

Income Tax and VAT Issues Concerning Leases after IFRS 16 Convergence in Indonesia

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Abstract: *This study analyzes income tax and value-added tax (VAT) issues on lease transactions after IFRS 16 convergence in Indonesia into PSAK 73. The data collection is through in-depth interviews and literature review. We interviewed informants selected purposively. We also used secondary data from literature studies to enrich the analysis. This study concludes that the tax authorities need to make tax policies that can provide legal certainty. The new tax regulation needs to accommodate a more precise direction of the policy. Among the three available options, this study favors realization taxation as a more appropriate option for Indonesia's current situation, other than mark-to-market or hybrid taxation. To narrow the practical gap between accounting and tax, this study recommends that tax authorities initiate a discussion with relevant stakeholders to prevent potential tax disputes in the coming years. Tax authorities need to notice some issues with withholding tax when the lessee records interest expenses as well as transfer/delivery issues causing VAT payable when the lessee recognizes a right-of-use asset.*

Keywords: *lease, IFRS 16, PSAK 73, income tax, value-added tax*

Abstrak: *Penelitian ini menganalisis isu-isu terkait Pajak Penghasilan (PPh) dan Pajak Pertambahan Nilai (PPN) atas transaksi sewa setelah konvergensi IFRS 16 di Indonesia menjadi PSAK 73. Pengumpulan data dilakukan melalui wawancara mendalam dengan informan yang dipilih secara purposive. Kami juga menggunakan data sekunder untuk memperkaya analisis. Penelitian ini menyimpulkan bahwa otoritas pajak perlu membuat kebijakan perpajakan yang dapat memberikan kepastian hukum. Regulasi perpajakan yang baru perlu mengakomodasi arah kebijakan yang lebih tepat. Di antara tiga opsi yang tersedia, penelitian ini cenderung pada realization taxation sebagai opsi yang lebih sesuai untuk situasi terkini Indonesia daripada mark-to-market atau hybrid taxation. Untuk mempersempit kesenjangan praktis antara akuntansi dan pajak, sebaiknya otoritas pajak memulai diskusi dengan para stakeholder terkait demi mengurangi potensi sengketa pajak di tahun-tahun mendatang. Otoritas pajak perlu memerhatikan isu withholding tax saat lessee mencatat biaya bunga, serta isu penyerahan yang mengarah pada isu PPN terutang saat lessee mengakui aset hak guna.*

Kata Kunci: *sewa, IFRS 16, PSAK 73, pajak penghasilan, PPN*

1. Introduction

Statement of Financial Accounting Standard (SFAS) 73 or PSAK 73 Leases has been effectively valid in Indonesia since January 1, 2020. To understand PSAK 73, we need to refer to IFRS 16 Leases as the reference of PSAK 73. IFRS 16 prevails since January 1, 2018. The background of the issuance of IFRS 16 is the current condition when the information in the financial statements related to leases is deemed unable to meet the users' needs. The background that highlights the adoption of IFRS 16 is that financial statements do not always provide leasing transactions' faithful representation since there are various ways to account for the leases (Edman, 2011). According to International Accounting Standard (IAS) concerning Leases 17 superseded by IFRS 16, lessees did not recognize assets and liabilities arising from operating leases (Rapoport, 2013; Săcărin, 2017).

The implementation of IFRS 16 significantly impacts lessees' financial statements (Čevizović & Mijoč, 2019). Therefore, PSAK 73 must also have significant implications for lessees' financial statements since it adopts IFRS 16. Under PSAK 30 Leases (IAI, 2011), which was later superseded by PSAK 73, lessees distinguished between operating lease and finance lease. PSAK 73 requires lessees to recognize almost all of their lease contracts in their statements of financial position. Such a requirement is inapplicable for short-term leases (less than 12 months) and low-value leases. Meanwhile, IFRS 16 adopted to PSAK 73 introduces a single accounting model for lessees (Săcărin, 2017). As a result, substantial changes will occur to lessees' financial accounts depending on the current operating lease volume (Morales-Díaz & Zamora-Ramírez, 2018b).

A lessee must recognize its leased asset representing its right-of-use asset and a lease liability representing its obligation to pay the lease. As a result, the right-of-use asset results in a depreciation issue, whereas the lease liability results in the interest issue (Hladika & Valenta, 2018). The lessee's cash flow statement also needs to present cash payments on the lease liability and interest expense (Săcărin, 2017). In the context of Indonesia, the lessee should apply PSAK 2 concerning the Statement of Cash Flows.

The lessee measures the right-of-use asset and the lease liability by using present value (Morales-Díaz & Zamora-Ramírez, 2018b). Besides, the lessee's measurement includes payments settled during the optional period for both conditions. The first is that the lessee has a bargain purchase option to extend the lease if reasonably sure to exercise the option. The second is that the lessee has the option to terminate the lease if reasonably sure not to exercise the option.

IASB also issued a Basis for Conclusions on IFRS 16 Leases (IASB, 2016), summarizing basic conclusions and reasons for preparing accounting arrangements under IFRS 16. IFRS 16 introduces a single lease accounting model for lessees with a "right-of-use" accounting model for leased assets with maturities of more than 12 months and non-low value assets (Segal, 2020). Under the "right-of-use" accounting model, the lessee will record the lease transaction by debiting the right-of-use asset and crediting the lease liability. Besides, the lessee also records lease transactions at value based on the time value of money.

Literature shows several studies concerning IFRS 16 and its impacts. The literature discusses and analyzes various topical subjects and regions. Some of them are lease reporting ahead of the implementation of IFRS 16 by corporate real estate in Australia (Heywood, 2020), its impact on the economic (Giner et al.), its consequences on financial statements (Hladika & Valenta, 2018; Săcărin, 2017) and financial indicators (Săcărin, 2017). Other studies also investigate its impact on company decisions on financial statements (Morales-Díaz & Zamora-Ramírez, 2018a), the effect on the case of maritime companies' financial statements (Belesis et al., 2021), the impact on airline companies in China (Yu, 2019), or the effect on key financial ratios (Joubert et al., 2017; Morales-Díaz & Zamora-Ramírez, 2018b). For the Indonesian setting, Mashuri and Ermaya (2021) have analyzed the application of lease accounting standards on the performance of companies' financial statements listed on the Indonesian stock exchange. However, from the literature that we have detailed, only a few of them discuss the tax aspect.

