



REVISITING VALUE-ADDED TAX STRUCTURES: STRATEGIES FOR MITIGATING REGRESSIVITY IN BASIC COMMODITIES CONSUMPTION

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Abstract

This study explores the advantages and disadvantages of implementing a value-added tax on tax-exempt essential goods in Indonesia. The research employs historical, comparative, empirical, and normative legal methods to analyze the tax policy's legal and socio-economic context and assess its impacts and challenges. The analysis shows that applying VAT to necessities with exemptions can increase transparency, reduce tax avoidance, and ensure a fair distribution of the tax burden among businesses and consumers. However, this policy may impose additional administrative burdens and financial pressures on companies, particularly small and medium enterprises. It is crucial to balance promoting tax compliance and alleviating excessive administrative requirements. This research provides extensive insights into the dynamics of VAT policy on essential goods in Indonesia. It presents new perspectives on the distribution of economic burden and provides recommendations based on thorough legal analysis.

Keywords: Basic goods; Tax exemption facility, Value-added tax

Abstrak

Penelitian ini bertujuan mengeksplorasi keuntungan dan kerugian atas pengenaan Pajak Pertambahan Nilai atas barang kebutuhan pokok dengan status pembebasan di Indonesia. Penelitian ini menggunakan kombinasi metode penelitian hukum historis, komparatif, empiris, dan normatif untuk menganalisis konteks hukum dan sosio-ekonomi dari kebijakan pajak tersebut serta menilai dampak dan tantangannya. Analisis menunjukkan bahwa penerapan PPN pada kebutuhan pokok dengan pengecualian dapat meningkatkan transparansi, mengurangi penghindaran pajak, dan memastikan distribusi beban pajak yang adil di antara pelaku usaha dan konsumen. Namun, kebijakan ini juga dapat menimbulkan beban administrasi tambahan dan tekanan keuangan pada perusahaan, terutama perusahaan kecil dan menengah. Sangatlah penting untuk mencapai keseimbangan antara mendorong kepatuhan pajak dan mengurangi persyaratan administratif yang berlebihan. Penelitian ini memberikan wawasan yang luas mengenai dinamika kebijakan PPN atas barang kebutuhan pokok di Indonesia. Penelitian ini menyajikan perspektif baru mengenai distribusi beban ekonomi dan memberikan rekomendasi berdasarkan analisis hukum yang menyeluruh.

Kata Kunci: Barang kebutuhan pokok, Fasilitas pembebasan pajak, Pajak pertambahan nilai

INTRODUCTION

Taxes serve as the primary source of funding for governments around the world, including Indonesia, and are instrumental in driving economic growth and funding a wide range of national development needs. This critical aspect of government financing allows for allocating resources to essential public services, infrastructure development, and social programs, thereby promoting overall economic progress and societal well-being (Abomaye-Nimenibo et al., 2018; Nikoloski, 2020). In addition, an effective tax system enables the government to maintain fiscal stability, address income inequality and foster a favorable investment climate. Understanding the relationship between tax policy and economic development is becoming increasingly important in this context. As the primary source of revenue, taxes must be managed prudently and equitably to ensure the financial health of the country and the fair distribution of wealth among citizens (Nwekeaku, 2013; Zhattau, 2013). As a result, policymakers are challenged to design tax regimes that not only bolster government coffers but also stimulate economic growth and promote social equity. The Indonesian government, for example, has introduced various tax schemes to encourage investment, job creation, and sustainable development.

In Indonesia, taxes can be categorized into several types, including direct and indirect



taxes (Sinaga, 2016; Sutedi, 2022). Both categories play distinct roles in the nation's fiscal landscape, impacting individuals and businesses differently. One of the types of indirect taxes in Indonesia is the Value Added Tax (VAT). VAT is a critical tax instrument in Indonesia, contributing significantly to the country's revenue. As an indirect tax, VAT is levied on domestic consumption and is a crucial driver of national income. This tax system is applied to every production and distribution chain transaction. The main objective of VAT is to reduce the tax burden on the final consumer. VAT minimizes double taxation and promotes transparency by taxing the value added at each stage of the production process. It also reduces the cascading effect of taxation and ensures that the final consumer is not overtaxed. VAT also promotes economic efficiency as it generally has a neutral impact on businesses and promotes a level playing field between different industries. This tax system does not discriminate between different types of goods and services, thus promoting fair competition in the market. In addition, VAT is considered a relatively stable source of revenue as it is less sensitive to economic fluctuations than other forms of taxation. This stability is crucial for governments to maintain consistent public services and infrastructure development funding.

Indonesia applies a negative list system of VAT to all types of goods and services (Iswahyudi, 2017; Wijaya et al., 2020). Under this approach, all goods not included in the negative list are taxed. This comprehensive tax structure ensures that various goods and services contribute to the country's revenue, thus promoting a broad tax base. Using a negative list system, the Indonesian government can target tax relief measures more effectively, promoting social equity and reducing the regressive effects of VAT. This approach allows for a more nuanced tax policy that considers different population segments' different needs and circumstances. In addition, the negative list system can adapt to changing economic conditions and policy priorities, ensuring that the tax system remains relevant and responsive to the country's needs. However, a negative list system can pose challenges, such as potential ambiguities in classifying goods and services, leading to disputes and compliance problems. Ensuring that the negative list is straightforward and comprehensive is essential to avoid confusion and maintain the integrity of the VAT system. In addition, the negative list may need to be regularly reviewed and updated to reflect changing market trends and consumer preferences.

