THE IMPLICATION OF VAT REGULATION TO TAX REVENUES: THE CASE OF SMALL RETAILER IN INDONESIA

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ABSCTRACT

According to the VAT Act the category of small enterpreneur is an entrepreneur who attempts the circulation does not exceed 600 million rupiah, while according to the Income Tax Act is a business entrepreneur who has the total of revenues no more than 4.8 billion rupiah. The small retaillers with sales revenue above 600 million and below 4.8 billion rupiah which Income Tax Act could use the special rate of 0.75% of the total revenues required to levy VAT at 10% of sale revenues or when under 1.8 billion rupiah the VAT rate is of 3-4%. The imposition of value added tax which unfairly results in the lower level of taxpayer compliance. This study focuses on the implications of VAT rates on the small retailler who has the circulation of business between 600 million to 4.8 billion rupiah to the amount of tax revenue. From the research conducted based on the comparatives research method, the descriptive analysis of documents and interviews produced that the reduction in the VAT rate impacts in increased state revenue.

Keywords: Small Retailer, VAT, Income Tax

ABSTRAK

Menurut Undang-undang PPN kategori pengusaha kecil adalah pengusaha yang peredaran usahanya tidak melebihi 600 juta rupiah sedangkan menurut Undang-Undang Pajak Penghasilan adalah pengusaha yang total peedaran usahanya tidak lebih dari 4.8 milyar rupiah. Pengusaha retail kecil dengan sales revenues di atas 600 juta dan di bawah 4.8 milar rupiah yang secara Undang-Undang PPh boleh menggunakan tarif special sebesar 0.75% dari total revenues wajib memungut PPN sebesar 10% dari sale revenues atau bila di bawah 1.8 milyar dengan tarif PPN 3-4%.Pengenaan pajak pertambahan nilai yang kurang adil berakibat pada turunnya tingkat ketaatan pembayar pajak.Penelitian ini memfokuskan pada implikasi tarif PPN pada pengusaha eceran kecil yang memiliki peredaran usaha antara 600 juta sampai 4.8 milyar rupiah terhadap jumlah penerimaan pajak. Dari penelitian yang dilakukan dengan metode penelitian komparatif, deskriptif, analisa dokumen dan wawancara menghasilkan bahwa penurunan tarif PPN berdampak pada peningkatan penerimaan Negara.

Kata kunci: Pengusaha Retail Kecil, PPN, PPh

INTRODUCTION

Economic growth in the Asia Pacific region would be strong in 2011 and 2012 with a growth rate of nearly 5 per cent according to the IMF assessment as quoted by Ernst & Young in the 2011 Asia Pacific Tax Outlook. Indonesia with a growth of 4.55% is one of the six Asian countries that experienced positive growth in 2009, according to the IMF database outlook 2010. Furthermore, in 2010 Indonesia's economy proved to be stable in the midst of the world economy is still unstable. It is characterized by the exchange rate tends to strengthen, export and import performance reaching up, relatively low inflation and foreign exchange reserves continue to rise. To maintain the stability of the national economy, the Finance Ministry manages fiscal policy as the main source to support development activities in all fields in order to move more quickly, effectively and efficiently.

Tax revenues as part of fiscal policy are the main source of state revenue that the focus of the government in this cases the Ministry of Finance with the program extensification and intensification. These policies include policies for the improvement of the taxation laws of the growth of the business world that is conducive to promoting the principle of neutrality and fairness in the rate implementation as well as the intensification program which includes increasing the number of taxpayers both individual taxpayers and corporate taxpayer.

In order to increase the number of taxpayers who have implications on increasing revenue and tax ratio, the government plans to impose special tariff for SMEs as well as to maximize revenue from the underground economy activities with tax census that will continue in the future (DJP: 2011). In terms of the number of SMEs that have not registered it is still considerable potential revenue when the amount of taxpayer can be improved. In addition the plan of the Director General of Taxes and Statistic central Bureau Chief to collect taxes from the sector of Underground Economy will add to the increase in tax revenue if conducted with a reasonable calculation as stated by the observers of taxation of Indonesia University and the former Director of Tax Audit in Directorate General of Taxes: Professor Gunadi (Bisnis Indonesia: 2012).

