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ABSTRACT

PSAK 73 Leases took effect on January 1, 2020 and have an effect on lessees' asset and liability presentation. This study aimed to analyze the tax implication these leases to contribute to tax policy recommendations. The regulations and interview results with taxpayers, tax consultants, and regulators were examined. The results showed that tax authority and taxpayers differed in understanding the income tax treatment in PSAK 73 Lease implementation. Recognizing depreciation and interest expense during lease measurement results in a number of fiscal reconciliation choices, each of which results in a different taxable income. Furthermore, the leases prompt additional debt and interest, affecting Debt calculation to Equity Ratio (DER) as per tax provisions. The initial recognition of liability and right-of-use assets is distinct from the tax base for land/building leases under Income Tax Article 4 paragraph (2). The tax authority should confirm the fiscal reconciliation done on PSAK 73 – a component of the DER calculation as a result of its implementation - and regulate the gross lease, which becomes the final tax base in Article 4 paragraph (2) of land/building leases.

Keywords: IFRS 16 Leases, KMK-1169 Leasing, lease income tax, lease tax treatment; PSAK 73 Leases

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1. INTRODUCTION

Financial Accounting Standards (PSAK) 73 Leases Statement, which became effective on January 1, 2020, requires significant changes to lease accounting records. Recognizing a single lease-centric lease accounting model raises new issues that need addressing. This has an impact on financial reports and tax returns. By focusing on tax issues, it is necessary to investigate the actual practice of income tax treatment for PSAK 73 Leases. Currently, no tax authority policy exists to address these changes. With no regulation to provide legal certainty, there will be tax disputes. Therefore, this study aimed to provide an overview of the income tax treatment on lease accounting in practice, expecting the results contribute to its implementation and serve as a policy recommendation to the tax authority.

IAS 17 classified lease transactions into two main categories, namely operating and finance, which are treated separately when presented in the financial position statement. The operating and finance leases are off- and on-balance sheet, respectively. The accounting treatment is no longer relevant for financial reports users since it does not describe the transparency of financial reports and companies' compatibility. Consequently, the International Accounting Standard Board (IASB) ratified the International Financial Reporting Standard (IFRS) 16 Lease in January 2016, which became effective on January 1, 2019, replacing IAS 17. Indonesia adopted IFRS 16 in the Lease Statement of Financial Accounting Standards (PSAK) 73, succeeding PSAK 30. PSAK 73 applies a single accounting model for lessee by recognizing right-of-use assets and lease liability except for those with a term of less than 12 months or low-value lease assets. The lessor's accounting treatment of lease transactions is similar to the previous PSAK.

The PSAK 73 application also raised several tax issues. For instance, an increase in the value of the Debt to Equity Ratio (DER) due to recognizing a right-of-use asset and a lease liability influences the capital ratio debt specified by the Finance Regulation Minister No.169/PMK.010/2015 (PMK-169). The tax treatment of depreciation and interest expense recognized at contractual lease payments also appears obscure irrespective of whether its application is treated as interest or returned to lease expense. Therefore, it is possible to instigate a dispute between the tax authority and taxpayers related to fiscal reconciliation and the imposition of tax payables. Such an ambiguous circumstance might promote tax avoidance practices.

The Income Tax Law and the Minister of Finance’s Decree No. 1169/KMK.01/1991 (KMK-1169) control the income tax treatment of leasing agreements. The lease provision classifies lease into rent and other income derived from property use, and leasing. The lease concept evolves in accounting following the development of the business context. However, according to article 28, paragraph (7) of the General Tax Provisions and Procedures Law, the tax provision recognizes bookkeeping as a Financial Accounting standard only if the regulation is unspecified.

As a regulator, the Directorate General of Tax (DGT) should develop, prepare, and implement harmonization of tax policy and technical standardization in tax regulations through appropriate procedures. Legal certainty is a critical attribute in upholding taxpayers' justice. Presently, there has yet to be a tax policy in response to the PSAK 73 implementation. It is necessary to evaluate the leasing business model development. Eventually, the policies must secure state revenues and assess opportunity and risk.

Further investigation is required in light of the previously indicated concern. Previous study identified the potential impact (Iswandana et al., 2019) and income tax-related issues (Saptono, 2021) due to the convergence of IFRS 16 Leases into PSAK 73. This study aimed to depict tax provision implementation on lease treatments according to the income tax regulation since the PSAK 73 enactment. Therefore, it can provide insight into tax policy to be made in the future.

This study improved accounting and taxation literacy and benefited policymakers, tax authority, taxpayers, and other stakeholders. To remain focused and in-depth, the scope provided was limited to the lessee's perspective on the implementation of Income Tax provisions related to PSAK 73 leases.

2. Literature Review

2.1. Different Lease Definitions

In connection with the lease concept according to tax provision, it might refer to several provisions. According to article 4 of the Income Tax Law, rents and other income related to property usage are taxable objects. It also defines a lease as any compensation received or accrued in connection with the use of moveable or immovable property, such as a car, office, house, or building rent. The term "leasing" is also regulated under Article 9 Paragraph 1 Letter c of the Income Tax Law and Decree No. 1169/KMK.01/1991 of the Indonesian Minister of Finance. According to this law, only states in the formation or accumulation of reserve funds originating from the reserve for bad debts can be deducted from the taxpayer's taxable income. For the purposes of KMK-1169, leasing is a financing activity that provides capital goods either on a finance or operating lease to be used by the lessee for a period on regular payments. However, the lessor who performs leasing activities under KMK-1169 is only limited to financial lease companies or those with a business license from the Minister of Finance.