One of the ongoing controversies in Indonesia's current taxation landscape is the inclusion of basic commodities as taxable goods granted exempt status (Pink, 2022; Sembiring, 2021; Visaro, 2022). This is accommodated in Article 16B of Law Number 7 of 2021 on Harmonisation of Tax Regulations. These basic commodities were initially categorized as non-taxable goods as stipulated in Article 4A paragraph (2) of the 1984 Value Added Tax Law. This policy change has sparked debate, imposing an additional administrative burden on businesses operating in the affected sectors. Entrepreneurs in these industries are now required to issue invoices and submit monthly tax reports, which can be time- and resource-consuming. Critics argue that this increased administrative burden may lead to higher business costs, potentially increasing consumer prices. In addition, the complexity of the new policy may need to be clarified, which may increase the risk of non-compliance, further complicating the tax environment.

On the other hand, proponents of this policy change believe it will foster greater transparency and accountability in the tax system, ensuring that companies pay taxes fairly and contribute to state revenues. In addition, this policy change also aims to address concerns regarding tax avoidance and evasion, which are often associated with exemptions and reduced tax rates. By requiring companies to keep proper documentation and report their transactions, the government can more effectively monitor and enforce tax compliance, ultimately improving revenue collection efforts. Moreover, this policy change may also encourage businesses to



improve their record-keeping and financial management practices, ultimately contributing to better corporate governance and accountability. Nevertheless, the government must balance encouraging tax compliance and ensuring that businesses, tiny and medium enterprises, are not overburdened by excessive administrative requirements. This balance can be achieved through targeted support measures, such as simplified tax reporting and filing procedures and capacity-building initiatives to improve businesses' understanding of their tax obligations. In conclusion, including staple commodities as taxable goods with exempt status represents a significant shift in Indonesian tax policy, with potential benefits and challenges. As this policy continues to be debated and implemented, it is imperative for the government to carefully consider its implications on businesses and consumers, seeking a balance that encourages tax compliance while minimizing the burden on affected parties.

This study analyses the advantages and disadvantages of implementing Value Added Tax (VAT) on essential goods with exemptions in Indonesia. While many studies have been conducted on various sectors of the economy, there is a gap in the optimal policy formulation of VAT imposition on basic goods. Febriana et al. (2022) positively assess the policy change toward health services that become taxable services with a limited VAT exemption, emphasizing aspects of justice and state revenue. According to research by Gultom et al. (2022), the imposition of VAT with exempted facilities met the criteria of fairness, flexibility, and revenue better than other mechanisms. Saragih et al. (2022) investigated the impact of changes in the VAT taxation scheme on Educational Services, which were previously exempted but are now either exempted or not subject to VAT. This study highlights the gaps in the analysis of the impact of VAT policies on basic goods, particularly regarding transparency, tax fairness, and administrative burden for businesses. Supporters of VAT with exemptions argue that this policy enhances corporate governance transparency, reduces tax evasion, and ensures a fair distribution of the tax burden. However, there are concerns that this policy could burden companies, especially MSMEs, due to administrative and financial obligations.

This research makes both theoretical and practical contributions. Theoretically, it offers a new perspective on the impact of VAT on the economy and society, particularly regarding its regressivity and administrative burden. Practically, it provides data-driven policy recommendations, including implementing VAT exemption schemes, zero rates, and reduced rates for specific goods. This research aims to alleviate the tax burden on low-income consumers and support the sustainability of small and medium enterprises. Therefore, it significantly contributes to shaping the theoretical basis and practical application of tax policy decision-making in Indonesia.

LITERATURE REVIEW

The Value-Added Tax in Theory

VAT is an objective and indirect tax, functioning as a tax on consumption, specifically targeting expenditures made for domestic consumption (Bikas & Andruskaite, 2013; Ibadin & Oladipupo, 2015). This tax system aims to distribute the tax burden across various stages of the production and distribution chain, ultimately affecting the final consumer. VAT is imposed on the added value of a good or service. Value added represents the value producers add to the raw materials or goods they buy before selling new, improved goods or services. Raw materials and supplies are purchased in production, and workers are hired to carry out the production process until the goods are ready for sale (Bikas & Andruskaite, 2013; Ismail, 2017; Oktaria, 2011). VAT is a sophisticated tax system, which makes it difficult to administer (Mascagni et al., 2023). The wealth of information generated by VAT is one of its main advantages. However, this also burdens the tax administration to store and analyze it to ensure the benefits of law enforcement are realized. Ensuring successful implementation and compliance with the VAT



system requires efficient management and a complete understanding of its implications for both tax authorities and taxpayers due to the inherent complexity of the VAT system.

VAT incurs compliance costs on taxpayers who register for the scheme. These costs include the obligation to document all transactions, regularly collect these records (either monthly or quarterly), and provide reports to the appropriate tax authority (Faridy et al., 2014; Smulders & Evans, 2017). Taxpayers must also submit input tax claims concerning purchasing goods and services used in production and distribution and support these claims with relevant evidence and records (Marimuthu & Bidin, 2016; Zainol et al., 2013). Taxpayers have to ensure that they provide accurate and complete information and comply with the rules and regulations set by the tax authorities. As a result, taxpayers must invest time, labor, and money to fulfill these compliance obligations, which can affect their productivity and profitability (Mascagni et al., 2023). However, this compliance burden is seen as a natural consequence of implementing an efficient and effective VAT system designed to generate revenue for the government and ensure a fair distribution of the tax burden throughout the production and distribution chain.

