

DIFFERENCES BETWEEN TAXABLE INCOME AND BUSINESS INCOME

(With special reference to Indonesia case)

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Abstract

The primary causes of differences between financial statement for tax purposes and that for financial reporting, are the differing objectives of the Income Tax Law and Standar Akuntansi Keuangan Indonesia (Generally Accepted Accounting Principles). Tax objectives are providing revenue for the operation of government, and on occasion it may used to regulate the economy, or achieve other social objectives and little concerned with the best matching of revenues and expenses or any of the other specific external accounting objectives

The Income Tax Return is one kind of accounting report and the net profit (or loss) shown in the taxpayer's account is not necessarily the net profit (or loss) for tax purposes. There are some of the cases where discrepancies may exist between the tax and accounting profit and loss figures, are caused directly by specific requirements in the tax law. Other differences arise because of choices which the taxpayer can make, that could be avoiding the income tax, such as profit shifting. The use of cash basis may cause a confusion in the income calculation, that is the amount of income can be adjusted every year by arranging cash income and expenses. For that reason, the calculation of income tax using the cash basis should consider using the mixed (hybrid) system

Where are discrepancy occurs, a statement reconciling the net profit or loss for accounting purposes with the taxable income or loss should be made for tax purposes. Such a statement is required at the time filing the income tax return

Keywords: discrepancy, reconciliation, income tax law

Introduction

The purpose of accumulating accounting data is to produce reports for users. The financial statement is the end product of the application of accounting principles and assumption to transactions. Many different type of accounting reports have been developed to serve society's need for economic information. These are prepared for almost every business or other economic unit, including institutions, welfare organizations and governments. The Income Tax Return is one kind of accounting report and the net profit (or loss) shown in the taxpayer's account is not necessarily the net profit (or loss) for tax purposes.

The primary causes of differences between financial statement for tax purposes and that for financial reporting, are the differing objectives of the Income Tax Law and Standar Akuntansi Keuangan Indonesia (Generally Accepted Accounting Principles). Tax objectives are providing revenue for the operation of government, and on occasion it may used to regulate the economy, or achieve other social objectives and little concerned with the best matching of revenues and expenses or any of the other specific external accounting objectives.

Tax accounting is driven by different goals than financial accounting. Although in some instances tax accounting conforms with Generally Accepted Accounting Principles, in many cases it differs markedly from GAAP. Its clearly articulated the reason why tax accounting and financial accounting must necessarily diverge.

The primary goal of financial accounting is to provide useful information to management, shareholders, creditors, and others properly interested; the mayor responsibility of accountant is to protect these parties from being misled. The primary goal of the income tax system, in contrast, is the equitable collection of revenue; the mayor responsibility of Directorate General of Taxes (Indonesia Tax Office) is to protect the public fisc. Consistently with its goals and its responsibilities, financial accounting has as its foundation the principle of conservatism, with is corollary that "possible errors in measurement (should) be in the direction of understatement rather than overstatement of net income and net assets.

Variations between business income and taxable income can be categorized as either permanent differences that affect only on the current year and temporary differences that affect more than one year.

Permanent Differences

The tax rules governing the recognition of income or gain and the deduction of expense or loss can reate a permanent difference between business income and taxable income. In many cases, a tax rule that causes a permanent difference was not enacted to improve the measurement of taxable income. Instead it was enacted to implement an economic or social policy. These differences can be divided into four sub categories.

1. *Income is excluded from taxable gross income but included in financial income.* For example, Payment from insurance company to an individual in connection with health insurance, accident insurance, life insurance, endowment insurance, and scholarship insurance.
2. *Income is included in taxable gross income but excluded from financial income* For example, imputed interest on intercompany loans.
3. *Certain items and losses are deductible for tax purposes but are not expensed and losses for financial reporting.* For example, if gross income after deduction gained losses, those losses shall be compensate to income.

4. *Expenses and losses are not deductible for tax purposes but are expensed for financial reporting*
For example, compensation or recompense in relation to employment or services given in the form of in kind or amenities should not be deducted from income.

Temporary Differences

The financial accounting rules and the tax accounting rules have many inconsistencies concerning the timing of income measurement. Because of these inconsistencies, items of income, gain, expense or loss are included in the computation of business income for one year and taxable income for another year. A business/tax difference resulting from a timing inconsistency is only a temporary difference. An excess of taxable over business income originating in the current year will reverse as an excess of taxable over business income in some future year (and vice versa). These differences can be divided into four sub categories.