According to PSAK 73, the initial step in identifying a lease is determining whether the contract is or contains a lease. A contract that grants the right to control the use of an asset for a time is deemed to be a lease. In this case, two requirements must be met, namely control and asset identification. The first condition is that control can include the right to obtain significant economic benefits from the use of the specified asset and the right to direct its use. In practice, a lease is not deemed valid if the supplier has the right to substitute an asset during the usage period and obtains economic benefits from the substitution. The second requirement relates to asset identification which a statement asset can identify in the contract. A physical feature of an asset, such as a building's floor, can also be used to identify it. Unless the portion represents the entire capacity of the asset substantially, it is not asset identification if it is not physically distinct. Therefore, the customer obtains a substantial right to the asset’s economic benefits.

PSAK 73 establishes recognition principles, measurement, presentation, and disclosure for lessees. The lessee recognizes a right-of-use asset and lease liability on the lease commencement date, where each component is recorded separately if a contract includes a lease and non-lease aspects. It may also record each lease and non-lease component by another practical step as if they are single. The right-of-use asset is then valued at cost, while the lease liability is discounted using either the implicit interest rate or the incremental borrowing rate if the implicit interest rate cannot be determined. For further measurement, the right-of-use asset can be measured by the lessee using the cost model while lease liability is calculated by increasing the carrying amount in reflecting interest on the lease liability, reducing the carrying amount in reflecting paid lease, and remeasuring the carrying amount in reflecting a revaluation or modification of the specified lease. The lessee must present the lease transaction in the Financial Position statement or disclose it in the financial report notes (CALK). Disclosure aims to enclose information to users of financial reports regarding the impact of the lease on the financial position, financial performance, and cash flows of the lessee.

2.2. Different Lease Classifications

Tax-wise lease arrangements fall into two categories, rents and other income related to property use under Article 4 of the Income Tax Law and leasing under KMK-1169. The scope of these two is comprehensive, while leasing is limited to operating and finance leases. According to KMK-1169, the lessor must be a finance or leasing company that has obtained a business license from the Minister of Finance. In case it does not comply with the leasing arrangement, it is considered rent and other income property use under Article 4 of the Income Tax Law. The classification of leases tax types includes Final Income Tax Article 4 paragraph (2) land/building rentals, Article 23 Income Tax for rentals in connection with property use, and Article 15 Income Tax concerning rental for ships or aircraft.

Different from tax provision, PSAK 73 solely stipulates one accounting model for the lessee. In this situation, the lessee recognizes the right to use assets and liability on a lease transaction lasting more than 12 months. Low-value assets are also exempt from the requirements. Previously, PSAK 30 classified leases into finance or operating for lessee and lessor and then recorded them independently. Since PSAK 73 applies a single accounting model for lessees, operating and finance leases are no longer distinct.

2.3. Debt to Equity Ratio (DER)

According to PSAK 73, recognizing right-of-use assets and lease liabilities affects the debt to equity ratio. According to the IASB publication (2016), IFRS 16 affects leverage ratio growth due to lease liability recognition. Morales & Zamora (2018) concluded that adopting IFRS 16 enhances entities' debt to equity ratio, specifically in industry sectors such as retail, airlines, and hospitality. Firmansyah (2020) explored that the PSAK 73 application improved the company's debt-to-assets ratio, debt-to-equity ratio, and return on equity while the company's return on assets decreased. Selvia (2021) also examined how the PSAK 73 implementation at PT Indosat and PT Unilever Indonesia increased the debt to assets ratio, debt to equity ratio, and EBITDA while decreasing the return on assets.

The PMK-169 stipulates a maximum debt-to-capital ratio of 4:1 for taxpayers whose capital is divided into shares and established or domiciled in Indonesia while calculating income tax. If the debt to equity ratio exceeds 4:1, the borrowing cost deducted from taxable income is according to the debt and equity ratio of 4:1. These may cover loan interest, discounts, and premiums in connection with loans, additional costs associated with borrowing arrangements, financing costs, compensation for loan repayment guarantees, and foreign exchange differences from the loan in foreign currency.

2.4. Fiscal Reconciliation

Equalization or reconciliation is an audit technique regulated in Circular Letter SE-65/PJ/2013. The Circular Letter attachment defines reconciliation as comparing the balances of two or more interrelated numbers. Fiscal reconciliation can be completed by comparing SAK and tax provisions financial report items. Equalization can be initiated by defining the items to be equalized. Additionally, fiscal reconciliation entails positive and negative fiscal corrections. A positive fiscal correction increases taxable income, whereas a negative one reduces taxable income.

