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Tax Implications On Financial Instruments Resulting From IFRS 9 Adoption In Indonesia

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ABSTRACT

This study aims to analyze the tax implications of financial instruments after International Financial Reporting Standards (IFRS) 9 adoption in Indonesia into Statement of Financial Accounting Standard 71 (PSAK 71). To gain an in-depth understanding regarding the implementation of PSAK 71, we conducted semi-structured in-depth interviews with policymakers, PSAK standard setters, academicians, tax consultants, and taxpayers. We also used case studies related to the convergence of IFRS 9 to identify the tax implications of implementing the new standard. The results show that the entities applying PSAK 71 generally measure and recognize financial assets or financial liabilities at fair value. Besides, they use amortized costs in specific conditions. However, current tax regulations relevant to financial instruments still refer to the acquisition cost following Article 10 of the Income Tax Law. Accordingly, the gains or losses in respect of financial instruments are not recognizable for tax purposes. Although fiscal correction has proven to be a panacea for bridging the gap between taxation and accounting standards, policymakers urgently need to revise the outdated regulations to provide taxpayers with legal certainty and ease of administration. The significant contribution of this study is the attempt to link the accounting and taxation aspect of financial instruments with the setting of Indonesia.

KEYWORDS: Financial instruments; IFRS; income tax; PSAK.

INTRODUCTION

The global financial crisis occurring in 2008 has demanded international organizations to immediately agree on standards that can improve accounting for financial instruments (Bischof and Daske, 2016). The financial crisis has warned of a total systemic collapse in financial markets, highlighting the significance of a high-quality global standard (Johannes et al., 2018). The critical reason for the financial crisis was that banks could invest using deposits in derivatives and securitization in the purchase of Mortgage-Backed Securities or MBS (with investors bearing the risk of default). The financial crisis also resulted from insurance firms' habit of selling credit default swaps and (indirectly) the use of public auditors' judgments in determining risk details. Simply put, among the criticisms of financial reporting systems and standards that apply during times of crisis are derivatives, asset securitization, and fair value (Marzuki et al., 2021). The fragility of the global financial system is the starting point for improving standards in financial instruments through the introduction of the International Financial Reporting Standard (IFRS).

However, the IFRS adoption related to accounting and reporting of financial instruments has posed challenges for countries globally concerning the convergence with applicable tax regulations in each jurisdiction. Perhaps it could be explained by the fact that each country's system is unique. A study shows that the tendency to accept IFRS adoption is high in countries with high economic growth rates, democratic political systems, common law systems, high economic openness, and high levels of education (Roekhudin, 2020). The incompatibility between accounting standards and tax rules is likely since adopting IFRS in the global world does not respond to any government policy (Olfa and Walid, 2018). For instance, IFRS requires an entity to account for all financial assets at either amortized cost or fair value, depending on the asset classification. The use of fair value leads to the formation of taxation concerns, which are frequently related to historical costs.

The fair value paradigm currently used by IFRS evolved from the decision-usefulness theory developed as part of the Financial Accounting Standards Board's (FASB) conceptual framework (CF) project (Hitz, 2007). The FASB was not alone in implementing the fair value paradigm; the International Accounting Standards Board (IASB) also got involved. Explicitly, the concept of decision usefulness became a part of the initial compilation of the CF (Trueblood Committee report). The report states that "the basic objective of financial statements is to provide useful information for making economic decisions" (AICPA, 1973, p.13).

Financial information must not only present significant occurrences but also be a faithful representation to be valuable. Financial information must be complete, unbiased, and error-free to promote faithful representation (Lee, 2015). The paradigm shift in accounting from the industrial to the information era presents tax authorities with an option between continuing to use realization taxation or reconsidering the accounting approach by applying accrual taxation or mark-to-market taxation. Every discussion about the convergence or adoption of IFRS must refer to the decision usefulness theory underlying the primary qualitative characteristics (relevance and faithful representation).

After IASB officially issued IFRS 9 on July 24, 2014, the Financial Accounting Standards Board (DSAK) of the Indonesian Institute of Chartered Accountants (IAI) adopted it into PSAK 71 Financial Instruments on July 26, 2016. PSAK 71 has been effective since January 1, 2020. Reporting entities are allowable to apply the standard earlier. Since IFRS 9 replaced International Accounting Standard (IAS) 39 adopted into PSAK 55 Financial Instruments:

Recognition and Measurement, the enactment of PSAK 71 automatically supersede PSAK 55.

631

Previous studies on IFRS have provided empirical evidence regarding the benefits of adopting these standards. These are, for instance, improving the information quality in capital markets (Horton et al., 2013), increasing liquidity and lowering the cost of capital (Daske et al., 2013), and increasing the organization's attractiveness as the investment destination relative to those that do not adopt the standard (Kim and Shi, 2012). From the investor's perspective, studies on more than 3000 listed European companies show that the high quality of pre-adoption information and the low quality of information asymmetry for pre-adoption positively impact the market-adjusted returns (MAR) (Onali et al., 2017). It means that company-specific factors influence investors' reactions to IFRS 9. The study also proves that the response of financial firms to the adoption of IFRS 9 is relatively worse than that of non-financial firms.