1. *Income is recognized in an earlier period for taxation than for financial reporting.* For example, amount received in advance for services to be performed in a subsequent period must be recognized for tax purposes in the year received. Financial accounting requires recognition only as the services are rendered.
2. *Income is recognized in a later period for taxation than for financial reporting.* For example, profit on an installment sale is generally recognized at the time of sale for financial reporting. For tax purposes, however, the profit may sometimes be deferred and recognized when cash collections are received on the installment contract.
3. *Expenses and losses are deducted in a earlier period for taxation than for financial reporting.* For example, accelerated cost recovery rules may allow assets to be depreciated over a shorter period and at more and at a more accelerated rate for tax purposes than that permitted by financial accounting principles.
4. *Expenses and losses are deducted in a later period for taxation than for financial reporting.* For example, financial accounting principles require that businesses, under normal circumstances, estimate their uncollectible accounts and expense the estimated amount in the year of sale. Tax rules, however, forbid the allowance or reserve method and permit bad debt deductions only as individual accounts receivables become worthless.

Contrasting Perspectives on Income Measurement

The more practical matter of the differences between financial statement for tax purposes and that for financial reports, is mainly caused by the differences between income determined under Standar Akuntansi Keuangan Indonesia (Generally Accepted Accounting Principles) and that computed for tax purposes. These differences are created by the many factors that enter into and influence the tax structure.

Primary among of these factors are the legal philosophies of the Nation (Pancasila), the (proper and improper) exercises of power by groups and lobbies with vested interest. The courts also create variations by their interpretation of the laws and regulations. The increasing use of tax policy as an instrument of economic planning and control is likely to make these differences a continuing problem.

Business managers have one attitude toward the measurement of income for financial statement purposes and a different attitude toward the measurement of income for tax purposes. Managers typically have incentives to report as much business income as possible. Their compensation and even their job security may depend on the level of earnings reported to existing and potential

investors in the firm. However the GAAP is based on a principle of conservatism. When in doubt , financial statements should delay the realization of income and accelerate the realization of losses. In theory at least, GAAP curbs any tendency on the part of management to inflate business income by overstating revenues or understating expenses. In contrast to their expansive attitude toward business income, managers typically want to deflate the taxable income (and resultant tax liability) reported to the government. Directorate General of Taxes are well aware of this measurement bias. Consequently, the Tax Law also embraces a principle of conservatism, but one that operates to prevent managers from understating gross income and overstating deductions. The natural tension between income measurement under GAAP and income measurement under the Tax Law only for firms that prepare financial statements for external users and income tax returns for the government.

Our purposes is not to identify all factors that influence the tax structure, but to develop an understanding of some basic tenets that underlie the body of tax laws and lead to major conflicts between the measurement of income for tax purposes and the computation of income for general accounting purposes. In order to prepare the financial statement for tax purposes correctly, some basic tenets that we will discuss here are:

- (1) Methods of accounting
- (2) Permanent differences
- (3) Temporary differences

In addition, without a good knowledge of how to compute income for tax purposes the financial statements for tax purposes could be prepared incorrectly. Income Tax Laws varies from country to country. I will later elaborate some details applicable in Indonesia. They provide specific information for Indonesia and a type of example for the more general cases.

Methods of Accounting

A firm must measure its taxable income every year and pay tax on an annual basis. Firms have considerable latitude with respect to the 12-month period over which to measure income. A firm's taxable year generally corresponds to its annual accounting period for financial statement purposes. The choice of a calendar or fiscal year is usually dictated by the firm's operating cycle; firms want to close their book and calculate their profit at the end of a natural cycle of business activity

After establishing its taxable year, a firm must assign the items of income and deduction from its transactions to a particular year. To do this, the firm must adopt a method of accounting: a consistent system for determining the point in time at which items of income and deduction are recognized (taken into account) for tax purposes. To provide a frame work for method of accounting, we first outline the general requirements for all tax accounting methods as follows:

- (1) The method of accounting must conform to that used for book purposes
- (2) The method of accounting must clearly reflect income
- (3) Subject to requirements 2 and 3, taxpayers may used any of the following methods of accounting
 - a. The cash receipts and disburments method (cash method)
 - b. An accrual method
 - c. Any other permitted method (for example the percentage of completion method)
 - d. Any combination of these methods permitted under regulation (a hybrid method)
- (4) A taxpayer engaged in more than one trade or business may use a different method of accounting for each trade or business.
- (5) Unless provided otherwise, taxpayers must obtain the Directorate General of Taxes to change the accounting method.

