



THE COMPLEXITY OF VAT IMPLEMENTATION ON THE SUPPLY OF MEDICINES IN INDONESIA: WHAT ARE THE CONSEQUENCES?

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Abstract

The policy on the imposition of Value-Added Tax (VAT) on medicines transactions in Indonesia contributes to increasing state revenue. However, this policy has not yet fully favored the public, as VAT is one of the main factors in determining drug prices, which ultimately increases the financial burden on society, especially for those suffering from various illnesses. This study aims to analyze the VAT policy on pharmaceutical transactions and identify more effective policy alternatives. The research employs a qualitative approach, utilizing in-depth interviews and literature studies as data collection techniques. The findings indicate that this policy has not fully met the principle of ease in its administrative implementation. Therefore, the proposed policy alternatives include, firstly, classifying pharmaceutical products as essential goods exempt from VAT. Secondly, implementing a multi-tiered VAT system to reduce the tax burden on pharmaceutical transactions. This study recommends simplifying the tax mechanism to ensure easier implementation for taxpayers while also prioritizing the convenience of taxpayers in fulfilling their VAT obligations related to pharmaceutical transactions.

Keywords: Easy of administration, Tax policy, VAT, VAT rate, Medicines

INTRODUCTION

Every Indonesian citizen is entitled to receive health services without exception, as emphasized by WHO in the WHO Constitution of 1946 concerning the right to health information, health technology, and an adequate standard of living (Notoatmodjo, 2008). With vast geographical coverage comprising tens of thousands of islands and a population of 273 million in 2023, equitable access to healthcare remains a significant challenge for Indonesia's health system. The government is required to ensure the availability of medicines, which is influenced by the size of the population and medicine prices (Raharni et al., 2018; Mulyani, 2022). The urgency of medicine availability is expected to increase due to Indonesia's growing population. The demand for medicines continues to rise, as evidenced by the sharply increasing trend in the pharmaceutical sector's total market share related to medicine production. In 2016, the total market share of medicine demand was IDR 65.9 trillion and rose significantly to IDR 88.36 trillion in 2019 (Kemenperin, 2021). Additionally, growth in the pharmaceutical sector, particularly medicines, is projected to increase by approximately 4.77% through 2025 (Indonesia, 2025). This growth can be attributed to various factors, including rising income levels, increasing health awareness, and expanded knowledge regarding health among Indonesians.

WHO recommends governmental strategies for managing medicine prices, as such policies significantly influence the pricing of medicines in circulation (Vogler et al., 2015). In Indonesia, suboptimal price-control policies, especially concerning generic medicines, hinder community access to essential medications. The Indonesian government has yet to fully balance the interests of the public and pharmaceutical industry, particularly regarding price controls on medicinal products, notably generic medicines. Consequently, the public has not been able to maximally benefit from these medicines (Raharni et al., 2018).

Tax rates on medicines also contribute to the increased prices that patients must (World Health Organization, 2020; Creese, 2011). In Indonesia, the supply of medicines at each stage of distribution remains subject to VAT at the standard rate of 11%. However, there are generally differences in tax treatment for medicines used by outpatients compared to those for inpatients or emergency cases (Mikaelsen et al., 2024). Furthermore, the exemption of VAT on medicines



was specifically applied during the COVID-19 pandemic, limited solely to medications used for COVID-19 patients (Husna, 2022). Once COVID-19 was declared endemic, the Ministry of Finance officially announced that it would not extend the tax incentives previously granted during the pandemic.

The imposition of VAT on all types of medicine supplies is likely to trigger extensive debates in its implementation. From the perspective of state revenue, applying VAT to medicines could enhance government income, which could subsequently be allocated towards infrastructure development and community welfare programs, especially within the health sector (Mulyani, 2022). However, imposing VAT on medicine supplies also sparks significant controversies. The application of VAT on medicines will increase the cost of living, potentially resulting in negative outcomes, as was the case in South Africa (Lambojon et al., 2020). Moreover, applying VAT to medicines disproportionately affects vulnerable groups, particularly the poor and elderly populations (Creese, 2011). Additionally, imposing VAT on medicines positions them as ordinary consumer goods, despite the reality that medicines are essential commodities required by many individuals under specific health conditions (Moon, 2008; Leibovici & Santacreu, 2020).

Fundamentally, VAT is an objective tax whose collection does not consider the socioeconomic conditions of those bearing the tax burden (Williams, 1996). While there is potential for increased state revenue, it is crucial to evaluate whether the regressive effects of imposing VAT on medicines, particularly impacting lower-income and elderly groups, justify the revenue gains. Comparing Indonesia's VAT rates on medicines to those of other developing countries, it is generally observed that many nations apply differentiated VAT rates between medicines and other goods and services. For instance, Malaysia imposes a general VAT rate of 7% for goods and services yet applies a 0% VAT rate specifically to prescription medicines. Conversely, over-the-counter medicines in Malaysia are subject to the standard VAT rate of 7% (Wong et al., 2017). Similarly, the Philippines implements a 0% VAT rate on medicines included in an essential medicines list prepared by the Philippine Health Authority (Lambojon et al., 2020). Medicines not included on this list and sold without prescriptions are subject to the standard VAT rate of 12%. This research aims to analyze policies related to the imposition of VAT on medicines and to identify potential alternative taxation policies.