Legal Character Value-Added Tax

The legal implication of VAT being an indirect tax is that the tax burden and debt fall on two parties. By law, consumers of goods and services shoulder the VAT burden, whereas entrepreneurs, as sellers, have to pay and report VAT to the government. Moreover, VAT is an impartial tax, implying that the obligation to pay arises from objective factors such as circumstances, events, or legal acts subject to taxation. Creating a VAT liability solely depends on the presence of a taxable object (Setyowati et al., 2020). VAT is charged at every production and distribution chain stage or as a multi-stage tax. This means that every transfer of goods or services subject to VAT from a producer to a retailer is liable for taxation.

Consequently, the operators involved in the production and distribution process must register with the tax authorities to identify them as taxable operators (Putri & Murwendah, 2019; Vanessa & Murwendah, 2020). The indirect subtraction method calculates the VAT payable to the Treasury. The taxable entrepreneur is not required to pay the tax collected from the consumer immediately to the State Treasury. The VAT payable to the State Treasury is calculated by deducting the input VAT (tax paid to other taxable entrepreneurs) from the output VAT (tax collected from consumers). If the resulting difference is positive, it represents the amount payable, and if it is negative, it can be compensated or refunded. In the context of tax policy and administration, this detailed discussion of the characteristics of VAT provides a comprehensive explanation of how the tax operates and its impact on consumers and businesses (Bardopoulos, 2015; Kristoffersson, 2021).

VAT is a tax on general domestic consumption (Guo & Shi, 2021). One consequence of this characteristic is that VAT is only levied on the consumption of goods and services within the country. Imported goods are subject to the same tax as they will be consumed domestically. On the other hand, exported goods are not subject to VAT within the country, as they will be consumed abroad. However, for entrepreneurs engaged in export activities, to recover input VAT paid on the acquisition of goods intended for export, exports are subject to VAT at a 0% rate. VAT is considered neutral because it is levied on the consumption of goods and services and adheres to the destination principle. By imposing VAT on consumption, it does not influence consumption patterns among the public. If VAT were only applied to the consumption of goods, people would tend to consume more services, as they would not be subject to VAT (Amand, 2013; Prüm et al., 2015). VAT does not result in double taxation. Although it is applied at every stage of production and distribution, VAT does not create double taxation because it is only collected on the added value. The tax credit mechanism used in calculating the tax payable allows entrepreneurs to recover VAT from acquiring raw materials, auxiliary materials, and capital goods. This comprehensive discussion of VAT characteristics provides a thorough



understanding of the tax system and its implications for consumers and entrepreneurs in the context of taxation policy and administration (Sukardji, 2015).

METHODS

This study employs a combination of historical and comparative approaches and empirical and normative legal research methods to investigate the optimal policy formulation for imposing VAT on basic commodities. The historical approach involves tracing the evolution of legal institutions over time, which assists researchers in understanding the underlying philosophy and principles of legal rules as they have developed (Marzuki, 2017). In this context, the historical approach will examine the regulation of basic commodities in Indonesia's 1984 Value-Added Tax Law. The comparative approach entails conducting a comparative legal study, which involves comparing the laws of one country with those of another or the laws of one time period (Marzuki, 2017). This approach will examine the regulation of VAT imposition on basic commodities in other countries.

This research uses a collection of laws and regulations, decisions of the Constitutional Court, and official documents related to taxation policies on necessities in Indonesia as data sources. The analysis interprets the content and implications of these documents on the dynamics of tax policy and its impact on society and the economy. It is conducted qualitatively. This method enables a comprehensive comprehension of tax policy's legal and socio-economic context. It also aids in identifying the impacts and challenges that arise during implementation. This qualitative analysis approach is important for exploring the broader meanings and consequences of tax policy and providing insights for more effective and sustainable policy recommendations.

The study employs both empirical and normative legal research methods. The empirical legal research method, or juridical-empirical method, will focus on the analysis of Constitutional Court Decision No. 39/PUU-XIV/2016, while the normative legal research method, or juridical-normative method, will examine various applicable laws and regulations related to the topic at hand. Legal materials utilized in this study consist of primary and secondary legal sources. Primary legal sources include relevant legislation, case law, and other authoritative legal documents, while secondary legal sources comprise scholarly articles, commentaries, and other academic works that analyze and interpret primary legal sources. By combining these research approaches and methods, this study aims to provide a comprehensive and in-depth analysis of the VAT policy on basic commodities, ultimately contributing to developing a fair, efficient, and sustainable taxation system.

RESULTS AND DISCUSSIONS

Regulation of Basic Commodities in the VAT Law in Indonesia

The discussion regarding the legal politics of basic commodities regulation in the VAT Law in Indonesia begins with examining the Republic of Indonesia Law Number 8 of 1983 Concerning Value Added Tax on Goods and Services and Luxury Goods Sales Tax. In this law, there is no specific regulation related to the imposition of VAT on basic commodities, but the law states that Taxable Goods are goods resulting from processing or manufacturing. Subsequently, based on Article 4A of the Republic of Indonesia Law Number 11 of 1994 Concerning Amendments to Law Number 8 of 1983, it is stated that necessities that are highly needed by the general population, such as rice and iodized salt, are not subject to Value Added Tax. Furthermore, Article 4A paragraph (2) letter b of the Republic of Indonesia Law Number 18 of 2000 Concerning the Second Amendment to Law Number 8 of 1983, asserts that necessities that are highly needed by the general population are not subject to Value Added Tax, which refers to basic needs in this regulation as rice and unhusked rice, corn, sago,



soybeans, salt whether iodized or not iodized.