By adhering to the purpose of the law on tax changes in Indonesia, among others, stated that the amendment to the income tax law include increased competitiveness with other countries, the principle of fairness, neutrality in the application of tariffs, it is necessary encouragement for the growth of small businesses, simplification and changes on the rate structure to provide a more proportional tax burden for each taxpayer in accordance with the principles of universal. Thus the principle of fairness and neutrality in the application of income tax rates to be one major factor in supporting the growth of SMEs. Therefore in order to increase state revenues either through intensification or extensification program the main objective of this study is to analyze the fundamental question of why the majority of the personal Taxpayers use norms in the calculation of taxable income? The next question is how the implication of VAT to Tax Revenue for Personal Taxpayers who are small retailers using recording and what the implication to the tax compliance of retailer is?

The discussion of tax taxpayer begins with the income's estimation for the middle class. The underground economy and tax for retailers is the next discussion. The discussion of the Scenario Approach to the impact of tax revenues is the next section. Moreover is a comparative analysis of the Middle Class and Scenario Approach. In the last part is the conclusion of the study.

Literature Review

The discussion about the tax revenues cannot be separated from the compliance of tax payer and underground economy. The literature about tax compliance includes many disciplines involving economics and psychology (Loo, McKerchar, Hansford, 2010). In respect of tax compliance, there are several ways to define the exact meaning of tax compliance. According to Andreoni, Erard and

Feinstein (1998), tax compliance should be defined as tax payers' willingness to obey tax law in order to obtain the economy equilibrium of a country. A simpler definition in which tax compliance is defined as the most neutral term to describe the willingness of taxpayers to pay their taxes (Kirchler: 2007). Furthermore Klepper and Nagin (1989) argue that tax compliance lie in the economics of crime and expected utility literature, in which it is assumed that tax payers are amoral rational economic evaders who would assess the likely costs and benefits of evasion behavior compared to those of compliance. In addition these costs and benefits can be associated with the tax rate, audit rate, the likely of detection and the penalties of compliance although findings of the effect of each of these factors generally lack consistency. In respect of tax rate, Friendland, Maital and Rutenber (1978) have argued that an increase in tax rate leads to an increase the probability of underreporting income, to larger non-payment problems (Besley, Preston, Ridge:1997), especially in the case of high income taxpayers (Ali, Cecil, and Knoblett: 2001)

According to Smith (1995) shadow economy is market based production of goods and services, whether legal or illegal, that escape detection in the official estimates of GDP. Furthermore shadow economy can be defined as economy activity which would generally be taxable where it reported to the tax authorities (Lippert and Walker: 1997). From the above definition the shadow economy may include barter or monetary transaction of unreported income from the production of legal goods and services. However a precise definition seems quite difficult as the shadow economy develops all time according to the principle of running water: it adjusts to changes in taxes, to sanction from the tax authorities and to general moral attitudes, etcetera (Mogensen, et. al. 1995).

It is seldom that academics, administrators and politicians try to meet all their interests such as theoretical issues of taxation, how to implement legislation and how to ensure that academics idea are married to practicality to best serve the need of the country and their constituents (Tait: 1998).

In Indonesia the VAT Act was first enacted on July 1, 1984 and has been amended several times, the latest amendment by Act No. 42 of 2009. In Article 1 of the VAT Act for Individual Entrepreneurs are defined as individual (OP) or corporate in any form of business or work activities to produce goods, import goods, export goods, trade, use of goods obtained from outside the customs area, do the business services referred export services, or use the services from outside the customs area. Still in the same article is defined as taxable entrepreneur businessman who delivers and taxable good (BKP) or taxable service (JKP) taxed by VAT Act. The employer is not required to be an entrepreneur when taxable in the category of small business as provided in Article 3A paragraph (1) of the VAT law which limits stipulated by the Minister of Finance. Furthermore, according to the Minister of Finance Regulation No. 68 of 2010 that are included in the category of Small Entrepreneurs are entrepreneurs who for a year have delivered taxable goods and / or services subject to tax by the amount of gross income and / or gross receipts of no more than 600 million rupiah (six hundred million rupiah). It can be concluded that the circulation of business under 600 million rupiah per year shall not be taxable Entrepreneur (PKP) or collect VAT to the buyer.