These rules seem to give all taxpayers much leeway in selecting an accounting method, but once a firm adopts a method of accounting, it may not change unless it formally request and receive permissions to do so from Directorate General of Taxes. The request must state the reason why the firms want to change and provide a detailed description of its present and proposed method of accounting. The Directorate General of Taxes does not rubber-stamp these request. When the Directorate General of Taxes does grant permission, it carefully monitors the change to make sure that the firm does not omit income or duplicate deductions in the year of conversion to the new method of accounting

The law recognizes that no uniform method of accounting can be prescribed for the taxpayers and it expects the taxpayers to adopt the forms and methods of accounting suitable for their purposes. Article 28 paragraph (1), (2), (5), (6), (7) Law of The Republic Indonesia Number 6 Year 1983, Concerning General Provisions and Tax Procedures as Lastly Amended by the Law Number 28 Year 2007, among other said :

Article 28

- (1) *Individual Taxpayer conducting business activities or independent personal service and Corporate Taxpayer in Indonesia shall maintain bookkeeping.*
- (2) *Taxpayers exempted from the obligation of maintaining bookkeeping as referred to in paragraph (1), but obliged to maintain recording, are individual Taxpayer engaged in businesses or independent personal services who in accordance with the provisions of the tax laws are permitted to calculate net income using the **net deemed profit** and individual Taxpayer who are not engaged in businesses or independent personal services*
- (4) *The bookkeeping or recording shall be conducted in Indonesia using Latin alphabets, Arabic numbers, Rupiah currency, and shall be written in Indonesian Language or in any foreign language permitted by the Minister of Finance.*
- (5) *Bookkeeping shall be maintained with consistency principle and using **accrual or cash method***
- (6) *Any change in the method of bookkeeping and or financial year period shall be secure approval from the Directorate General of Taxes.*
- (7) *Bookkeeping shall at the least consist of records of assets, liabilities, equity, income and expenses, sales and purchases, so that the amount of tax payable can be calculated.*

You can find the **Net deemed profit** in Article 14 Law of The Republic Indonesia Number 7 of 1983 concerning Income Tax as Lastly Amended by Law Number 36 of 2008. as follows:

- (1) *Deemed profit to determine net income shall be formulated and adjusted from time to time, and issued by the Director General of Taxes.*
- (2) *An individual Taxpayer whose gross income of business activities or independent service in on year is less than Rp4.800.000.000,00 (four billion eight hundred million rupiah), may calculate his net income by applying the deemed profit as referred to in paragraph (1), provided that it is communicated to the Director General of Taxes within the first three months of the taxable year concerned.*
- (3) *A Taxpayer who calculates net income using the deemed profit as referred to in paragraph (2), shall be obliged to keep records as referred to in the provisions of the Law on General Rules and Procedures of Taxation.*
- (4) *A Taxpayer who fails to inform the Director General of Taxes to choose deemed profit as referred to in paragraph (2) is deemed to choose to keep books of account*
- (5) *A Taxpayer who is obliged to keep books of account or records, including a Taxpayer as referred to in paragraphs (3) and (4), but fails to keep or completely keep records or books of account, or fails to reveal records or books of account or supporting evidence, in such case the net income*

will be calculated using deemed profit and the gross income will be calculated in other basis as stipulated by or based on the Minister of Finance Regulation

(6) *.Deleted.*

(7) *The amount of gross income as referred to in paragraph (2) may be adjusted by the Minister of Finance Regulation.*

The cash method of accounting is both simple and objective because the measurement of taxable income is based on cash receipts (bank deposits) and disbursements (checks written). The cash method also provides some control over the timing of income recognition. Because the cash method can be manipulated to defer income and accelerate deductions, the tax law limits its use by large corporations.

Elucidation Article 28 paragraph (5) Law of The Republic Indonesia Number 6 Year 1983, Concerning General Provisions and Tax Procedures as Lastly Amended by the Law Number 28 Year 2007, among others said :

Cash basis is a method which the calculation is based on the earned income and paid expense.

In the cash basis, income is recognized when it is received in cash within a certain period, and expense is recognized when it is paid in cash within a certain period.

