

# **CHAPTER I**

## **INTRODUCTION**

### **1.1 BACKGROUND OF STUDY**

In business, most of such asset is in form of fixed assets. Fixed asset can have a significant effect on the long term performance results and therefore it is essential to have reliable and correct accounting of fixed asset. Fixed assets represent those assets and investments owned and used by the business for the long term to further the business. Fixed assets have been purchased to be used in the business with a view to generating income. These assets are expected to be used for more than one accounting period. Fixed assets are generally not considered to be a liquid form of assets unlike current assets. Fixed assets are not held for resale but for the production, supply, rental or administrative purposes. Once an asset is recognized, the next step is to depreciate it properly. This process involves estimating an asset's useful life and any salvage value. In balance sheet, fixed assets are reduced in value by depreciation.

Fixed assets are assets acquired in the form of ready-to use or have built before, which is used in company operations, not intended for sold in the framework of normal business activities and have a useful life of more than one years. (IAI, 2015). Asset recognition criteria is needed in order to determine which assets will be included in the balance sheet. When a expenditure is made, it can either be recognized as an expense or an asset. In preparing commercial financial statement, the company should recognizes fixed asset based on Financial Accounting Standard. Fixed assets should initially be measured at cost. This is consistent with the cost principle. Cost includes all normal and reasonable expenditures necessary to get the asset in place and ready for its intended use. (IAI, 2015). In preparing fiscal financial statement, the recognition of fixed asset is done based

on Income Tax Provision. According to Article 18 paragraph 4 Income Tax Law Number 36 of year 2008, the acquisition price to the purchaser is the price actually paid and the selling price to the seller is the price actually received. Included in the acquisition price are the purchase price and expenses incurred to obtain the asset, such as import duty, transportation expenses and installation costs. (Director General of Tax, 2008).

After the passage of time, the economic value of the fixed assets will decrease. The way in recording the decreasing of economic value of fixed asset is with implementing fixed asset depreciation. Depreciation is the systematic allocation of the depreciable amount of an asset over its useful life. (IAI, 2015). The company must be able to apply the proper depreciation method on certain fixed asset. A key characteristic of these assets is that they are consumed over several periods, leading to the need to recognize a depreciation expense, which can be a large item in the income statement. Depreciation method are likely to greatly impact the calculated income. The different depreciation methods will give impact to different depreciation cost allocation. A variety of depreciation methods can be used to allocate the depreciable amount of an asset on a systematic basis over its useful life. These methods include the straight-line method, the diminishing balance method and the units of production method. (IAI, 2015).

There are a lot of differences between Financial Accounting Standard and Income Tax Provision. The main differences in depreciation calculation are asset classification, useful life of asset and the choice of depreciation method. The Income Tax Provision specifically regulates the fixed assets classification. All of fixed asset except buildings is divided into four group. Taxpayers must classify their fixed asset. This regulation has high difficulty because of high variety from the fixed assets in the company. This regulation also state

that every fixed asset class has certain economics useful life. Estimated useful life of fixed asset based on Income Tax Provision is prohibited. In Financial Accounting Standard, the company can estimate fixed asset useful life. The different useful life of the fixed assets between Financial Accounting Standard and Income Tax Provision will give impact in the fixed asset depreciation calculation.

This research is done at PT Mahadana Mitra Kencana Medan. The company is engaged in sales of cooling equipment and generator. The company has fixed assets that is used for the business activities such as building, vehicle, office equipment, furniture and fixture. The company should recognizes fixed asset acquisition cost based on the Financial Accounting Standard in commercial financial statement. Fixed asset acquisition cost should be recognized as expense through depreciation. The company implements the certain depreciation method for the fixed asset. The company uses double declining balance depreciation method. The depreciation expense has impact on the financial statement because the depreciation expense is part of cost element. For tax purpose, the company should conduct the tax obligation based on Income Tax Provision. The company as taxpayer must conduct the calculation of entity income tax each year. Therefore, the company also need to calculate the depreciation expense in determining taxable income. The depreciation calculation for tax purpose should be done based on Income Tax Provision. The company's employee doesn't have sufficient experience and knowledge of tax. There is possibility that the depreciation expense in the company isn't in accordance with Income Tax Provision because the company's employee conduct the improper calculation of depreciation expense. The amount of depreciation expense is significant in income statement because the depreciation expense is one of highest cost in income statement beside cost of goods sold and salaries. Therefore, the improper calculation of depreciation expense

can make the improper calculation of income tax expense. If the income tax expense isn't in accordance with Income Tax Provision, the company will get tax sanction from government in form of administrative sanction and criminal sanction. The administrative sanction is given in form of fine, interest and surcharge.