Income tax regulations, specifically Article 6 and Article 9 paragraph (1) of the law, govern the fiscal reconciliation of deductible and non-deductible expenses. According to Article 6 of this law, expenditures subtracted in determining taxable income include those expended in obtaining, collecting, and maintaining income. Numerous deductible expenses are stated, including costs associated with commercial activities, such as rentals, interest, royalties, and depreciation charges for the acquisition of tangible assets and amortization, as defined in Article 11 and 11A. Paragraph 1 of Article 9 details costs that cannot be deducted from taxable income. According to Article 13 of Government Regulation No. 45 of 2019, there are expenditures associated with obtaining, collecting, and maintaining information that cannot be deducted if the income is not taxable, the tax imposition is final and is calculated in accordance with the standards set forth in Articles 14 and 15. Finally, Article 6 paragraph (1) provides for the deduction of rental payments made for business reasons from taxable income.

3. Research Methods

This study used a qualitative approach to explore the phenomenon using various data sources (Cooper & Schindler, 2008). Meanwhile, PSAK 73 uses a case study approach to understand income tax treatment. The case study allowed the researchers to examine a specific phenomenon (Creswell, 2009).

The data used in this study encompassed primary and secondary data. Interviews were employed to collect primary data from participants, while secondary data employed archives and documents relevant to the problems studied and other pertinent sources, including tax regulations, PSAK, and official publications. The analysis of document data would help gain a deep understanding of the study object and applicable regulations.

Table 1 shows the eight informants who participated as sources for in-depth interviews. These resource persons included tax policymakers and auditors, account representatives, taxpayers, tax consultants, and academics from various analytical units, including The Directorate of Tax Regulations II DGT, Medium Tax Office, Small Tax Office, Tax Consultant Office, and Telecommunication Company, which are stakeholders related to this study object to enrich the analysis from various perspectives. Direct interviews were performed at the offices of tax policymakers and tax consultants during the interviewing process. Other than that method, the interview process was conducted using Zoom, an online conferencing platform. The interview procedure lasted from 30 minutes to two hours. Additionally, the researchers made informal contact with many tax officials by phone, text messages, and talks (September to November 2021).

In conducting analysis techniques, document data analysis was applied as the basis for interview questions for participants. An application case simulation was also developed to aid in answering the research topic. The data from the interviews were analyzed in several stages. The first stage was to transcribe the interviews and remove irrelevant data. Reading the outcomes of the data processing was the next stage. Participants' thoughts were then summarized and grouped into categories for further study. The next stage was to develop conclusions based on the theme or descriptive meaning to answer the study questions.

Table 1. Participant Demographics

No	Type of Participants	Participant Units	Code
1	Tax Policy Maker (Staff)	Directorate of Tax Regulations II DGT	TPM
2	Tax Auditor	Medium Tax Office	AUD_1
3	Account Representative	Medium Tax Office	AR_1
4	Tax Auditor	Small Tax Office	AUD _2
5	Account Representative	Small Tax Office	AR_2
6	Tax Consultant	Tax Consultant Office	CONS
7	Tax & Accounting Supervisor	Telecommunication Company	TPYR
8	Academics	-	ACAD

4. ORGANIZATION PROFILE

The unit of analysis used in this study was the Directorate of Tax Regulations II DGT, Medium and Small Tax Office, Tax Consultant Office, and Telecommunication Company. They were related to the study object to provide different views. The Directorate of Tax Regulations II DGT was in charge of formulating and implementing technical standardization policies, including income tax provisions and harmonization of tax regulations. Medium and Small Tax Office performed service-related duties, supervision, orderly administration, and tax revenue. The only difference was in taxpayers characteristics. The Tax Consultant Office was established in 2010 and provides professional tax-related and accounting services, tax training, and other services to tax consultants who hold level A to C certificates. Taxpayers used in this study is the leading telecommunications company in Indonesia, which has built communication access to remote areas of the country, therefore, the main activity is leasing related to the provision of Base Transceiver Stations (BTS).

5. RESULT AND DISCUSSION

5.1. DIFFERENT PERSPECTIVES IN INCOME TAX TREATMENT ON IMPLEMENTATION OF PSAK 73

According to the document data and interviews analysis, stakeholders had varying perceptions of the PSAK 73's tax effects. The following are some opinions on leases from Account Representatives, Tax Auditors, and Taxpayers.

Account Representatives

Regarding lease transactions, AR equalized the Periodic Tax Return data with the Annual Tax Return. AR compared the lease expense included in the financial report attached to the Annual Tax Return to the payment and reporting required under Article 23 of the Internal Revenue Code. Likewise, leases related to the final income tax should be matched with the Final Income Tax Return in Article 4 paragraph (2). Furthermore, he sent the SP2DK to taxpayers and requested a response within the prescribed time limit on any mismatch between income tax payments and financial reports. AR also conducted an on-site inspection of the taxpayer's business to inspect the lease's physical item and supporting documentation, such as the lease agreement.

However, the PSAK 73 treatment, which recognized a right-of-use asset and lease liability, had an impact on oversight. Certain ARs were confused on how to determine the lessee's accounting methodology. Previously, they could readily connect leasing expense in financial reports to income tax paid under Article 23 or Article 4 paragraph (2) of the Internal Revenue Code. Due to the accounting treatment discrepancy, AR may lose sight of the possibility of taxation on lease transactions.