Moreover, Article 4A paragraph (2) letter b of the Republic of Indonesia Law Number 42 of 2009 Concerning the Third Amendment to Law Number 8 of 1983 confirms that necessities highly needed by the general population are not subject to value-added tax. Necessities that are highly needed by the general population include:

“a. rice; b. unhusked rice; c. corn; d. sago; e. soybeans; f. salt, both iodized and non-iodized; g. meat, fresh meat without processing, but has gone through slaughtering, skinning, cutting, cooling, freezing, packaging or not packaging, salting, liming, souring, preserving in other ways, and/or boiling; h. eggs, which are unprocessed eggs, including eggs that are cleaned, salted, or packaged; i. milk, fresh milk that has undergone cooling or heating processes, does not contain added sugar or other ingredients, and/or packaged or not packaged; j. fruits, which are fresh fruits picked, either having gone through the process of washing, sorting, peeling, cutting, slicing, grading, and/or packaging or not packaging; and k. vegetables, which are fresh vegetables picked, washed, drained, and/or stored at low temperatures, including freshly chopped vegetables.”

From the chronological review of basic commodities regulation in the VAT Law in Indonesia, it can be observed that regulations have become more specific in stating the necessities exempt from VAT over time. This reflects the government's efforts to adjust fiscal policies to the population's evolving needs.

Judicial Review of Basic Commodities in VAT Law in Indonesia

The Constitutional Court Decision Number 39/PUU-XIV/2016 results from a judicial review of Article 4A, paragraph (2) of Indonesia's Value Added Tax Law. This article governs the types of goods subject to tax, which has sparked debate due to its perceived impact on fulfilling basic needs for consumers and traders of food commodities. The petitioners in this material test are Dolly Hutari P (Petitioner I) and Sutejo (Petitioner II). Both of them submitted their qualifications in the petition as individual Indonesian citizens. Petitioner I is a housewife who identifies herself as a consumer of food commodities, while Petitioner II is a trader of food commodities. Both petitioners believe that the Explanation of Article 4A, paragraph (2) of Law 42/2009, has violated their constitutional rights. Petitioner I feels that the provision in the Explanation of Article 4A, paragraph (2) of Law 42/2009 is burdensome in her efforts to meet the nutritional needs of her family, particularly for the majority of the Indonesian population who live below the poverty line and have low purchasing power. The limitation of basic necessity goods regulated in this provision becomes an obstacle in fulfilling her basic needs. Meanwhile, Petitioner II, as a local food commodity trader, feels discriminated against by the provision in the Explanation of Article 4A, paragraph (2) of Law 42/2009. This is due to the price difference in local food commodities not included in the eleven types of food commodities stipulated in the provision. This price difference occurs due to the imposition of VAT on those local food commodities.

The Constitutional Court's decision to accept Petitioner I's explanation concerning the constitutional rights infringement due to the implementation of the Explanation of Article 4A paragraph (2) of Law 42/2009 is a significant determination in this case. As for Petitioner II, although no explicit discrimination occurred, the Court believes there is sufficient reason to accept Petitioner II's reasoning. This is because Petitioner II is indirectly disadvantaged in fulfilling their basic needs due to the different treatment of food commodities, categorized as essential goods. Such a decision is grounded in the understanding that the indirect harm to Petitioner II's constitutional rights to satisfy their necessities stems from the disparate treatment of food commodities that fall under the same classification of essential items. Based on these considerations, the Court has concluded that the Petitioners possess the legal standing to act as petitioners in this application. Acknowledging the indirect infringement of Petitioner II's



constitutional rights highlights the complex nature of the case and the Court's willingness to carefully examine the consequences of the implementation of the Explanation of Article 4A paragraph (2) of Law 42/2009. This decision is an essential step in upholding the constitutional rights of Indonesian citizens and ensuring that the government's policies are consistent with the principles of justice and equality. By recognizing the indirect impact of this regulation on Petitioner II's constitutional rights, the Court has taken a crucial step in addressing the broader implications of the law and its potential to affect the lives of countless individuals. Furthermore, the Court's decision to accept both Petitioners' explanations demonstrates the importance of considering various perspectives and the interconnected nature of constitutional rights, especially in cases involving essential goods and their impact on the well-being of citizens.

The Court asserts that satisfying the basic needs, especially those highly desired by most of the population, is integral to the general welfare promotion endeavor. The Constitution vests the responsibility of fulfilling these needs, as highlighted in the fourth clause of the Preamble of the 1945 Constitution, upon the government. This endeavor aims to achieve social justice for all Indonesian citizens, a fundamental objective of the Indonesian nation and the state's establishment as an independent and sovereign nation in alignment with Pancasila, the state's principles. Additionally, the Constitution recognizes these fundamental needs as constitutional rights, which include the right to fulfill basic needs as a part of exercising the right to self-development and live a prosperous life in both material and spiritual aspects. These entitlements are provided in Article 28C, paragraph (1), and Article 28H, paragraph (1) of the 1945 Constitution. As a result, the state's constitutional obligation in this matter is increasingly emphasized. This emphasis on the state's responsibility highlights the critical importance of ensuring that government policies and actions align with the broader objectives of promoting social justice and enhancing the well-being of all citizens. The Court's decision underscores the essential role that legal institutions play in safeguarding the rights and interests of the people by acknowledging the constitutional rights related to the fulfillment of basic needs. This case reminds us of the significance of taking a comprehensive approach to tackling concerns related to fundamental needs and how they affect ordinary people's lives. In the end, the Court's verdict is making a substantial contribution to the continuous progress of the Indonesian legal system, guaranteeing that the country's legal structure addresses its citizens' necessities and rights while honoring the vital principles of social fairness and welfare.

