost for calculating the corporate income tax for the period 1925 to 1983. The regulation provision does not clearly, concisely and implicit. The Government has issued government regulation (Perpu) No.12/1959 and Tax Law on Interest, Dividend and Royalties (PBDR 1970). Tax legislation has a clear, unequivocal and explicitly mentioned that dividend paid by companies is not a deduction from gross income fee (non-deductible expense) for the period 1983 to the present.

Based on description literature review above, the government had consistently since the 1925 company tax ordinance until the newest regulation in 2009 that embraced classical system. The classical tax policy system had been acknowledged for twice or double taxation, because when the company earned profits are taxed and when divided by the shareholders subject to tax again. This policy tends to encourage controlled-shareholders never distributed the dividend, there by encouraging private shareholders to invest. Investors tend not to set up the company, because the double taxation imposed and the company management tends not to distribute dividend, but the profits are reinvested.

Funding decisions which are often used by the

publicly listed company of the Indonesia Stock Exchange, whether using static trade-off theory (balancing / debt-taxshield) or using its free cash-flow according to the pecking order theory, then researcher conducted a multivariate regression testing. Based on the results of a multivariate regression testing has been conducted by researcher, the relationship between the variables could be summarized as above.

The result for effect of selected variable toward leverage and debt can be summarized as follow: (1) Leverage and debt are significantly negatively correlated with income, means the greater the profit the company can easily reduce more debt; (2) Leverage and debt are significantly negatively correlated with rate of profitability return, means the greater ability of the company's profitability may reduce the amount of debt; (3) Leverage and debt are significantly positively correlated with firm size, means that the larger the size of firms the greater ability to get loans; (4) Leverage and debt are negatively correlated with growth opportunity, means the greater growth opportunity use less debt to finance company's investment because company can use its own capital.

Result findings of this study that is related to the choice of a public company financing decisions had confirm similar studies both within and outside the country, in example: Baskin (1989), Homaifar-Zeits-Benkato (HZB, 1994) and Chandra (2007). The choice of funding decisions for publicly listed company followed the pecking order hypothesis. With evidences that encountered significant negative correlation between debt to earnings, the profitability, then strengthen by significant negative effect of growth opportunities, which the company's expansion funded over funds from internal sources rather than external ones.

The research funding confirmed that negative correlation between current earning and the level of corporate debt. So that, the finding also given imperative that companies tend to optimize their own funds known to be free cash flow that one of the free cash flow is income. Because the composition of debt and equity could not be in certain amount, then the static optimal capital structure trade-off hypothesis not valid (Baskin, 1989), so the pecking order hypothesis could give better explanation on how the public listed company decide their financing decision choice/policy.

Researcher conducted Focus Group Discussion (FGD). And the results related to the choice of financing decisions of public companies listed on the Indonesia Stock Exchange, in order strengthen the quantitative data findings, interviewees expressed agreement with the main findings as follows:

"This is the characteristics of the public company was said to be in line with theory. That is fully correct the

result is, huge size of the company is impact to the ability of firms to pay dividend, is fully correct (FGD results, with academician and tax practitioners)”

In line with the statement from tax practitioners, the second focus group also expressed agreement with the choice of corporate financing decisions that come from internal sources for instance retained earnings with the statement:

“From what you have found was reasonable. If our cost of funds for financing through bank loans is very high so companies prefer internal sources. That was always the case in Indonesia’s capital market. (FGD results, with securities company analyst and capital market participants)”

Above two statements above, there searcher stated that the findings of research on funding decisions according to the rules of the pecking order is precisely the convergence of opinion between statistical test and FGD results. Another finding from FGD is the additional coverage evaluation tax policy on loan interest and dividend for multinational companies. The multinational companies will operate differently from public companies listed on the Stock Exchange, because the strategy of multinational companies in the funding will be influenced a variety off actors, including tax planning run by the parent company.