> *"If the PSAK 73 treatment that records it as an asset in lease liabilitiy, is correct, and appears inaffected by the taxation. Therefore, tax is tax and accounting is accounting."* AR_2

Tax Auditor

To test compliance with lease transactions, it was completed based on audit procedures as stated in the Minister of Finance Regulation Number 17/PMK.03/2013 on audit procedures as amended by PMK-184/PMK.03/2015 and the Regulation of the Directorate General of Taxes Number 23/PJ/2013 on Audit Standards. Regarding audit methods and techniques, the auditor refers to SE-04/PJ/2012 containing guidelines for preparing audit programs to verify compliance with tax obligations, SE-65/PJ/2013 on guidelines for using audit methods and techniques, SE-25/PJ/2013 regarding e-audit guidelines, and SE-10/PJ/2017 on technical guidelines for field audit to verify Compliance with Tax Obligations. Generally, these audit methods and techniques apply to all sectors, not leases only. The DGT audit is not based on a specific lease transaction but on the tax type or tax period, for instance, the Income Tax Audit for the 2020 Fiscal Year or the December 2020 VAT.

Based on the analysis, the main steps taken by tax auditors in conducting lease audits include audit preparation, field observations, information requests to taxpayers, written requests to third parties, or electronic data use. Along with these steps, the auditor must be familiar with the audit method and technique. The direct method is preferred over the indirect one. The tax auditor should also master the audit technique and audit method. The auditor could employ several audit techniques, including internal and/or external information from the DGT, substantive testing, analyzing and tracing numbers, tracing evidence, equalization or reconciliation, requesting evidence, confirmation, vouching, interviewing, and sampling. In the testing lease transaction, the auditor may use one or more audit techniques according to the Tax Auditor's professional judgment, as stipulated by a provision.

The tax auditor must understand the accounting treatment of PSAK 73 Leases to conduct audit techniques. Based on the interview, tax auditors had different understandings of practices.

> *"Yeah, I read it. PSAK 73 says that when we conduct a lease, we can recognize it as an asset, right, that means prepaid lease, right? How is journal?" AUD_2*

> *"Perhaps the most crucial thing from the lessee's point of view is that there is no operating lease anymore. So the potential tax controversy exists. In nature it is an operating lease but with PSAK 73, everything can be said to be a financial lease. Maybe that is what I think is the point that will become a potential dispute between the tax authority and taxpayers later" AUD_1*

Taxpayer

Due to PSAK 73's lease treatment distinction, taxpayers should expect a lease transaction audit and segregate leasing transactions that are taxable lease objects, then collect and transfer the tax. They should also keep track of leasing data as a right-of-use asset and a lease obligation to minimize audit issues.

Although the tax provisions remain the same, the variations created by the adoption of PSAK 73 will increase compliance costs. According to taxation, the taxpayer's primary focus should be documentation related to transactions contained in operating leases. Consequently, more human and financial resources must be prepared. In actuality, taxpayers do not always make any significant adjustments. It should consider the company size, the amount of lease transaction, and the business complexity.

> *"In the practice of PSAK 73, it does not bring any significant impact. As a lessee, it does not affect anything. The point remains the same. Although we record, until present we have withheld it according to the tax." TPYR*

Given this situation, the tax authority and taxpayers continue to have divergent views on the tax implications of PSAK 73. If not intercepted, this could potentially result in the state losing revenue from the lease.

5.2. Practices of Income Tax Treatment on implementation of PSAK 73 Leases

Tax provisions typically require a rules-based approach while defining a lease, whereas accounting requirements take a principles-based approach. Taxation appears to take the legal aspect of a lease into account. However, as the Income Tax Law acknowledges income in any name or form, the tax treatment can conform to the substance principle over form. In contrast, PSAK 73 prioritizes the lease's substance over its legality. The contract can meet the criteria of "lease" even if it does not specifically state it. The interpretations of accounting and tax differ notwithstanding their commonality (Saptono, 2021).

Concerning lease categorization, PSAK 73 recognizes one accounting model, therefore, it does not distinguish between operating and finance leases. Accounting and taxation are intertwined, although they have different fundamental requirements. The basis for determining income tax is bookkeeping through financial reporting. According to article 28 paragraph (7) of the general tax provisions and procedures law, bookkeeping entails maintaining asset records, liability, capital, income, expense, sale, and purchase to calculate payable tax. If the tax provision does not specifically regulate terms according to Article 28 paragraph (7), bookkeeping must be conducted following the system commonly used in Indonesia, based on Financial Accounting Standards (PSAK). Therefore, a fiscal reconciliation must be conducted if there is a discrepancy between accounting and tax calculations.

To gain an in-depth understanding, this study applied case simulations to capture how leases are taxed, as shown in Example 1. It is undertaken due to the confidentiality and inaccessibility of the taxpayer's tax return, which can be compared to the financial statements by the public.

Example 1

PT ABC signed a five-year operating lease for a property. The annual lease payment was IDR 100,000, which was paid at the end of each year. The interest rate implicit in the lease was 5%. Additionally, PT ABC also paid a service charge of IDR 5,000 annually. Measurement of the lease obligation at the present value of 5 payments was IDR 100,000, discounted at an interest rate of 5% annually, which was IDR 432,948.