In the discussion of Constitutional Court Decision No. 39/PUU-XIV/2016, the Court stated that the Explanation of Article 4A(2)(b) of Law 42/2009 contradicts the intention of the article itself, which aims to exempt necessities from value-added tax (VAT). This is because VAT should only be applied to goods that have undergone an added value, such as those processed during manufacturing. The Explanatory Note to the Article is also considered unfair because certain other goods that are not necessities are exempt from VAT, while other necessities not included in the 11 types mentioned in the Explanatory Note are subject to VAT. The potential for legal uncertainty arises from the possibility that a basic necessity may be subject to VAT in one place and exempt in another. The Court held that the Explanation to Article 4A(2)(b) of Law 42/2009 was incompatible with the 1945 Constitution, as it impeded the fulfillment of citizens' rights to necessities and the right to a prosperous life and did not provide legal certainty. The Court understands the difficulty faced by the legislator in detailing all types of necessities in high demand by the general public. If the details in the Explanatory Memorandum are intended to serve as examples, the legislature should further regulate the details of the types of necessities in government regulation. However, using the word "includes" in the Explanatory Memorandum gives the impression that the list is restrictive. Based on the above considerations, the Court considers the applicant's application partly justified. The Explanation to Article 4A(2)(b) of Law 42/2009 is declared unconstitutional in a conditional



manner, in so far as the list of " necessities in high demand by the general public" is not limited to the 11 types mentioned in the Explanation to the Article.

Compliance Costs, Regulatory Complexity and VAT Regressivity Issues

Despite the clear outline of the role and function of Value Added Tax (VAT) in the law, taxpayers and tax officials frequently encounter contradictory messages and confusing practices during their interactions in reality. This ultimately impacts the high compliance costs borne by taxpayers. One aspect contributing to these high costs is the complexity and ambiguity of tax regulations. Taxpayers frequently encounter convoluted and challenging regulations, resulting in increased time and resources spent understanding and adhering to these rules. Furthermore, the technical guidelines and instructions tax authorities provide are sometimes unclear and inconsistent, adding to the difficulty of comprehending tax obligations. Differences in interpretation between taxpayers and tax officials regarding VAT law provisions lead to legal uncertainties and discrepancies in VAT collection and remittance. Consequently, taxpayers face the risk of sanctions and fines for non-compliance, which are not due to their negligence but rather stem from unclear tax regulations.

Regarding VAT as an objective tax, it should be noted that it is regressive when low-income individuals are taxed more heavily than high-income individuals. VAT is considered an objective tax imposed on consumption without considering individuals' economic capacity. A prime illustration of VAT's regressiveness is the increased price of basic food commodities generally consumed by low-income households arising from the VAT. The amplified price places a more tremendous load on low-income households than high-income ones due to the more significant share of food expenditure in the budget of low-income households. For example, if VAT is applied to the purchase of rice, the price will increase. Rice is a staple food for most Indonesians, especially those with lower incomes. The increase in rice prices due to VAT burdens low-income households, as they must spend more money to meet their basic needs. In addition, VAT's regressivity is seen in purchasing more expensive food items such as meat, fish or vegetables. Although high-income households also consume these items, their share of expenditure on such food items is not as high as that of low-income households. In this context, VAT becomes a regressive tax because it imposes a greater burden on low-income households in meeting their basic needs, such as food. This tax burden reduces their ability to meet other needs, such as health, education and housing. To address the regressivity of VAT, the government should consider providing exemptions or reductions for essential goods, especially for low-income households, thereby reducing the tax burden and enabling low-income households to meet their basic needs more easily.

Concerning the application of VAT on basic commodities, farmers face VAT compliance costs, which may affect them unevenly. Small farmers who register for VAT or choose to do so incur costs that tend to be proportionately higher than those incurred by large farmers who have better accounting systems. It indicates the presence of regressivity in the VAT system, where farmers with lower incomes have to bear a higher proportional tax burden. This inequity may be caused by several factors, such as a lack of understanding of the tax rules, limited resources to keep proper accounts, and additional costs to comply with VAT rules. As a result, small farmers may need help managing their finances and may be under greater financial pressure than larger farmers. Meanwhile, while VAT-exempt farmers do not have to bear compliance costs, they still face the problem of non-deductible input VAT. It means exempt farmers continue to pay VAT on raw materials and goods purchased for business purposes but cannot deduct it from their taxes. Consequently, these farmers also experience a higher tax burden due to penalties, input tax, and compliance costs.