LITERATURE REVIEW

Tax policy is an integral part of fiscal policy. Such policy is crucial to support government expenditure, as taxation represents one of the largest sources of national revenue. According to Mansury (2002), tax policy, in a broader sense, refers to policies employed to influence employment opportunities, public production, and inflation through instruments of tax collection and necessary government spending. In a narrower sense, tax policy determines the tax base, identifies taxpayers, calculates the amount of tax payable, and establishes procedures for tax payments (Irianto, 2015).

Gunadi (2020) further elaborates the definition of tax policy as follows:

1. Options selected by the government to support state revenues and create conducive economic, business, and investment conditions.
2. Decisions made by the government to increase state revenue originating from taxation.
3. Actions undertaken by the government to collect tax obligations from citizens to meet state needs.

Gunadi (2020) indicates that tax policy aimed at supporting state revenue typically involves expanding and increasing the taxpayer base, refining tax rates for different types of taxes, broadening tax objects, and reforming tax administration. Additionally, the objectives of tax policy are to encourage investment, establish fairness, and maximize revenue (Williams,



1996). Thus, tax policies developed by the government must encompass these three objectives to be considered effective.

When formulating tax policy, there are several fundamental aspects that a government must consider. Vaughan (1983) outlines three essential elements that must be fulfilled in formulating tax policy:

1. Equity; To fulfill this principle, policymakers must adhere to three fairness principles: horizontal equity, where taxes are imposed equally if taxpayers have equivalent incomes; progressive equity, where higher taxes are imposed as taxpayer incomes increase; and benefit-based equity, where higher taxes are imposed on taxpayers who benefit more from public services.
2. Efficiency; Efficiency is achieved when taxpayers' obligations align with the public services received. Ultimately, an efficient taxation system must contribute positively to a country's economic growth.
3. Administrative Cost; Tax policies should not solely focus on profit maximization but must also consider administrative costs incurred by both the government and taxpayers in fulfilling their tax obligations. If administrative costs are excessively high for either party, the tax policy cannot be considered optimal.

Bird (2014) argues that tax policy is not only about economic considerations but also involves political factors, reflecting concerns about fairness and governmental interests in maintaining authority. There are always inherent limitations in any tax policy. Furthermore, successful tax policy requires the government, as policymakers, to minimize unnecessary taxation costs. To achieve this, three general rules can be applied (Bird, 2014):

1. Broad tax base: A broad-based consumption tax still affects labor efforts but minimizes policy distortions. Similarly, income taxes should also have a broad tax base, uniformly treating income from similar sources.
2. Low tax rates: Tax rates for each type of tax must be set according to revenue needs. Tax efficiency costs arise due to impacts on relative prices and generally increase proportionally with the square of tax rates. It is preferable to apply a single rate on a broad base rather than segmenting the base with differentiated rates.
3. Limitation of taxes on production: Taxes on production, such as sales and income taxes, cause distortions by influencing business location, changing production stages, and altering business structures.

Tax administration policies must consider several essential principles to enhance compliance. One crucial principle in tax collection is ease of administration (Nurmantu, 2003). Ease of administration emphasizes four critical dimensions (Irianto, 2015):

- a. Certainty principle: This principle emphasizes certainty regarding four elements: identifying taxable and non-taxable parties, clarity on taxable objects, certainty regarding the tax base and tax rates, and clarity about the withholding and collection system. Failure to fulfill these elements can lead to conflicts between taxpayers and tax authorities.
- b. Efficiency principle: Efficiency is evaluated from two perspectives: tax authorities and taxpayers. From the tax authorities' viewpoint, efficiency is achieved when collected taxes exceed collection costs (operating costs). From taxpayers' perspective, efficiency increases as compliance costs decrease. Operating costs include expenses for taxpayer compliance audits, tax collection actions, and handling legal actions by taxpayers. Taxpayers also bear compliance costs consisting of fiscal costs (expenses to meet tax obligations), time costs (time spent fulfilling tax obligations), and psychological costs (psychological burdens during the tax compliance process).



- c. Convenience principle: This principle suggests that taxpayers should fulfill their tax obligations upon earning income. Convenience is further achieved by allowing taxpayers to pay taxes in monthly installments over the tax year rather than in a lump sum, easing their payment process.
- d. Simplicity principle: The simplicity principle emphasizes taxpayer interests by ensuring tax administration systems are easy to understand, straightforward, and not overly complicated. A simple and clear tax administration system facilitates taxpayer compliance.

Value Added Tax

Value-Added Tax (VAT) is a sales tax levied on the added value generated at every stage of production and distribution (Irianto, 2015). The added value refers to production factors arising throughout the circulation of goods and all costs incurred to generate profits (Lasok Qc, 2020). Added value is defined as the value added by producers to raw materials before selling new products or services. This means that inputs are purchased, workers are paid wages to process these inputs, and when the goods are sold, there is a profit from these sales (Lasok Qc, 2020). According to Rahayu and Suhayati (2013), VAT is a tax imposed on every added value that arises due to production elements used in the production and distribution process. Additionally, Tait (1988) states that VAT is a tax levied on the added value of goods and services throughout their circulation from producers to consumers.

VAT is an objective tax, meaning the rates applied are fixed at a certain percentage. Due to its objective nature, this tax is calculated based on the existence of a taxable object, without considering the conditions or status of the taxpayer. This results in all consumers, regardless of their financial capacity, being taxed equally. Consequently, the fixed rate system creates a regressive effect in VAT burdens, where individuals with higher financial capacity bear a smaller percentage of tax, whereas those with lower purchasing power face a higher tax burden.