Based on preliminary research, the company recognizes the fixed asset acquisition cost that comprises purchase price and any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable in using for the company's activities such as installation cost, transportation cost and so forth. For tax purpose, the company records should record purchase price as the fixed asset acquisition cost with considering other cost such as installation cost, transportation cost and discount price. The company uses the straight line method for fiscal depreciation expense. Besides that, the company uses the useful life of fixed asset in commercial financial statement in calculating fiscal depreciation expense. This condition shows that there is improper implementation of Income Tax Provision in calculating entity income tax. The fiscal correction should be done to commercial depreciation expense based on Income Tax Provision in order that depreciation expense can be recognized for calculation entity income tax.

Based on this background study, then the writer is interested to conduct the research with title as follows : **“The Analysis of Fixed Asset Recognition and Depreciation Method Applied towards Entity's Income Tax at PT Mahadana Mitra Kencana Medan”**

## 1.2 PROBLEM FORMULATION

The company uses fixed asset in business activities. The amount of fixed asset is high in financial statement. Therefore, the recognition and depreciation of fixed asset should be done properly based on Financial Accounting Standard and Income Tax Provision.

The company doesn't conduct same recognition of fixed asset in commercial financial statement and fiscal financial statement such as element of fixed asset acquisition cost. Besides that, the company must allocate the fixed asset acquisition cost in income statement through depreciation expense. The company uses different method of depreciation method between commercial financial statement and fiscal financial statement. Based on the background study that has been described previously, the problem formulated by the writer in this research is: "What is the analysis of fixed asset recognition and depreciation method according to Income Tax Provision to entity's income tax at PT Mahadana Mitra Kencana Medan?"

### **1.3 RESEARCH FOCUS**

There are many types of expense in income statement. Each expense has impact in calculating entity income tax. The expense in fiscal income statement can be divided into deductible expense and non deductible expense. The recognition of expense should be done based on Income Tax Provision. The depreciation expense is part of company's expense. The improper calculation of depreciation expense can give impact in calculating of entity income tax. The research focus is implementation of fixed asset recognition and depreciation in calculating entity income tax at PT Mahadana Mitra Kencana Medan in year 2017.

### **1.4 RESEARCH OBJECTIVE**

The objective of doing this research is to know the implementation of fixed asset recognition and depreciation according to Income Tax Provision to entity income tax in PT Mahadana Mitra Kencana Medan.

## **1.5 BENEFIT OF THE RESEARCH**

The benefits from conducting this research are as follows:

### **1.5.1. THEORETICAL BENEFIT**

1. This research gives benefit in increasing the knowledge of tax for writer especially depreciation expense and entity income tax.
2. This research is used as theoretical review in understanding difference of depreciation method between Financial Accounting Standard and Income Tax Provision
3. This research can be used as reference in conducting the research with same topic.

### **1.5.2. PRACTICAL BENEFIT**

1. This research can be used as suggestion for the company in improving the depreciation expense and entity income tax based on Income Tax Provision.
2. This research can be used by other company as reference in calculating depreciation expense and entity income tax based on Income Tax Provision.

## **1.6 SYSTEM OF WRITING**

The systems of writing in this *skripsi* will be as follows :

### **Chapter I : Introduction**

In this chapter, the writers will explain background of the study, problem formulation, research focus, research objective, benefit of the research and systems of writing. In this chapter, it describes presentation of fixed asset in financial statement, fixed asset recognition, the calculation of depreciation expense based on Financial Accounting Standard and Income Tax Provision, recognition of fixed asset and depreciation expense in commercial financial statement at PT Mahadana Mitra Kencana Medan, and

recognition fixed asset and depreciation for calculating entity income tax in the company.

## **Chapter II : Literature Review**

In this chapter, the writer will explain theoretical background, previous research and framework of thinking. This chapter consists of theory that is used as background in this research such as definition of fixed asset, type of fixed asset, recognition of fixed asset based on Financial Accounting Standard, recognition of fixed asset based on Income Tax Provision, definition of depreciation, types of depreciation method based on Financial Accounting Standard, types of depreciation method based on Income Tax Provision, and income tax calculation.

## **Chapter III : Research Methodology**

In this chapter, the writer will explain research design, research object, data collection method and data analysis method. This research uses descriptive research method. This chapter will describe the descriptive research method. Data collection methods used are communication and documentation. This chapter also explains the step in analysis of recognition of fixed asset and depreciation in the company.

## **Chapter IV : Data Analysis and Discussion**

In this chapter, the writer will explain general view of research object, data analysis and discussion. In general view of research object, it will describe the company's history, organization structure, presentation of financial statement, the depreciation method and calculation of entity income tax. In data analysis and discussion, it will describe evaluation of fixed asset recognition based on Income Tax Provision, evaluation of depreciation expense based on Income Tax Provision, recalculation of entity income tax based on Income Tax Provision after analysis of fixed asset recognition and depreciation method in the company.

## **Chapter V : Conclusion**

In this chapter, the writer will provide conclusion in impact of fixed asset recognition and depreciation method according to Income Tax Provision to entity's income tax. This chapter describes suggestion for the company in improving depreciation method and entity income tax calculation. The implication of this research is given based on analysis of fixed asset recognition and depreciation expense in the company.