Cash basis is usually used by small enterprises, individual, or services companies such as transportation, entertainment, and restaurant businesses, where the time frame between the service delivery and the cash earning should not be too long. In the pure cash basis, income from goods or services delivery are recognized at the time the payment from customers is received, and expenses are recognized at the time the goods, services, and other operational expenses are paid.

This way, the use of cash basis may cause a confusion in the income calculation, that is the amount of income can be adjusted every year by arranging cash income and expenses. For that reason, the calculation of income tax using the cash basis should consider among others:

(1) Sales calculation within a period of time should include both cash and non-cash sales. All purchases and inventories should be taken into consideration in the calculation of cost of goods sold.

(2) In acquiring depreciable assets and amortizable rights, the expense deducted from income can only be done through depreciation or amortization.

(3) The use of cash basis should be operated consistently.

*Therefore, the use of cash basis for taxation purpose can also be named as **mixed system***

Permanent differences

Many of the differences between gross income as reported on tax return and on a financial statement result from provisions set in the relevant tax law, that exclude from the tax base specific items of income and certain business expenses are held to be non deductible for tax purposes or the amount deductible in the tax return is limited. In addition, a limited number of statutory tax deductions are not considered expenses for accounting purposes. There are three types of permanent differences:

(1) Revenue recognized for financial accounting reporting purposes but is never taxable

(2) Expenses recognized for financial accounting reporting purposes that are never deductible

(3) Income tax deductions that do not qualify as expenses under generally accepted accounting principles,

Permanent differences may affect either financial accounting income or taxable income, but not both. A corporation that has nontaxable revenue or additional deductions for income tax purposes will report a relatively lower taxable income as compared to pretax accounting income than it would have if

these items were not present whereas a corporation with expenses that are not tax deductible will report a relatively higher taxable income.

Provisions in the Income Tax Law that cause permanent differences are:

(A) Disallowed deductions

Excluding an item from gross income means, in a practical sense, that the item is not a part of the gross income that is the starting point in computing the income tax. You can exclude an item from gross income for any of the following reasons:

1. It is not deductible under the Income Tax Law.
2. It does not come within the definition of “income”
3. It is expressly excluded by statute.

Items in classes 1 and 2 are not deductible and you can find these items that cause permanent differences, in provisions in the Income Tax Law in article 9 Law of The Republic Indonesia Number 7 of 1983 concerning Income Tax as Lastly Amended by Law Number 36 of 2008. as follows:

- (1) *In determining the taxable income of a resident Taxpayer and a permanent establishment, the following are not deductible*
- a. *distribution of profit in whatever name or form, such as dividends, including dividends paid by an insurance company to policyholders, and any distribution of the surplus by a cooperative;*
 - b. *expenses charged or incurred for the personal benefit of shareholders, partners or members;*
 - c. *formation or accumulation of reserves, except:*
 1. *reserve for bad debt of a bank and other business which conduct business as a creditor, financial lease company, consumer finance company and factoring company;*
 2. *reserves in an insurance business including reserve for social aid made by Social Security Agency;*
 3. *guarantee reserve for Deposit Guarantor Institutions.*
 4. *reserves for cost of reclamation in general mining,*
 5. *reserve for cost of reforestation in forestry business;*
 6. *reserve for closing and maintaining industrial waste site conducted by industrial waste processing Business;*
.the terms and conditions of which shall stipulated by or based on the Minister of Finance Regulation;
 - d. *insurance premiums for health, accident, life, dual purpose, and education insurance which are paid by an individual Taxpayer, except those paid by an employer where premiums is treated as income of the Taxpayer;*
 - e. *consideration or remuneration related to employment or services given in the form of a benefit in kind, except provision of food and beverages for employees or consideration or remuneration given in the form of a benefit in kind in certain regions and in connection with employment as stipulated by or based on the Minister of Finance Regulation;*
 - f. *excessive compensation paid to shareholders or other associated parties as consideration for work performed;*
 - g. *gifts, aid or donations, and inheritances as referred to in Article 4 paragraph (3) subparagraph a and subparagraph b, except donations as referred to in Article 6 paragraph (1) subparagraph i to subparagraph m and zakat received by an Amil Zakat Board or other amil zakat institutions established or approved by the government or compulsory religious donation for the followers of religions acknowledged by the Government, received by religious institutions established an approved by the Government, which are stipulated by or based on a Government Regulation.*
 - h. *income tax;*
 - i. *cost incurred for the personal benefit of a Taxpayer or his dependents*

- j. salary paid to a member of an association, firm, or limited partnership the capital of which does not consist of stocks;
 - k. administrative penalty in the form of interest, fines, and surcharges, as well as criminal penalty in the form of fines imposed pursuant to the tax laws.
- (2) Expenditures for earning, collecting, and securing of income having a useful life of more than one year, shall not be charged directly to income but shall be deducted through depreciation or amortization as referred to in Article 11 or Article 11A.