To mitigate this regressive impact, two strategies can be implemented. First, by providing certain facilities such as tax exemptions or reductions to zero percent. Second, by imposing higher tax rates on specific luxury goods. The tax applied at a higher rate for luxury goods is known as Luxury Goods Sales Tax (PPnBM) (Musgrave & Musgrave, 1989).

According to (Tait, 1988), several categories of taxpayers are liable to pay VAT:

1. Taxable Person; Although VAT primarily applies to the supply of goods and services, Taxable Persons are responsible for remitting VAT to the authorities. Not all business operators are subject to VAT; they must be registered taxpayers, operate a business, and be legally recognized entities. Taxable Persons are subject to VAT if they conduct business exceeding a minimum turnover threshold and employ a certain number of workers to surpass this target.
2. Partnerships; The taxation of partnerships is often complex due to their flexible nature, allowing members to be involved in different partnerships. While partnerships are generally not considered legal entities, some countries, such as France, recognize partnerships as taxable legal entities. This flexibility enables individuals within partnerships to reduce their tax liabilities. This issue remains unresolved, and each country adopts its own approach to address this challenge.
3. Firms; The administration of firms is often considered complicated, as firms frequently change members annually. Ideally, firms should be classified as legal entities subject to VAT. Tax courts or tax authorities must evaluate all aspects of a firm to determine whether a taxable person is liable for one or multiple firms.
4. Groups of Companies; It is common for groups of companies to register as a single entity comprising multiple companies. Ownership and control within the group are defined by the proportion of capital contributions, nominal shares, and the allocation of



profits as dividends. Groups of companies appoint representatives responsible for filing VAT returns and handling tax-related activities on behalf of the group. The group must ensure that each member is accountable for tax compliance and provides the necessary information for VAT assessments.

5. Other Persons; The imposition of VAT on other individuals (such as personal representatives, curators, and liquidators) must be clearly defined by tax authorities in each country. This is essential to prevent VAT avoidance by bankrupt companies that owe unpaid VAT obligations.

Additionally, VAT applies to specific taxable events (Putranti, 2011):

1. Supply of taxable goods within a customs area by a taxable person.
2. Importation of taxable goods and services.
3. Supply of taxable services within a customs area by a taxable person.
4. Utilization of intangible taxable goods from outside the customs area within the customs area.
5. Utilization of intangible taxable services from outside the customs area within the customs area.
6. Export of tangible taxable goods by a taxable person.
7. Export of intangible taxable goods by a taxable person.
8. Export of taxable services by a taxable person.

William Williams (1996) states that VAT becomes payable upon the occurrence of a transaction subject to VAT (goods and services). Thuronyi (1996) further defines VAT as a tax on transactions, meaning its scope covers transactions between producers and consumers. These transactions are categorized into two types Thuronyi (1996):

- a. Supply of Goods: VAT liability arises when goods are supplied as part of a business activity by a taxable person and must meet certain cumulative conditions, *namely*:
 - The supply must have a transactional value.
 - It must fulfill the criteria for goods supply.
 - The supply must be conducted by a Taxable Person (PKP).
 - The supply must occur within the territorial jurisdiction of the country.
 - The Taxable Person must engage in activities that fall within the scope of the economy.
- b. Supply of Services: Any transaction not classified as a supply of goods is considered a supply of services, characterized by intangibility, direct consumer involvement, and simultaneous production and consumption. The characteristics that differentiate services from goods include:
 - Services are heterogeneous products.
 - Services are intangible and immaterial.
 - Services are defined as processes.
 - Services involve inseparable production, distribution, and consumption processes.
 - The production process typically involves direct consumer participation.
 - Services cannot be inventoried.
 - The core value of services lies in the interaction between providers and consumers.

The amount of VAT payable is determined by the VAT Tax Base (DPP PPN) and the VAT rates applied in a country. The mechanism for determining the tax base and rates varies across jurisdictions. The VAT Tax Base plays a significant role in defining the total VAT liability (Darussalam & Septriadi, 2018). Shenck & Oldman (2007) describe the VAT Tax Base as the calculation of monetary amounts and the fair market value considered as the amount received at the time of the transaction. Additionally, Shenck & Oldman (2007) outline the key components of the VAT Tax Base:



1. Selling Price: The monetary value, including costs charged by the seller, excluding VAT and applicable discounts.
2. Import Value: The monetary value used as the basis for calculating import duties, including levies imposed under national law.
3. Compensation: The amount of money charged by service providers for taxable services, excluding VAT and applicable discounts.
4. Export Value: The monetary value, including all costs charged by the exporter.
5. Other Values: Monetary values serving as the tax base for taxable goods and/or services as prescribed under relevant tax laws.

Public Goods and Essential Goods

Public goods refer to goods that can be consumed collectively (joint consumption) by society. Access to these goods does not require competition (non-rivalry) and is not restricted by costs (non-excludable). The concept of joint consumption indicates that certain goods provide benefits to multiple individuals simultaneously. The greater the level of shared consumption and the lower the exclusivity, the more a good aligns with the characteristics of a public good. Conversely, the lower the shared consumption and the higher the exclusivity, the more the good resembles a private good (Musgrave & Musgrave, 1989).

An efficient government is an essential public good that ensures optimal budget utilization and effective distribution of resources for societal welfare. A government is considered efficient when it minimizes bureaucratic costs while continuing to provide public goods and services. As a public good, efficient governance is "purchased" by society through electoral voting, reflecting their choice of leaders deemed capable of running the government effectively. Additionally, efficient governance is "funded" through tax contributions paid by the public, which are allocated to finance public service administration (Mulyono*, 2020).