The tax implications for the IFRS 16 adoption have emerged in several cases in certain jurisdictions, such as aspects of income tax and value-added tax in the UK (Agarwal, 2019; Walker, 2018). However, taxation principles adopted in various jurisdictions are different. The tax aspect of lease transactions will depend on the relevant tax policies in each country (Yu, 2019). For the case in Indonesia, Iswandana et al. (2019) explore the tax implications of IFRS 16 convergence, although it is limited to the telecommunications industry. In the same setting, Nasip, and Sudarmaji (2018) also conducted a comparative study of the possibility of applying IFRS 16 and the tax aspects of retrofit project financing. We see research gaps that need to discuss aspects of taxation at a broader level.

The tax provisions in Indonesia regarding leases have not changed (Gunawan & Yuliani, 2018; Iswandana et al., 2019). We identified a Minister of Finance Decree No. 1169/KMK.01/1991 (from now referred to as “KMK-1169/1991”), which has prevailed effectively since January 19, 1991, until now. The issuance of the decree refers to the 1983 Income Tax Law. According to Procházka (2017), one of the unintended consequences of IFRS convergence is taxation and regulatory task. Anyhow, an astonishing fact reveals that throughout 2020 Government of Indonesia and parliament agreed to amend tax legislation twice through an omnibus law model (Khozen et al., 2021; Saptono & Khozen, 2021b). Unfortunately, they have not amended clauses resulting in accounting issues at all. As Olfa and Walid (2018) revealed, one of the reasons might be that the IFRS convergence worldwide is not a response to any government policy.

Several studies have shown an increase in the quality of accounting information after changes in accounting standards (Karunia et al., 2020; Lestari & Takada, 2015). Thus, based on the phenomena and research gap described above, this study aims to analyze the tax treatment of leases in Indonesia, issues emergent after the convergence of IFRS 16, and tax aspects related to leases transactions under PSAK 73. The scope of this article includes income tax and VAT (value-added tax). To provide an adequate picture of the issues we examine, we use an exploratory qualitative research approach.

The selection of the Indonesian setting for the case of Income Tax and VAT as an implication of the IFRS 16 adoption is the main contribution of this study. The significant practical contribution of this study is to outline three primary materials related to tax aspects surrounding PSAK 73 that can be taken into account by the relevant parties. However, this study does not provide a quantitative presentation of the impact of IFRS 16 on taxation but rather an attempt to enrich the current debate on tax aspects while informing policy considerations. As an exploratory, it can be the basis for further research, which may be a quantitative approach.

The remainder of this study organizes sections as described in the following. Section 2 contains a literature review related to leases accounting on IFRS 16, its development, and the history of its regulation in Indonesia. Then, we propose several prepositions from the available literature. Section 3 presents our approach in conducting this study. In Section 4, we synthesize the results of this study, revealing broader findings of the developed prepositions. It begins by describing the tax treatment of leases in Indonesia, then develops prepositions based on the issues and tax implications of IFRS 16 convergence. Finally, in section 5, we summarize and conclude the content of this study and identify limitations and recommendations for further research.

2. Literature Review

Warren (2016) identified a substantial change from the adoption of IFRS 16 by predicting the reporting of almost all leases as assets and liabilities on the balance sheet. He emphasized that the paradigm, shifting leases to the balance sheet, could affect the critical financial ratios derived from the company's balance sheet and debt-to-equity ratios and any agreement that seeks to maintain a certain level of ratio associated with the balance sheet. Meanwhile, Joubert et al. (2017) examine the implications of operating lease inclusion in the balance sheet for large companies in the aviation and telecommunications sectors on the Australian stock exchange. They found that the inclusion of previously operating leases impacted increasing returns on total assets and debt-to-equity ratios.

Morales-Díaz and Zamora-Ramírez (2018a) stipulate that the impact of IFRS 16 will depend on the intensity of the lease carried out by each company. Therefore, they outline the need for a strategy for companies to deal with the impacts arising from IFRS 16. Fundamentally, Segal and Naik (2019) identify the impact of implementing IFRS 16 for the South African context with six potential changes and implications. They identified the parties affected, from lenders, drafters, and analysts, and the sectors most commented on were banking and retail. Prior, Sari et al. (2016) had simulated the effect of IFRS 16 on the retail sector in Turkey. As a result, the new standard has a significant effect on several financial ratios tested for 2010-2013, namely debt/assets, debt/equity, return on assets (ROA), and return on equity (ROE).

In the real estate sector for the case in Australia, Heywood (2020) describes the practice of reporting on corporate real estate (CRE) before the implementation of IFRS 16, which shows that there is biased reporting on leasehold CRE information. Yu (2019) also analyzed lease accounting on IAS 17 and IFRS 16 and their impact on airlines in China. The research identification of the loss of off-balance-sheet gains on operating leases highlights that those who rely on operating leases must consider the impact of lease capitalization by making adjustments to their business. Carrying lease payable on the balance sheet, which is likely to be experienced by a company that has traditionally held a large number of operating leases, could have a material impact on its financial statement ratios (Segal & Naik, 2019).

The literature review shows that research related to IFRS 16 has been carried out in various areas even though it has minimally identified tax aspects. However, we have identified some of them. For example, Walker (2018) cites the UK government's reluctance to move away from the *status quo* so that lessees for tax purposes will still classify leases as finance leases or operating leases. However, only finance leases result in potential financial burden restrictions under the Corporate Interest Restriction (CIR) rules. Given a similar situation, Agarwal (2019) analyzes each of three tax implications for the UK case: (i) operating leases, in which the lessee chooses to apply IFRS 16 so that the leased asset and lease liability are recognized; (ii) operating leases, for which

the lessee chooses not to apply IFRS 16, so there is no recognition of the leased asset and lease liability; and (iii) finance leases.

