

Input Value Added Tax Refund Policy for Taxable Enterprise Experiencing Production Failures

RUT OKTARIA

Public Servant in Tax Services Office of Jakarta Province, Indonesia

rut_oktaria@yahoo.com

Abstract. In their effort to amend the legislation of Value Added Tax (VAT), the government and the House of Representatives have amended the latest Law Number 8 of 1983 with Law Number 42 of 2009 pertaining to the third amendments of VAT on Goods and Services and Luxury Sales Tax (LST). Substantial changes, occurred in the policy of Input VAT refund for Taxable Enterprise experiencing production failures, is the focus of this research. This study aims to describe the background of the issuance of the Input VAT restitution refund policy for Taxable Enterprise experiencing production failure, and create inventory of the potential problems that may arise in relation to the issuance of the aforementioned policy. This study uses qualitative approach and library and field research as its data collection techniques. The result shows that there are incongruities among the Law, the general concept and the legal character of VAT. On the other hand, the regulation is amended to prevent any abuse on the mechanism of VAT restitution. The problems that may potentially arise from this new regulation are the issues related to the regulation consistency within the basic concept of VAT, and economic disincentives that can be experienced by Taxable Enterprises from certain industries. Therefore, at the macro level, this policy may hamper the growth of investment in Indonesia.

Keywords: *value added tax, goods and services luxury sales tax, restitution*

INTRODUCTION

Taxation is a dynamic instrument of fiscal policy; its application must follow the dynamics of the economy (Rosdiana, 2006). Amendment in taxation legislation is a step taken by the Government and The House of Representatives to improve the tax system and adapt it to the economic development. In 2009, Law no. 42 of 2009 pertaining to the Third Amendment of Law no. 8 of 1983 regarding Value Added Tax on Goods and Services and Luxury Sales Tax (VAT Act) has been ratified.

First introduced in France in the 1950's, Value Added Tax (VAT) has been adopted in over 120 countries (Lin, 2008). VAT is basically a sales tax levied for the value added on all production lines and distributions. Value added is all additional values arising from all lines of production and distribution of goods, including interests, rents, wages, and margins as well as all costs for a profit. In every selling price of a product there is always the value added in the form of gross profit (mark up), because every seller demands profits (Rosdiana and Tarin, 2005). Alan A. Tait (1988) defines added value as: "The value That a producer (whether a manufacturer, a distributor or, advertising agent adds to his material or purchases (other than labor) before selling the new improved product or service. Value added can be looked at from the additive side (wages plus profits) or from the subtractive side (output minus inputs)." In line with the opinion, Hooper and Smith (1997) describe the technical imposition of VAT as:

"The consumer ultimately pays the value-added tax at the time of purchase. However, it is actually collected incrementally at each intermediate stage of the production process. At each production stage, the seller taxes the sale, collects the full tax amount from the purchaser, and remits to the government that amount, minus the tax paid on its previous purchases. The VAT taxes the difference between the sale price and the purchase cost of a product (the value added) at each stage of production".

Although the VAT has been adopted and spreads to various countries, its implementations develop differently thus constitute no parallel phenomenon (Tait, 1988; Rosdiana and Tarin, 2005). In Indonesia the VAT is levied by the central government. While in Brazil and Germany, VAT is collected by the central government and shared with the regions (states). Particularly in Germany, VAT is distributed based on its population ratio. Meanwhile, India implements the VAT levied by the regions (states) with less control from the central government, which is different from China and Russia whose VAT is handled by the central government (Mukhopadhyay, 2002). Different implementations of VAT in different countries are also applied to the default rates ranging from 25% (Denmark, Hungary, Sweden, and Norway) to 5% (Singapore) (Lin, 2008). Indonesia itself applies a single rate of 10%, although there is 0% VAT for exports.

VAT Law (No. 42 of 2009) brings some considerably fundamental changes. Firstly, the addition of the definition, specifically Intangible Taxable Export Goods and Export of Taxable Services, secondly, the defini-

Table 1. Amendment of Article 9 Paragraph (2a) of the VAT

| Law Number 18 of 2000 Article 9 Paragraph(2a) | Law Number 42 of 2009 Article 9 Paragraph (2a) |
|---|--|
| In the case where there is no Output VAT in a particular tax period, then the Input VAT can still be credited. | For Taxable Enterprises which are not yet producing, they have not made the tax payable submission, the Input VAT upon the acquisition and/or import of capital goods can be credited. |
| <p>Explanation: In the case of Taxable Enterprises which are not yet producing, or has not made the consignment of either Taxable Goods or Services, or Taxable Goods export so that there is no Output VAT (zero), then the Input VAT which is paid by the Taxable Enterprises at the time of acquisition and the import of Taxable Goods or the receipt of Taxable Services, and the utilization of intangible Taxable Goods, still can be credited in accordance with Article 9 paragraph (2), except for Input VAT as stated in Article 9 paragraph (8).</p> | <p>Explanation: The Input VAT is credited along with the Output VAT in the same tax period. However, for the Taxable Enterprises which is not yet in production, the Input VATes on the acquisition and/or import of capital goods are allowed to be credited as referred to in Article 9 paragraph (2), except for Input VAT referred to in Article 9 paragraph (8).</p> |