Essential goods are items crucial for daily life, whose demand remains unchanged regardless of price fluctuations (Mutaqin, 2018). Essential goods include staple foods, emergency supplies, medical equipment, pharmaceutical products, and petroleum-based products (Beckman & Smith, 2015). These goods consist of final products and all necessary inputs across the supply chain for production, distribution, and retail operations. Due to their fundamental role in society, demand for essential goods remains stable even when prices rise (Leibovici & Santacreu, 2020). Recognizing essential goods as a distinct category underscores their significance in sustaining daily life. This classification aligns essential goods with other crucial items, such as medical equipment and pharmaceuticals, that may not be explicitly categorized as essentials but hold equal importance (Beckman & Smith, 2015).

The definition of medicine, according to Sumardjo (2006), refers to chemical substances that affect living organisms and serve functions in disease prevention, diagnosis, and treatment. Generally, medicine can be described as a single or compound substance used by living beings to prevent, cure, or alleviate illness (Syamsuni, 2005). Furthermore, Anief (2006) defines medicine as a substance utilized to facilitate diagnosis, reduce, prevent, and heal diseases or injuries in humans and animals, as well as to enhance physical appearance.

Medicines can also be understood as formulated pharmaceutical products comprising biological substances and contraceptives, which are commonly used to influence physiological systems for diagnosis, treatment, recovery, and health improvement in both humans and animals (Abdullah et al., 2019). The ultimate purpose of medicine is to analyze diagnoses, prevent, alleviate, and eliminate diseases, as well as to enhance the health of living organisms. In Indonesia, medicines are categorized into various types, including essential medicines, patented medicines, generic medicines, and traditional medicines (Abdullah et al., 2019). However, this study will focus specifically on generic medicines, patented medicines, and essential medicines available in Indonesia.



METHODS

This study employs a post-positivist approach. Researchers utilizing a post-positivist approach adopt a perspective that focuses on a specific theory (Creswell & Creswell, 2018). The post-positivist approach was chosen because this research aims to provide an overview and understanding of the processes and dynamics involved in policy implementation. The researcher collects data that both support and contradict the tested theory. Subsequently, the researcher conducts revisions and additional testing as necessary to validate the theory (Creswell & Creswell, 2018).

There are several key assumptions in research that employs a post-positivist approach (Creswell & Creswell, 2018):

1. Knowledge is conjectural and antifoundational, meaning that absolute truth cannot be established. Consequently, the evidence obtained in research may contain errors and imperfections.
2. Research is a process of testing statements, where a given statement can be refined or replaced by a stronger statement.
3. Knowledge is constructed through data, evidence, and rational considerations.
4. The objective of research is to generate relevant and valid statements.
5. Researchers must maintain objectivity in analyzing methods and drawing conclusions.

In this study, the theory applied is related to the principle of administrative convenience. The researcher collects data relevant to this theory to support the research analysis process. Subsequently, an analysis is conducted regarding the policy on Value-Added Tax (VAT) imposition on pharmaceutical products using the principle of administrative convenience. The data processing phase follows this conceptual framework.

This study employs a cross-sectional data collection method with semi-structured interviews. The researcher conducted interviews with nine informants, comprising representatives from the Fiscal Policy Agency's National Revenue Policy Center, Directorate General of Taxes, taxation practitioners, healthcare professionals, academics, the National Professional Officer for Essential Medicines at the World Health Organization (WHO), representatives from a Regional Public Hospital (RSUD), pharmacy business operators, and practicing doctors at an RSUD.

The data analysis technique used in this study is qualitative analysis, which consists of three main steps: data reduction, data presentation, and conclusion drawing (Sugiyono, 2019). The researcher gathered data from interview transcripts, literature studies from books, journals, and relevant regulations. The collected data were then filtered and selected to ensure their relevance to the research focus on VAT imposition on pharmaceutical product transactions in Indonesia. The data were subsequently analyzed and presented in tables and figures within the research report. The final stage of data analysis involved drawing conclusions based on the presented findings.

The researcher adopted several concepts relevant to the research topic to analyze real-world conditions using the applied data collection techniques. The qualitative data analysis method was employed in this study. The informants in this research include representatives from the Directorate General of Taxes (DJP), the Fiscal Policy Agency (BKF), the World Health Organization (WHO), academics specializing in healthcare services and government levies, taxation practitioners, pharmacy business operators, general practitioners, and hospital tax administrators.



RESULT AND DISCUSSION

VAT Imposition on Medicines in Indonesia

Medicines are a vital necessity for Indonesian society. Ensuring the availability of medicines is a priority for the Indonesian government as part of its sustainable development goals (Islami et al., 2023). In Indonesia, medicines are categorized into various types. Generally, the public recognizes classifications such as liquid medicines, traditional medicines, finished drugs, patented medicines, essential medicines, and generic medicines (Rahayuda, 2016); (Indahri, Lestari, Retnaningsih, Hakim, & Yuningsih, 2014). However, commonly, pharmaceuticals in Indonesia are grouped into three primary categories; patented medicines, generic medicines, and essential medicines. These three categories are the most frequently referenced by the public when discussing pharmaceuticals in Indonesia (Kemenkes, 2023).