Agarwal (2019) identifies the VAT aspect for the first and second situations because it is not an “installment credit agreement” but a rental agreement. Therefore, VAT claims are for each installment and are not upfront on the total cash cost. For the third situation, if it qualifies as an installment credit agreement, the lessee must claim the input VAT upfront on the total cash costs of the underlying transaction. For the Corporate Tax implications of the first situation, a higher burden on the Income Statement in the early years results in temporary differences. Therefore, the lessee needs to recognize deferred tax assets/liabilities.

For the second situation, a lease of fewer than 12 months generally results in a constant annual fee. Because there are no significant changes to the new standard, there are no deferred tax assets or liabilities on the lessee’s books, and lease payments are deductible expenses. For the third situation, a finance lease, the lessee in its books recognizes a deferred tax asset or liability. In addition, the lessee needs to consider depreciation under the Capital Allowances Act and interest expenses under the Interest Restriction rules on deductibility.

For the Indonesian setting, research conducted by Nasip and Sudarmaji (2018) initiated the management of tax disputes regarding the implications of IFRS 16 on the financing of retrofit projects. Retrofit constitutes “replacing old equipment with new equipment and or building new infrastructure to increase energy efficiency and reduce utility costs before the old equipment is damaged or its economic life runs out” (Nasip, p. 201). This case study underscores the urgency of handling and co-management with tax officials regarding misperceptions on retrofit projects due to business constraints, including the impact of IFRS and taxation.

2.1. Lease Accounting Dynamic

Lease transactions are increasingly popular in their development and have become one of the fastest-growing capital investment forms (Kieso et al., 2018). Instead of borrowing funds to buy assets such as planes, computers, or satellites, companies have

more periodic payment funds to lease these assets. As a result, many global companies seem to corroborate Aristotle’s words that wealth does not lie under ownership but in the use of things (Miller, 1986).

A simple example is a lease transaction involving a minimum of two parties: the lessor and the lessee. The lessor agrees to lease the leased asset to the lessee, just as the lessee agrees to use the leased asset and pays the lease compensation over the lease term. Based on this simple understanding, the IASB (International Accounting Standard Board) defines a lease as “a contract, or part of a contract, that conveys a right-of-use asset (the underlying asset) for a period in exchange for consideration” (IASB, 2016). IAI also adopted this definition into PSAK 73.

If the lease duration is less than one year, it is easy to apply accounting treatment for the lessor and the lessee. The lessor recognizes rental income when the lessee completes the payment (Deloitte, 2020) and accrues rental expenses. When the lease contracts exceed one year, several options exist for making different lease accounting treatments. A classic example of a long-term lease story like this one is the rental of planes in the airline industry (Kieso et al., 2018). Conceptually, long-term lease transactions are comparable to asset purchase transactions on credit (Table 1).

Table 1.
Accounting treatment between long-term leases and purchases of assets on credit

No.	Transaction	Accounting Treatment
1.	PT Airlines borrowed funds from PT Finance for ten years to buy 1 unit of aircraft from PT Aircraft.	PT Airlines debits the aircraft’s fixed assets purchased in cash from PT Aircraft and credits long-term debt to PT Finance.
2.	PT Airlines buys 1 unit of aircraft from PT Aircraft on credit for ten years.	PT Airlines debits the aircraft’s fixed assets purchased in cash from PT Aircraft and credits long-term debt to PT Aircraft.
3.	PT Airlines leases one aircraft from PT Lease for ten years.	There are four options for accounting treatment: a. PT Airlines does not recognize aircraft fixed assets but only debits the rental expense and credits the bank/cash related lease payments to PT Lease; b. PT Airlines capitalizes the chartered aircraft assets such as Transaction No. 2 (IASB

No.	Transaction	Accounting Treatment
		chose this option due to the consideration of the concept of substance over form);
		c. PT Airlines capitalizes long-term leased aircraft assets; or
		d. PT Airlines capitalizes the assets of irrevocable leases if the sanctions are significant.

From the example of the accounting treatment for long-term leases following Table 1, IASB emphasizes that PT Airlines must capitalize leased assets, which substantially transfers all the benefits and risks of ownership of aircraft assets as long as the contract cannot be canceled (Kieso et al., 2018). The criteria for transferring all benefits and risks of ownership make the lease transaction divided into two: (1) capital/finance lease; and (2) operating lease. If there is no transfer of all the benefits and risks of ownership of the leased asset, the lease is an operating lease. The opposite condition is a finance lease. Therefore, companies involved in leasing contracts must identify characteristics that indicate a substantial transfer of all the benefits and ownership risks.

The term “capital lease” is used in US GAAP (the United States Generally Accepted Accounting Principles) because the standard treats leased assets as if the lessee owned them so that the lessee recognizes them as assets in the statement of financial position (Chaudhry et al., 2015). The description above underlies IAS 17 Accounting for Leases published in 1982 and revised in 2003 and 2009. PSAK 30 (1990) concerning Leases (IAI, 1990) also adopts the same basic concept. However, the criteria to qualify as a finance lease in PSAK 30 (Revised 2007) before IFRS (effective before 2012) are more stringent than operating leases. The finance lease must meet all criteria, while PSAK 30 (Revised 2011) based on IAS only meets at least one criterion to be categorized like a finance lease (Ahalik, 2019).

Proposition 1 (P1): *There is a significant difference between PSAK 30 based on US GAAP (1990) and PSAK 30 based on IAS (revised 2011).*

In subsequent developments, the IASB & FASB consider that the lease accounting model that existed before IFRS 16 failed to meet the financial statement users (IASB,

2016, par. BC3) due to three criticisms. First, information about operating leases is less transparent, resulting in information asymmetry in the market. Second, both lease accounting models (operating lease & finance lease) have similar economic substance, but the accounting treatment is so different that comparability decreases and opportunistic behavior arise. Third, the requirement to disclose sufficient information to lessors in previous financial accounting standards was lacking, particularly for credit risk and asset risk on leased assets classified as operating leases.

