

MARKET REACTION TOWARDS DIVIDEND TAX RATE CHANGES OF THE OMNIBUS LAW ON JOB CREATION IN INDONESIA

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Abstract

This paper is to investigate the changes in the dividend tax rate effect on the stock price of the companies listed on the Indonesia Stock Exchange (IDX) and to demonstrate the existence of abnormal returns by examining stock trading situations before and after the ex-dividend date. Standard event study methodology, using the market model, is employed to determine the abnormal returns surrounding the ex-dividend date. The findings are useful to researchers, practitioners, and investors interested in companies listed on the Indonesian stock market for their proper strategic decision-making. In particular, the results can be used to encourage transparency and good governance practices in the Indonesian stock market. This study is the first to use dividend tax rate data after the Introduction of the Omnibus Law on Job Creation and the Law on Harmonization of Tax Regulations. By using the event study method, the study reveals that there is no significant difference in abnormal returns before and following the ex-dividend date, both preceding and after the reduction in the new tax rate. Thus, the dividend tax rate reduction does not affect the market reaction in the event window.

Keywords: *Dividends, Ex-Dividend Date, Dividend Tax Rate, Market Reaction, Event Study.*

Introduction

Management as an agent of the company has the task of increasing the wealth of shareholders by maximizing the return on investments made to the company, this is in line with the financial theory (Jensen, 2001). In carrying out the distribution of surplus wealth through dividends, the company has a policy in determining when dividend distribution should be done, how the proper scheme in its reimbursement, and whether this will last over time (Lease Ronald C. et al., 1999)? Therefore, the company should pay close attention to the measures taken so that the management's goal of maximizing the wealth of its investors is well achieved. Thus it can be concluded that the significant factors that determine the dividend policy are an important contribution to the process of making dividend decisions (Damodaran, 1996).

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According to (Gitman & Zutter, 2003), the capital market is the place where suppliers and demanders conduct long-term instrument transactions. Weston and Brigham (1990) propose that stock price fluctuations can be attributed to many sources such as earnings per share (EPS), interest rate, cash dividend, company profit, and risk and return. Stock return refers to the financial gain experienced by investors as a result of their investment in shares. According to Ang (2010), investors are unlikely to allocate their assets towards investments that do not yield any profits. The actual return refers to the rate of return derived from historical data acquired by shareholders in previous periods. Consequently, it holds significant importance as it serves as a key metric for evaluating the performance of a company.

Fama (1970) mentions that a market can be said to be an efficient market when the market fully provides comprehensive information through the stock price as a reflection of accurate signals so that investors can make decisions in the purchase of stocks in the market. Dividends are profits earned by shareholders from capital deposits made either in cash or in shares as a distribution of the company's profits (Ross et al., 2022). Dividends, which serve as a mechanism for companies to allocate earnings to their shareholders, can be classified into four distinct forms: regular cash dividends, extra dividends, special dividends, and liquidating dividends. The company that's going to distribute cash dividends has to do some defining and launching dividend distribution. The dividend policy does not affect the price of shares or the cost of capital issued by the company (Miller & Modigliani, 1961).

The dividend signaling theory states that an entity can use the dividend as a signal to shareholders to inform the company's future value and can even change investors' expectations of the company (Bhattacharya, 1979). An announcement of a surprise dividend will influence the price of the stock which will adjust to the announcement (Miller & Rock, 1985). The market reaction to dividends can be seen in abnormal returns that show that dividends become useful information compared to information in financial statements (Aharony & Swary, 1980). Comparison of the amount of dividends paid between the current and previous periods will have a direct effect on the price of the stock. A decrease in dividend payments will result in a fall in the share price and an increase in the dividend paid will have an impact on the stock price which is also rising (Aharony & Swary, 1980).

According to Ross et al. (2022), the chronological order of announcement procedures leading to the disbursement of dividends includes the declaration date, date of record, ex-dividend date, and date of payment. (Litzenberger & Ramaswamy, 1979) stated that investors prefer capital gains to dividends because they can defer tax payments until the shares they own are sold, while dividends should be made as soon as possible.