- **Patented Medicines**

Patented medicines refer to finished drugs registered under a brand name by the manufacturer with exclusive rights and are sold in official packaging from the producing pharmaceutical company. Patented medicines are defined as drugs containing active ingredients initially discovered by a pharmaceutical company. These medicines are generally protected by patents until their exclusivity expires, making their prices significantly higher than generic and essential medicines.

- **Generic Medicines**

Generic medicines are pharmaceuticals identified by their generic names, which are designated by the Indonesian Pharmacopoeia based on World Health Organization (WHO) standards for their active ingredients (Yusuf, 2016). Generic medicines are essentially expired-patent drugs, meaning that once a patent expires, pharmaceutical companies can manufacture and distribute the same formula while still paying royalties (Kementerian Kesehatan, 2023). The government recommends generic medicines for use within the National Health Insurance (JKN) system.

- **Essential Medicines**

Essential medicines are drugs that are deemed necessary for healthcare systems and must be continuously available in sufficient quantities to meet priority healthcare needs (Ministry of Health, 2023). The selection of essential medicines is based on key factors such as safety, efficacy, availability, and public health requirements in specific regions. The Indonesian government has compiled a National Essential Medicines List (or DOEN) to regulate and monitor these medicines.

According to Minister of Finance Regulation No. 99/PMK.010/2020, the supply of pharmaceuticals falls under healthcare services for the Indonesian public. However, its taxation treatment differs depending on whether it involves the supply of goods and/or services. Specifically, the Value-Added Tax (VAT) applies to both healthcare services and the supply of medicines. These two taxation areas are closely linked to the concepts of Taxable Goods and Taxable Services, which are defined as strategic in Indonesia's VAT Law.

However, based on the VAT Law, medicines are not classified as strategic Taxable Goods, which would have otherwise been exempt from VAT. As a result, all pharmaceutical transactions across production and consumption chains are subject to VAT. The VAT applies to all categories of medicines in Indonesia without exception. Therefore, patented medicines, generic medicines, and essential medicines are all subject to the standard VAT rate of 11%.

Additionally, there is a distinction in the taxation of medicines supplied to outpatients. Outpatient medicine supplies from pharmacies or hospital pharmacies are subject to 11% VAT, as hospital pharmacies are treated similarly to standalone pharmacies that sell medicines directly to the public. However, hospital pharmacies that serve only inpatients and/or emergency patients are exempt from VAT, as their activities are considered part of hospital



healthcare services. Since hospital pharmacies also cater to outpatient needs, they are subject to VAT in the same manner as regular pharmacies.

Analysis of VAT Imposition on Medicine Supply

Certainty Principle in Tax Policy

A taxation policy must embody the principle of certainty, providing clarity for all parties involved in tax administration, including tax officials and taxpayers (Irianto, 2015). This principle encompasses certainty regarding the subject, object, rates, procedures, and other aspects within the taxation system. Such certainty is crucial to enable taxpayers and tax authorities (fiscus) to avoid errors in fulfilling tax obligations and monitoring processes. In the context of imposing Value Added Tax (VAT) on the supply of medicines, the tax subjects include individuals and entities conducting transactions within the customs area. Generally, patients, pharmacies, and hospitals are parties involved in the medicine supply chain.

Additionally, taxation policy must ensure certainty regarding taxable objects and rates. In the Indonesian taxation system, all types of medicines are subjected to a VAT rate of 11%. However, there are differences in the implementation mechanism, especially for essential medicines, which receive government-borne VAT incentives (Ditanggung Pemerintah or DTP) under the National Health Insurance (Jaminan Kesehatan Nasional or JKN) program.

Type of Medicine	Rate
Patented Medicines	11%
Generic Medicines	11%
Essential Medicines	11% (VAT incentive borne by government)

Although all medicines are subject to the same VAT rate, the implementation mechanism varies depending on the type of healthcare service provided.

1. Outpatient Services – Medicines provided to outpatients remain subject to an 11% VAT at the point of supply.
2. Inpatient or Emergency Patients – Medicines supplied to inpatients or emergency patients are exempt from VAT, as they are classified under healthcare services that are excluded from taxation.

Additionally, the VAT credit mechanism for essential medicines benefiting from the government-borne VAT incentive (VAT DTP) under the National Health Insurance (JKN) program requires careful implementation. Essential medicines receiving VAT DTP incentives are categorized as non-aggregated VAT income. Therefore, hospitals, as tax administrators, must separate purchase transactions for JKN and non-JKN patients.

To ensure accuracy in tax reporting, hospitals must establish precise record-keeping systems, including calculation templates to differentiate:

1. VAT income from the general supply of medicines.
2. VAT DTP income from medicines supplied under the JKN program.

The implementation of this mechanism is expected to enhance transparency, accuracy, and compliance with prevailing tax regulations concerning medicine taxation.

Efficiency Principle in Tax Policy

Tax policy must be implemented efficiently, meaning that the taxes imposed on the public should be proportional to the public services provided. The government designs the tax system primarily to increase state revenue while also supporting public services (Irianto, 2015). The principle of tax efficiency can be analyzed from two perspectives:

1. The perspective of the tax authority (fiscus) – Tax collection is considered efficient if the administrative costs incurred by the tax office are lower than the total tax revenue collected.



2. The perspective of taxpayers – Tax collection is deemed efficient if the costs incurred by taxpayers in fulfilling their tax obligations are minimized.