(B) Exclusions

Items in classes 3 are wholly exempt (excluded) and you can find these items in article 4 paragraph (3) Law of The Republic Indonesia Number 7 of 1983 concerning Income Tax as Lastly Amended by Law Number 36 of 2008, said as follows:

There shall be excluded from taxable object:

- a. 1. aids or donations, including zakat received by *amil zakat board* or other *amil zakat institutions* established or approved by the Government and received by eligible zakat recipients compulsory religious donation for the followers of religions acknowledged by the Government, received by religious institutions established and approved by the Government and received by eligible donations recipients, which are stipulated by or based on a Government Regulation; and
- 2. gifts received by relatives within one degree of direct lineage, and to religious body, educational or other social entity including foundation, cooperative, or to any individual who conducting micro and small business which stipulated by or based on a Minister of Finance Regulation, provided that aforementioned parties have no business, employment, ownership nor control relationship; and
- b. inheritance;
- c. assets including cash received by an entity referred to in Article 2 paragraph (1) subparagraph b, in exchange for shares or capital contribution;
- d. consideration or remuneration in the form of benefits in kinds in respect of employment or services received or accrued from a Taxpayer or the Government, except given by a non Taxpayer, Taxpayer which is imposed by final tax or Taxpayer using deemed profit as referred to in the Article 15
- e. payments by an insurance company to an individual in connection with health, accident, life or education insurance;
- f. dividends or distribution of profit received by or accrued by a resident limited corporation, cooperative, state-owned enterprises, or local government-owned enterprises through ownership in enterprise established and domiciled in Indonesia, provided that:
 - 1. dividends are paid out from retained earnings;
 - 2. limited corporations and state-owned enterprises and local-owned enterprises receiving the dividends must own at least 25% of the total paid-in capital;
- g. contributions received or accrued by a pension fund which its establishment is approved by the Minister of Finance, either paid by an employer or an employee;
- h. income from a capital investment of the pension fund as referred to in sub paragraph g, in certain sectors as determined by the Minister of Finance Decree;
- i. distribution of profit received or accrued by a member of a limited partnership, whose capital does not consists of shares, partnership, association, firma, and kongsi, including a unit holder of collective investment contract ;
- j. Deleted;
- k. income received or accrued by a venture-capital company in the form of profit distribution of a joint-venture company established and conducting business or engage in activities in Indonesia, provided that:

1. the investee is a micro, small, medium-sized enterprise, or engaged in activities in business sectors stipulated by or based on the Minister of Finance Regulation; and
 2. the investee's shares are not traded in the stock exchange in Indonesia;
- l. scholarships that fulfill certain requirements which are stipulated by or based on the Minister of Finance Regulation;
 - m. a surplus received or accrued by an institution or a non-profit organization engaged in education and /or research and development, which has been listed in corresponding institutions, which is reinvested in the forms of infrastructures of education and / or research and development, within no more than 4 (four) years period of time since it is received or accrued, as stipulated by or based on the Minister of Finance Regulation.
 - n. aid or donation paid by The Social Security Agency to a certain Taxpayer, as stipulated by or based on the Minister of Finance Regulation

(C) Valuation of Inventories

Income Tax Law only permitted using two ways of valuing inventories: (1) the average (2) the first-in-first-out method (FIFO). Once a method is adopted, it may not be change without Directorate General of Taxes permission. The method adopted must be used for the entire inventory. Provision in Income Tax Law concerning the valuation of inventories is article 10 paragraph (6) Law of The Republic Indonesia Number 7 of 1983 concerning Income Tax as Lastly Amended by Law Number 36 of 2008, said as follows:

Inventories and the use of inventories for calculation of cost of goods sold shall be valued on the basis of acquisition cost on average or using the first-in-first out method

Temporary Differences

As I mentioned earlier, the tax and financial accounting variations that result from temporary differences can be subdivided into four categories