The Imposition of VAT on Basic Commodities after the Law on Harmonisation of Tax Regulations and Its Implications

The regulation of basic commodities after enacting the Law of the Republic of Indonesia No. 7 of 2021 on Tax Harmonisation (HPP Law) is significant. HPP Law is an omnibus law that amends several tax laws simultaneously, including the Income Tax Law, the VAT Law, the General Provisions and Tax Procedures Law, and the Excise Tax Law. Since the enactment of the HPP Law, basic goods have been removed from Article 4A(2)(b) of the VAT Law. As a result, the status of basic commodities under the HPP Law has become that of taxable goods. Nevertheless, basic commodities still receive exemption facilities based on Article 16B of the VAT Law. It includes details of basic commodities the general public needs, such as rice, unhusked rice, corn, sago, soybeans, salt, meat, eggs, milk, fruits and vegetables. Following the enactment of the HPP Law, Government Regulation No. 49 of 2022 on VAT Exemptions and the Non-Collection of VAT or VAT and Luxury Goods Sales Tax on the Import and/or Supply of Certain Taxable Goods and/or the Supply of Certain Taxable Services and the Utilisation of Certain Taxable Services from Outside the Customs Territory (PP No. 49 of 2022) was issued. This decree lists additional taxable goods exempt from VAT, such as the consumption of white crystal sugar obtained from sugar cane without adding flavoring or coloring agents, fresh spices, and fresh tubers.

In this section, we will discuss the impact of classifying basic commodities as Taxable Goods and the implications that arise in business practices in Indonesia. First, entrepreneurs with a turnover above the small business threshold must be confirmed as Taxable Entrepreneurs, as stipulated in Article 3A of the Value Added Tax Act. This obligation implies an increase in administrative burdens and tax compliance for entrepreneurs who previously did not need to register as PKP. Second, entrepreneurs who have become PKP must issue Tax Invoices to deliver basic commodities under Article 13, paragraph (1) of the VAT Law. It impacts entrepreneurs in terms of increased administrative costs and more complex reporting processes, considering that the Tax Invoice is an essential document in the VAT system.

Moreover, entrepreneurs must also understand and follow the procedures for creating Tax Invoices under applicable regulations. Third, entrepreneurs must submit a Periodic Notification Letter every month to report the VAT collected or exempted under the obligations outlined in the General Provisions and Tax Procedures Law. This obligation creates additional burdens for entrepreneurs regarding the time and resources needed to fulfill this responsibility. In this context, entrepreneurs must recognize the importance of accurate and timely reporting to avoid potential tax penalties.

Another impact of classifying staple commodities as taxable goods granted exemption facilities is the treatment of input tax for entrepreneurs confirmed as taxable entrepreneurs in this field. If we examine Article 16B paragraph (3) of the Value Added Tax (VAT) Law, which regulates “input tax paid for the acquisition of taxable goods and/or services, the import of taxable goods, and the utilization of intangible taxable goods from outside the Customs Area within the Customs Area, and/or the utilization of taxable services from outside the Customs Area within the Customs Area that are exempted from Value Added Tax, cannot be credited. This provision implies a situation where taxable entrepreneurs cannot credit input tax that should be able to reduce the burden of output tax.” In this context, entrepreneurs must be more careful in managing input tax and understand the applicable regulations related to VAT exemption facilities. The following is an illustrative example in the Memorandum of Explanation of Article 16B paragraph (3) of the Value Added Tax Law.

“Taxable Entrepreneur B produces taxable goods that receive VAT exemption facilities from the state, meaning that the delivery of such taxable goods is exempted from Value Added Tax. In the production process, Taxable Entrepreneur B uses other taxable goods and/or



taxable services as raw materials, auxiliary materials, capital goods, or other cost components. When purchasing the other taxable goods and/or services, Taxable Entrepreneur B pays Value Added Tax to the taxable entrepreneurs who sell or deliver the taxable goods and/or services. However, the Value Added Tax by Taxable Entrepreneur B to the supplier taxable entrepreneur becomes input tax that cannot be credited because there is no output tax related to granting VAT exemption facilities. This situation can create an additional burden for entrepreneurs, as they must bear the input tax that should be creditable. Therefore, entrepreneurs must understand the impact of providing VAT exemption facilities and consider appropriate business strategies to address this situation.”

Comparison of VAT Imposition on Basic Commodities

A literature review was carried out to compare the different VAT treatments of basic goods in several countries worldwide. Basic commodities (primarily food) are generally classified into three groups, namely unprocessed basic commodities (non-processed food), processed basic commodities (processed food), and non-basic commodities (non-basic food). The following table compares how VAT is applied to basic commodities in different countries.

Table 1. Comparison of VAT Imposition on Basic Commodities in Several Countries

No	Country	Description Basic Commodities	VAT Facility
1	Republic of Korea	“Exemption on certain goods and services (e.g., basic life necessities and services, such as unprocessed foodstuffs and agricultural products)”	Exemption from VAT Imposition
2	Mexico	“Applicable to a substantial number of transactions, including the sale of certain basic foodstuffs, agricultural goods and services. ”	Zero Rate
3	Portugal	“The intermediate rate applies to supplies of some foodstuffs ... The intermediate rate is also applicable to pre-cooked meals , in ready-to-eat and take-away or home delivery regimes, and to food and beverage services rendered, excluding alcoholic beverages, soft drinks, juices, nectars, and carbonated water, or added carbon dioxide or other substances.” “The reduced rate applies to the supplies of some basic foodstuffs”	The Intermediate Rate is 13%, and The Reduced Rate is 6%.
4	Russian Federation	“The standard VAT rate is 18% in Russia (with a lower rate of 10% applicable to certain basic foodstuffs ...”	Lower Rate of 10% from Applicable Rate
5	Slovenia	“... generally applies to foodstuffs , live animals, seeds, plants, water supplies, medicines, medical equipment, transport of passengers, books, admission fees, ... “	9,5%
6	South Africa	Certain basic foodstuff	Zero Rate