The practice of corporate financing decisions between different industrial sectors will diverse as well. In the crude palm oil (CPO) sector which its operation based plasma choose to distribute loans from banks prior to the affiliated company- a subsidiary CPO. Eventually, that financing practice will lead to different funding options.

Additional in sight for researcher also received from the focus group findings. Input derived from analysts who had unconventional sources of funding such as the repurchase agreement or Repo to obtain cheaper funds than bank loans in these two statements below:

“Then the repo itself that should be included, as some people here had already admitted it. And several supporting criteria could already produce debt. Only the main problem is that pension funds shouldn’t be doing the repo, but the big companies or state-owned company could issue a repo, repo could be used as instruments (FGD results, with securities company analyst and capital market participants)”

Also a statement as follows:

“There are some instruments in the capital markets, such as Repo or Employee Management Option Plan, I think they are actually part of a financing behavior of listed companies. For example, when it reduced its liquidity, so liquidity would be influenced the process for company’s financing. (FGD results, resource analyst with the company’s securities and capital market players)”

Therefore, with increasing number of non-conventional financing instruments such as repo, cash pooling or pool fund, as well as advanced instruments that emerged from financial innovation. This positive development in the future is needed to be observed and regulated by the government and the regulator such as Directorate General of Taxation and also capital market financial institution supervisory agency. This advanced level of financial should be benefit to the development of non- bank financial instruments.

From the author’s study literature on the treatment of loan interest for the company (corporation) based on tax ordinance of the Company since 1925 to the Income Tax Law No.7/1983 as several times amended and the latest amendment by the Law No. 36/2008. The loan interest is treated as interest expense may be deducted in calculating taxable income. This provision applies in general, for both listed and non-listed company. Especially for companies that have a loan at the same time and placement of the deposit, where the deposit amount equal to or greater than the loan, the loan interest does not recognized as an expense. In case of deposit less than the amount of the loan, the interest cost is recognized in proportion. By limitation provision of such interest cost, the possibility of acting thin capitalization will be less.

The dividend treatment as a component of income for the recipient ad expressly stipulated in the Act No.7 /1983 on Income Tax as amended several times the last Law is Law No. 36/2008. Dividend payment for the company had also been stipulated in the Act since 1925 through corporate tax ordinances and law. There was no difference in the treatment of dividend paid to companies listed or non-listed, therefore it should not be deducted in calculating taxable income.

Thus, there is no implication different between listed companies and nonlisted companies. For the individual receiving dividend will taxed at 10 percent rate final, and when distributed to corporate entity with an ownership stake of more than 25 percent and it was active company then exempt from it. Implications of the regulation will probably end not to divide dividend for the company’s majority shareholder if most shareholder corporate-based. Another implication is the existence of double taxation in the taxation of corporate income.

From researcher’s finding there is corporate financing policy from 2000 to 2007, tend to follow corporate policy based on the pecking order theory. Then corporate tend not to do tax planning by increasing borrowing, in term of thin capitalization, is not proven. There is set of rule governing loan interest is limited as a cost item for the company. While company at same time placing deposit, tend to reduce tax evasion probability. With above description,

researcher appreciate the government's policy to suspend debt equity ratio provision is appropriate.

Theoretical implication of this evaluative research related to finding sand implications for future studies. The findings of this study confirm result of previous research in the Indonesia (Chandra, 2007) foreign researcher (Baskin,1989) that the pecking order theory is able to explain the effect of income on the level of corporate leverage. For further research, evaluation study under theme of tax policy needs to improve classification of public companyased on market capitalization and ownership structure. Next researcher also needs to further enrich and deepen the study of tax policy evaluation on interest and dividend, especially in the various multinational companies appear in the discussion. The later findings will be adding our knowledge and stakeholders understanding on the tax practices of multinational company the holding company.