Before analyzing the tax treatment of PSAK 73 leases, it is crucial to compare the accounting requirements of PSAK 73 and the prior PSAK 30. PSAK 73 influences financial position and income statements, while PSAK 30 solely affects the income statement. PSAK 73 determines the financial position statement to recognize a right-of-use asset and lease liability at contract commencement. In terms of the income statement, it also recognizes interest expense, depreciation expense, and service charge in contractual cash payments, while PSAK 30 instantly records it as operating expenses, including lease and service expenses. PSAK 73 acknowledges depreciation expense using the straight-line asset method plus discounted interest expense at the end of each lease payment year, while PSAK 30 recognizes lease expense for the total amount of cash incurred. However, cumulatively, this differing classification resulted in the same total net income at the end of the lease term (see detail in Table 2).

Table 2. Comparison of Lease Treatment according to PSAK 73 and PSAK 30

	Jan-20	Dec-20	Dec-21	Dec-22	Dec-23	Dec-24	Total
PSAK 73							
Impact on Financial Position							
Right of use asset	432,948	354,595	272,325	185,941	95,238	0	
Lease liability	432,948	354,595	272,325	185,941	95,238	0	
Impact on Income Statement							
Operating Expense-Service		5,000	5,000	5,000	5,000	5,000	25,000
Depreciation		86,590	86,590	86,590	86,590	86,590	432,948
Interest Expense		21,647	17,730	13,616	9,297	4,762	67,052
Net income		**(113,237)**	**(109,320)**	**(105,206)**	**(100,887)**	**(96,352)**	**(525,000)**
PSAK 30							
Impact on Financial Position							
Right of use asset	0	0	0	0	0	0	0
Lease liability	0	0	0	0	0	0	0
Impact on Income Statement							
Operating Expense-Service		105,000	105,000	105,000	105,000	105,000	105,000
Net income		**(105,000)**	**(105,000)**	**(105,000)**	**(105,000)**	**(105,000)**	**(525,000)**

Source: processed according to pwc.com

As seen in Table 2 above, changes to financial statements will impact the income tax calculation. Then, the tax analysis is broken into three sections, namely income tax treatment on initial recognition, the lease measurement, and the debt to equity ratio to further illustrate this scenario.

Income Tax Treatment on Initial recognition

According to PSAK 73, calculating lease transactions applies the concept of the time value of money. Since the operating lease is not recognized under the single lessee accounting model, it should be recorded as a right-of-use asset and a lease liability. The present value method is used to record assets in cash that must be paid if the same asset is purchased currently. On the one hand, recording liability in terms of the current discounted future net cash flows is used to settle obligations. It is more likely to deviate from realizable value tax calculation. The asset transaction value is determined using the cash currently obtained while selling the asset under normal disposal. Liability is calculated based on its redemption value, which is the amount of undiscounted cash or cash equivalent to paying the obligation’s normal operation. Table 4 illustrates journal accounting.

In practice, tax authority should determine whether or not recognizing a right-of-use asset and lease liability at the lease commencement date has implications. While examining the PSAK 73 provision, lease payment may or may not occur depending on the contract agreement at the contract’s inception. If the transaction is found to be taxable, it will be taxed, and the lease must comply with Article 4 of the Income Tax Law or KMK 1169. In terms of leasing, Article 3 of KMK 1169 defines what constitutes a financial lease. In the meanwhile, it is deemed an operating lease if it meets the criteria set forth in Article 4 KMK 1169. The tax authorities' definitions of the applicable rules remain vague.

> *"The problem is that the tax authorities refer to KMK 1169 whereas 1169 is for lessor which comes from the finance company, direct finance leases. Most of them always turn to that provision. In the long term, there is no option right. In fact, with or without option right for KMK 1169, it is specifically for lessor who finances." CONS*

Frequently, tax authority identifies lease agreements based on legal contracts. The tax authority can assess whether it is taxable income tax and tariff loaded. The reason for this is that a contractual document establishes legal certainty. After identifying the debt, the following stage is to comprehend the amount owed. If no payment is made when the income tax is due, this constitutes non-compliance, which may result in fines/penalties for overdue tax. Concerning leases, this study discussed withholding tax on first recognition in terms of income tax Article 23 and final income tax Article 4 paragraph (2).

Income Tax Treatment Article 23

While examining case Example 1, it is clear that there is no lease payment at the lease commencement. Although a transaction is a taxable item, no lease payment is involved, hence, no withholding tax has been made. According to Article 23 paragraph (1) and (3) of the Income Tax Law, income tax withheld at the end of the month is paid, or the deemed income payment on the due date, depending on which event occurs first. Therefore, if the property is equipment or machinery, there is no tax implication at the initial lease recognition time.

*Income Tax Treatment Article 4 paragraph (*2)

If the property is an island/building, as in Example 1, it is critical to determine whether or not the recognition of a right-of-use asset and lease liability will have a tax effect. Based on Government Regulation No. 34 of 2017, 10% (ten percent) of the gross lease value of land and/or building will be taxed. The definition of gross lease value of land and/or building according to Government Regulation No. 34 is the amount paid or deemed as debt by the lessee in whatever name and form in connection with the land and/or building, including maintenance costs, security deposit, service charge, and other facility fees, whether the agreement is separated or combined.

