New Regulation on Value Added Taxes on Agricultural Products and Its Potential Impacts

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Bankground

Taking into consideration the importance of agriculture, the government has provided various support and incentive policies. The support includes general services such as infrastructures, research and development, natural resource conservation, market promotion, standard and certification. In addition, the government also provides support with influence agriculture revenue more directly such as input subsidy, price support, and direct cash transfer to be used as working capital. However, on the opposite side, the government also collect various taxes and levies, such as land taxes, export levies (only applied to palm oil and cocoa), and value added taxes. The purpose of this brief is to update new developments on value added taxes policy and potential impacts to agriculture.

Policy framework

According to the Law No.8/1983 on Value Added Taxes which has been amended most recently by Law No.42/2009, some strategic agriculture products (rice, paddy, maize, soybean, sago, fruits and vegetables) are exempted from taxes. However, Government's Regulation No. 31/2007 mandated that all agriculture, perennial crops, and forestry products are exempted from value-added taxes. Furthermore, Regulation of the Minister of Finance No.197/2013 mentioned that any company (including farmers) receiving annual gross revenue less than or equal to US$391,600 are also exempted from value added taxes.

In 2013, the Indonesian Chamber of Commerce (*KADIN)* sent a request to the Supreme Court to review current Law and Regulations related to that matter. The *KADIN's* justification to this request are: (a) implementation on tax credit to input in practice does not work; (b) increase tax burden and cost of production which ultimately reduce competitiveness. Responding to the *KADIN's* proposal, the Supreme Court released a Decree No.70/2013 which amended agriculture commodities from the list of strategic products exempted from the value added taxes. Following that Decree, Directorate General of Taxes, Ministry of Finance released Circulation Letter No.24/2014 mandating the operational implementation of the aforementioned Decree. Annex to the letter listed agriculture and forestry products exempted or not exempted from the taxes. It is clear that some products such as estate crops, selected food crops, ornamental crops, and forest products, are no longer, exempted from taxes. The value added tax rate are: (a) 10% for any products sold in domestic market; (b) 10% for the imported products; and (c) 0% if the product is exported.

Potential impacts

Conceptually, there are some potential impacts of this new regulation. ***First,*** this policy should not influence smallholder farmers since their gross revenue are less than the threshold value (US$ 391,600). However large company buying agriculture product from the farmers will pass by the cost to the farmers, and ultimately they receive lower price. ***Second,*** 0% taxes for the products exported will lead to higher export but less incentive to do business on down stream industry.

Considering the potential negative impacts of this policy, the Ministry of Agriculture has taken the following steps: (a) send a proposal to the Ministry of Finance to return to the earlier policy which treats 0% value added taxes for agricultural products; (b) promote competitiveness of agriculture by improving productivity, quality, and efficient utilization of resources.

Concluding remarks

New regulation on applying value added taxes to some agricultural products is predicted to reduce competitiveness in the agro-food sector and reduce farmers' income. The proposal of the Ministry of Agriculture to treat 0% taxes on all agriculture products is highly appreciated by many stakeholders. Irrespective of what policy regime on the value added taxes, promoting competitiveness in the agricultural sector is a never-ending policy perspective.

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