A lower dividend tax than a capital gain tax is preferred by investors, and will increase demand for dividends, and vice versa (Al-Malkawi et al., 2010). The Clientele Effect states that different groups want a different dividend payment policy anyway. Companies tend to attract investors with the company's dividend policy. Investors will be interested in companies that apply dividend policies that fit their circumstances (Al-

Malkawi et al., 2010). Increased investments from previous years that a company wants to make will necessarily require more money to finance future investments so that the company pays less dividends and makes more investments to maximize expected profits (Myers & Majluf, 1984).

The Income Tax Law Number 7 of 1983 in Indonesia governs the taxation of income, including the dividend tax. This tax applies to both domestic and foreign taxpayers, with rates of 15% and 20% respectively. According to the First Amendment, Corporate Taxpayers and Mutual Funds are granted an exemption from dividend tax. The Second Amendment does not alter the dividend tax but instead imposes supplementary obligations on Corporate Taxpayers.

To qualify for an exemption from income tax, Corporate Taxpayers must own a capital amount above 25%. In the year 2008, the government implemented Law Number 36 Year 2008, which established a definitive tax rate of 10% applicable to individual taxpayers. Tax benefits for local taxpayers have been provided by the government, as stipulated in Job Creation Law Number 11 of 2020. These policies are designed to enhance investment in the nation, with a focus on attracting both domestic and international investors.

In the United States, the effect of dividend tax cuts in 2003 had no significant impact on the company's dividend payment policy (Brav et al., 2008). The 2012 dividend tax reform in China, forced companies to increase their dividend payments as a result of the demand from controlling shareholders (Yu et al., 2021). Dividend tax cuts have a positive impact on corporate policy, not just in Canada (Deslandes et al., 2015), but also in South Korea (Lee & Park, 2023). The decrease in dividend tax rates in Indonesia in 2009 prompted companies to increase dividend payments to shareholders (Wayan & Eka, 2019).

If the dividend payout is large, then the price of the stock will fall because the tax on dividends is higher than the tax imposed on capital gain (Park & Evans, 2011). According to Miller and Modigliani (1961), the stock price in the perfect capital market will not be affected by the company's dividend payment policy. This is because shareholders believe that cash dividends and profit are equally important (Miller & Rock, 1985). The stock price will be subject to movement before and after the announcement of the dividend announcement until the payment of dividend payout issued by the company. Investors will react to the dividend announcement, whether it's positive or negative (Ross et al., 2022).

Blandon, Blasco, and Bosch (2011) found the same situation where stock prices will fall on the ex-dividend date. Other research shows that the events that occur around the ex-dividend date are due to the difference in tax rates between dividends and capital gains on marginal long-term investors (Elton and Gruber, 1980). With a decrease in the dividend tax rate, investors will benefit more from their stock dividends. A change in the dividend tax rate can also affect a company's dividend policy.

Previously, companies may not pay dividends or pay them at a small percentage. However, after the new rules are implemented, companies may decide to pay dividends

or increase the percentage of dividends paid out. By earning dividends, an investor will get a more certain return in the future than capital gains due to changes in stock prices (Nam, Wang and Zhang, 2010). From this theory, it can be hypothesized that:

H1: There is a difference in market reaction due to the new dividend tax rate before and after the ex-dividend date.

This paper contributes to research to see to what extent the market reaction to reduced dividend tax rates before and after the ex-dividend date by comparing conditions before and after the implementation of the Omnibus Law on Job Creation and the Law on Harmonization of Tax Regulations.

Research Methods

168 companies and 336 samples are represented in the dataset, sourced from the Indonesia Stock Exchange (IDX). The entities are corporations that distribute dividends throughout the specified period. The research period is 2019 and 2022, encompassing the year preceding and the year following the implementation of the Omnibus Law on Job Creation and the Law on Harmonization of Tax Regulations.