1. *Income is recognized in an earlier period for taxation than for financial reporting.* For example, amount received in advance for services to be performed in a subsequent period must be recognized for tax purposes in the year received. Financial accounting requires recognition only as the services are rendered
2. *Income is recognized in a later period for taxation than for financial reporting.* For example, profit on an installment sale is generally recognized at the time of sale for financial reporting. For tax purposes, however, the profit may sometimes be deferred and recognized when cash collections are received on the installment contract.
3. *Expenses and losses are deducted in a earlier period for taxation than for financial reporting.* For example, accelerated cost recovery rules may allow assets to be depreciated over a shorter period and at more and at a more accelerated rate for tax purposes than that permitted by financial accounting principles.
4. *Expenses and losses are deducted in a later period for taxation than for financial reporting.* For example, financial accounting principles require that businesses, under normal circumstances, estimate their uncollectible accounts and expense the estimated amount in the year of sale. Tax rules, however, forbid the allowance or reserve method and permit bad debt deductions only as individual accounts receivables become worthless

Mere temporary differences do not generally have a significant effect on the total income ultimately reported, or on the aggregate tax liability eventually paid, by any taxpayer. Temporary differences occur either because revenue is recognized in one period for income tax purposes and in a different period for accounting purposes or because expenses are recognized either earlier or later for accounting purposes than for tax purposes. The accounting treatment for such differences is termed interperiod tax allocation.

Each of those timing differences as indicated above, requires the use of interperiod income tax allocation procedures in order to properly match income tax expense against accounting income, to properly match taxes payable against taxable income, and to properly recognize deferred income taxes.

Temporary differences may be caused by other factors in addition to these that are caused by the differing objectives of income taxation and financial reporting. As I mentioned earlier, the purpose of tax law is to raise revenue for the government and not necessarily to accomplish the best matching of revenues and expenses or any of the other specific external accounting objectives.

Provision in Income Tax Law that cause temporary differences is depreciation and amortization. According to the Income Tax Law, depreciations for assets is determined under the Modified Accelerated Cost Recovery System (MACRS). It was intended to simplify the former depreciation process and as a way of stimulating economic expansion by allowing the recovery of asset's cost over a shorter time period and also replaced the accelerated depreciation, investment allowance and tax holiday that used as incentives for investment in Indonesia before the year 1984. The MACRS replaced the useful life concept with prescribe recovery periods of 4, 8, 10 or 20 years, depending on the type of property and had statutory depreciation percentages. Special rules apply when an asset becomes obsolete, or when it sold, exchanged, abandoned, or retired without disposition.

The distinction between depreciation and amortization for tax purposes is not quite as clear as it is under usual accounting rules. Normally we depreciate tangibles and amortize intangibles and usually amortization is reserved for special situations that are not covered by the depreciation rules, like certain types of capital expenditure may be amortized instead of a cost deductible at once. The amortization period is the same as depreciation method.

Income Tax Law does not use the term "depletion" for the gradual reduction of the original amount by removal for use of minerals, oil and gas, other natural deposits and timber that are known as wasting assets. Instead of depletion, Income Tax Law uses "the production unit method", that can clearly be defined as a percentage of the production in the year concerned from the estimated total production. However, for a mining other than oil and gas, and forestry, the deduction cannot exceed 20% per year, while for oil and gas mining, no limitation at all.

The Impact of IFRS Convergence to Taxation for Indonesian Company

Accounting is the universal language of business. It is estimated that by 2013, as many as many as 310 of the 500 largest global companies will be using international accounting standards. However the profession faces many challenges in establishing international reporting standards, such as developing a sound conceptual framework, use of fair value measurements, proper consolidation of financial results, off-balance-sheet, and proper accounting for leases and pensions.

IFRS Convergence Plan in Indonesia uses a gradual strategy. Partial adoption up to 2010, and full implementation starts in 2012. Most PSAK (Indonesian Accounting Standard) will be revised to follow IFRS, but local conditions and regulations will be considered. PSAK for specific industry, which are in substance already included in IFRS, will be deleted and PSAK which are not in IFRS will be improved.