Since PSAK 73 recognizes debt (the lease liability) at the beginning of the contract, the need to withhold income tax should be completed when the lease liability is recognized as debt under Government Regulation 34. Indeed, it burdens taxpayers considering the significant tax load that must be imposed at the onset. It is expected that the tax authority and taxpayers will differ whether a contract has tax implications or otherwise. However, the ability to pay must also be considered.

> *"In my opinion, one of the tax principles is convenient to pay. Therefore, it is the comfortableness to pay. Paying taxes as soon as you receive money or income will make the taxpayer feel more comfortable. If, for example, it is imposed at the beginning and the lessor has not yet earned income, I think it would violate the principle of convenience to pay. In my opinion, it is still based on cash lease payment." AUD_1*

PSAK 73 mandates that each component of a contract that includes a lease and non-lease elements be recorded separately. According to tax, the service charge is incorporated in the gross lease value in Government Regulation 34 of land/building lease. As further defined in SE-14/PJ.53/2003, a service charge is a fee that enables a leased room to be used for the lessee's purposes. It includes electricity, water, security, cleaning, and administration costs.

Income Tax Treatment on Measurement

According to PSAK 73, the lessee can measure the right-of-use asset using the cost model. The lease liability is calculated by increasing the carrying amount to reflect interest, reducing the sum to show paid lease, and remeasuring the carrying amount to reflect a revaluation or modification of the specified lease. Table 4 details the accounting journal entry for lease measurement.

Referring to case Example 1, Table 3 summarizes the lease payment components during measurement. According to PSAK 73, a service charge does not contain the leasing component.

Table 3. Components of the Initial Recognition and Measurement of PT ABC Leases

Lease Term	Lease Payment (cash)	Interest Expense	Principal Debt	Depreciation Expense	Lease Liability
Lease Commencement					432,948
End year 1	100,000	21,647	78,353	86,590	354,595
End year 2	100,000	17,730	82,270	86,590	272,325
End year 3	100,000	13,616	86,384	86,590	185,941
End year 4	100,000	9,297	90,703	86,590	95,238
End year 5	100,000	4,762	95,238	86,590	0
Total	500,000	67,052	432,948	432,948	

source: processed from various sources

Table 4. The Accounting Journal of PT ABC Leases

Lease Term	Accounting Journal	Dr	Cr
Beginning year 1	ROU asset	432,948	
	Lease liability		432,948
End year 1	Interest expense	21,647	
	Lease liability	78,353	
	Cash (1st lease payment)		100,000
	Depreciation (432,948 ÷ 5)	86,590	
	Accumulated depreciation		86,590
	Operating Expense-Service	5,000	
	Cash		5,000

PSAK 73 includes depreciation and interest expense for lease payments from the end of the first year to the end of the fifth year. Depreciation expense is calculated using the straight-line technique and charged annually at the corresponding amount. Meanwhile, interest expense is calculated based using discounted lease liability's interest rate. Therefore, the recognition of depreciation and interest expense will affect the company's income statement commercially.

Because accounting and taxation are structured differently, it is essential to determine whether each accounting component has a tax effect at the time of cash payments at the end of the year. Interest and depreciation expenses are deductible in calculating taxable income under tax laws. However, it is unknown whether this treatment applies to leased assets. In practice, not all tax authorities and taxpayers understand it, resulting in various fiscal reconciliation choices.

> *"It will be fatal if the tax authority does not understand accounting. Moreover, the company also does not understand. It should be fiscally reconciled because there is no lease expense. What appears are interest expense and depreciation expense. Depreciation in accounting is allowed, but not in tax. Therefore, what about the interest expense? Which income is the tax levied? There is no object. The auditor will be unsure of how much interest and lease costs are, and will need to verify this information." CONS*

It is vital to assess which expenses can be subtracted when computing taxable income while performing fiscal reconciliation. The following are expenses that continue to create concern regarding when the lease payments are made:

- *Lease payment*

  The lease payments from the first to the fifth years are subject to Article 23 income tax. 2% of the total lease payment is payable in this transaction, namely 2% x IDR 100,000 = 2,000. As a lessee, the obligation to withhold income tax under Article 23 is before the end month in which income is deemed paid. However, it is unclear whether taxpayers can deduct the cash payments made after accounting no longer records them as lease expenses. According to PSAK 73, lease payments are recognized as depreciation and interest expense.
- *Depreciation Expense*

  According to tax provision, depreciation expense must be calculated according to Income Tax Law Article 11 about the cost of purchasing, erecting, expanding, improving, or replacing tangible assets. Since the leased property does not belong to the lessee, it does not comply with Income Tax Law Article 11. In the event of the transaction being leasing, the lessee is not permitted to depreciate the capital asset leased for business purposes under KMK 1169. It highlights the non-depreciation of leased assets except for the residual value if the lessee exercises his option right. Therefore, the depreciation expense associated with the leasing transaction will not be recognized for tax reasons.