Table 1. Sample Selection Criteria

Number	Sample Selection Criteria	Number of Companies
1	Companies listed on the IDX that pay dividends in 2019 and/or 2022	283
2	Companies listed on the IDX that pay dividends in 2019 and 2022	200
3	Companies that have dividend details (ex-dividend date) in 2019 and 2022 on Eicon Thomson Reuters	177
4	Companies that have active stock price movements every day	173
5	Companies that do not take any other corporate actions	168
6	Amount of Samples	336

Source: The Author

This research uses a quantitative method that uses numerical data to test the hypotheses that are formulated. This method is intended to see phenomena that occur based on samples that have been generalized to a wider population (Creswell, 2009). Investors will receive dividend profits from the company if they purchase shares before the ex-dividend date. Cum dividend date is the last day that investors receive dividends (Ross et al., 2022). The increase in dividends paid compared to the previous year is a positive signal to investors about the company's performance in maximizing company profits in the years to come (Brigham & Houston, 2009).

The method used in this study is the Event Study. This method is used to look at the market reaction to the announcement of dividend payments made by the company by measuring abnormal share returns. This method is often used in financial research including mergers and acquisitions. Other important events such as new equity, debt financing, and trade deficits also implemented event studies (Mackinlay, 1997).

According to Fama (1991), the market would react to the company's announcement of dividend payments. This announcement will affect the stock price on the market as information reaches investors. According to research conducted by (Dharmarathne & Dharmarathna, 2020), the estimated period is set to be 120 days before the event window, i.e. t-130 to t-10.

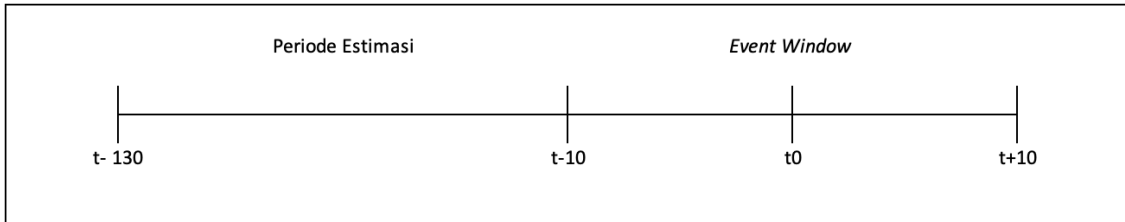


Figure 1. Observation Period
Source: The Author

To assess the impact of the decrease in dividend tax rates resulting from the implementation of recent governmental policies, the initial course of action entails computing the factual rate of return. The determination of the real return is achieved by computing the daily stock returns inside the designated event window utilizing the prescribed formula.

$$R_{i,t} = \frac{P_t - P_{t-1}}{P_{t-1}} \tag{1}$$

Where $R_{i,t}$ is the actual return of firm I on day t; P_t is adjusting the close stock price of firm I on day t; and P_{t-1} is adjusting the close stock price of firm I on day t-1

The calculation of market return involves the computation of Indeks Harga Saham Gabungan (IHSG). The calculation of market return occurs within the estimation period, specifically 120 days before the event window (t-10).

$$R_{mt} = \frac{IHSG_t - IHSG_{t-1}}{IHSG_{t-1}} \tag{2}$$

Where R_{mt} is the market return on day t; $IHSG_t$ is IHSG on day t; and $IHSG_{t-1}$ is IHSG on day t-1. The market model can be utilized to estimate α (alpha) and β (beta). The Ordinary Least Squares (OLS) regression model is used to conduct a regression between the market return and stock returns for this method.

$$R_{it} = \alpha_i + \beta_i R_{mt} + e_{it} \tag{3}$$

Where R_{it} is excess return; α is intercepted; β is beta; R_{mt} is excess return market portfolio, and e_{it} is firm-specific. Next, the expected return $E(R_{it})$ will be calculated using the market model's derived α (alpha) dan β (beta) values from Equation 3.

$$E(R_{it}) = \alpha_i + \beta_i Rm_t \tag{4}$$

The abnormal return (AR_{it}) is used to calculate the excess return compared to the expected return, taking into consideration the systemic risk associated with the asset. The measurement of abnormal return for each issuer involves the subtraction of the actual return from the expected return.

$$AR_{it} = R_{i,t} - E(R_{it}) \tag{5}$$

The Average Abnormal Return (AAR) is determined by aggregating the abnormal return of each firm within a specific t-day period and then dividing it by the total number of sample companies present on that particular t-day

$$AAR_t = \frac{\sum_{i=1}^n AR_{it}}{n} \tag{6}$$

where AAR_t is the average abnormal return on day t; AR_{it} is abnormal return firm I on day t; and n is several samples.