However, understanding problems related to IFRS interpretation could be more comprehensive when connected to tax issues, debt measurement, and other matters beyond the reconciliation with IFRS (Sharma et al., 2017). In practice, tax consultants/practitioners, accounting standard-setters, or the government usually identify tax implications resulting from IFRS adoption. For example, HM Revenue & Customs ("HMRC") in the UK periodically makes a Tax Information and Impact Note regarding the adopted international standards. In addition, HMRC observes how the IFRS 9 adoption impacts exchequer, economy, individuals, households or families, businesses, civil society organizations, and HMRC operations themselves (HMRC, 2015).

Osunsan and Alao (2017) also reviewed the IFRS 9 adoption in Nigeria, and their review reveals that Deposit Money Banks (DMBs) face a significant tax impact. Besides, insurance companies also have a significant impact on financial instruments. IFRS 9 implementation in Nigeria affects higher and unstable impairment loss on the capital ratio because of lower returns. From a tax perspective, the impact significantly lowers profits but increases scrutiny of particular impairment losses, a part of which are not allowable for tax purposes. Furthermore, the impact also increases the number of fair value movements in the income statements so that reporting entities need to track and make adjustments for tax purposes. Nigerian tax provisions allow only 25% of the total insurance premium for deductible expenses resulting from impairment losses for insurance companies. Consequently, such restriction could further drain the capital base in general insurance businesses.

Meanwhile, Bowdern et al. (2018) analyzed the tax implications of IFRS 9 adoption in Hong Kong. Their study reveals that the Hong Kong Inland Revenue Department (IRD) continues to accept Tax Returns made based on the fair value at that time did not have legal standing. Furthermore, the study stipulates that the Financial Services and the Treasury Bureau (FSTB) submitted the proposed amendments related to the application of fair value financial instruments for tax purposes to the Legislative Council (LegCo) at the end of 2018. Currently, the legal basis is available to allow taxpayers to choose in writing, which is generally irrevocable, whether to select a fair value for financial instruments for tax purposes (PwC, 2020). If taxpayers choose to adopt fair value, the tax treatment will be in line with commercial accounting principles so that they do not need to make a reconciliation. However, the provisions that apply under the Departmental Interpretation and Practice Notes (DIPN) No. 42 allow taxpayers to continue using the realization basis for financial instruments (IRD, 2020).

The studies above show numerous works investigating IFRS 9 adoption, but only a few discuss tax implications arising from the IFRS 9 adoption. However, the studies above do not apply to the Indonesian context since Indonesian tax rules differ from those of the above studies' locus (Saptono and Khozen, 2021). Because of the significant effects of IFRS 9 adoption, as found in the case of Nigeria, Indonesian policymakers must have a plan to mitigate the consequences of the implementation of PSAK 71 adopted from IFRS 9. Additionally, while tax provisions in Indonesia and Hong Kong appear to retain the realization concept, Hong Kong's tax policies seem more adaptable. As a result, it is necessary to explore tax consequences deriving from PSAK 71.

This study will contribute to the tax policymakers in selecting proper tax treatment relevant to fair value measurement under PSAK 71, which adopts IFRS 9. According to Saptono (2020), there are three available options for tax treatments: (1) mark-to-market taxation in line with fair value accounting; (2) realization taxation still aligning with historical cost accounting; or (3) hybrid taxation combining mark-to-market taxation and realization taxation with specific requirements.

In a specific setting, the accounting treatment for financial instruments under PSAK 71 relates to the tax treatment on measurement after initial recognition under Article 9 paragraph (1) letter c of Income Tax Law ("UU PPh"). Under the provision, the Minister of Finance ("MoF") has issued MoF Regulation No. 81/PMK.03/2009 as the implementing rule for tax treatment relevant to financial instruments ("MoFR-81/2009"). Our study also considers the MoF Regulation and its possibility for amendment after Law No. 7 of 2021 concerning harmonized tax laws ("UU HPP") comes into force in 2022. However, the latest amendment of Law No. 7 of 1983 concerning income tax law ("UU PPh") refers to UU HPP. Moreover, MoFR-81/2009 must be subject to revision since the concept underlying Article 9 paragraph (1) letter c of UU PPh after and before the UU HPP enactment is significantly different.

METHOD

Research Design

This study uses a qualitative method with a descriptive approach. The research design we used is a descriptive study. According to Lamb (2005), the descriptive approach is applicable for tax research clusters that focus on the accounting standards development and their interaction (interrelationship) with the related tax system. Because the main component of the research is qualitative descriptive, this study will very certainly lean toward content analysis. However, it will not quantify the coding of the data, although it is allowable in this approach (Vaismoradi et al., 2013). We perform content analysis on the gathered materials, which consist primarily of documents and interview transcripts.

Data Collection Technique

The data collection of this research uses document analysis and in-depth interviews. We design the analysis of documents and archives to accurately describe the tax implications of the IFRS 9 adoption in Indonesia through PSAK 71. The advantages of document analysis are: (1) it enables researchers to obtain language and words textual; (2) can be accessed at any time; (3) presents weighted data and has been written in-depth; and (4) can save researchers time in transcribing (Creswell, 2013). We summarize details of the documents collected during the research process in Table 1. Most of the documents in the table are textual for qualitative research according to the research objectives.

Table 1.
Details of
Documents as
Research Data
Sources

No.	Group	Types of Documents
633	1. Accounting	<ul style="list-style-type: none"> a. Financial Reporting Conceptual Framework issued by IASB and IAI; b. PSAK issued by IAI; c. books, thesis/dissertation research results, and scientific journals related to research objectives and topics in various countries; and d. public company financial statements.
	2. Tax Policy	<ul 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, Minister of Finance regulations, and Director-General of Taxes regulations; c. circular and letters of the Director-General of Taxes.