Individual taxpayer conducting business or the independent gross circulation within 1 (one) year of less than 4,800,000,000 rupiah (four billion eight hundred million rupiah) may calculate net income by using Net Income Deemed notify condition to the Director General of Taxes in the period of three months of the tax year in question in accordance with Article 14 paragraph (2) of Law No. 42 of 2008 (Income Tax Act). Based on decision of Director General of Taxes is number: KEP-536/PJ./2000, the norm rate for retailer ranges from 15% to 30% of gross revenue or 0.75% to 1.5% for taxable rate using the lowest rate of individual income rate. Furthermore, based on the Director General of Taxes Regulation number of 32/PJ/2010 stated that individual taxpayer (WPOP) conducting business as a retailer that has one or more places of business is categorized as WPOP of certain employers. The criteria are an individual retailer that sells to both wholesale and retail, and / or delivery of services through a fixed place of business. The installment of Income Tax Article 25 WPOP of certain employers is at 0.75% of total gross income. Furthermore, according to regulation of

the Minister of Finance No. 74/PMK.03/2010 for individual taxable enterpreneur exempt from the obligation to keep books of business is having a circulation within 1 (one) year will not exceed 1,800,000,000 rupiah (one billion eight hundred million rupiah) for Taxable Employers who conduct delivery Taxable Goods is 3% (three percent) of the Tax Base, while conducting Taxable Services is 4% (four percent) of the Tax Base. It can be concluded that for a WPOP who sells taxable goods shall pay Income Tax and VAT of 3.75% to 4.5% of the total circulation of business. This has an impact on the taxpayer certainty and fairness. As research conducted by Sari (2012) in an interview with the staff of the Directorate General of Taxation that in terms of net income is deemed difficult to formulate a simple tax collection at the same time satisfy the justice.

As mentioned by many researchers that fairness is perceived to be important drivers for taxpayer's compliance. Kirchler and Hoelz (2006) point out the fair treatment of taxpayers and trustworthiness of tax authorities will enhance voluntary compliance. Murphy (2004) argues that there is a correlation between fair and correct treatment of the taxpayer and trust in the revenue body. If regulators are seen to be acting fairly people will trust the authority's motive, therefore fairness and trust are thus interlinked and the one cannot exist without the other.

RESEARCH METHOD

The method used in the conduct of research is comparative research methods, descriptive, interviews and document analysis. Comparative studies conducted with the investigation and understanding of tax laws that have been enacted by the reaction of subjects associated with the collection of research data derived from interviews with tax laws and taxpayers. The descriptive study carried out by assessing the existing regulation. Based on literature analysis and observation of the data obtained made comparisons that can give an idea to answer questions about the purpose of research. Furthermore in order to obtain an overview of the impact of tax law that is fairer conducted using the scenario and the middle class approach.

RESULTS AND DISCUSSION

Income Estimation for Middle Class

The broadest classification of middle class suggests that the middle class consists of anyone who is not poor, which according to the World Bank means those who earn an income in excess of $2 a day after adjusting for purchasing power (Chen and Ravallion: 2010). Moreover the most widely used measure of the middle class was proposed by Branko Milanovic and Shlomo Yitzhaki (2002), who counted people with daily incomes between roughly USD10 and USD50, after adjusted for purchasing-power parity. While there is no widely accepted of what constitutes the middle class the recent research by Ali and Dadush (2012) assert that in the developing countries, buying a car is virtually synonymous with entry into the middle class. Therefore it can be concluded that the middle class is people who have daily income more than USD 10 and below USD 50 as well as could buy a car.

Since the middle class daily income is between USD 10 and USD 50, for this paper used USD 30 that comes from the result 10 add 50 divided by two. Furthermore assumed that the price of the cheapest car in Indonesia is 120 million rupiah for four years installment, as a result the annual payment is 30 million rupiah. In addition if the total annual installment payment is a third of the total income of the middle class as an individual in Indonesia, it can be concluded that the annual income is 90 million rupiah.

Individual Retailer Taxpayers

Based on data from the Director General of Taxation by the end of 2010 the number of Tax Identification Number (TIN) owners in Indonesia is 18,900,000 taxpayers, of which 16,900,000 are WPOP with the contribution for 40% of total revenue Income tax (Investor Daily, March 18.2011). At the end of 2011 the number increased to about 22 Million taxpayers. Besides, the Director General of Taxation (DGT) estimates that millions of people do not pay taxes (Investor Daily, May 21, 2011). Tax revenues have not yet optimal because the extensification and intensification tax program are not maximized. Here are data on the number of WPOP doing business recapitulated by Sari from Tax Information and Technology Directorate with additional processing as follows

Table 1 The Numbert of WPOP Doing Business and Report the SPT

Fiscal Year	Type	
	Norma	Bookeeping
2004	332,323	74,951
2005	96,374	305,797
2006	123,431	303,242
2007	263,355	161,769
2008	402,821	77,238
2009	552,730	57,819
2010	355,566	29,577
2011	413,886	34,428
2012	481,772	40,075

For the years 2011 and 2012 used the assumption is based on an increasing number of Taxpayers from 2010 to 2011. Based on the data from 2004 through 2012, it shows that the number of individual taxpayers has increased although small compared to the amount of personal taxpayers who keep books continuing to decline.