The first and second criticisms give rise to a new approach to lease accounting for lessees, which must recognize assets and liabilities for all lease transactions with terms of more than 12 months and non-low value assets (BC4). The new approach is known as the “right-of-use” accounting model for the lessee so that there is no longer an operating lease model. The accounting model for the lessor has not changed (finance & operating lease). With this new approach, the IASB believes that lease accounting reporting for lessees will improve the characteristics of faithful representation and transparency (IASB, 2016, par. BC4). As for the third criticism, the IASB works around this by setting obligations to expand the lessor’s risk exposure (BC4).

Burcă et al. (2019) stipulate that numerous studies underline the importance of higher financial transparency, especially in increasing financial disclosure. The aim is none other than provide a clearer picture to users of financial reports regarding the reasons accountants use in the accounting and reporting process. In turn, the IASB and the FASB agreed on lease accounting as the last project in achieving accounting harmonization and convergence (Rey et al., 2020).

PSAK 73 tightens the requirements for operating leases in the Indonesian context but simplifies finance lease requirements (Ahalik, 2019; Mashuri & Ermaya, 2021). Operating lease requirements must cover the following: (1) the lease term is up to 12 months; (2) the lease involves low-value assets. When not qualifying the two requirements, a lease transaction under PSAK 73 constitutes a finance lease. Besides, all lease transactions that meet the lease definition are treated as a finance lease from the lessee’s perspective. Therefore, the lessee has to present the lease transaction in its

statement of financial position by recognizing a right-of-asset account and a lease liability account (Iswandana et al., 2019).

Proposition 2 (P2): *PSAK 73 differs from PSAK 30 since PSAK 73 adopts a single lease accounting model for lessees so that lessees only recognize lease transactions based on finance leases.*

2.2. Development of Lease Accounting in Indonesia

PSAK 30 (IAI, 1990) became the basis for leasing arrangements in Indonesia for subsequent periods. The standard is also the basis for taxation arrangements under KMK-1169/1991. Until now, KMK-1169/1991 is still valid (Iswandana et al., 2019). However, KMK-1169/1991 only regulates tax provisions for direct financing leases and does not cover sales-type lease models due to the definition of the lessor that limits only to finance companies. Table 2 summarizes the development of accounting standards regarding leases in Indonesia.

Table 2.

The development of accounting standards regarding lease in Indonesia

No.	PSAK/SFAS	Revised Year	Effective Period	Reference
1.	PSAK No. 30 Leasing	1990	1991-2007	<ul style="list-style-type: none"> • US GAAP (SFAS No. 13 Accounting for Leases (FASB, 1976)) • IAS 17 Accounting for Leases (IASC, 1982)
2.	PSAK 30 Lease	2007 Revision	2008 – 2011	IAS 17 (IASC, 2003)
3.	PSAK 30 Lease	2011 Revision	2012 – 2019	IAS 17 (IASC, 2009)
4.	PSAK 73 Lease	2018	Starting from 2020	IFRS 16 Leases (IASB, 2016)

The principles referred to in PSAK 30 (IAI, 1990) are SFAS 13 from US GAAP. The principles in PSAK 30 then shifted to refer to international accounting standards under IAS 17 after the revisions in 2007 and 2011. We do not find in the accounting regulatory literature in Indonesia that political aspects influence the adoption of an accounting standard as much as in Australia (Zeff, 2002). However, that does not mean it has never happened. The fact that the tax principle on leases still refers to the old standard could raise new issues in the following years. Accounting and taxes have not faced severe problems for the standards applied under PSAK 30 (2007 and 2011

revision). However, when the adoption of PSAK 73 has been effective since 2020, tax accounting and financial accounting begin to differ drastically.

Proposition 3 (P3): *There is a significant difference between the arrangements regarding leases under KMK-1169/1991, which have not changed, and the arrangements under accounting standards that have often evolved*

With the enactment of PSAK 73 with an approach that records all lease transactions as capital/finance leases, it will cause interest expenses and also depreciation expenses on leased assets (Gunawan & Yuliani, 2018). Changes in the recording of these expenses affect the decline in tax revenues in Indonesia, especially from Article 23 of Income Tax and Value Added Tax (VAT) as stipulated in KMK-1169/1991. The regulation states that the delivery of services in operating lease transactions is the object of VAT. Likewise, with the payment of leases with option rights (finance leases), there is no withholding of Income Tax Article 23.

Proposition 4 (P4): *Part of the impact of the convergence of IFRS 16 or PSAK 73 in Indonesia is the potential loss of tax revenue.*

3. Research Method

This study is exploratory since few studies concerning IFRS convergence, especially those related to taxation aspects in Indonesia. This study was conducted by exploring the concepts and practices of implementing IFRS 16 or PSAK 73 in Indonesia. We use qualitative methods to obtain a more comprehensive explanation, where the data collection techniques through literature studies and strengthened with in-depth interviews. We collected data from literature studies by looking for theoretical references relevant to issues related to the implementation of PSAK 73 (Table 3).

Table 3.
Details of Documents as Research Data Sources

No.	Group	Types of Documents
1.	Accounting	a. Financial Reporting Conceptual Framework issued by IASB and IAI; b. PSAK issued by IAI; and c. books, thesis/dissertation research results, and scientific journals related to research objectives and topics in various countries.

Table 3.
Details of Documents as Research Data Sources

No.	Group	Types of Documents
2.	Tax Policy	<ol style="list-style-type: none"> a. scientific books and journals related to tax accounting; b. legislation in the field of taxation, which includes laws, government regulations, regulations of the Minister of Finance, and regulations of the Director-General of Taxes; and c. circular and letters of the Director-General of Taxes.

Document data analysis is the first step taken when we conducted this study. First, we analyzed the documents obtained to support the understanding of the phenomenon studied. The literature study technique gathers information related to the topic of interest, which involves identifying, recording, understanding, making meaning, and conveying information (Onwuegbuzie & Frels, 2016). Document data analysis resulted in specific codifications, which became the basis for preparing interview questions (Table 4).