- a. Operating Cost (Fiscus Operational Cost)

The expenses incurred by the government or tax authorities in implementing tax policies are referred to as operating costs. These include administrative and monitoring expenses. In the context of VAT imposition on the supply of medicines in Indonesia, the application of a single 11% VAT rate simplifies administration, as it eliminates the need for complex monitoring. The government does not need to allocate additional costs to oversee different VAT rates, except for specific exemptions such as essential medicines under the National Health Insurance (JKN) program.

Applying VAT to all types of medicines enables the government to monitor taxable transactions more efficiently. Furthermore, VAT reporting in Indonesia follows a self-assessment system, where taxpayers report their tax obligations independently through tax returns (SPT) (Gunadi, 2020). Thus, a single-rate scheme reduces administrative costs compared to a multi-rate system, which requires stricter oversight (Darussalam, 2021). However, if a multi-rate scheme is adopted, the government will face challenges in ensuring taxpayer compliance, particularly in verifying that each transaction is subject to the correct VAT rate. An alternative approach to maintaining tax revenue without burdening low-income populations is to impose VAT only on non-essential medicines, such as cosmetic products and health supplements that are not directly related to life-saving treatments.

- b. Compliance Cost (Taxpayer Compliance Cost) When designing tax policies, it is crucial to consider compliance costs, which refer to the expenses incurred by taxpayers in meeting their tax obligations. The implementation of VAT on medicine supply presents several challenges for taxpayers, particularly for hospitals, which function as taxable enterprises (PKP).

Hospitals must separate VAT reports based on patient categories:

1. Outpatient Services – Medicines provided to outpatients remain subject to an 11% VAT.
2. Inpatient and Emergency Patients – Medicines are exempt from VAT, as they fall under healthcare services.

This differentiation creates administrative challenges for hospitals, which must prepare separate reports for each transaction type. While the government considers this mechanism standard and manageable, hospitals—as taxpayers and taxable enterprises—encounter difficulties in its implementation. This indicates that tax policies that do not adequately account for taxpayer compliance costs can reduce overall tax system efficiency. These challenges would not arise if medicines were categorized as strategic taxable goods (BKP) or essential goods exempt from VAT. However, if a multi-rate scheme is introduced, taxpayer compliance costs will increase due to the higher complexity of tax (Aryani & Tambunan, 2022).

Convenience Principle in Tax Policy

The principle of convenience in taxation primarily benefits taxpayers, as it relates to ease and comfort in fulfilling tax obligations (Irianto, 2015). A high administrative burden in tax compliance can reduce taxpayers' convenience. Therefore, the tax system should be designed to enable taxpayers to meet their obligations more efficiently and comfortably.

In the context of VAT imposition on medicine supply, VAT becomes due at the point of transaction between the seller and the buyer. This affects patients' convenience as consumers since they must pay VAT to obtain medicines necessary for their recovery. Medicines are essential goods required for health recovery, yet no individual voluntarily seeks illness. Thus, medicines constitute a necessity rather than a discretionary consumer product.



When sick patients are still required to bear VAT costs on the medicines they need, their convenience as taxpayers is further diminished. Additionally, VAT on medicines increases the financial burden on patients, particularly among low-income and elderly populations who are more vulnerable to health conditions. This affects not only taxpayer convenience but also medicine accessibility, as tax burdens increase market prices, potentially limiting access to essential medications (Mulyani, 2022).

Simplicity Principle in Tax Policy

A tax policy must have a concise and simple mechanism to ensure that taxpayers can easily understand and comply with it (Irianto, 2015). Simplification in the tax system contributes to increased taxpayer compliance. In the context of Value Added Tax (VAT) on the supply of medicines in Indonesia, the current mechanism is relatively simple. One of the key supporting factors is the application of a single-rate scheme applicable to all taxable goods and services within the customs area, including medicines. The implementation of a flat VAT rate of 11% allows taxpayers, such as hospitals, to report and remit VAT on medicine supply more easily.

Although a single-rate scheme simplifies tax administration, differences exist in the VAT imposition mechanism for outpatient and inpatient/emergency patients. This distinction creates administrative challenges for hospitals, particularly in segregating revenue received from medicine sales to different patient categories. There is a divergence in opinion between the government and taxpayers regarding this policy. The government asserts that the current system functions well and poses no significant issues for hospitals. However, in practice, hospitals continue to face difficulties in distinguishing revenues from medicine sales to outpatient versus inpatient/emergency patients.

To address these challenges, hospitals have established dedicated pharmaceutical units responsible for segregating revenue reports based on patient categories. This initiative aims to facilitate the calculation of VAT payable on medicine supply. Therefore, the government should consider the following measures:

1. Categorizing medicines as strategic taxable goods (BKP) or essential goods exempt from VAT to simplify taxation mechanisms for hospitals and improve medicine accessibility for the public.
2. If the government maintains VAT imposition on medicines, a multi-rate scheme could be considered. However, implementing a multi-rate system could reduce the simplicity of the tax system, as taxpayers would need to exercise greater caution in determining the applicable tax rate for each medicine transaction.

Thus, a simple and easily implementable tax policy will enhance taxpayer compliance while reducing the administrative burden on healthcare institutions.

Alternative VAT Policies on Medicine Supply in Indonesia

Government-Borne VAT Scheme in the National Health Insurance Program for Medicine Supply

The imposition of Value Added Tax (VAT) on medicine supply has the potential to burden lower-middle-income groups, necessitating appropriate government interventions. As a solution, the government, through the Ministry of Health, introduced the National Health Insurance (Jaminan Kesehatan Nasional or JKN) managed by the Health Social Security Administration (BPJS Kesehatan). This program aims to provide universal healthcare coverage for all Indonesians (Saputro & Fathiyah, 2022).