In Indonesia SMEs who are retailers have two major obligations that are to pay tax income and value added tax. The other taxes such as PBB and BPHTB are not discussed since there is no significant impact to the compliance of taxpayers.

To limit the discussion concerns the definition of retailers for SMEs is SMEs retailers who meet the appropriate criteria Income Tax Law article 31E that is entrepreneurs who have sales revenue under 4.8 billion rupiah choosing to use norms and small entrepreneurs under the VAT Act. This is based on the consideration that SMEs have limitations to hold the books.

Underground Economy and Tax for Retailers

The profit of retailers in various markets ranges from 3-5%, as informed by the small traders in the market such as Cengkareng, Glodok, Tanah Abang, Pasar Pagi and other markets in Jakarta. Research conducted by the BI and Central Bureau of Statistics in 2008 in Palembang explained that small retailers could gains around 6.32%. Based on data from the retailers in Jakarta can be used as a standard indicator of retailers' profits do not exceed 5% of total sales. The implication that arises is VAT and income tax expense as low as 3.75% tax to be something difficult for the retailer. The maximal profit as sum as 5% is reduced by 3.75% tax would generate gross profit of less than 2%. Tax rate is to be one factor in addition to the character of dishonest taxpayers in tax compliance.

Interview with one of the businessesman in Cengkarang market which reported a total circulation of about 300 million rupiah indicates that the tax rate is an aggravating factor for the retailers. According to traders under a pseudonym Mr. X average profit generated by the traders in the Cengkarang market including himself is about 3-4% so that they always report the total businesses circulation under 600 million rupiah. Unfortunately in 2012 Mr. X caught by the tax officer has a circulation of around 3 billion, 3.5 billion and 4 billion for 2009, 2010 and 2011 respectively. When asked for the reason for not reporting the actual appropriate amount by the tax officer Mr. X argued that the profit rate of only 4% of gross revenue. The same argument is conveyed by a retail merchant of bottle beverage: Mr. Y in Glodok. According to Mr. Y with a net profit of about 3% when having revenues over 600 million and a PKP there can be a loss in business. Mr. Z, one retailer of spare parts of cars, in the explanation of its said that the rate of return of 5% is hard to be PKP. Therefore Mr. Z still maintains total annual revenue below 600 million. It is impossible for Mr. Z to be given PKP since the tax to be paid is approximately 10.75%, although the total revenues approximately 15 billion per year. According to Mr. Z goods sold are items purchased from merchants who may not pay taxes. It is a dilemma for Mr. Z while his competitors sell at prices that are the price of underground economy. In fact quite a lot of small retailers that have revenue above the 4.8 billion but they report below 600 million rupiah as arguments by Mr. Z.

According to the data of BPS the gross profit for the retailer is about 20%, while Sari (2012) argues from the study about 15%, which according to the reseach of Bank of Indonesia ranges from 6.25% and according to retailers around 5%.

As shown in table 1 it can be seen a reduced amount WPOP bookkeeping. Based on the result of interviews between Sari with the staff of Directorate General of Taxes for retail traders it can be knewn that income tax rates are still less fair for SMEs retailers.

The Scenario Analysis

To give an idea of the tax revenue from the Income Tax and Value Added Tax then the table 2 below shows the amount of tax revenues from 2006 to 2012:

Table 2 Revenues 2006-2012 (in Billion Rupiah)

| Items | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 |
	Audited	Audited	Audited	Audited	Audited	Rivised	Proposed
Domestic Tax	395,971.1	470,051.9	658,700.8	601,251.8	694,392.1	831,745.3	976,898.8
i.Income tax	208,833.1	238,430.9	327,497.7	317,615.0	357,045.5	431,997.0	512,834.5
ii VAT	123,035.9	154,526.8	250,478.8	193,067.5	230,604.9	298,441.4	350,342.2

Assuming that the number of owners who do business using norm is retailers who easily recorded because being in public places, therefore it can be made the calculation of the impact of a 3% VAT rate for tax revenues. Discussion of the method used is to create a scenario analysis on the level of tax revenues since 2010 to 2012 when VAT rate was reduced to 1% for small businesses reach a circulation of 600 million rupiah and under 4.8 billion per year and the income tax rate is 0.75% accordance with the provisions of Income Tax Act 36 of 2008. It is also assumed that the average revenue reported before the VAT rate is decreased to be 1% is 500 million rupiah. The research method for the scenario analysis is as follows:

Method I: Worst Case assuming individual taxpayer who will report to the maximal amount of approximately 4.8 billion rupiah, only 25% of which and 75% reported in the minimal amount which is 600 million rupiah.