The Cumulative Average Abnormal Return (CAAR) is computed by aggregating the Abnormal Average Return (AAR) of day t (AAR_t) with the preceding day. The calculation of the cumulative abnormal return (CAAR) is determined by the event window period, which spans from h-10 to h+10 and is calculated using the formula.

$$CAAR_t = \sum_{a=t-10}^{t+10} AAR_{it} \tag{7}$$

In this study, we used parametric t-statistics for the hypothesis test. Two statistical approaches will be applied to conduct the difference test. These methods include the Two-Sample Assuming Equal and Unequal Variances, as well as the Two Sample Paired t-test.

Results and Discussion

To evaluate the effect of tax rate policy changes on market reaction, researchers conducted a daily t-test analysis within the event window. This event window covers 10 days before the ex-dividend date and 10 days after the ex-dividend date. The purpose of the test is to analyze and compare daily abnormal returns before and after the change in dividend tax rate policy due to the implementation of the Omnibus Law on Job Creation and the Law on Harmonization of Tax Regulations.

Table 2. The Analysis AAR at the event window period

Days	AAR		t (AAR)	p-value
	Before the new dividend tax rate	After the new dividend tax rate		
t-10	-0.003697	0.003395	-1.8756	0.0616*
t-9	0.000006	0.004276	-1.1231	0.2622
t-8	0.002585	0.003199	-0.1565	0.8757
t-7	-0.000120	0.007712	-1.9211	0.0556*
t-6	0.002790	-0.001631	1.1106	0.2675

t-5	-0.001830	-0.003178	0.3604	0.7188
t-4	0.003436	-0.000553	1.0953	0.2742
t-3	0.000479	0.002315	-0.491	0.6237
t-2	-0.000216	0.002962	-0.7911	0.4295
t-1	-0.000776	-0.001573	0.2402	0.8103
t ₀	0.007620	0.007447	0.0511	0.9593
t+1	-0.006732	-0.001495	-1.1531	0.2497
t+2	-0.006803	-0.002405	-1.2239	0.2219
t+3	-0.002167	0.000507	-0.6849	0.4939
t+4	0.001693	0.001911	-0.0604	0.9519
t+5	0.004034	0.002928	0.2906	0.7715
t+6	-0.001380	0.002104	-0.9892	0.3233
t+7	0.000587	0.001297	-0.1874	0.8515
t+8	-0.000633	0.000530	-0.3241	0.746
t+9	0.000051	0.000332	-0.0786	0.9374
t+10	-0.002262	-0.001753	-0.1451	0.8847

Note: *significance level $\alpha = 10\%$, **significance level $\alpha = 5\%$

Source: The Author.

Table 3 The Analysis CAAR at the event window period

Days	CAAR		t (CAAR)	p-value
	Before the new dividend tax rate	Setelah tarif pajak dividen yang baru		
t-10	-0.003697	0.003395	-1.8756	0.0616*
t-9	-0.003691	0.007671	-1.7829	0.0755*
t-8	-0.001106	0.010869	-1.3302	0.1844
t-7	-0.001226	0.018581	-1.9189	0.0558*
t-6	0.001564	0.016950	-1.3607	0.1745
t-5	-0.000266	0.013772	-1.1325	0.2582
t-4	0.003170	0.013220	-0.7271	0.4677
t-3	0.003649	0.015534	-0.7768	0.4378
t-2	0.003433	0.018496	-0.8656	0.3873
t-1	0.002657	0.016923	-0.7830	0.4340
t ₀	0.010277	0.024370	-0.7409	0.4593
t+1	0.003545	0.022876	-0.9328	0.3516
t+2	-0.003258	0.020470	-1.0737	0.2837
t+3	-0.005425	0.020977	-1.1120	0.2670
t+4	-0.003732	0.022888	-1.0514	0.2938
t+5	0.000302	0.025816	-0.9361	0.3499
t+6	-0.001078	0.027920	-1.0136	0.3115
t+7	-0.000491	0.029217	-0.9848	0.3255
t+8	-0.001124	0.029747	-0.9879	0.3239
t+9	-0.001072	0.030079	-0.9572	0.3392
t+10	-0.003335	0.028326	-0.9268	0.3547

Note: *significance level $\alpha = 10\%$, **significance level $\alpha = 5\%$

Source: The Author.

