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RESEARCH ARTICLE

CORPORATE REACTION ON NEW TAX LAW: CASE STUDY FROM INDONESIAN CAPITAL MARKET.

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Abstract

The purpose of this study was examine property and real estate company reaction on new tax law. The author uses window period two years before and two years after implementation of new tax law. Population of this research is property and real estate companies listed on Indonesia Stock Exchange. Thirty two companies are taken as sample. The result of Paired Sample T-Test shows that the discretionary accrual before and after implementation of new tax law statistically different. This implies that property and real estate companies are indicated take earnings management

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Introduction:-

In 2007 Indonesian government has made changes in taxation law. One of the new tax regulation is Act No. 36 of 2008 regarding income tax. This regulation described that the income derived from real estate business is final taxable income. The implication of this regulation is the amount of income tax for real estate based on any sales made. The new regulation stated that the income tax rate for property and real estate business is 5% of the transaction gross amount.

This new regulation will be very beneficial for real estate companies because the company's effective tax rate becomes smaller. If managers seek to maximize firm value by minimizing the tax burden, this regulation will benefit for managers (Subagyo and Octavia, 2010). Setiawati in Saputro and Setiawati (2004) revealed that managers tend to postpone recognition of income prior to the enactment of new tax rates in order to minimize the amount of taxes paid.

Many researchers have done studies on corporate reaction related to changes in tax policy. Mo and Yue (2008) conducted research related to earnings management actions undertaken by Chinese companies in anticipation of a decline in corporate income tax rates. In their research, Mo and Yue (2008) concluded that companies in China convicted of earnings management to report smaller profits prior to imposition of tax rate reduction.

In addition, Lu, Lin, and Zhang (2007) conducted a study related to the same thing. Lu, et al. (2007) tested the effect of changes in income tax rates on earnings management. Lu, et al. (2007) found that companies in China conducted earnings management before income tax rate reduction. Lin, Lin, and Tsai (2004) also conducted a similar study in Taiwan. Lin, et al. (2004) examined earnings management related to tax rate changes in Taiwan. The results of this study found that companies in Taiwan conducted earnings management in the early years of the implementation of new tax rate.

In Indonesia, research on associational between earnings management with changes in tax policy have been made by Wulandari, Kumalahadi, and Prasetyo (2004). Wulandari et al. (2004) examine earnings management actions undertaken by the company related to tax rate reduction. The results of these studies indicate that the management of

companies tends to transfer their earnings after the new tax regulation is implemented because at this period income tax rate has declined so that companies can obtain tax savings.

Subagyo and Octavia (2010) also conducted research related to indications of earnings management before the implementation of changes in tax rates. Subagyo and Octavia (2010) examine earnings management undertaken by the company related to income tax rate reduction. Subagyo and Octavia (2010) found that the profit manufacturing companies tend to conducted earnings management. Subagyo and Octavia (2010) also found that earnings management is influenced by the tax incentives and non-tax incentives. Based on the description above, this study intends to reexamine whether the company conducted earnings management in response to changes in taxation policies.

Literature review:-

Empirical Findings:-

Many researchers have done studies on earnings management undertaken by the manager related to changes in tax policy. Mo and Yue (2008) conducted research related to earnings management actions undertaken by Chinese companies in anticipation of reduction in corporate income tax rate. By using discretionary accruals, Mo and Yue (2008) tested the effect of tax variables, shareholder control structures, and net income. In their research, Mo and Yue (2008) concluded that companies in China conducted earnings management to report low profits before income tax rate reduction.

In addition, Lu, et al. (2007) conducted a study related to the same thing. Lu, et al. (2007) also tested the effect of changes in income tax rates on earnings management action. In contrast to Mo and Yue (2008), Lu, et al. (2007) used discretionary current accruals as earnings management parameters. In addition, Lu, et al. (2007) using a variable effective tax rate, share ownership, Return on Equity (ROE), expected long-term growth, the level of corporate profits, total assets, and cash flow from operating activities as an independent variable. Lu, et al. (2007) found that China companies conducted earnings management. Companies that perform earnings management is more likely done by private companies.

Lin, et al. (2004) also conducted a similar study in Taiwan. Lin, et al. (2004) examined earnings management actions related to changes in income tax rates in Taiwan. By using discretionary accruals as an earnings management parameters, Lin, et al. (2004) examine the effect of variable effective tax rates, the size of the company, the company's long-term debt ratio, standardized prediction errors, and the book value of share ownership by directors. The results of this study found that companies in Taiwan conducted earnings management in the early years of the implementation of the new tax rate. Companies that perform earnings management is more likely done by private companies.