Table 4.
Interview Guidelines

1.	Development of tax accounting before and after the implementation of IFRS in Indonesia
a.	How is the development of tax accounting thinking in Indonesia before and after the IFRS convergence in Indonesia?
b.	What are the reasons for the use of “bookkeeping,” not “accounting,” in the General Provisions and Tax Procedures Law (KUP Law)?
c.	Regarding leases in PSAK 30, which has changed to PSAK 73. If we look at the tax provisions regarding Leases, the complete one is in KMK 1169/1991. However, the rule still refers to PSAK 30 (version 1990). the question is whether the provisions regarding leases are still relevant to current conditions, even though the rules still refer to the old ones?
2.	Accounting and tax connections before and after the IFRS convergence
a.	How has the connection between accounting and tax regulations developed in Indonesia since 1983 up to now? Is the difference between accounting and tax settings getting larger or smaller?
b.	How is the interpretation of bookkeeping provisions under Article 28 paragraph (7) of KUP Law after PSAK converged with IFRS since the rule does not change before and after IFRS convergence?
c.	Regarding leases, especially for lessees who no longer record rent expenses but nowadays record them as interest expense, then amortize the lease payable. Now the question for the lessee is, is the withholding of the income tax on interest expense or on rent expense which is no longer visible in the accounting records?
d.	How to achieve legal certainty regarding the gap between tax regulations and the development of accounting standards?

We selected informants for in-depth interviews purposively, namely those with relevant knowledge and information relating to the research topics (Anastasiu & Georgescu, 2020). The informants in this study consisted of members of the Accounting Standards Board (DSAK) IAI for the 2018-2020 period (Informant X1), a lecturer from Universitas Indonesia, and Head of the Sub-directorate of Corporate Income Tax regulations at the Directorate of Tax Regulations II, Directorate General of Taxes (DGT) (Informant X2), a tax consulting practitioner (Informant X3), a tax practitioner in a go-public company (Informant X4), and a formulator of Corporate Income Tax Policy at DGT (Informant X5).

We interviewed the informants using a recording device and written notes. We then transcribed the interview results and performed manual processing by comparing them with literature studies related to research. In this regard, we processed primary data and secondary data and described them in a narrative form according to the data needs of the discussion.

The data analysis of this study, following Creswell (2013), consists of several activities. First, after collecting data and information from the field, we organized the data into several categories, transformed the data into stories or descriptions, and wrote them into text. Second, regarding the amount of field study data that we obtained, we manually represented it into several patterns and categories following codes and themes, then interpreted it by triangulating it with accounting standards and tax laws. Finally, we compared one interview result to another one and compared interviews before the documentation data. We used such techniques to ensure that we could justify that every conclusion in this research has a high level of validity.

4. Results and Discussion

Under Income Tax Law (UU PPh), there are two terms for leases that we know widely. First, rent and other income in connection with the use of assets. This type of lease arrangement is under UU PPh Article 4 paragraph (1) letter i, Article 23 paragraph (1) letter c item 1, and Article 26 paragraph (1) letter c, as well as the Director-General of Taxes Circular Letter No. SE-35/PJ/2010. Referring to point 2 of SE-35/PJ/2010, the

terminology of this type of lease is income received or obtained in connection with an agreement to grant the right to use of the property for a certain period either with a written or unwritten agreement so that the rights recipient can only use the property during the agreed period.

The second type of lease is Leasing (SGU). For this type of lease, the arrangement is under UU PPh Article 9 paragraph (1) letter c item 1 and Article 23 paragraph (4) letter b, as well as KMK 1169/1991. Article 1 letter a of the decree defines SGU as a financing activity in providing capital goods, either with an option right (finance lease) or without an option right (operating lease) to be used by the lessee for a certain period based on periodic payments. From the perspective of Indonesian taxation, the classification of leasing activities with option rights (finance lease) or without option rights (operating lease) depends on whether or not the tax regulation fulfills the criteria, as summarized in Table 5. Therefore, the table also compares the lease definition under perspectives of accounting and taxes.

Table 5.
Lease according to accounting and tax in Indonesia

Description	Accounting	Tax
Definition of lease	A lease is an agreement between the lessor and the lessee, wherein the lessor assigns the right to the lessee to use the asset for an agreed period. As a consideration, the lessor receives a payment or series of payments from the lessee.	<ul style="list-style-type: none"> ▪ Leasing is a financing activity in the form of provision of capital goods, both Leasing with option rights (finance lease) and Leasing without option rights (operating lease) to be used by the lessee for a certain period based on periodic payments (KMK 1169/1991) ▪ Leases and other income in connection with the use of assets as referred to in Article 23 point 1 letter a UU PPh are income received or obtained in connection with an agreement to grant the right to use assets for a certain period either with a written or unwritten agreement so that the correct recipient can only use the assets for the agreed period [Point 2 SE-35/PJ/2010]
Finance lease	A lease is a finance lease if it substantially transfers all the risks and rewards incidental to ownership of the underlying asset.	A lease is categorized as Leasing with option rights if it meets all of the following criteria: <ol style="list-style-type: none"> a. the leasing payment amount during the first leasing period must be sufficient to cover the cost of leased capital goods plus the calculation of the lessor's profit;

Description	Accounting	Tax
Operating lease	Property rights are ultimately transferable or non-transferable	b. The leasing period is stipulated to be at least two years for Group I capital goods, three years for Group II and III capital goods, and seven years for buildings group; c. the clause regarding option rights for lessees is explicitly on the leasing agreement.
	if the lease does not substantially transfer all the risks and rewards incidental to ownership of the underlying asset, the lease constitutes an operating lease.	A lease is categorized as Leasing without option rights if all of the criteria below are met: a. the leasing payment amount during the first leasing period is not sufficient to cover the cost of leased capital goods plus the calculation of the lessor’s profit; b. the clause regarding option rights for lessees is not on the leasing agreement.