Source: processed by researchers

To gain an in-depth understanding of research on the tax implications of the IFRS 9 adoption in Indonesia, we also conducted semi-structured in-depth interviews. We use the interview question guidelines during the interview process, as presented in Table 2. In-depth interviews were conducted purposively with several informants who represent a variety of organizations and hold a qualification as a Chartered Accountant. They were a member of PSAK standard-setters (A1), an official within the Directorate General of Taxes (DGT) as policymaker (A2), an academician (A3), a tax consultant (A4), and a tax manager of a listed company (A5).

The basis for selecting the policymaker as our informant is due to the direct involvement in implementing the rules regarding financial reporting. We also interviewed an academician to gain an understanding at the conceptual level. The tax manager is selected because his company has implemented PSAK 71 early, apart from his position in the company. Meanwhile, we interviewed standard-setters to confirm further several principles in the IFRS 9 adoption to PSAK 71.

Table 2.
Interview
Guidelines

No.	Main Discussion	Primary Question
1.	Accounting and tax connections before and after the IFRS convergence	<p>a. How has the development of accounting and tax regulations in Indonesia since the Tax Reform I in 1983 until now? Is the difference between them getting bigger or smaller?</p> <p>b. How to interpret the provisions related to bookkeeping in Article 28 paragraph (7) of the 2007 UU KUP after the Financial Accounting Standards have converged with IFRS, even though the formulation of the tax provision occurred before IFRS convergence?</p> <p>c. Is the unrealized gain under PSAK 71/IFRS 9 already an object of income tax based on the definition of income in Article 4 paragraph (1) of the Income Tax Law (UU PPh)?</p> <p>d. On the other hand, if the unrealized loss occurs, is the loss a deductible expense based on Article 6 paragraph (1) of UU PPh?</p>
2.	Policies to improve harmony between accounting and taxes.	<p>a. In the literature studies, there are three types of bookkeeping, namely: (1) one-book system; (2) two-book system; and (3) a three-book system. Concerning the three types of bookkeeping above, which model is most suitable for future application?</p> <p>b. Considering arrangement under PSAK 71, what should be the tax policy regarding tax accounting arrangements in the new regime of UU PPh?</p> <p>c. The realization doctrine is related to the ability-to-pay principle because taxpayers must pay taxes when they can pay. Meanwhile, this doctrine has been abandoned in terms of IFRS-based accounting because the FVA concept is in line with mark-to-market accounting, which is no longer concerned with realization. In the future, is the doctrine of realization still relevant and should be included in the provisions of the new regime of UU PPh?</p>

Source: processed by researchers

The in-depth interview technique is the approach that we chose in this qualitative research. Authors have carried out research-oriented open methods during the interview process, making it possible to explore informants' perspectives and feelings about a complex phenomenon (Brounéus, 2011). On the other hand, we select qualitative interviewing techniques to directly access informants' "lifeworld" (Miles et al., 2014). In this sense, we select experts in their respective fields based on several important considerations. With the help of such an interview method, informants can express their personal views, sentiments, and experiences, which we then triangulate against the available data and facts.

Data Analysis Technique

635

The data analysis in this research, following Miles et al. (2014), consists of three concurrent activity flows, namely: (1) data condensation, (2) data display, and (3) conclusion drawing/verification. We used Erlingsson and Brysiewicz’s (2017) technique for content analysis, as seen in Figure 1. The first step is to read and reread the entire interview to understand it further. Afterward, we split the text into smaller components or units of meaning. We then condense them further while retaining their essence. The following step is to label the condensed meaning units by creating codes and then categorizing them. After this, we can proceed to a higher level of abstraction and build themes.

Higher levels of abstraction	Overarching theme	The current definition of income is no longer relevant, and it should be updated.	Adopting the idea of fair value consists of a host of factors, including the administrative burden on taxpayers.
	Theme	Relevance of income definition in UU PPh	Adoption of the fair value principle in UU PPh
	Category	Modifications to the income definition	Fair value plus/minus
	Code	Income definition	Fair value
	Condensed meaning unit	Propose changing or reviewing the income definition which doesn't appropriate to the current context	Do not have to adopt fair value to all transactions, consider the burden of prove by taxpayers
Lower levels of abstraction	Meaning unit	“We propose changing the definition of income, or at least reviewing the definition of income which doesn't seem very appropriate in this context in UU PPh.”	“Let's take a look at the pluses and minuses because we don't necessarily follow all the fair values. It means..., fair value will automatically have a burden on taxpayers to prove it.”

Figure 1. Examples of data analysis leading to higher levels of abstraction

Source: Authors’ processed (2021)

To enrich the picture regarding IFRS 9 adoption, we adapted some related cases from Kieso et al. (2020). The use of these cases is to identify the tax implications that arise from the adoption of IFRS. According to the last paragraph of the explanation of Article 28 paragraph (7) of Law on General Procedures and Taxation Rules (“UU KUP”), tax treatments, in general, follow accounting treatments. However, in case tax rules have specific provisions different from accounting rules, taxpayers must refer to tax rules for tax reporting.

RESULTS AND DISCUSSION

Accounting treatments for financial instruments are one of the complex accounting systems. Therefore, IAI had to issue three different PSAKs: (1) PSAK 50 Financial Instruments: Presentation, (2) PSAK 60 Financial Instruments: Disclosure, and (3) PSAK 71 Financial Instruments, which supersedes PSAK 55 Financial Instruments: Recognition and Measurement.