In Indonesia, research on correlation earnings management with changes in tax rates has been done by Wulandari, et al. (2004). Wulandari et al. (2004) examine earnings management undertaken by the company related to tax rate reduction. In detecting the presence of earnings management Wulandari et al. (2004) use discretionary accrual approach. The results of these studies indicate that discretionary accrual after the implementation new tax rate is higher than the previous period. This means that the management of companies tends to transfer their earnings in the period after the implementation new tax rate because at this period income tax rate has declined so that companies can obtain tax savings.

Subagyo and Octavia (2010) also conducted research related to similar things. Subagyo and Octavia (2010) examine earnings management undertaken by the company related to income tax rate reduction. Subagyo and Octavia (2010) divide research samples into two groups, profit firms and loss firms. They examined the effect of tax incentives and non-tax incentives on earnings management behavior by manufacturing companies in order to respond to changes in tax rates. Subagyo and Octavia (2010) using discretionary accruals in detecting earnings management and found empirical evidence that the profit manufacturing companies conducted earnings management in order to respond to changes in tax rates. In addition, Subagyo and Octavia (2010) also found evidence that earnings management is influenced by tax incentives and non-tax incentives.

Hypothesis Development:-

In 2009 Indonesia government imposed a new tax policy for income tax on property and real estate business through Act No. 36 of 2008 Article 4 Paragraph 2 and PP No. 71 of 2008 Article 4 Paragraph 1. In this regulation the income tax rate of property and real estate business is 5% and shall be final. With this provision, the property and real estate

companies will benefit significantly. If the management of company seeks to minimize the tax burden, the change tax rate will provide benefits to the company.

According to the theory of positive accounting, the political cost is one of earnings management motivation. Income taxation is one of form political cost motivation (Ujiyantho, 2004). Several previous studies revealed that the company is likely to do earnings management in anticipation of reduction in income tax rates (Mo and Yue, 2008; Lu, et al., 2007; Lin, et al., 2004). Wulandari et.al (2004) revealed that the management of companies tends to transfer their earnings in the period after the implementation of new tax rate because at this period income tax rate has declined so that companies can obtain tax savings. Based on this description the property and real estate companies will conduct earnings management before and after the enactment of Act No. 36 of 2008.

H1: Property and real estate companies indicated to conduct earnings management before and after the implementation of Act No. 36 of 2008.

Methodology:-

Population and Sample:-

The population of this study is property and real estate companies listed on the Indonesia Stock Exchange. The sample selection is based on purposive sampling in order to obtain samples in accordance with the purpose of research. Some of the criteria established to obtain the sample include:

1. Companies engaged in property and real estate sector
2. Companies listed on the Indonesia Stock Exchange in 2007 until 2010.
3. Company published annual financial statements have been audited during the period 2007 to 2010.
4. The data on the variables to be studied are available in the company's financial statements from 2007 until 2010.

Variable Identification and Measurement:-

Variable in this study is management earnings (ML). Earnings management is the selection of accounting policies by managers to achieve certain goals (Scott, 2006:344). This study used discretionary accrual approach to detect earnings management. Discretionary accrual is calculated by subtracting the total accrual (TACC) and nondiscretionary accrual (NDACC). The calculation of discretionary accruals in this study used the Modified Jones model. The calculation of discretionary accruals can be described as follows:

a. Calculating the total accrual:-

Based on the modified Jones model total accrual is calculated by subtracting net income with cash flow from operating income. This can be formulated as follows:

$$TACC_{it} = NI_{it} - CFO_{it} \dots \dots \dots (1)$$

Where:

$TACC_{it}$: total accrual
 NI_{it} : net income
 CFO_{it} : cash flow from operation

b. Calculate the non-discretionary accrual:-

Non-discretionary accrual is can be formulated as follows:

$$TACC_{it}/TA_{it-1} = \alpha_1(1/TA_{it-1}) + \beta_1((\Delta REV_{it}-\Delta REC_{it})/TA_{it-1}) + \beta_2(PPE_{it}/TA_{it-1}) \dots \dots \dots (2)$$