The tax provisions further limit the meaning of the lessor and lessee in the lease transaction. KMK 1169/1991 defines a lessor as a finance company or leasing company that has obtained a business license from the Minister of Finance and carries out SGU activities. Thus, to comply with tax regulations, the lessor needs to obtain a license as a finance company from the Minister of Finance. Meanwhile, a lessee is a company or individual that uses capital goods with financing from the lessor so that the lease is subject to VAT. Under UU PPh, the imposition of taxes on rent or other income from the use of assets is under various implementing provisions (Table 6).

Table 6.
Types of leases and the withholding taxes

No.	Type of Leases	Income Tax Treatment	Tax Rate	References
1.	Finance leases			
	a. Without option rights	Subject to Article 23 UU PPh	2%	Article 23 UU PPh
	b. With option rights	Not subject to Article 23 UU PPh	–	Article 23 UU PPh
2.	Operating lease			
	a. Renting land and or building	Subject to Article 4 par. (2) UU PPh	10%	Government Regulation No. 5/2002; Minister of Finance (MoF) Decree No. 120/KMK.03/2002; and GR No. 34 of 2017
	b. Renting ships from domestic shipping	Subject to Article 15 UU PPh (final)	1,2%	

No.	Type of Leases	Income Tax Treatment	Tax Rate	References
	companies			
c.	Renting aircraft from domestic aircraft companies	Subject to Article 15 UU PPh (non-final)	1,8%	
d.	Renting ship/aircraft from international shipping/aircraft companies	Subject to Article 15 UU PPh (final)	2,64%	
3.	Use or the right to use industrial, commercial, or scientific equipment (royalty)	Subject to Article 23 UU PPh	15%	Article 23 UU PPh
		Subject to Article 26 UU PPh	20% or following tax treaty (P3B)	Article 26 UU PPh
4.	Leases other than those mentioned lease above	Subject to Article 23 UU PPh	2%	Article 23 UU PPh & MoF Regulation No. 244/PMK.03/2008

4.1. Issues Concerning IFRS 16 Convergence in Indonesia

The analysis of this study produces a different picture of the impact of the implementation of IFRS 16 in Indonesia on income tax and VAT issues. However, since the tax base that is the reference for leases has not changed, this attempts to complement the previous findings and recommendations on tax and accounting harmonization discussed in the literature and summarized in prepositions 1-5. Thus, this study yields new insights beyond the literature and is formulated in the following prepositions A-E.

PSAK 73, which replaced PSAK 30 starting January 1, 2020, relates to lessees' transactions (Kumar et al., 2018). While lessors' recognition has not changed significantly since the IASB decide to resume the capital lease accounting treatment for lessors by referring to the standard under IAS-17 (Nasip & Sudarmaji, 2018). The lessors continue classifying the lease as operating or finance leases (Čevizović & Mijoč, 2019). The adoption of IFRS 16 led to the emergence of additional taxes, starting from understanding the impact of changes in lease accounting from an existing tax perspective, preparing initial adjustments for deferred tax, and compiling a tracking book for each transaction or tax difference (EY, 2016).

Concerning the application of PSAK 73, we raised two issues with sources. The first issue relates to the tax provisions on Leasing (KMK 1169/1991) issued in 1991 and refers to PSAK 30 Leasing Business (IAI, 1994). The second issue relates to withholding tax by the lessee after the entry into force of PSAK 73. For the first issue, under UU PPh, there are two terms of leases. The first term is “rent and other income in connection with the use of assets” under Article 4 paragraph (1) letter i of UU PPh. The second term is “leasing with option rights” under Article 9 paragraph (1) letter c and Article 23 paragraph (4) of UU PPh.

Leasing (Sewa Guna Usaha; SGU) consists of leases with option rights (finance lease) and leases without option rights (operating lease). The treatment of income tax on SGU, either with option rights or without option rights, refers to the minister of finance regulation (KMK 1169/1991) that is still valid today and has never been revised. On the other hand, the term SGU which first appeared in PSAK 30 (IAI, 1994), has been changed twice in 2007 and 2011 (IAI, 2011) until finally starting from 2020, replaced by PSAK 73 Leases (IAI, 2017). Therefore, the tax provisions regarding SGU (KMK 1169/1991) refer to PSAK 30 concerning Leasing (IAI, 1990), an essential fact that the Minister of Finance’s regulation regarding SGU has not undergone any revision to date.

Related to the first issue regarding leases above, an informant (Informant X1) emphasizes the fact about the application of PSAK 73, which shows that the accounting world has developed so significantly. However, at the same time, the tax arrangements are still unchanged. As a result, tax arrangements are retarded behind. To resolve that issue, he suggests as follows:

“I might, instead of speculating on which system is the most specific, of course, I might even suggest this. DGT needs to sit together with stakeholders related to accounting. The policymakers (BKF or Badan Kebijakan Fiskal and DGT) and other stakeholders should discuss together to find the best solution. We do not follow all accounting principles, but we should consider tax principles.”
(Informant X1)

Another informant (Informant X2) also underlines that the regulation regarding SGU (KMK 1169/1991) is no longer relevant with current development. However, the

decree is still valid and used by tax officials because Finance Minister has not revoked the rule yet, as disclosed by the informant below. Thus, the tax arrangement that stands in place while the rapidly growing accounting arrangement (P3) needs modification in light of the doubts about the relevance of the tax arrangement.

“For KMK, yes, because it has not been under revocation, we automatically still use it, even though now it is very contrary to accounting principles. Now there are a lot of arrangements, like ISAK 8 and ISAK 16. They also regulate whether or not the transaction constitutes a lease. When the transaction is leasing, we, as tax officers, only hold to KMK 1169/1991. If it does not include inclusive under KMK 1169/1991, it is not in the lease category. In the current condition (the rule), we still use it.” (Informant X5)

Proposition A: *There are significant developments in accounting arrangements that make tax arrangements on leases far behind and possibly irrelevant.*

The second issue relates to whether the lessee has to deduct Income Tax on rental expenses that they never record again in the journal entries. Lessee also has questions about withholding tax related to interest expense according to the journal entries they compile under PSAK 73, even though it is not related to the lessee’s loan to the lessor. The recognition of assets for lease transactions is related to the balance sheet orientation concept and the definition of assets, including rights, potential to generate economic benefits, and controls. Thus, the recognition of assets is not related to ownership of these assets because accounting treatment also emphasizes the substance aspect, not only the legal aspect (substance over form). A transaction should indeed present the substance of the transaction and economic reality, not only in its legal form (Martani et al., 2012).