Some basic principles of accounting that are difference between Taxation Law/Regulation and IFRS based are as follow:

Taxation Law/Regulation	IFRS based
1. Assets & liabilities are measured on the basis of historical cost principles 2. Acquisition price/purchase price/sales price are the amount really paid and received for a given items 3. Taxable income for taxpayer who has special relationship with other taxpayer in accordance to fairness and common business practise which is not influenced by special relationship , using comparable uncontrolled price method, resale price method, cost plus method, or other method 4. Revaluation could be carried out by a taxpayer after obtaining permission from the Direktorat General of Taxes using independent appraisal. Tangible asset revaluation can be carried out every 5(five) year and imposes 10% final tax on surplus of revaluation 5. Bookkeeping at least consist of records concerning assets,liabilities, capital, income and expenses, as well as sales and purchases Therefore could be calculated the amount of tax payable 6. Bookkeeping using foreign language and currency other than Rupiah could be carried out by a taxpayer after obtaining permission from the Minister of Finance	1. The enhancement of the use of fair value on income, expenses, assets & liabilities 2. The judgement and estimation are allowed 3. Asset revaluation can be carried out every year by management in form of surplus revaluation and impairment 4. IFRS is more principle based. That is, the standards provide more general guidance by starting broad objectives, outcomes, and principle without providing detailed guidance 5. Bookkeeping : the use of functional currency

Differences between Taxation Law/Regulation and IFRS based concerning the classification & the transaction cost are as follow:

Taxation Law/Regulation	IFRS based
1. Does not regulate the classification of financial instrument 2. Regulates specifically the income tax levy on income from financial instrument types, such as stock traded on stock marked, bonds, or central bank certificate 3. Other financial instrument such as stock which is not traded in capital market is imposed on general income tax (art.17) 4. The expenses related to the final income tax are undeducted expenses. 5. The financial asset and liability are recorded on historical cost (Art 10 (1) ITL)	1. Either the Financial asset which is classified as Fair Value Through P&L (FVPTL) and Available For Sale (AFS) or the financial liabilities which is classified as FVTPL are measured by fair value method 2. The changes of fair value on the financial assets and liabilities which are classified as FVTPL are regognized on P/L 3. The changes of fair value on the financial assets of AFS are recognized on equity (other Comprehensive Income)

	4. The acquisition cost of financial assets or liabilities (i.e. Broker fee) on FVTPL category is recognize as an expense. 5. Furthermore . The acquisition cost of financial assets or liabilities on AFS, Hold to Maturity (HTM), and Loans and Receivables (LR) categories is recognized as a part of the acquisition cost 6. Thus, the entity record the acquisition cost in regard to the category (i.e FVTPL, AFS, HTM, or LR)
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Differences between Taxation Law/Regulation and IFRS based concerning interest structure are as follow

Taxation Law/Regulation	IFRS based
1. Income Tax Law (art 4 (1)) states that the object of tax is income, that is every additional economic capability recieved or obtained by Taxpayer, whether originating from Indonesia or abroad that can be used to consume or to increase the wealth of the taxpayer, in whatever name or form, including interest 2. Difference in recognizing interest income between tax and accounting will be reconciled and shown on P/L	1. Currently, the entity provides debt with various interest structures (effective, flat or annuity) 2. The creditors are consisted of banking and non banking entity 3. Indonesia Accounting Standard (PSAK) 55 (2006) states that an entity has to recognize interest income based on Effective Interest Rate (EIR) although in contract explicitly recognized interest income based on flat or annuity 4. In certain cases, there will a significant difference on interest revenue recognition between the accounting and the contract

Differences between Taxation Law/Regulation and IFRS based concerning off market interest & provision are as follow :

Taxation Law/Regulation	IFRS based
1. Off Market Interest, reference DGT Circular Letter 16 year 1999 2. Provision Income are recognized based on accrual or cash base (art 4 (1)) 3. Taxation law is not recognized income amortization 4. There will be a temporary difference between tax and accounting and will be reconciled and shown on P/L	1. Fair value measurement on in initial measurement of financial instrument. 2. If an entity provides a debt to other party, such as employee loan, with off market interest, for example, lower interest rate than market interest rate, the entity must record the interest income with market interest rate. The spreAd between the contractual and the market interest rate are recorded as an expense at the transaction time. 3. An entity amortizes finance charge on credit period 4. The provision is one of transaction cost

	type which could be attributed directly as a acquisition cost. 5. Provision income which is earned is amortized with EIR method (PSAK 55 (rev 2006) par.47)
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Differences between Taxation Law/Regulation and IFRS based concerning the reserve of the value impairment loss & unwinding interest are as follow :