PSAK 50 adopting IAS 32 (2009) Financial Instruments: Presentation defines a financial instrument as any contract giving rise to a financial asset of an entity and a financial liability or equity instrument of another entity. Based on this definition, a financial instrument consists of (1) financial assets, (2) financial liabilities, and (3) equity instruments. Table 3 summarizes examples of financial instruments and their measurement methods.

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11.3

Due to the complexity of financial instrument issues according to accounting professionals and practitioners, PSAKs on financial instruments have implementation guidelines and illustrative examples, both before and after IFRS convergence. However, PSAK 55 uses

various categories with different measurement methods and is quite complicated. Therefore, PSAK 71 replaces PSAK 55 by simplifying the business models to measure financial instruments, especially for financial assets.

Table 3.
Examples of
Financial
Instruments
and Their
Measurement
Methods

No.	Type	Example of Accounts	Measurement methods
1.	Financial Assets	<ul style="list-style-type: none"> ▪ Cash and cash equivalents ▪ Equity investment ▪ Debt investment ▪ Account receivable ▪ Notes receivable ▪ Loans and other receivable 	<ul style="list-style-type: none"> ▪ Nominal value ▪ Fair value ▪ Fair value, or ▪ Amortized cost ▪ Fair value, or ▪ Amortized cost
2.	Financial Liabilities	<ul style="list-style-type: none"> ▪ Account payable ▪ Notes payable ▪ Others payable ▪ Bank loans and other loans 	<ul style="list-style-type: none"> ▪ Fair value, or ▪ Amortized cost
3.	Equity Instruments	<ul style="list-style-type: none"> ▪ Common shares ▪ Preferred shares 	<ul style="list-style-type: none"> ▪ Cost

Source: Adapted from PSAK 55 Financial Instruments: Presentation and PSAK 71 Financial Instruments

The classification of financial assets under IFRS 9 refers to (1) business models and (2) contractual cash flows (Shkulipa, 2021). Therefore, PSAK 71 also classifies financial assets based on the two criteria. The following paragraphs describe those criteria in more detail:

- What is the business model for the company in managing its financial asset? The answer could be that the company's business model is (1) to hold the financial asset for collecting contractual cash flows or (2) to sell the instrument before its contractual maturity in realizing its fair value changes.
- What are the characteristics of the contractual cash flow of the financial assets? Such a question relates to whether the contractual terms of the financial asset give rise to cash flows (solely payments of principal and interest on the outstanding principal amount) on specified dates.

When financial assets meet all the above criteria, the entity measures the financial assets at amortized cost. On the contrary, when financial assets do not meet one or both of the above criteria, the entity measures the financial assets at fair value. Based on these criteria, Table 3 also summarizes measurement methods for all elements of financial assets. For example, based on Table 3, the entity measures debt investments held to maturity (HTM) and loans &

receivables at amortized cost. In addition, the entity measures (a) equity investments, (b) financial assets available for sale (AFS), and (c) debt investments, which the entity can sell before its contractual maturity in realizing its fair value changes, at fair value through profit and loss (FVTPL).

For financial liabilities, PSAK 71 (paragraph 5.1.1) stipulates that an entity measures a financial liability at fair value at initial recognition. At subsequent measurement after initial recognition, the entity measures all financial liabilities at amortized cost using the effective interest method. However, PSAK 71 allows the entity to measure a financial liability (including derivatives) at fair value through profit or loss when a contract consists of one or more embedded derivatives, and the host is an asset outside the scope of PSAK 71.

For equity instruments, an entity measures all investments in equity instruments and contracts on those instruments at fair value. However, in limited circumstances, the cost may be an appropriate estimate of fair value. For example, measurement at cost is preferable if more recent information is insufficiently available to determine the fair value. Another condition is a wide range of possible fair value measurements, and that cost represents the best estimate of fair value within that range.

For taxation, the primary issues are relevant to the first two of four accounting treatments: (a) recognition, (b) measurement, (c) presentation, and (d) disclosure. Recognition relates to the accrual accounting method, whereas measurement relates to historical cost accounting (HCA) versus fair value accounting (FVA). According to Saptono (2020), the shift of the financial accounting paradigm from HCA to FVA results from the movement from the accounting system in the industrial era to the accounting system in the information era. The development of ICT (Information, Communication, and Technology) results in radical changes in the accounting era. Therefore, under the decision-usefulness theory underlying the conceptual framework of financial reporting, FVA is more relevant for investors than HCA because HCA cannot provide predictive values, which debt and equity investors require for economic decision-making.

However, although tax accounting development is still dependent on financial accounting development, the shift from HCA to FVA for financial accounting cannot automatically bring about the tax accounting movement by leaving HCA toward FVA. Therefore, tax accounting must refer to UU PPh still not changing its accounting paradigm and keep using HCA. Such a treatment refers to Article 10 of UU PPh as the reference for implementing HCA for tax purposes. So, based on this provision, UU PPh still adopts realization taxation in line with HCA instead of accrual (or mark-to-market) taxation aligning with FVA.