For this matter, according to the informants (X1; X2), the tax authorities should look again at that it is a lease contract, not a loan contract. Therefore, in this case, the tax authorities need to look at the legal form. Instead of supporting the issue of reducing potential tax revenues due to the implementation of PSAK 73 (P4), we put more emphasis on the emerging administrative burdens borne by the lessee.

Proposition B: *Since the implementation of PSAK 73, the lessee no longer keeps a recording journal in the form of withholding tax on rental/lease expenses but requires to record interest cost and amortization of the leased asset. Therefore, the lessee needs to make positive fiscal corrections for tax purposes. On the other hand, the lessee also needs to make a negative correction on the rental/lease expenses and impose income tax based on such expenses.*

Besides, since the tax imposition is very different, the alternative solution is for the tax authorities to discuss with the relevant stakeholders to make arrangements that provide more legal certainty (Informant X1). Firms tend to make creative decisions, especially when situations are full of uncertainty and ambiguity (Meredith & Baxter, 2017). The legal certainty principle is fundamental in a taxation system (Saptono & Khozen, 2021b). When the state is too late to eliminate creative accounting, the only steps are to impose significant fines and use court resolution (Blazek, 2021), all of which result in enormous costs. According to practitioners (Informant X3; X4), companies in Indonesia are well-experienced in finding loopholes in tax regulations. Therefore, to further promote legal certainty, all relevant stakeholders need to meet and have intensive discussions to obtain the best solution.

Proposition C: *To provide more legal certainty regarding tax treatment on leases, it needs an alternative solution allowing the relevant stakeholders to discuss together.*

4.2. Tax Implications after IFRS 16 Convergence

For the Indonesia situation, we can analyze the tax implications of the implementation of PSAK 73 from the development of tax accounting for leases since the passage of the 1983 UU PPh and its amendments. Two implications need to get a solution in terms of legal certainty and the ability-to-pay principle to minimize tax disputes in the future: clarity of SGU arrangements by the Minister of Finance and the basis for measuring lease benefits as an object of Income Tax. For the first implication, the two lease terms under UU PPh still do not provide clarity for taxpayers, especially the term leasing (SGU), where the arrangement is specific under a Minister of Finance decree (KMK 1169/1991).

From the accounting side, SGU and lease terms have the same word background when referring to PSAK 30 in 1990. However, from the tax perspective, the two phrases

have different meanings under UU PPh. The SGU term with option rights in Article 9 paragraph (1) letter c and Article 23 paragraph (4) letter b of UU PPh does not get an adequate interpretation in the explanatory section of the referred provisions. The tax regulation on SGU by the Minister of Finance (KMK 1169/1991) also does not refer to specific articles on UU PPh as the basis for its implementation. Although the Minister of Finance's consideration of the tax arrangements for SGU is to provide legal certainty, its implementation often creates uncertainty.

Spirit regarding leases in KMK 1169/1991 is a direct-financing lease. As stated by Kieso et al. (2018), direct-financing leases are generally regulatory products with lessors engaged in the financing business, such as banks and insurance companies. Therefore, tax auditors often use this provision when they obtain findings concerning finance leases that refer to PSAK 30 Leases even though they are in the form of sales-type leases, not direct-financing leases, which are the spirit of KMK 1169/1991. Therefore, the policy choice regarding leases is to harmonize the tax arrangements according to a higher hierarchy of rules to increase legal certainty and clarity. In addition, it is in line with the literature (Gunawan & Yuliani, 2018; Iswandana et al., 2019), which supports the convergence of tax and accounting rules to minimize compliance costs so that many fiscal corrections are no longer needed (P5).

For the second implication, tax disputes could arise after the entry into force of PSAK 73 are the basis for measuring the finance lease for tax purposes. However, the measurement basis for operating leases for lessors does not raise tax issues because they are both income-statement oriented and based on historical cost. Meanwhile, the measurement of operating lease transactions for lessees refers to fair value accounting (FVA) that emphasizes the time value of money consideration. Thus, options of tax policy relevant to finance leases are (1) mark-to-market taxation, (2) realization taxation, or (3) hybrid taxation (see Budi & Rahayu, 2021; Saptono & Khozen, 2021a; Saptono & Rahayu, 2020).

The mark-to-market taxation or accrual taxation option can increase book-tax conformity because it aligns with the ideal SHS concept and aligns with mark-to-market

accounting (FVA) underlies PSAK 73. However, this choice can lead to uncertainty of measurement basis since the considerations come from the taxpayer. Taxpayers' considerations and estimations may differ from tax officials to potentially increase tax disputes and tax litigation. The impact of IFRS 16 and taxation are part of the business constraints that need joint handling to manage tax disputes (Nasip & Sudarmaji, 2018). In addition, the issue of compliance costs potentially increases since the cost for proofing transactions refers to FVA.

Meanwhile, the realization taxation option can increase the book-tax difference due to the difference in the measurement basis between accounting (FVA) and tax (which refers to historical cost accounting; HCA). The tax option is related to the meaning of substance over form concept, which is different between accounting and tax, even though they both use a contract-based revenue recognition model. PSAK 73 explains the doctrine of substance over form to raise assets and liabilities in both lessors' and lessees' financial statements. In this regard, the measurement basis for tax purposes is still HCA-based; it does not recognize the time value-based FVA measurement under Article 10 UU PPh and KMK 1169/1991.

For the hybrid taxation option, we need to combine the mark-to-market taxation option and realization taxation. Suppose the government is to implement this option. In that case, it needs a clear dividing line between the mark-to-market taxation and the realization taxation to provide legal certainty. Therefore, we do not recommend the Indonesian government implement this option because of the difficulty in considering the separation of taxation limits on leases that must refer to the two options above. An informant as a business actor expressed his experiences and grievances related to the convergence of new standards under PSAK 73 and its tax aspects.