No	Country	Description Basic Commodities	VAT Facility
7	Sweden	<i>“Reduced rates apply to a few goods and services, such as hotel accommodation, foodstuffs (excluding alcoholic beverages), restaurant meals, and low or non-alcoholic drinks (12%), as well as newspapers, magazines, books, passenger transport, maps, musical notes, some cultural services, transport in ski lifts, etc. (6%).”</i>	Reduce Rate
8	Uganda	<i>“Some supplies are exempt from VAT, the main categories being government subsidies, some unprocessed foodstuffs, ...”</i>	Exemption from VAT Imposition
9	Antigua and Barbuda	<i>“Certain supplies are zero-rated, including exports, basic food items, water, electricity for residential use, sale of new residential property, construction of new residential premises, and fuel.”</i>	Zero Rate
10	Barbados	<i>“Certain supplies are zero-rated, including exports, basic food items, prescription drugs, crude oil, and the supply of certain items to the international financial services sector ...”</i>	Zero Rate
11	Netherlands	<i>“The reduced 6% VAT rate applies to certain prime necessities ...”</i>	Lower Rate of 6% from Applicable Rate
12	United Kingdom	<i>“Most exports, food, public transport, books and publications, and certain other essential goods and services are zero-rated.”</i>	Zero Rate

Source: PwC (2018)

The table presents various countries' value-added tax (VAT) treatment for basic commodities. Specific goods and services, such as necessities and agricultural products, are exempted from VAT imposition in the Republic of Korea. In Mexico, several transactions, including selling staple foodstuffs and agricultural goods and services, are subject to a zero rate. Meanwhile, Portugal applies an intermediate rate of 13% and a reduced rate of 6% for certain food products. The Russian Federation enforces a standard VAT rate of 18%, although some basic foodstuffs are subject to a lower rate of 10%. Slovenia imposes a 9.5% VAT rate on food products. In South Africa, certain basic foodstuffs are subject to a zero rate. Sweden applies lower VAT rates for food items (excluding alcoholic beverages), restaurant meals, and low or non-alcoholic drinks (12%). Uganda waives VAT for government subsidies and certain raw food materials. Antigua, Barbuda, and Barbados enforce a zero rate for several supplies, including exports and staple food items. The Netherlands imposes a lower 6% VAT rate for certain essential goods. Meanwhile, in the United Kingdom, most foods are subject to a zero rate.

There are various facilities for imposing VAT on basic commodities, including zero-rating, exemption, and reduced rates. Zero-rating is a treatment where goods or services are subject to a zero per cent VAT rate, which means that businesses do not need to collect VAT



from their customers, but they can still claim credit for the input VAT they have paid on production costs. Exemption is a facility where certain goods or services are exempted from the imposition of VAT altogether. In this case, businesses cannot claim credit for the input VAT they have paid, so the tax burden remains their cost. VAT exemptions are usually given to basic commodities, goods, and services deemed essential by the government, such as education and health services. Meanwhile, the reduced rate is a treatment where goods or services are subject to a lower VAT rate than the standard rate. This facility aims to reduce the tax burden on goods or services considered essential but not essential enough to obtain a VAT exemption or zero rating. In the context of basic commodities, the reduced rate is usually applied to goods that have been processed or are considered to have a higher added value than unprocessed basic commodities. In general, the provision of zero-rating, exemption, and reduced rate facilities in the imposition of VAT on basic commodities aims to reduce the tax burden on consumers, support domestic industries, and create a conducive environment for economic growth. However, implementing these facilities needs to be balanced with appropriate fiscal policies so as not to reduce state revenues significantly. Therefore, the government needs to consider the long-term impact of providing these facilities and ensure that the policy achieves its goal of improving people's welfare.

Proposal for Revisiting Value-Added Tax Structures Policy on Basic Commodities

The general conclusion on the VAT collection facilities for basic commodities included exemption, zero rates, and reduced rates (Mahkamah Institusi, 2016). Currently, the status of VAT collection on basic commodities in Indonesia includes VAT items with exemption facilities. Based on the Value Added Tax Law and Government Regulation No. 49 of the Year 2022, the types of basic commodities exempted from the imposition of VAT are unprocessed food, while other than unprocessed food will be subject to VAT at the standard rate. Given the importance of basic commodities in people's lives, Indonesia needs to reformulate policies based on categorizing them. An exemption for unprocessed food should be applied, given the community's basic needs for these goods. Then, for processed foods that the wider community needs, applying a zero rate or a reduced rate from the standard rate may be a solution to reduce the tax burden on the consumer. Meanwhile, for processed foods unrelated to the livelihood of many people and non-basic foods, the standard rate should be considered so as not to reduce government revenues significantly. Here is a scheme to see the imposition of VAT on basic commodities in Indonesia.