Source:

tion changes such as the utilization of intangible Taxable Goods from the outer region and then, other changes which encompass the VAT object concerning the boundaries and types of Intangible Taxable Goods whose exports subject to VAT, transfer of assets whose original purpose is not for sale, the agreement of consignment and non consignment Taxable Goods, non Taxable Goods and non Taxable Services, Taxable Enterprise (PKP), refunds of VAT upon consignment of Taxable Services, criteria and fare of Luxury Sales Tax (LST/PPNBM), restitution, deemed input VAT, crediting input VAT (PM), concentration of the VAT payable, Tax Invoice, when depositing and reporting VAT, the taxation facilities and joint responsibility.

From some of the above changes there is particularly one which is interesting for further scrutiny, namely the crediting. In this case, note that the Input VAT is a VAT that should have been paid by Taxable Enterprises upon the acquisition of Taxable Goods/Services and/or the utilization of either Intangible Taxable Goods or Taxable Services from outside the Customs Zone and/or the import of Taxable Goods (Article 1 (24) of Law No. 42 of 2009), while the Output VAT is a payable VAT which is obligatorily collected by Taxable Enterprises performing consignments of Taxable Goods and Services, Tangible and Intangible Taxable Goods exports, and/or exports (Article 1 (25) of Law No. 42 of 2009).

Prior to the application of Law No. 42 of 2009, the provision of Input VAT crediting is applied to Taxable Enterprises that newly establish their business, includ-

ing those having not yet been in production or made the consignment of Taxable Goods and Services or Taxable Goods exports resulting in the unavailability of the Output VAT. Those Taxable Enterprises, like other Taxable Enterprises in general, are allowed to credit their Input VAT.

The permissibility of crediting all the Input VAT of start-up Taxable Enterprises, which is certainly not in production yet, is indeed part of the tax accessibility provided by the Government for the business world. Taxable Enterprises, who have not made the payable submission of VAT, are allowed to have a greater amount of Input VAT than that of the Output VAT which can be requested back through restitution (Indonesian Tax Review, 2010). But now based on Article 9 Paragraph (2a) of Law No. 42 of 2009, crediting is limited only to the Input VAT of the acquisitions and/or the imports of capital goods.

Below is a table of amendments of Article 9 Paragraph (2a) of the VAT Act that regulates Input VAT crediting for Taxable Enterprise who have not been in production yet:

Article 9 Paragraph (2a) of Law No. 42 of 2009 (the later law) is different in substantiation and scope from Article 9 Paragraph (2a) of Law No. 18 of 2000 (the former law). Substantively, Article 9 Paragraph (2a) in the new law only regulates Input VAT upon the acquisition/import of capital goods; it does not include the Input VAT upon the acquisition/import of Taxable Services and the utilization of intangible Taxable Goods from outside the Customs Zone. This may mean that the Input VAT apart from the acquisition/import of capital goods cannot be credited. The encompassment of Article 9 Paragraph (2a)

in the new law is only to regulate manufacturer Taxable Enterprises, which is narrower than that of Article 9 Paragraph (2a) in the former Law. It can be indicated that non-manufacturer Taxable Enterprises' Input VAT is a subject to the provisions of Article 9 paragraph (2) and not a subject to the restrictions in Article 9 Paragraph (2a).

Input VAT crediting for Taxable Enterprises is significantly valuable, since it could help alleviating the cash out (cash expenditure) of concerned entrepreneurs. Basically, the mechanism of collection, the remittance and the reporting of VAT uses a mechanism called Subtraction Credit Method or Indirect Method. Through this mechanism, Taxable Enterprises will pay VAT at the acquisition time of capital goods, raw materials or merchandises and then shift the tax expense to the next series of production or distribution by levying the VAT when performing delivery to the buyer. In the practice of Indirect Method Subtraction mechanism, Output VAT minus Input VAT mechanism is applied. All Input VATes can be credited with Output VATes in the same tax period by fulfilling several requirements, namely, those acquired Input VATes have been paid and the Input VATes earned are not included in the excepted according to Article 9 paragraph (8) VAT Law.