“In the new standard, asset leases relevant to long-term leases are recognized as leased assets. Then, we depreciate in accounting in such a way so as if it is an asset that belongs to us. There was no transfer of title there. So, if it is taxable from an administrative side, first, if applied to taxes, the leased asset will be entered into the asset register on a tax basis. That adds up to more work to put back all kinds of things, sir. Finally, it will have the final net book value of all kinds, even though it is not ours.” (Informant X4)

Based on the three tax options for the lease above, by referring to the principle of ability to pay and legal certainty, the option of realization taxation is a more appropriate policy option. Two primary considerations underlie it. First, the authorities have implemented this option for leasing transactions since 1991 –although there is no clear distinction yet–, the tax authorities only need to update the tax provisions on SGU according to the current accounting regulations. The term lease replaces the term SGU, and there needs to be a more apparent distinction between direct-financing leases and sales-type leases in the new arrangement. Second, UU PPh in Indonesia from 1983 until now does not consider the time value of money. The tax accounting paradigm still refers to the HCA, prioritizing reliability characteristics for verification and proof purposes. If the government uses FVA according to the mark-to-market taxation concept, there will be a problem of proof on the side of the taxpayer when there is a tax dispute. Besides, the application of revenue recognition for potential tax purposes is against the ability to pay principle.

However, the solution was oversimplified by proposing an alignment by recommending the tax provisions to follow accounting (P5). However, from the discussion above, it appears that there are differences in principle between accounting and tax (P3), which are not only in the implementing regulations but even fundamentally under UU PPh. As such, the recommendation to fully follow accounting is unconfirmed (e.g., Iswandana et al., 2019) and leads to an altered proposition.

Proposition D: *The choice of tax policy for leases favors following the realization approach with several updates to the tax provisions on leasing to comply with PSAK 73.*

Meanwhile, the lessee under PSAK 73 no longer records lease transactions by recording rent/lease expenses. In this case, the lessee records this lease transaction as a right-of-use asset. Regarding the VAT issue, the emergence of recording accounts in the form of a right-of-use asset can lead to the tax authorities' interpretations regarding the delivery issue. However, right-of-use assets have not yet raised the issue of handover, so no VAT aspect has emerged. In this case, the recording assets are a consequence of recognizing leased assets so that the tax authority should notice the

issues around asset leasing services. However, the lessee needs to make fiscal reconciliations to assure the tax authorities that no transfer of assets has occurred. This fiscal reconciliation is also helpful in calculating corporate income tax to correct interest expenses that arise due to the standard under PSAK 73. For this purpose, the lessee should separate or mark the recording of interest expense resulting from borrowing and interest expense resulting from PSAK 73. Likewise, for records regarding depreciation, the lessee should separate the recording of depreciation of fixed assets from the depreciation of leased assets.

***Proposition E:** Potential VAT disputes due to different interpretations since PSAK 73 adoption are because the lessee no longer records lease transactions with rental/lease expenses but records them as right-of-use assets. To address the issue of delivery that could result in VAT payable, the lessee needs to make a fiscal reconciliation that allows identifying the fixed assets and leased assets easier.*

5. Conclusion, Implication, and Limitation

This study analyzes the tax issues concerning IFRS 16 adoption in Indonesia. Indonesian Accountants Association (IAI) has adopted IFRS 16 Lease into PSAK 73, which became effective from January 1, 2020. The enactment of this new standard also changed the accounting paradigm for leases allegedly able to meet financial statement users' needs better. However, developments in accounting standards have not been followed by adjustments to tax regulations, causing tax regulations to be several steps behind. It is because the tax regulation regarding leases still refers to the rule released in 1991.

The regulatory gap between accounting and tax requires that the tax authorities and stakeholders negotiate as soon as possible to prevent tax disputes in the future. The raising issue regarding these differences was the withholding tax issue. Thus, lessees face a dilemma regarding the absence of rent expense in the journal entries they record. However, based on substance over form, the lessee still needs to consider tax issues that may arise by referring to the tax aspects under the Indonesian setting, as summarized in Table 6. On the same basis, the standards in PSAK 73 that raise interest expenses in principle do not raise withholding tax issues because the interest expense is substantially related to the time value of money. The practical implication is, the lessee

still needs to prepare a fiscal reconciliation to prove to the tax authorities that the differences arising are reasonable due to differences in accounting standards and tax provisions.

In closing the distinction between accounting and taxes, tax authorities have to deal with two main issues: the clarity of lease arrangements and the measurement basis for lease benefits to calculate Income Tax. The lease arrangement in KMK 1169/1991 does not have legal standing based on UU PPh, so it often creates legal uncertainty. With this problem, the tax authorities need to harmonize tax arrangements regarding leases according to a higher hierarchy of rules to meet legal certainty.

Concerning the basis in measuring lease for tax purposes, we analyze three tax policy options: mark to market, realization, or hybrid. Under the principle of legal certainty and ability to pay, the realization taxation option is more appropriate than the two other options. For the VAT issue, the emergence of recording accounts in the form of a right-of-use asset can lead to interpretations of the handover issue, which will then become the basis for deemed VAT. As an implication, it is mandatory to record these assets by recognizing the leased asset. Therefore, the lessee should prepare an apparent fiscal reconciliation where the tax authorities are also more open in discussing the possibility of this issue.

The scientific contribution of this study is in the field of public policy, especially tax policy for the Indonesian setting. We expect tax policymakers to take into account the findings presented. Policymakers can identify efforts that tax authorities can consider to address the growing disparity between accounting treatment and tax treatment due to IFRS convergence. These efforts are related to taxation policies that the tax authorities can choose after IFRS 16 convergence in Indonesia, as we have described in this study. However, one of the limitations of this study is that among the four pillars of accounting currently in Indonesia, this study only has a little concern about PSAK. Moreover, from the existing PSAK, the taxation aspect only focuses on standards under PSAK 73. Further research can complement these limitations,

including other standards, not only IFRS 16, and conduct further investigations from empirical data.

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