Anyhow, Saptono (2020) reveals that some provision under UU PPh adopts accrual taxation (i.e., unrealized foreign exchange gains/losses). In contrast, another particular provision of UU PPh adopts hybrid taxation (i.e., unrealized gains on fixed asset revaluation). Meanwhile, unrealized gains/losses arising from financial asset/liability measurement under PSAK 71 are not allowable for tax purposes because those are in line with realization taxation under UU PPh. Several informants (A1; A2; A3) also agree that the tax provisions for unrealized holding gains/losses on financial instruments currently refer to HCA adopted by Article 10 of UU PPh.

For subsequent measurement after initial recognition under PSAK 71, income tax provisions under UU PPh (before the enactment of UU HPP) and relevant to PSAK 71 regulate as follows:

- 1) Impairing financial assets, in general, are not allowable for tax purposes under Article 6 paragraph (1) letter h and Article 9 paragraph (1) letter c of UU PPh because UU PPh adopts realization taxation;
- 2) Impairing particular financial assets for specific industries are allowable under Article 9 paragraph (1) letter c of UU PPh and MoFR-81/2009 because they have high-risk investments.

The particular financial assets for specific industries, as meant under item (2) above, are as follows:

- 1) allowance for bad debts for banks and other financial business entities that provide credit, financial leases with option rights, consumer financing companies, and factoring companies;
- 2) reserves for insurance companies, including reserves for social assistance established by the Health Social Security Agency; and
- 3) guarantee reserves for the Deposit Insurance Corporation.

When PSAK 71 provides a principle-based approach in subsequent measurement for accounting purposes, MoFR-81/2009 provides specific provisions adopting a rules-based approach to establish legal certainty for taxpayers. However, MoFR-81/2009 still adopts former regulation issued by the Central Bank of Indonesia. At that time, for subsequent measurement of financial instruments when asset impairment occurs, accounting treatment applied an allowance for earning asset write-off or PPAP (*Penyisihan Penghapusan Aset Produktif*).

In addition, bank directors often try to establish general reserves to maximize their bonuses. General reserves are also often used for income smoothing in the income statement. In earnings management practice, increased earnings can lead to a higher level of firm performance and, as a result, a higher level of bonus compensation for management (Zubaidah, 2020). Hence, the new standard under IFRS was endorsed with detailed rules on how to calculate bad debts. In addition to other initiatives that emphasize the importance of Good Corporate Governance in preventing fraud (Rochmawati et al., 2020).

After enacting PSAK 55 and PSAK 71, such a provision method is no longer allowable. Instead, PSAK 55 and PSAK 71 apply allowance for impairment losses or CKPN (*Cadangan Penurunan Kerugian Nilai*). Anyhow, a comprehensive understanding of tax implications arising from different treatment between accounting rules and tax rules for financial instruments (especially financial assets) is necessary. Therefore, several illustrations in the sub-section below describe the different treatments between PSAK 71 and UU PPh.

Example 1: Debt Investments

For example, on January 1, 2021, PT MBR purchased a bond - issued by PT PDAJ - worth IDR 100,000, with an interest rate of 8%, with a discount so that PT MBR paid IDR 92,278¹. The bonds will mature on January 1, 2026, with an interest rate of 10% p.a. Interest is payable

¹ The bond price after discount of IDR 92.278 is calculated based on information n (period) = 10; i (interest rate) = $10\% / 2 = 5\%$; PMT (payment) = 4.000; and FV (future value) = 100.000.

on July 1 and January 1, respectively. Based on this information, Table 4 summarizes bond interest income and bond discount amortization according to the effective interest rate².

639

No.	Date	Cash Received	Interest Revenue	Bond Discount Amortization	Carrying Amount of Bonds
1	01/01/2021	-	-	-	92.278
2	01/07/2021	4.000	4.614	614	92.892
3	01/01/2022	4.000	4.645	645	93.537
4	01/07/2022	4.000	4.677	677	94.214
5	01/01/2023	4.000	4.711	711	94.924
6	01/07/2023	4.000	4.746	746	95.671
7	01/01/2024	4.000	4.784	784	96.454
8	01/07/2024	4.000	4.823	823	97.277
9	01/01/2025	4.000	4.864	864	98.141
10	01/07/2025	4.000	4.907	907	99.048
11	01/01/2026	4.000	4.952	952	100.000
	Σ	40.000	47.723	7.723	

Table 4.
Calculation of Interest Income & Bond Discount Amortization (in IDR)

Source: adapted from Kieso et al. (2020)

Based on Table 4, Table 5 summarizes relevant journal entries. Entries 1, 2, 3, 4, and 5 refer to the amortized cost approach applied to debt investment. Measurement at fair value refers to entries no. 1, 2, 3, 3a, 3b, 5, 5a, and 5b. In the end, the two measurement methods have the same result when the entity sells the debt investment. Entry no. 5b as of December 31, 2023, nullifies the remaining Fair Value Adjustment credit balance of IDR 924.

² Cash received of IDR 4,000 is calculated from $8\% \times \text{IDR } 100.000 \times 6/12$. Interest income, for example of IDR 4.614, is calculated based on the formula $10\% \times \text{IDR } 92.278 \times 6/12$. For discount amortization, for example IDR 614, it is calculated based on the formula $\text{IDR } 4.614 - \text{IDR } 4.000$. For recorded value, for example IDR 92.892 as of July 1, 2021, it is calculated based on the formula $\text{IDR } 92.278 + \text{IDR } 614$. The calculation applies for the next period until the end of January 1, 2026.