Method II: Base Case with the assumption that 25% of individual taxpayer reported at 600 million rupiah and 50% on average ((600 +4800) / 2) = 2.700 million rupiah while the rest 25% reported at the maximal amount of 4.8 billion rupiah.

Method III: Best Case with the assumption that 25% of individual taxpayer reported total revenues in the amount of 600 million rupiah while the rest 75% reported at the maximal amount of 4.8 billion rupiah. According to calculations based on the three methods the above scenario can be displayed in the table 3 as follow:

Table 3 Worst Case

Tahun	VAT	Income Tax	Tax Revenues
2010	5,866,839,000,000	3,066,756,750,000	8,933,595,750,000
2011	6,829,124,761,905	3,569,769,761,905	10,398,894,523,810
2012	7,949,245,754,598	4,155,287,553,540	12,104,533,308,138
	20,645,209,516,503	10,791,814,065,445	31,437,023,581,948

Table 4 Base Case

Tahun	VAT	Income Tax	Tax Revenues
2010	9,600,282,000,000	5,866,839,000,000	15,467,121,000,000
2011	11,174,931,428,571	6,829,124,761,905	18,004,056,190,476
2012	13,007,856,689,342	7,949,245,754,598	20,957,102,443,941
	33,783,070,117,914	20,645,209,516,503	54,428,279,634,417

Table 5 Best Case

Tahun	VAT	Income Tax	Tax Revenues
2010	13,333,725,000,000	8,666,921,250,000	22,000,646,250,000
2011	15,520,738,095,238	10,088,479,761,905	25,609,217,857,143
2012	18,066,467,624,087	11,743,203,955,656	29,809,671,579,743
	46,920,930,719,325	30,498,604,967,561	77,419,535,686,886

Based on the table above it can be concluded that the possibility of potential losses due to unfair tax in VAT for retailers for 3 years is about 31.4 trillion rupiah for the worst case, and 54.4 trillion rupiah for the base case and 77.4 trillion rupiah for the best case.

The Scenario Analysis and the Middle Class Approach

It is assumed that the gross profit is 5% and expenses approximately 1%, as a result the net income would be 4% for small retailers who have a private car with the average income is 108 million rupiah per year. Therefore the average business circulation of retailer is equal to 2.7 billion rupiah annually. Based on the middle class approach the potential loss of tax revenues could be shown in table 6 below:

Table 6 The Middle Class approach

Tahun	VAT	Income Tax	Tax Revenues
2010	9,600,282,000,000	5,866,839,000,000	15,467,121,000,000
2011	11,174,931,428,571	6,829,124,761,905	18,004,056,190,476
2012	13,007,856,689,342	7,949,245,754,598	20,957,102,443,941
	33,783,070,117,914	20,645,209,516,503	54,428,279,634,417

The middle class approach generates the result as same as the base case analysis that is the possibility of potential tax revenues lost by Rp 54.4 trillion rupiah.

CONCLUSION

The existence of a shadow economy affects the quality of fiscal data reported in government budgetary paper. As mentioned earlier the objective of this research is to examine why the majority of individual taxpayers use the norm of calculation for determining the taxable income and how the implication of the rate of value added tax for retail trader impacts to the tax revenue.

Based on this research conducted using the Scenario and the Middle Class Approach, there is considarible evidence to indicate that the rate of value added tax for small retailers affected to taxpayer compliance. This can be seen from the total of individual taxpayers who do business around 90% uses the norm of calculation to determine the taxable income.

This research also found that the reduction in the VAT rate affects the possibility on increasing the amount of tax revenues both VAT and income tax based on both the Middle Class and Scenario approach. The number of potential tax revenue lost for the year 2010 to 2012 amounted to 59.1 trillion rupiah.

In general it is found that compliance increases with a decrease in the marginal tax rate and with an increase of the audit rate. It can be seen from the likely increase in tax revenue and the fear of the taxpayer when inspected by the tax opfficer. However this study has the limitation of data on the number of users using calculation's norm for 2011 and 2012 as well as the degree of compliance if the tax rate lowered. In addition the total revenues are assumed to range between 600 million till 4.8 billion rupiah. Therefore further research is required to provide a more comprehensive picture of the effectiveness of the reduced tax rate on tax compliance of the taxpayer and its implications for state revenue.

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