Tables 3 and 4, show a significant difference in the average abnormal return (AAR) on t-10 and t-7, as well as the cumulative average abnormal return (CAAR) on t-10, t-9, and t-7 before the ex-dividend date, with a significant level of $\alpha = 10\%$. The impact of the new dividend tax rate on stock prices on t-10 and t-7 is uncertain, considering there are no substantial variations in stock prices on other days.

The rise in stock price may be attributed to shifts in investor sentiment towards the company, improvements in corporate fundamentals such as strong financial performance, or attractive market conditions. Nevertheless, when examined collectively within the specified time frame, there was no significant difference in the AAR and CAAR. This suggests that the tax change's announcement did not result in any information leaks, which means the market's response was not significantly impacted.

No one consistently earns a superior return in an efficient market due to the direct incorporation of publicly available information that affects the stock's value into the stock price. Hence, the average abnormal return (AAR) does not demonstrate a consistent positive or negative trend over a long time, both before and after the ex-dividend date. The AAR graph presented in Figure 2 illustrates a varied reaction of the overall average normal return before the ex-dividend date (t_0).

Before and after the implementation of the new dividend tax rate, the return fluctuates both positively and negatively. The new dividend tax rate has a minor impact on market reaction a day before the ex-dividend date ($t-1$), known as cum dividend. At cum dividend, the market retains the shares it owns with the expectation of generating profits through dividends received on the next day. Regardless of whether there is a tax on dividends or not, investors or shareholders are motivated to hold onto their stocks to maximize the benefits derived from their dividends.

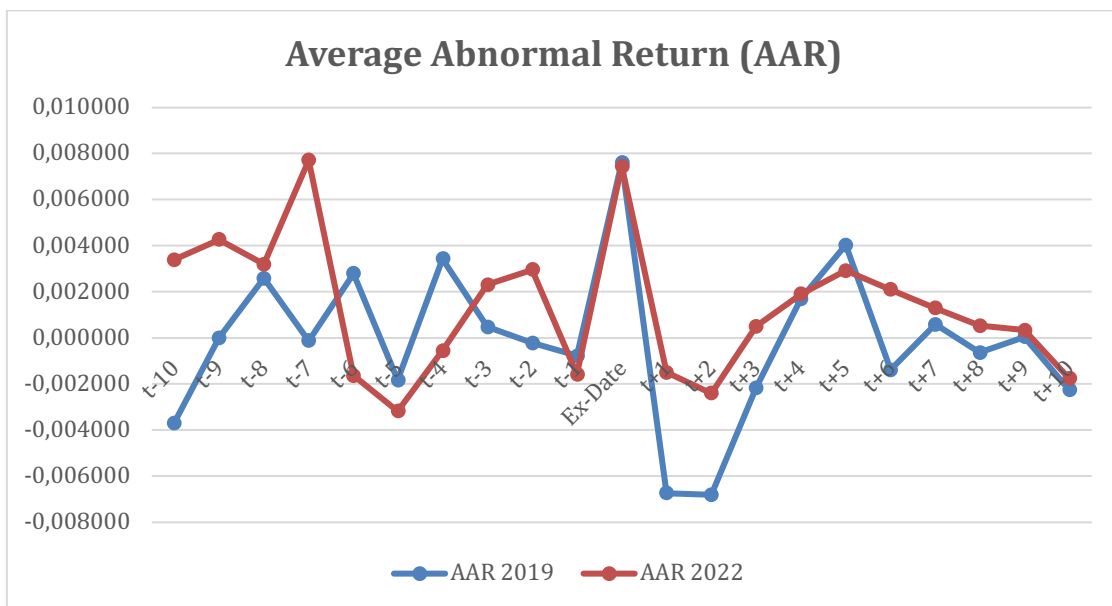


Figure 2 The figure shows the plot for AARs before and after the new dividend tax rate policy.