No.	Description	Date	Dr (IDR)	Kr (IDR)
1.	To perform initial recognition of PT MBR's debt investment 01-01-2021			
	Debt Investments		92.278	
	Cash			92.278
2.	To recognize the first received cash from interest revenue. 01-07-2021			
	<i>Cash</i>		4.000	
	<i>Debt Investments</i>		614	
	<i>Interest Revenue</i>			4.614
3.	To recognize interest income and discounted amortization 31-12-2021			
	<i>Interest Receivable</i>		4.000	
	<i>Debt Investments</i>		645	
	<i>Interest Revenue</i>			4.645
3a.	To adjust investment value when using the fair value on December 31, 2021, it was Rp. 95,000 because there was a decrease in the interest rate [IDR 95.000 – IDR 93.537 = IDR 1.463]			
	<i>Fair value adjustment³</i>		1.463	
	<i>Unrealized Holding Gain or Loss – Income</i>			1.463

³When investments are valued at their fair value, the Fair Value Adjustment account is debited instead of Bond Investment account. The use of Fair Value Adjustment allows PT MBR to continue to record the value of its Bond Investment based on amortized cost. Because the Fair Value Adjustment account is debited, the fair value of the bond investment is greater than the amortized value. The Fair Value Adjustment account is not included in the income statement, but is still used to evaluate debt investments to match fair value. Meanwhile, the Unrealized Holding Gain or Loss—Income account is recorded under Other Expenses (Income).

No.	Description	Date	Dr (IDR)	Kr (IDR)
3b.	To adjust investment value when using the fair value 31-12-2022 on December 31, 2022, amounted to IDR 94,000:			
a)	The carrying amount of the bonds as of 31/12/2022		94.924	
b)	Fair value as of 31/12/2022		<u>94.000</u>	
c)	Unrealized gain (loss) [a-b]		(924)	
d)	Fair value adjustment debit balance		<u>(1.463)</u>	
e)	Fair value adjustment [c+d]		(2.387)	
	<i>Unrealized Holding Gain or Loss – Income</i>			2.387
	<i>Fair value adjustment</i>			2.387
4.	To recognize the discounted amortization at the sale 01-11-2023 of the bonds at 99.75% plus accrued interest. Discount amortization is calculated for the period 1 July – 1 November 2023 = IDR 784 x 4/6 = IDR 522.			
	<i>Debt Investments</i>		522	
	<i>Interest Revenue</i>			522
5.	To recognize the sale of a bond based on amortized 01-11-2023 cost of 99.75% x IDR 100,000) = IDR 99,750 plus accrued interest			
	<i>Cash [IDR 99.750 + IDR 2.667]</i>		102.417	
	<i>Interest Revenue [4/6 x IDR 4.000]</i>			2.667
	<i>Debt Investments [IDR 95.671 + IDR 522]</i>			96.193
	<i>Gains [(99,75% x IDR 100.000) – IDR 96.193]</i>			3.557
5a.	To recognize the sale of bonds based on a fair value 01-11-2023 of 99.75% plus accrued interest [the transaction journal is the same as number 5]			

No. Description	Date	Dr (IDR)	Kr (IDR)
5b. To recognize Fair Value Adjustment balances written 31/12/2023 off based on the fair value method because the entity sells the bond investment:			
<u>Db(Kr)</u>			
a) <i>Fair value adjustment</i> per 31-12-2021	1.463		
b) <i>Fair value adjustment</i> per 31-12-2022	(2.387)		
c) <i>Fair value adjustment</i> per 1-11-2023	(924)		
<i>Fair value adjustment</i>		924	
<i>Unrealized Holding Gain or Loss – Income</i>			924

Source: adapted from Kieso et al. (2020)

The income tax aspects related to journal entries in Table 4 explicitly refer to Article 4 paragraph (1) letter f and paragraph (2) of UU PPh and its implementing regulations (namely Government Regulation No. 16/2009; Minister of Finance Regulation No. 85/PMK.03/2011; Government Regulation No. 100/2013; Minister of Finance Regulation No. 07/PMK.011/2012). Interest income, including premiums, discounts, and returns because debt repayment guarantees are subject to a final tax. The provisions for withholding income tax do not apply if the recipient of the bond interest income is:

- a) a pension fund company whose establishment or formation get approved from the Financial Service Authority and meets the requirements as stipulated in Article 4 paragraph (3) letter h of UU PPh; and
- b) a bank established in Indonesia or a branch of an overseas bank in Indonesia.

If the party receiving the bonds is a Pension Fund Company, as referred to above, the bond interest is a non-object of income tax. Meanwhile, suppose the bond recipient is a bank established in Indonesia or a branch of an overseas bank in Indonesia. In that case, the income tax imposition refers to Article 17 of UU PPh because income paid or owed to the bank is not subject to withholding income tax under Article 23 paragraph (4) letter a of UU PPh.

The income tax treatment on bond interest refers to the amortized cost approach. The “Unrealized Holding Gain or Loss—Income” accounts (when the position is in credit according to the fair value approach) are not subject to income tax under Article 4 paragraph (1) letter f and paragraph (2) of UU PPh and its implementing regulations. Based on the realization principle under UU PPh, the “Unrealized Holding Gain—Income” account is still not subject to tax. One of the informants said as follows:

In our opinion, if we look at Article 4 again, the additional economic capacity should be realizable. Then, it should be subject to tax. However, if it is still unrealizable, taxpayers have not benefited from the unrealized income. So, there is no benefit for the unrealized, so it is not worth a tax. (A5, tax manager)

Similarly, the Unrealized Holding Loss-Income account is still not allowable for tax purposes according to Article 6 paragraph (1) of UU PPh. Using the analogy based on the matching cost against revenue principle, one of the informants (A4, tax consultant) stipulates the following. “It is a bit unfair, if something is still unrealized, whether it is a gain or loss, it must be subject to tax when it is realizable. However, if the tax has accepted the fair value accounting principle, then the unrealized loss is acceptable in the tax books as allowable deductions.”