After getting the value of the coefficient, the normal accrual rate can be calculated by the following formula:

$$NDA_{it} = \alpha_1(1/TA_{it-1}) + \beta_1((\Delta REV_{it}-\Delta REC_{it})/TA_{it-1}) + \beta_2(PPE_{it}/TA_{it-1}) \dots \dots \dots (3)$$

Where:

$TACC_{it}$: total accrual
 TA_{it-1} : total assets last year
 ΔREV_{it} : difference between revenue last year with this year
 ΔREC_{it} : difference between the receivables this year with last year
 PPE_{it} : total assets this year

c. Calculating the discretionary accruals:-

This can be formulated as follows:

$$DA_{it} = TACC_{it}/TA_{it-1} - [\alpha_1(1/TA_{it-1}) + \beta_1((\Delta REV_{it}-\Delta REC_{it})/TA_{it-1}) + \beta_2(PPE_{it}/TA_{it-1})] \dots \dots \dots (4)$$

Data Analysis:-

This study used the paired sample T-Test with SPSS version 16. In addition, this study also uses panel data regression analysis with Eviews version 4. H1 was tested using paired sample T-test.

Result and discussion:-**Sample Selection:-**

Population used in this study is the property and real estate company which has been listed on the Indonesia Stock Exchange (BEI) in 2007 to 2010. The sampling method is purposive sampling. There are 37 companies used in this study. Based on purposive sampling method there are five companies that are removed from the sample. Thus, 32 companies are being sampled in this study.

Table 1. Sample Selection

Criteria	Total
1. Companies listed on the Indonesia Stock Exchange in 2007 until 2010	37
2. Company published annual financial statements have been audited during the period 2007 to 2010.	(1)
3. The data on the variables to be studied are available in the company's financial statements from 2007 until 2010.	(4)
TOTAL	32

Descriptive Statistic Analysis:-**Discretionary accrual (Y):-**

In Table 2 shows the descriptive statistic of discretionary accruals during 2007-2010.

Table 2. Descriptive Statistic of Discretionary Accruals

Statistic	Year			
	2007	2008	2009	2010
Mean	0,27382	0,27382	-0,04662	0,02488
Maximum	1,30188	1,30188	0,05653	0,37096
Minimum	-0,35309	-0,35309	-0,15496	-0,12045
Std. Deviation	0,42659	0,42659	0,05231	0,09940

Based on table 2 the lowest discretionary accruals occurred in 2009 and the highest discretionary accruals occurred in 2007 and 2008. This shows that in 2009 the property and real estate company has negative discretionary accruals. In 2007, 2008, and 2010 these companies have the positive discretionary accruals.

Corporate Reaction on Act No. 36 of 2008:-

Through paired samples t-test discretionary accruals has significant difference between before and after implementation of Act No. 36 of 2008. Based on table 8 discretionary accruals after the implementation of Act No. 36 of 2008 was lower than before the implementation of Act No. 36 of 2008. Thus first hypothesis is accepted. This means that property and real estate companies are indicated conducted earnings management before and after implementation of Act No. 36 of 2008.

Discretionary accruals before income tax rate reduction showed positive values and value discretionary accrual after income tax rate reduction shows a negative value. This suggests that property and real estate companies are conducted earnings management by delaying its earnings in the period after the enactment of tax policy changes. Based on these two H1 accepted.

The result of this study is consistent with research conducted by Wulandari et. al. (2004). Wulandari et. al. (2004) found that there were significant differences between the discretionary accrual between before and after the implementation of Act No. 17 of 2000. Discretionary accrual after the implementation of Act No. 17 of 2000 is higher than discretionary accrual before the implementation of Act No. 17 of 2000. This suggests that the reduction in tax rates encourage earnings management.

Table 3. Result of Paired Sample T-Test

	Mean	Sig (2-tailed)
Discretionary Accrual before implementation of Act No. 36 of 2008	0,2738234	.037
Discretionary Accrual after implementation of Act No. 36 of 2008	-0,0091131	

Conclusion:-

This study aims to examine property and real estate company reaction on new tax law. Based on the result paired sample T-Test property and real estate companies in Indonesia indicated conducted earnings management before and after the implementation Act No. 36 of 2008. This earnings management is conducted by delaying the recognition of income in the period before the implementation of new policies. The condition was describe by the value of discretionary accruals are lower in the period before the tax rate reduction than the period after the decline in tax rates. This supports the hypothesis proposed previously.

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