The market reacts negatively to the ex-dividend date ($t+1$) both before and after the implementation of the new dividend tax rate. This can be seen by a decrease in the average return on investment (AAR), which indicates a significant sell-off appears immediately after stockholders receive their dividend rights. On the day following the ex-dividend date, after the dividend tax rate has been implemented, the fall in stock price is equivalent to the dividend received on the ex-dividend day.

This is in line with the statement made by Ross, Westerfield, and Jaffe (2012) that the fall in stock price is equivalent to the dividends earned on the ex-dividend date in nations that do not impose a dividend tax. However, the amount of reductions in stock prices might be affected by the dividend tax rate that is implemented. This phenomenon is shown in Figure 4.1, where the fall in the stock price at time $t+1$ before the implementation of the new tax rate is more significant compared to the fall in stock price after the new tax rate.

Researchers tried to compare the cumulative average abnormal return (CAAR) in the period $t-10$ to $t-1$ (cum dividend date) and t_0 (ex-dividend date) to $t+10$ to find out whether the new tax rate policy made a significant difference to the market reaction. Table 3 shows the calculation carried out to test the cumulative average abnormal return at $t-10$ to $t-1$ before and after the implementation of the new dividend tax rate. The t-test result shows -0.8480 with a significance level of 0.3970 . Therefore, we do not reject the null hypothesis which states that there is no market reaction related to the new tax rate before the ex-dividend date.

Table 4 The analysis CAAR t_0 s.d $t+10$

t-Test	p-value	Remarks
-0.8480	0.3970	Insignificant

Based on the test results presented in Table 4, it is evident that the implementation of a new dividend tax rate does not significantly affect the market reaction regarding the retention of owned shares before the ex-dividend date. This is because investors continue to anticipate benefits from the dividends received, despite the reduction in the dividend tax rate.

Table 5 shows the calculation of cumulative average abnormal return at $t-0$ to $t+10$ before and after the implementation of the new dividend tax rate policy. The t-test result shows -0.8640 with a significance level of 0.3882 . Therefore, we do not reject the null hypothesis which states that there is no market reaction related to the new tax rate after the ex-dividend date.

Table 5 The analysis CAAR t_0 s.d $t+10$

t-Test	p-value	Remarks
-0.8640	0.3882	Insignificant

Table 6 shows the results of the CAAR analysis during the event window starting from $t-10$ to $t+10$ in 2019 the year before the new tax rate takes effect and 2022 which is the year when the reduced tax rate takes effect. The t-test result shows -1.1172 with a significance level of 0.2655 . Thus, we do not reject the null hypothesis which states that there is no market reaction both before and after the ex-dividend date because of the implementation of the new dividend tax rate.

Tabel 6 The analysis CAAR $t-10$ s.d $t+10$

t-Test	p-value	Remarks
-1.1172	0.2655	Insignificant

Figure 3 illustrates a clear positive trend in the CAAR before and after the implementation of the new dividend tax rate, as observed before the ex-dividend date. This demonstrates that investors consider the ex-dividend date information as positive

news, leading to a market response where they buy shares before the ex-dividend date to get dividends. Nevertheless, the decrease in the new tax rate does not generate a significant difference in market reaction before the ex-dividend date.