Taxation Law/Regulation	IFRS based
1. Refer to Ministerial Decree Number 81 Year 2009 the reserve of value impairment loss is adeductible expense only for specific industries, such as banking , leasing, financing company, factoring company, etc. 2. However , there is a difference approach in calculating the reserve between taxes and accounting, which taxes regulation refers to Central Bank Regulation 3. Reconciled and shown in P/L	1. PSAK 55 (rev.2006) par.55 states that an entity evaluates financial asset in every balance sheet date whether there is an objective proof of value impairment or not 2. The method of financial asset evaluation could be individually or collectively on historical data

Reconciling Business Income and Taxable Income

As I indicated earlier, the net profit (or loss) shown in the taxpayer's account is not necessarily the net profit (or loss) for tax purposes, because of the differences between the measurement of income for tax purposes and the measurement of income under generally accepted accounting principles (GAAP) Where a discrepancy occurs, the corporation must reconcile on Attachment – I Annual Income Tax Return For Corporate 1771-I, Calculation of Fiscal Net Income, in form of **Positive Adjustment** and **Negative Fiscal Adjustment**, as follows:

No	DESCRIPTION	IDR
1	Domestic Commercial Net Income	
	a. Gross Income b. Cost of Goods Sold c. Other expenses d. Net Income from Business (1a-1b-1c) e. Income from Non Business activities f. Expense from Non Business activities g. Net Income from Non Business activities h. Total (1d + 1g)	
2	Foreign Commercial Net Income (From Special Attachment 7A column 5)	
3	Total of Commercial Net Income (1h + 2)	
4	Income subject to Final Tax and Non-Taxable Income	
5	Positive Adjustment	
	a. Expenses charged or incurred for the personal benefit of shareholders, partnership or members b. Formation or accumulation of allowances	

	c. Consideration or remuneration related to employment or services given in the form of a benefit in kind d. Excessive compensation paid to shareholders or other associated parties as a consideration of work performed e. Gifts, aids or donation f. Income tax g. Salaries paid to a member of association Firma, or Limited Partnership which capital does not consist of stocks h. Administration penalties i. Less commercial depreciation over fiscal depreciation j. Less commercial amortization over fiscal amortization k. Deferred expenses l. Other positive fiscal adjustment m. Total 5a to 5l	
6	Negative Fiscal Adjustment a. Less commercial depreciation under fiscal depreciation b. Less commercial amortization under fiscal amortization c. Deferred income d. Other negative fiscal adjustment e. Total 6a to 6d	
8	FISCAL NET INCOME (3-4+5m-6e-7b)	

Conclusion

When the amount of income determined for income tax purposes differs from the amount reported for financial accounting purposes, the prevailing viewpoint is that the income tax expense reported should be based upon the income reported for financial accounting purposes. Differences between business income and taxable income are either permanent or temporary. The primary causes of differences in the way income is determined for income tax purposes and financial accounting purposes, is the differing objectives of the tax law and financial reporting. The goal of generally accepted accounting principles (and financial statements prepared in accordance with GAAP) is to provide useful and pertinent information to management, shareholders, creditors, and other business decision makers. In contrast, the primary (but certainly not only) goal of the tax law (and the responsibility of Directorate General of Taxes) is to generate and protect government tax revenues and not necessarily to accomplish best matching of revenues and expenses or any of the other specific external accounting objectives.

A permanent business/tax difference affects only the year in which occurs, Consequently, income tax expense for financial statement purposes is based on business income adjusted for all permanent differences, while temporary differences occur when an item of income, gain, expense or loss is taken into account in a different year (or years) for book purposes than for tax purposes. Any excess of taxable income over book income from a temporary difference turns around to become an excess of book income over taxable income in some future year, and visa versa.

We have learned that firms must choose a method of accounting to divide a continues stream of income into 12-month segments. The choice of accounting method has very little to do with the measurement of taxable income over the life of a firm, but everything to do with the measurement of income for each taxable year, or in other word, the computation of business/ taxable income depends on the taxable year and the method of accounting adopted by the firm. Firms often use the same overall method for both financial reporting and tax purposes. Even so, many discrepancies exist between the

computation of business and taxable income. For that reason, the firm must reconcile in form of **Positive Adjustment** and **Negative Fiscal Adjustment**, on Attachment – I Annual Income Tax Return For Corporate 1771-I,