Example 2: Equity Investments

Equity investment represents the investor’s ownership of an investee in the form of shares/investments. The accounting treatment of equity investment depends on the level of investors’ voting rights on investees. When voting rights are less than 20% on investees, investors must apply fair value measurement under PSAK 71. However, when voting rights are between 20% and 50% on investees, investors must apply the equity method under PSAK 15, adopting IAS 28 Investment in Associates and Joint Ventures. When voting rights exceed 50%, investors must consolidate investees’ financial statements according to PSAK 65 Consolidated Financial Statements.

To illustrate the difference between fair value measurement under PSAK 71 and equity method under PSAK 15, suppose PT A (investor) owns shares up to 20% voting rights in PT B (investee). Then, Table 6 illustrates the transaction of PT A becoming an investor by acquiring shares of PT B as an investee.

No.	Description	Db (IDR)	Cr (IDR)
1.	On January 2, 2021, PT A acquired 48,000 shares of PT B (20%) with a nominal value of IDR 10/share		
	<i>Equity Investment on PT B</i>	480.000	
	<i>Cash</i>		480.000
2.	During 2021, PT B reports a net profit after income tax of IDR 200,000, and PT A’s investment in PT B is equivalent to 20% or IDR 40,000		
	<i>There is no journal entry</i>		
3.	On December 31, 2021, the market price of PT B’s shares was IDR 12/share or IDR 576,000, so that PT A records IDR 96,000 profit		
	<i>Fair Value Adjustment</i>	96.000	
	<i>Unrealized Holding (Gain) Loss — Equity</i>		96.000

Table 6.
Illustration of
Comparison of
Fair Value
Methods

No. Description	Db (IDR)	Cr (IDR)
4. On January 26, 2022, PT B announced and paid out a cash dividend of IDR 100,000, and PT A received 20% or IDR 20,000		
a. Journal entry when using the fair value method:		
<i>Cash</i>	20.000	
<i>Dividend income</i>		20.000
b. Journal entry using the cost method according to tax rules:		
<i>Cash</i>	17.000	
<i>Advance Income Tax Article 23</i>	3.000	
<i>Dividend income</i>		20.000
5. In 2022, PT B reported a net loss of IDR 50,000, and the impact on PT A was 20% or IDR 10,000.		
<i>There is no journal entry</i>		
6. On December 31, 2022, the market price of PT B's shares was IDR 11/share or IDR 528,000, so PT A records a loss of IDR 48,000.		
<i>Unrealized Holding (Gain) Loss — Equity</i>	48.000	
<i>Fair Value Adjustment</i>		48.000

Source: adapted from Kieso et al. (2020)

Income tax aspects that emerge from Table 6 relate to the “Unrealized Holding (Gain) Loss—Equity” account and “Dividend Income” account. The “Unrealized Holding Gain—Equity” in the credit side is not subject to tax under Article 4 paragraph (1) of UU PPh even though PT A includes the gain into the Other Comprehensive Income (OCI). However, OCI is not a tax object because OCI is to record unrealized gains or losses arising from fair value measurement in balance sheet accounts. Meanwhile, the “Dividend Income” account on the credit side qualifies tax object under Article 4 paragraph (1) of UU PPh.

Example 3: Loans & Receivables

Loans and receivables (from now on “L&R”) are non-derivative financial assets with fixed or determinable payments and do not have quotes in an active market. Examples of L&R are: account receivables, loans to customers, note receivables, advances to officers and employees, deposits paid to potential damages or losses paid as a guarantee of performance or payment, advances to subsidiaries, claims to other parties, and dividends & interest payable. In general, the entity classifies L&R based on the period in which L&R payment occurs. For example, if the payment is up to a year, usually, the L&R is classified as a current

receivable. However, if the payment is more than a year, the L&R is classified as non-current receivables.

645

After initial recognition, financial instruments classified as L&R are measured at amortized cost regardless of the entity's intention to hold them to maturity. The way to do that is the entity assesses and reports short-term receivables based on cash realizable value, that is, the net amount it is expected to receive in cash. To determine cash realizable value, an estimate of the bad debt, the amount paid, or the allowance is required (Kieso et al., 2020).

To illustrate measurements after initial recognition and recognition of impairment, suppose that PT Bank disbursed a loan to PT Debtor amounting to IDR 100,000. The effective rate on loans is 10% per annum. The principal is due in full at the end of the third year. Because PT Debtor is experiencing significant financial difficulties, PT Bank indicates that PT Debtor cannot pay all the principal and interest on the loan. Table 7 describes the contractual cash flows according to the credit loan agreement (a total of IDR 130,000), the expected cash flows projected to be receivable until the end of the agreement (a total of IDR 115,000), and the estimated cash flow losses (a total of IDR 15,000).