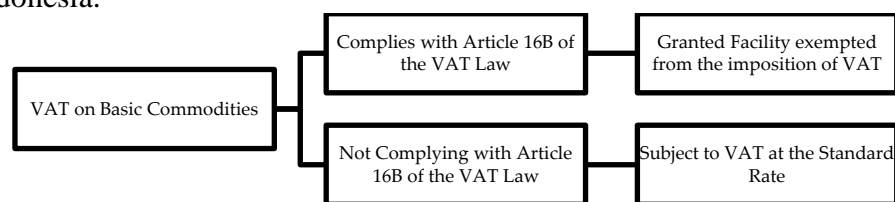


Figure 1. Existing Regulation of VAT Imposition for Basic Commodities

The policy that can be applied to non-processed food should involve exemption from taxation by categorizing it as a tax object with exempted facilities or as non-taxable goods. Reducing the tax burden on the community is important, particularly given the significance of non-processed food in fulfilling basic needs. Secondly, reconsidering the classification of basic commodities as non-taxable goods is necessary, as historically and according to previous Constitutional Court decisions, VAT has been imposed on manufactured goods. Thirdly, when determining the status of basic commodities as tax objects with exempted facilities, the administrative burden arising during the implementation of this regulation must be considered. Although, in principle, assigning this status would facilitate transaction tracking for tax authorities, it is crucial to be aware of the potential administrative impacts on business operators, especially those related to reporting and the obligation to fulfill other requirements.

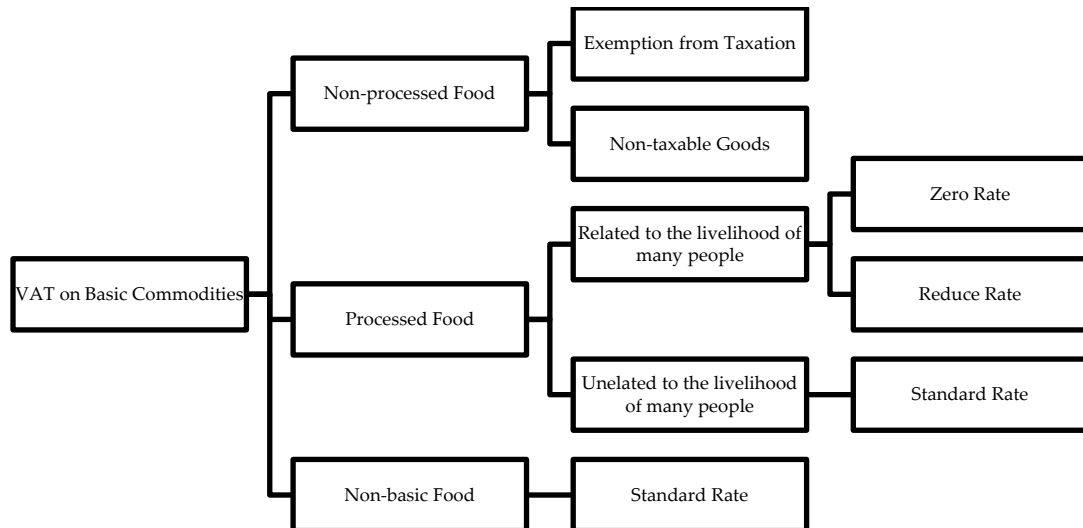


Figure 2. Proposal for VAT Imposition for Basic Commodities

Applying a zero rate or reduced rate from the standard rate for processed food, which is needed by the wider community, can be a solution to reduce the tax burden on consumers. The terminology of processed food can refer to VAT regulations in other countries. For example, in Uganda, the term "unprocessed" includes low value-added activities such as sorting, drying, salting, pickling, slicing, deboning, freezing, refrigeration, or bulk packaging, provided that the value-added does not exceed 5% of the total value of the supply. Thus, to interpret what processed food is, we will examine it as a contrario. Zero and reduced rates are chosen, considering entrepreneurs who can add value are usually large businesses. Therefore, input tax crediting is necessary so businesses do not pass on the already paid VAT, which would result in higher prices for goods. Through this policy, the government can reduce the consumer tax burden and incentivize entrepreneurs to increase their product's added value. However, it is essential to remember that when implementing this policy, the balance between the government's interest in maintaining tax revenue and the public's interest in obtaining necessities at affordable prices must always be considered.

CONCLUSIONS AND SUGGESTIONS

This study compares the arguments for and against imposing Value Added Tax (VAT) on exempt essential goods in Indonesia. The analysis shows that imposing VAT on essential goods with exemptions can increase transparency, reduce tax avoidance, and ensure a fair distribution of the tax burden among businesses and consumers. However, this policy also has the potential to burden companies, particularly small and medium-sized enterprises, due to increased administrative and financial pressures. It is important to balance encouraging tax compliance and ensuring businesses are not overwhelmed with excessive administrative requirements. This research is limited by its approach, which is a literature review and does not involve direct empirical data from the field. Therefore, the resulting findings and recommendations need to be further validated through empirical studies. This will enable a deeper understanding of the true effects of VAT policy on the overall economy and various segments of society.

Several policy recommendations for the tax authorities in Indonesia can be proposed based on the research results. Firstly, it is recommended that changes be made to the imposition of VAT on basic goods. This involves tax exemptions for unprocessed foods, the application of a zero rate or a reduced rate from the standard rate for processed foods needed by the public at large, and the application of a standard rate for processed foods that are not related to the livelihood of many people and non-staple foods. These recommendations should be considered



when drafting the Legal Characteristics of VAT in Lawmaking. By considering the results of this study, policymakers can better understand the impact of VAT imposition on necessities. This understanding can help them formulate more effective and efficient policies to improve public welfare. For future research, it is recommended that an empirical study be conducted to validate the findings and recommendations. This will enable a more in-depth analysis of the impact of VAT policy on the overall economy and various segments of society. This empirical research is significant in producing accurate and practical policy recommendations. Policymakers can use these recommendations to formulate a more equitable and sustainable taxation structure, particularly in the Indonesian economy.

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