Managerial implication for the Directorate General Taxation is the government policy through the Directorate General Taxation on Debt to Equity ratio does not restrict with particular ratio is appropriate. Although important to note the behavior of corporate funding had been developed, sophisticated, and constantly innovating, publiclisted company is no exception. Tax policy on interest rates and dividend policies have been more detailed from period to other period. Clarity of tax treatment should be based on clear legal basis and policies that urgent follow the development of corporate financing and innovative instruments. Innovative financing scheme will be increasingly necessary in the future. Tax contribution is projected increased for national development, while giving maximum opportunity for the company to keep growing and more profitable.

Managerial implications for public company is based on our research the company should consider the tax deduction, in capital structure literature tax shield, to be adopted view form static-trade off theory. Beside the internal funds which are considered proxy peckingorder theory. Although this is idea not necessarily in same favor of tax authorities (government). Because this company decision will probably reduce tax revenues as a result of higher interest costs and will reduce the potential tax revenues.

Managerial implications for the Capital Market and Financial Institution Supervisory Agency (Bapepam-LK) is non-conventional sources of funding are part of capital market instruments to obtain cheaper funding than bank loans. Among other short-term instruments such as Repurchasing Agreement (Repos) - Reserves, cash pooling, stock replacement salary instead of bonus shares and advanced instruments requires foresight and

proactively participation of Capital Market and Financial Institution Supervisory Agency to set good strategy dealing with vast financial innovation. This research also implied to provide protection for as many as possible individual investors from sophisticated capital market products.

## CONCLUSION

Based On this research, we could understand the financing policy of company listed on Indonesia Stock Exchange for the period of 2000-2001 adopted pecking order theory. The result indicated companiest end to use their own funds of accumulated earnings to finance their company's operation. The study also found that there is no indication of thin capitalization practices undertaken by companies listed on the Stock Exchange. The study concluded that the policy of suspension implementing Debt to Equity Ratio (DER) for tax purpose to the Indonesian listed companies tend to be very relevant. Because tendency of enlarging the loan, or tax expert titled thin capitalization, in publiclisted companies is not proven.

For companies that are corporate tax payer listed on the Indonesia Stock Exchange better using loans as a funding source. The companies will enjoy a lighter tax burden because the burden of loan interest can be deducted as an expense (deductible). Dividend payments for public companies that are corporate tax payer are required as element of profit sharing. And profit sharing for beneficiaries will subject to income tax, except for corporate tax payers who meet certain requirements in accordance with regulations.

The recommendation could be addressed to correct deficiencies found while following on going research. Recommendation aimed for particular parties: (1) For Capital Market and Financial Institution (Bapepam-LK): The government still have to supervised financing behavior of companies listed on the Indonesia Stock Exchange. The supervision is in order to anticipate probability of corporate tax payer increase their company so that potential tax revenue is reduced. The Behavior of financing decisions is repeated financial decision choice. (2) For Directorate General of Taxation (DGT): The government should consider the benefits acceptance system of Integration of Distribution Profit, therefore will be reducing the excessive tax burden. Restriction policy on the loan, not ably for the company listed in Indonesia Stock Exchange, there is no tendency lending excessive. Directorate General of Taxation should still be cautious when making policy restrictions on lending should not be general, but have to be specific what kind of business or

industry they operate. Certain industries such as mining are likely to require larger loans than service industries. (3) For Public Companies: Public companies this occasion is the Indonesia Stock Exchange member of listed companies may consider the tax deduction or tax shield to adopt the static-trade off theory. Although this decision may not necessarily benefit the government because it could be lowering tax revenue as a result of higher interest costs that could reduce the potential taxes government will be accepted. (4) For further research: next researcher needs to further improve the classification of public enterprises to focus the study by market capitalization and ownership structure. Next researcher need to enrich and deepen the study of tax policy evaluation on the interest and dividend on a variety of multinational companies into holding company. Only by discussions and more findings will enrich the knowledge and understanding of the practice of taxation of multinational companies.

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