31 Dec	Contractual cash flow (IDR)	Expected cash flow (IDR)	Cash flow loss (IDR)
2021	10.000	5.000	5.000
2022	10.000	5.000	5.000
2023	110.000	105.000	5.000
Σ cashflow	130.000	115.000	15.000

Table 7.
Calculation of
Cash Flow
from Loans

Source: adapted from Kieso et al. (2020)

Based on Table 7, PT Bank calculates the present value of discounted future cash flows using the initial effective interest rate of the asset (10%). The result in Table 8 shows an impairment loss of IDR 12,434. Therefore, PT Bank needs to make some adjusting journal entries.

Table 8. Calculation of Impairment Losses on Accounts Receivable	No Description	IDR
	1. The carrying amount of the loan	100.000
	2. Calculation of the present value of estimated future cash flows:	
	a. Present value of IDR 100,000 which matures in 3 years; interest 10% [$IDR 100.000 \times 1/(1+10\%)^3$]	75.132
	b. The present value of the annual interest receivable is IDR 5,000 for 3 years; interest 10% [$IDR 5.000 \times (1/(1+10\%)^1 + 1/(1+10\%)^2 + 1/(1+10\%)^3)$]	12.434
	c. Total present value [a+b]	87.566
	3. Impairment loss [1 – 2]	12.434
	4. Adjusting journal entry:	
	Db. Impairment loss expense	12.434
	Cr. allowance for impairment losses (CKPN)	12.434

Source: adapted from Kieso et al. (2020)

The tax provision for the allowance of doubtful accounts before and after IFRS convergence remains unchanged. According to Article 6 paragraph (1) letter h of UU PPh, the method used is the direct method. Under such a provision, uncollectible receivables constitute deductible expense when qualifying the following requirements:

1. taxpayers have recorded uncollectible receivable as an expense in the commercial income statement;
2. taxpayers must submit bad debts list to the Directorate General of Taxes; and
3. a. taxpayers have submitted the collecting case to the State Court or the government agency that handles the state receivables; or
 - b. there is a written agreement regarding the debt write-off/debt relief between the creditor and the debtor concerned; or
 - c. taxpayers publish bad debts list in a public or special publication; or
 - d. the debtor acknowledges having written off a particular amount of debt.
4. The conditions outlined in number 3 do not apply to the write-off of bad debts owed by small debtors as defined in Article 4 paragraph (1) letter k of UU PPh.

The amortized cost approach under PSAK 71 is also applicable for tax purposes to record impairment losses on financial assets, even though the technicalities are different. The accounting approach is principle-based, while the tax approach is more rule-based (Budi and Rahayu, 2021). This application applies to several business fields with a high risk, as regulated in Article 9 paragraph (1) letter c of UU PPh and MoFR No. 81/PMK.03/2009 as amended by MoFR No. 219/PMK.011/2012.

CONCLUSION

647

PSAK 71 requires the entity to measure all of its financial assets at amortized cost or fair value depending on the classification of its financial assets. The classification reference is to the business model and the characteristics of the financial instruments from the contractual cash flows. Business models are concerned with how the entity manages its financial assets to generate cash flow. Conversely, the characteristics of cash flows relate to how the entity collects future cash flows arising from financial assets and whether these cash flows are relevant to payments of principal, interest, and other gains.

In general, the entity under PSAK 71 regime measures its financial asset or financial liability at fair value. Accordingly, it recognizes the unrealized holding gains/losses arising from measurements in profit or loss as FVTPL (Fair Value Through Profit & Loss). In addition, the entity recognizes unrealized holding gains or losses in profit or loss at amortized cost. This recognition occurs when a financial asset or liability is de-recognized as a result of the amortization process. Such accounting treatment also applies when the entity recognizes an impairment or loss for a financial asset. However, since the calculation of interest in amortized cost uses an effective rate, this may differ from the actual interest paid. As a result, the interest expense is not equal to the basis for calculating withholding interest.

Furthermore, since the tax regime only adheres to the concept of realization, the measurement of equity at fair value should be subject to fiscal corrections. Similarly, changes in fair value for debt investment are not allowable for tax purposes. Regarding the unrealized holding gains/losses originating from financial instruments, the current tax provisions in Indonesia still refer to the realization taxation under Article 10 of UU PPh. Accordingly, the unrealized gains or losses are still not allowable for tax purposes.

According to Article 9 paragraph (1), letter c of UU PPh after the enactment of UU HPP, tax provisions will follow accounting standards after the tax authority makes coordination with the Financial Service Authority. However, implementing the provision under UU HPP still requires government regulation. Therefore, based on three options of taxing income (accrual taxation, realization taxation, or hybrid taxation), realization is still preferable for taxing financial instruments. It is because realization taxation still aligns with the equity principle in the form of the ability-to-pay principle. Besides, realization taxation provides a legal certainty better than accrual taxation in line with fair value accounting under PSAK or IFRS.

This study contributes a novelty to the literature debate since it is one of the earliest studies linking accounting and taxes on financial instruments. We expect our findings to be valuable input for policymakers, especially tax authorities, in regulating financial instruments under UU HPP. These considerations are related to the taxation policies that the tax authorities can choose after IFRS implementation in Indonesia, as we have described in this study. However, this study's drawback is that it is far from quantification, although the approach used allows it. The limited number of informants underlies the authors' intention to do so. Further research can address these constraints by multiplying the number of informants to make generalizations. On the other hand, since impairment provisions become the specific subject under PSAK 48 Impairment of Assets, further research can discuss impairment issues more deeply with the standard in question.

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649

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