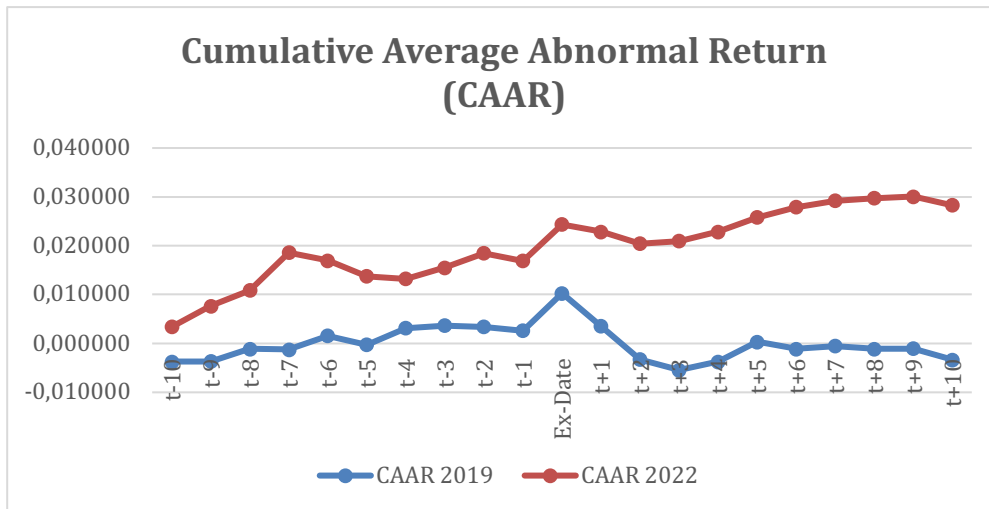


Figure 3. The figure shows the plot for CAARs before and after the new dividend tax rate policy.

The CAAR has a different pattern after the beginning of the post-ex-dividend date period. The CAAR had a declining pattern before the application of the dividend tax rate, primarily driven by investors' overreaction, leading them to sell their shares when the eligibility to receive dividends expired. Unlike CAAR after the implementation of the dividend tax rate, the trend exhibited an upward trend until t+10, although experiencing a decline until t+2 after the ex-dividend date.

This decrease usually happens as a result of market overreaction, leading to the sale of shares after the expiration of dividend rights. However, the market then undergoes a positive correction by purchasing shares at a lower price. Nevertheless, the decrease in the tax rate does not have a significant effect on the market's reaction after the ex-dividend date.

Conclusion

Dividends serve as a signal to investors regarding the future value of the firm and have the potential to influence the investor's perception of the company (Bhattacharya, 1979). The declaration of dividend reductions indicates a decline in a company's financial performance, whereas dividend increases indicate an improvement in the company's overall performance. Dividends play a crucial role in analyzing the market reaction by calculating the abnormal return obtained (Aharony and Swary, 1980). Taxation of dividends affects the company's dividend policy. A higher dividend tax rate can reduce the amount of dividends distributed to shareholders, whereas a lower tax rate can have the opposite effect.

This study examined the abnormal returns earned before and after the ex-dividend date as a result of the implementation of the Omnibus Law on Job Creation and the Law on Harmonization of Tax Regulations. Testing is conducted through the usage of the event research methodology, which analyzes financial market data to determine the

magnitude of the influence of an event on the value of a company. The event window spans 21 days, specifically from $t-10$ to $t+10$, in which t_0 represents the ex-dividend date. The estimation period covers 120 days, from $t-130$ to $t-10$.

Based on the outcomes of the t-test conducted on CAAR $t-10$ to $t-1$, it was determined that the implementation of the new dividend tax rate failed to generate any market reaction before the ex-dividend date. The t-test of CAAR t_0 to $t+10$ produced identical results, indicating that there was no market response after the ex-dividend date as a result of the effect of the new dividend tax rate. There was no reaction from the market either before or after the ex-dividend date, according to the results of the overall CAAR t-test that was conducted in the event window ($t-10$ to $t+10$). This finding is consistent with the research conducted by Nam, Wang, and Zhang (2010), which revealed that abnormal returns were not significantly different in the periods before and after the dividend tax rate cut.

Overall, the reduction in the dividend tax rate does not have any effect on the external factors that are associated with the company, such as the reaction of the market to the new policy, when the complete picture is considered. On the other hand, it affects the internal aspects of the company, particularly the policy that the corporation has taken about dividend payments. This aligns with the concepts of customer theory and catering theory, which believe that corporations recognize the advantages of dividend tax rate reduction for their investors.

To the advantage of its shareholders, the company will therefore implement a dividend policy by the new tax rate. Despite this, there has not been a big market reaction to the new tax rate policy, which implies that there are still a limited number of investors in Indonesia who are aware of the potential tax benefits.

As a result of this research, it has been discovered that in addition to distributions and dividend tax rates, other market information and market conditions can also be considered as factors that can influence changes in stock prices. According to Ghada (2015), changes in stock prices that are brought about by dividend announcements are also significantly impacted by other elements that have the potential to influence investor behavior, such as economics and politics

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