JKN also includes a mechanism to ensure medicine accessibility for vulnerable groups, including the poor and elderly. This initiative serves as a government subsidy to guarantee that healthcare services remain accessible to underprivileged communities. Under the JKN system, healthcare financing is structured based on participant contributions. Middle- and upper-income



groups pay BPJS premiums to access healthcare services, while poor and elderly individuals classified as BPJS Contribution Assistance Recipients (BPJS PBI) receive fully government-funded healthcare (Lestari & Puspadari, 2023; Pramana & Chairunnisa Widya Priastuty, 2023).

To support JKN implementation, the government applies a Government-Borne VAT (PPN Ditanggung Pemerintah or PPN DTP) scheme to facilitate medicine access. This policy allows the government to impose VAT on medicine supply while covering the tax liability itself. Through this mechanism, low-income and elderly individuals receiving medicine through JKN are not required to bear additional costs due to VAT imposition. The government prefers the PPN DTP scheme over a full VAT exemption to prevent potential policy misuse. As a result, PPN DTP is considered a more targeted solution to ensure medicine accessibility for vulnerable groups (Mulyani, 2022).

Despite JKN's implementation, challenges remain in ensuring medicine availability for participants. One major issue is that many JKN participants struggle to obtain medicines through the program due to the limited effectiveness of the PPN DTP incentive in securing medicine availability at healthcare facilities. Consequently, patients often need to purchase medicine outside the JKN system at higher prices, particularly because medicines outside the subsidy scheme remain subject to an 11% VAT rate. This situation indicates that although JKN is positioned as the primary instrument for medicine supply to the underprivileged, it has yet to fully alleviate their financial burden.

Medicines as Strategic Taxable Goods

In Indonesia, all medicines are subject to VAT as they are classified as non-strategic taxable goods (Barang Kena Pajak or BKP) by the government. This means VAT is imposed at every stage of production and distribution. In contrast, strategic taxable goods—typically considered essential commodities—can be VAT-exempt under the Harmonization of Tax Regulations Law (UU HPP).

VAT imposition on medicines has sparked public debate, particularly among low-income and elderly groups, as the tax burden contributes to higher medicine prices. Given the crucial role of medicine in public health, the government should reassess whether medicines should be classified as essential goods and thus exempt from VAT. Although the government argues that essential goods mainly include staple foods like rice and wheat, medicine, by its nature, is a fundamental necessity required by individuals regardless of income level (Mulyani, 2022).

Medicines play a crucial role in maintaining public health. The function of medicine in supporting health is equivalent to basic necessities, and VAT imposition can reduce accessibility, particularly for low-income and elderly populations. If medicine availability declines, mortality rates and disease transmission risks may rise. Therefore, the government should reconsider the classification of medicines as non-strategic taxable goods.

Despite this, as a developing country, Indonesia still relies on tax revenue, including VAT from medicine sales. However, data suggests that this sector's tax contributions do not significantly impact national revenue. The government could replace this revenue by imposing VAT only on non-medical products, such as cosmetics, aesthetic items, and personal care products.

One justification for categorizing medicine as non-strategic taxable goods is that it undergoes a manufacturing process. However, this argument is not entirely valid, as fertilizers, which also undergo production, are classified as strategic taxable goods and exempt from VAT. Medicines could be categorized as essential goods or strategic taxable goods and exempted from VAT if the government agrees to revise regulations. Moreover, policy adjustments should



consider real-world challenges, as many BPJS patients struggle to access medicines listed in the national formulary or those covered under the BPJS program.

Since medicine is a fundamental necessity, especially for the poor and elderly, imposing VAT on all types of medicine increases the financial burden on vulnerable groups (Fanni, 2022). However, if this policy is modified, the government must establish clear criteria for VAT-exempt medicines. The classification should differentiate between essential medical drugs and non-medical products, such as cosmetics and personal care items. Accordingly, additional regulations must be developed to ensure that only truly essential medicines qualify for VAT exemptions, preventing potential policy misuse.

Multi-Rate VAT Scheme for Medicine Supply in Indonesia

Currently, Indonesia implements a single-rate Value Added Tax (VAT) scheme. The applicable VAT rate for Taxable Goods (Barang Kena Pajak or BKP) and Taxable Services (Jasa Kena Pajak or JKP) is 11%, an increase from the previous rate of 10%, which was enforced following the enactment of Law No. 7 of 2021 on the Harmonization of Tax Regulations on October 7, 2021. The government opted for a single-rate scheme as it is considered the most effective mechanism for supporting state revenue, particularly from the VAT sector. Under this system, a uniform VAT rate applies to all goods and services, with the exception of a 0% rate for exports. This policy covers all types of BKP and JKP, including medicines, which are not classified as strategic taxable goods or essential items exempt from VAT. Consequently, all medicine supplies in Indonesia are subject to the standard 11% VAT rate.

In contrast, several Asian and European countries implement multi-rate VAT schemes. The VAT policy in the Philippines differs in several aspects from Indonesia's VAT policy on medicine supply. In the Philippines, the VAT rate for medicine supply is set at 12%, the same as the general VAT rate for taxable goods (BKP) in the country. However, unlike Indonesia, the Philippines exempts VAT on medicines for certain diseases, such as diabetes, hypertension, and cancer (Lambojon et al., 2020). Additionally, Philippine health authorities provide incentives for senior citizens and persons with disabilities by offering a 20% discount on medicines (Kurniati, 2021). This incentive enables an overall price reduction of up to 32% for certain groups. This policy has been in place since 2020 and continues to be utilized effectively.