- *Interest Expense*
  Interest arrangements taxed under Income Tax Law Article 4, namely interest, premium, discount, and compensation for loan repayment guarantees. Meanwhile, the deductibility of interest expenses is governed by Income Tax Law Article 6. Interest is mentioned as a factor to consider when repaying debt in this instance. Based on Article 3 paragraph (2) of PMK 169, borrowing costs may include loan interest, discounts and premiums, additional costs incurred in the borrowing arrangement, finance expense in leases, compensation for loan repayment guarantees, and foreign exchange differences from the foreign currency loan. The interest expense that may be charged must be calculated using the 4:1 DER formula. If the DER exceeds 4:1 it will be possible for interest expense not to be calculated for tax purposes. Nonetheless, it is unclear if leasing-related interest can be deducted from taxable income. Interest expense is taxable at 15% under Income Tax Law Article 23. Whether the PSAK 73 application's interest expense is taxable under Article 23 of the Tax law is still questionable.

If the accounting and tax treatment leasing transactions are not confirmed, it will lead to an inconsistent opinion while conducting fiscal reconciliation. Besides, there is a misunderstanding on both sides, taxpayers and tax authority, requiring a robust tax treatment. After analyzing the tax treatment during measurement, the following tax treatment may occur:

- **Option 1 (non-deductible depreciation expense and lease payment, but deductible interest expense)**
  If there is no depreciation expense on the lease recognized according to the tax provision, it will be a permanent difference. The taxpayer will make positive corrections in the depreciation recognized according to PSAK 73. Concurrently, the taxpayer's contractual lease cash payment is unrecognized as a leasing expense in financial reports. Even if the costs are paid to fulfill the 3M (Obtain, Collect, Maintain) in generating revenue, no one should be deducted according to taxes. It will most likely be damaging to taxpayers and increase tax evasion.

- **Option 2 (non-deductible interest expense and depreciation expense, but deductible lease payment)**
  If the cost incurred has been levied for income tax, it should be deducted when calculating the tax. Provided taxpayers is permitted to subtract the lease payment, he/she may make negative fiscal adjustments, even though it is not charged the same amount under PSAK. Taxpayers also manages positive fiscal corrections on interest and depreciation expenses to avoid double tax deductions for the same object.
- **Option 3 (deductible interest expense and lease payment, but non-deductible depreciation expense)**
  Option 3 illustrates that the taxpayer can make negative fiscal corrections on the lease payment. But on the other hand, the taxpayer only makes positive fiscal corrections on depreciation expense, while interest expense remains deductible for tax purposes. Taxpayers may deduct more expenses if they use this route. This is contrary to tax legislation, which sets a premium on the real worth of the payment.

Referring to Example 1, the fiscal reconciliation treatment of leasing transactions can be classified into three categories (assuming that service charges are excluded from the calculation). Table 5 shows them.

Table 5 Fiscal Reconciliation

	Jan-20	**Des 2020**	**Des 2021**	**Des 2022**	**Des 2023**	**Des 2024**
Impact on Financial Position						
Right of use asset	432,948	354,595	272,325	185,941	95,238	0
Lease liability	432,948	354,595	272,325	185,941	95,238	0
Impact on Income Statement						
Depreciation		86,590	86,590	86,590	86,590	86,590
Interest Expense		21,647	17,730	13,616	9,297	4,762
Net income		**(108,237)**	**(104,320)**	**(100,206)**	**(95,887)**	**(91,352)**
Fiscal Reconciliation (option 1)						
Net income		(108,237)	(104,320)	(100,206)	(95,887)	(91,352)
Depreciation		0	0	0	0	0
Interest Expense		21,647	17,730	13,616	9,297	4,762
Positive Fiscal Correction		86,590	86,590	86,590	86,590	86,590
Taxable Income		**(21,647)**	**(17,730)**	**(13,616)**	**(9,297)**	**(4,762)**
Fiscal Reconciliation (option 2)						
Net Income		(108,237)	(104,320)	(100,206)	(95,887)	(91,352)
Depreciation		0	0	0	0	0
Interest Expense		0	0	0	0	0
Positive Fiscal Correction		108,237	104,32	100,206	95,887	91,352
Cash Payment		100,000	100,000	100,000	100,000	100,000

	Jan-20	Des 2020	Des 2021	Des 2022	Des 2023	Des 2024
Negative Fiscal Correction		(100,000)	(100,000)	(100,000)	(100,000)	(100,000)
Taxable Income		**(100,000)**	**(100,000)**	**(100,000)**	**(100,000)**	**(100,000)**
Fiscal Reconciliation (option 3)						
Net Income		(108,237)	(104,320)	(100,206)	(95,887)	(91,352)
Depreciation		0	0	0	0	0
Interest Expense		21,647	17,730	13,616	9,297	4,762
Positive Fiscal Correction		86,590	86,590	86,590	86,590	86,590
Cash Payment		100,000	100,000	100,000	100,000	100,000
Negative Fiscal Correction		(100,000)	(100,000)	(100,000)	(100,000)	(100,000)
Taxable Income		**(121,647)**	**(117,730)**	**(113,616)**	**(109,297)**	**(104,762)**

source : processed by the authors

The recommended policy to resolve disputes is the second fiscal reconciliation option among the three studied options. The second option allows taxpayers to deduct lease payments with a negative fiscal correction while recognizing interest and depreciation charges as a positive fiscal adjustment. In either case, this is still constrained by the interest expense, whether it is a taxable object. To ensure legal certainty, taxation is governed by applicable rules. DGT must determine if the alternative treatment doubles the tax. However, the second option is more favorable fiscal reconciliation than the other two options.