In relation to the Input VAT crediting, a new article is added to the new law, namely Article 9 paragraph (6a), stating that the "Input VAT that has been credited as mentioned in paragraph (2a) and that has been refunded must be repaid by the Taxable Entrepreneur in the case that the Taxable Entrepreneur experiences production failure within a maximum of three (3) years from the start of the Tax Period when the Input VAT was credited". Thus, it is compulsory for the Taxable Enterprises experiencing production failure to repay the input VAT on the import/acquisition of capital goods which have been either credited or awarded restitution. The provision is affirmed in the Regulation of Finance Minister (PMK) No. 81/PMK.03/2010 which is applied on April 1, 2010. The regulation contains the rule in implementing Article 9 paragraph (6b).

According to the regulation, the Input VAT that has to be repaid is one which has been credited and has been given the refund and must be remitted by the end of the following month after the time of production failure (www.web.bisnis.com). The enterprises which are categorized as failed to produce are the manufacturer Taxable Enterprises that have not conducted the consignment activity of taxable goods or services within a period of three years since the first input VAT crediting, or the enterprises with the main business activities other than a manufacturer that within a period of one year since the first input VAT crediting have not performed any consignment or

export of taxable goods/services activity. However, if the condition of failing in production is caused by natural disasters or other causes beyond the control of the Taxable Enterprise (*force majeure*), the enterprise is not obliged to pay back the Input VAT on the import or the acquisition of capital goods which have been credited and given the refund (www.web.bisnis.com). The rule in this Minister of Finance Regulation needs to be criticized, since Article 9 Paragraph (2a) regulates the enterprises which have not performed the production activity yet (not the one that have not consigned the Taxable Goods). Logically, the implication of production activity is specifically related to the Taxable Enterprises of manufacturer/producer rather than just Taxable Enterprises, besides, the policy is set in order to encourage Taxable Enterprises of manufacturer to make as much effort and attempt as possible in order to successfully produce Taxable Goods or Services as well as to give a positive impetus to the Taxable Entrepreneur to increase the national production with the intention of providing employment and improving the social welfare (Inside Tax, 2008). But in reality, the issuance of the policy practically triggers many controversies because it is considered to be very burdensome for Taxable Enterprises since the enterprises that have already experienced losses from the production failures still have to return the Input VAT which has been restituted. The input VAT crediting itself is the enterprises' right guaranteed by the law, which is the characteristic of VAT. So when the crediting right is cancelled because the company failed to produce, besides violating the principle of VAT, the provision is perceived to be arbitrary and inhuman (www.pajakonline.com). Conceptually, there is nothing wrong with the provision of Article 9 Paragraph (2a), because the type of the VAT system in Indonesia is consumption. This means all goods (Taxable Goods and Services, including capital goods), that do not generate an output (PK), are considered to be consumed and therefore the VAT should be paid. Whether capital goods are VAT-able or not, depends on the function not the type. If capital goods generate output which consequently generate Output VAT, then the paid VAT functions as the Input VAT and can be credited. On the contrary, if the capital goods do not function to generate output, then it can be considered similar to the goods which are (functioning) consumed and therefore the VAT should be borne by the buyers (producers who fail to produce the output). The distinction of whether a particular item serves as capital goods or consumer goods occurred in the provisions of Article 16 D that applies the VAT upon the alienation (second consignment) of capital goods which has to be paid by the buyer Taxable Enterprises.

According to the above explanations, there are several

objectives to be achieved from this study, namely: (1) Explaining the background of the issuance of the Input VAT refund policy for Taxable Enterprises experiencing production failure, and (2) Describing the potential problems that will practically arise in connection with the issuance of the policy.

METHODOLOGY

This study applies the descriptive qualitative approaches (Creswell, 1994). It describes the emergence of Input VAT refund policy for Taxable Enterprises experiencing production failure in connection with the enactment of the VAT Law No. 42 of 2009 and the issuance of the regulation of the Finance Minister No. 81/PMK.03/2010. The benefits of this research are not only for academic purposes, but also for various parties associated with the issuance of the intended policies.

The data collection techniques applied in this research are literature studies (library research) and field studies (field research). Specifically in field studies, the researcher conducts the data collection by performing in-depth interviews to (1) Member of Commission XI of the House of Representatives, (2) The Board of Fiscal Policy (BKF), (3) The Directorate General of Taxation (DGT), (4) Taxation Academics, and (5) Tax Practitioners.

While in performing the analyses of data, the researcher uses the illustrative method, which applies empirical evidences to illustrate or repeat the theory (Creswell, 1994). Here, the researcher analyzes the data from an interview with the informants about the emergence of Input VAT refund policy for Taxable Enterprises experiencing production failure and uses the data and analyses in accordance with the questions of the research.