Meanwhile, in New Zealand, a Goods and Services Tax (GST) of 15% applies to medicine supplies. However, the policy in New Zealand differs from that of Indonesia. The New Zealand health authority categorizes medicines into two groups: (1) government-funded medicines, which may be fully or partially subsidized, and (2) non-government-funded medicines. Additionally, New Zealand covers the costs of medicines used by outpatients, either fully or partially (Vogler et al., 2015). This differs from Indonesia's VAT system, where outpatient medicine supplies remain subject to an 11% VAT rate.

Countries such as Italy, Austria, Belgium, Portugal, and several other European nations apply different VAT rates for medicines compared to general VAT rates. By adopting a multi-rate system, these countries can adjust VAT rates for essential goods, including medicines (Panov, 2020). This approach is based on the recognition that medicines are highly necessary commodities, allowing for lower VAT rates on medicine while maintaining higher VAT rates for less essential goods. Consequently, multi-rate VAT schemes are applied not only to medicines but also to other high-priority goods in these nations.

The Indonesian government, through the Ministry of Finance, continues to uphold the single-rate VAT scheme. According to (Darussalam & Septriadi, 2018), the single-rate system is considered the most effective for VAT implementation due to its key advantages:

1. Reducing administrative costs in tax management.
2. Simplifying the taxation process, making it easier for taxpayers to understand.



3. Enhancing tax compliance through a more straightforward regulatory framework. Conversely, the multi-rate VAT system also offers advantages over the single-rate scheme, which is why many European countries have adopted it. A multi-rate VAT scheme provides benefits in terms of equity and efficiency (Panov, 2020).

Efficiency in a multi-rate VAT system arises from VAT differentiation based on demand elasticity. Goods with elastic demand are subject to lower VAT rates, while inelastic goods are taxed at higher rates (Heru, 2023). Additionally, the multi-rate VAT scheme is considered fairer, as goods primarily consumed by lower-income groups are taxed at a lower rate, whereas those consumed predominantly by high-income groups bear higher tax rates.

Each VAT rate scheme has its advantages and disadvantages. As of now, Indonesia maintains a single-rate VAT system of 11%, including for medicine supply, as medicines are still classified as taxable goods (BKP). Consequently, all medicine-related transactions are subject to an 11% VAT. However, the multi-rate VAT system implemented in several European countries, which applies lower rates to medicines, could serve as a reference for Indonesia in formulating a more optimal VAT policy.

Furthermore, the National Health Insurance (JKN) program, implemented by the government through the Government-Borne VAT (PPN DTP) scheme as a tax incentive for low-income groups, has not yet functioned optimally. As a result, low-income individuals and senior citizens still incur additional costs to obtain medicines. Given this situation, the government may consider adopting a multi-rate VAT system, particularly for medicine supply, to assist lower-income communities in accessing more affordable medicines.

CONCLUSION

An analysis of the VAT imposition policy on medicine supply based on the principle of administrative convenience indicates that this policy has not fully met the four fundamental principles within this concept. Firstly, certainty – This principle has been fulfilled, as the relevant regulations have been clearly established, preventing confusion among taxpayers. Secondly, efficiency – This principle is not yet optimal since hospitals, as taxpayers, still encounter difficulties in reporting VAT revenue from medicines supplied to outpatients and inpatients. These challenges lead to an increased administrative burden and extended processing time. Thirdly, convenience – This principle has also not been fully achieved, as VAT is due at the time of the transaction when the patient receives the medicine. This requires patients to pay for medicines inclusive of VAT, resulting in inconvenience for taxpayers. Lastly, simplicity – This principle remains unmet, as certain tax obligations cannot be completed quickly and straightforwardly by taxpayers.

The alternative policies for VAT imposition on medicine supply in Indonesia include (a) Classifying medicines as essential goods or strategic taxable goods (BKP) exempt from VAT. (b) Implementing a multi-rate VAT scheme, allowing a lower VAT rate on medicine supply compared to the current rate. These policy alternatives refer to VAT policies on medicines adopted in several countries and are recommended in this study. The implementation of these alternatives could be considered by the government to enhance fairness in the VAT policy on medicine supply in Indonesia.

Recommendations

Simplifying Tax Compliance for VAT on Medicine Supply
The government should simplify tax compliance related to VAT imposition on medicine supply in Indonesia, considering that certain taxpayers, particularly hospitals, require more time to fulfill their tax obligations. Additionally, the government should consider the convenience of taxpayers who purchase medicines, as they must bear VAT costs while being unwell, which could further decrease their ease in fulfilling tax obligations.



Policy Recommendations for VAT Imposition on Medicine Supply
If the government intends to implement alternative VAT policies, the following recommendations should be considered:

- If medicines are classified as essential goods or strategic taxable goods (BKP) exempt from VAT, the government must establish clear criteria for medicines deemed critical for public health. Meanwhile, cosmetic and personal care products should remain subject to VAT to maintain state revenue.
- If the government implements a multi-rate VAT scheme to reduce VAT on medicine supply, comprehensive socialization efforts should be conducted to ensure taxpayers do not face an excessive administrative burden in complying with tax regulations.

These measures aim to improve efficiency, fairness, and accessibility in the taxation of medicines while ensuring an equitable balance between public health needs and government revenue considerations.

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