Different calculations and interpretations resulting from the use of PSAK 73 may exacerbate tax issues. However, because the due deadline for the 2020 tax year audit has not yet passed, no disagreement documents involving Income Tax on the PSAK 73 Leases implementation have been discovered. For the tax year 2020, the due date for Overpayment Income Tax is no later than 12 months from the submission date.

Income Tax Treatment on Debt to Equity Ratio (DER)

The lease liability recognition due to the PSAK 73 application influences the increasing debt to equity ratio. Based on Income Tax Law Article 18 paragraph (1), the Minister of Finance must determine the debt ratio to company capital in calculating the tax payable. The goal behind enacting this provision is to prevent the erosion of taxable income in Indonesia due to the deductible interest expense with borrowing costs under PMK-169.

PMK 169 prescribes that taxpayers' debt to equity ratio whose capital is divided into shares and is established or domiciled in Indonesia is at 4:1. If it exceeds the specified ratio, the borrowing cost that can be used to calculate taxable income is the borrowing cost by a 4:1 debt to equity ratio. If the DER appears to be greater than 4:1, there will be interest expense that cannot be charged.

When debt increases due to the PSAK 73 application, there is disagreement over whether the debt increases the deductible borrowing cost under PMK-169 or not. Therefore, the practice remains uncertain.

"Influencing. Why? Because the understanding is that DER relates to interest. DER with interest follows accounting, follows accounting standards, hence, it affects. The best practice is to have a case study for the company." CONS.

"Fiscal adjustment should be made so that debt related to the lease liability from the operating lease, in my opinion, should be omitted as debt on Liabilities and the Assets side should also be edited out." AUD_1

This study suggests that the tax authority must affirm legal certainty rules to eliminate the dissimilarity in interpretation. If the lessee's lease liability is treated as a DER calculation under PMK-169, he/she will face significant tax payments. However, if the tax authority excludes lease liability from the DER calculation, it must obtain implementation certainty. One of Iswandana et al. (2019) recommendations regarding this matter was that the tax authority should exclude a lease liability from the DER calculation according to PMK-169. This study concurred with that statement because the purpose of PMK-169 is to avoid the practice of thin capitalization on the loan interest used to reduce taxes. Therefore, the tax authority should develop a robust implementation method that benefits both the tax authority and the taxpayer.

6. CONCLUSION

This study aims to depict the practice of tax provision implementation on different lease treatments according to the provisions of Income Tax and PSAK 73 to recommend input to the tax authority’s policymaking. It will also improve accounting and taxation literacy while directly benefiting policymakers, tax authority, taxpayers, and other stakeholders.

In order to examine document data and conduct meaningful interviews with informants, a qualitative research approach was used. According to the interviews, the tax authority and taxpayers have different opinions on how the actual practice of income tax treatment on leases evolved from the implementation of PSAK 73. Based on the lease case example, recognition of payable right-of-use asset on the commencement date influences final income tax payable under Article 4 paragraph (2) land/building lease. The gross lease value of land/building covers services, while PSAK 73 excludes them from the lease component. Due to the confusing implementation of three income tax treatment alternatives at the measurement time, fiscal reconciliation was impacted. Another implication is duality in the tax treatment of increase in DER, whether calculated according to PMK-169 or not.

Given the range of perspectives on the lease tax treatment, this study recommended that the tax authority design policies that provide implementation guidelines for taxpayers and tax authority to reduce conflicts. Recognition of debt at the commencement date according to PSAK 73 deemed the final Tax Base of Income Tax Article 4 paragraph 2 of the lease of land/building should be re-arranged. There were some alternative tax treatments for leases during measurement, hence, it is necessary to establish guidelines. This study also suggests that option 2 be included in the implementation guidelines, which is fiscal reconciliation by applying positive corrections to depreciation and interest expense while making negative adjustments to lease payments. Regarding the DER increase, the tax authority should offer legal certainty and the mechanism for its implementation while calculating DER according to PMK-169.

Several recommendations should be implemented by the DGT as a tax authority. Due to the application of PSAK 73, there is no uniform understanding of how to perform lease supervision and tax audits. Therefore, the DGT should strengthen the tax authority's competence through educational programs such as training material, IHT, e-learning, and dissemination. DGT should release an urgent tax policy outlining implementation guidelines for both taxpayers and the tax authority to avert any disputes.

This study had limitations since no tax dispute documents were discovered due to PSAK 73 Lease implementation, although the 2020 Overpayment Tax Return audit is still ongoing. The study focused on income tax. Future studies are expected to probe and examine the verdicts subject to the dispute resulting from PSAK 73 lease implementation and a broader range of tax kinds, such as Value Added Tax issue.

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