RESULTS AND DISCUSSIONS

A. The Background of the Policy Issuance

Input VAT refund policy for Taxable Enterprises experiencing production failure is a new policy issued by the government. Theoretically, the emergence of the policy of Article 9 Paragraph (2a) of Law No. 18 of 2000 is considered violating the concept of Input VAT crediting pursuant to Article 9 paragraph (2) VAT Law, which explicitly states that the Input VAT can only be credited as long as there is an Output VAT. Theoretically in VAT, the value added is the difference between the output and the input, thus the Input VAT can only be credited if there are Output VATs, which means the Taxable Enterprises should perform a VAT payable submission.

If we relate it to its legal character, VAT is an indirect tax, which is ultimately charged or delegated to others.

The tax is paid by the manufacturer or the party that sells goods but borne by the consumer either explicitly or implicitly (included in selling price of goods or services).

Indonesia's VAT adhere Indirect Subtraction Method or Credit Method or Invoice Method. All of the taxes levied by the Taxable Enterprises or the Seller do not automatically flow to the state treasury. The payable VAT that has to be paid to the state treasury is the calculation result of subtracting the Input VAT with the Output VAT. When referring to Article 9 Paragraph (2a) of the VAT Law with the assumption that at that time the Output VAT was nil, it appears that the legal character of VAT will not be fulfilled.

To emphasize the rule of Article 9 paragraph (2) of Law No. 42 of 2009, in Article 9 paragraph (8f), it is set that "crediting the Input VAT as referred to in paragraph (2) cannot be applied to the expenditure for the acquisition of Taxable Goods outside the capital goods or Taxable Services before the Taxable Enterprises perform production referred to in paragraph (2a)". Therefore, the concept of VAT in this new regulation has been fulfilled.

The amendment of Article 9 Paragraph (2a) of the new law is also consequential for the emergence of Article 9 paragraph (6a) that regulates the process of refunding the Input VAT which has already been restituted and the period of which a particular enterprise can be categorized as fail to produce. Thus, the Taxable Enterprises which had failed to produce for three years since the time of the Input VAT crediting must repay the Input VAT on the import/acquisition of capital goods which have been credited and given the restitution. To emphasize the rules regarding the refund of restituted Input VAT for Taxable Enterprises experiencing production failure, the regulation of Finance Minister No. 81/PMK.03/2010 applied since April 1, 2010 was issued.

In addition to the above theoretical reasons, there are also some technical reasons of the emergence of the policy regarding the refund of Input VAT for Taxable Enterprises experiencing production failure, namely, to prevent misappropriation of VAT restitution based on Article 9 Paragraph (2a) of the VAT Law. Practically, during the enactment of Article 9 Paragraph (2a) of Law No. 18 of 2000, many people are taking advantage of this provision by crediting Input VAT on the acquisition and/or import of Taxable Goods or Services then making an application for restitution, but without making any VAT payable submission resulting in the absence of Output VAT as a comparison for the Input VAT. This enables the concerned Taxable Enterprise to never deposit the VAT to the state treasury. In this case, it is difficult for the government to monitor the deposits, resulting in the decreasing amount of state revenue gained from taxes. By amending Article

9 Paragraph (2a) and issuing the Regulation of Finance Minister No. 81/PMK.03/2010, the government took conservative steps to prevent such abuses. Besides, the purpose of the policy amendment is to avoid cost center corporation mode through the establishment of new companies.

The policy of Article 9 Paragraph (2a) in Law No. 18 of 2000 is actually issued by the DGT within the consideration of sound business practices which also based on good and positive thoughts. The government's thought is probably based on the business principle of an entrepreneur, which is trying to get the optimum benefits by spending as few as possible. This principle is implemented in the following manner: (1) if the business is conducted by certain manufacturing Taxable Enterprise, then the enterprise will immediately perform the production process after the purchase of raw materials or capital goods, and then set up their factories and so forth, or (2) certain Taxable Enterprise engaged in trading business expects their goods to be immediately sold. Thus there is a VAT payable submission. But in reality, many Taxable Enterprises that have a credited and restituted Input VAT have not returned a VAT payable thus resulting in the absence of the Output VAT. This is certainly detrimental for the country because those Taxable Enterprises do not pay their VAT. To cover the losses of the country, this policy is thus issued.

B. Potential Problems That Will Occur in Practice

Although it is noticeable that in certain cases, the purpose of limiting the Input VAT for Taxable Enterprises only has an appropriate intention to cover the potential loss of the country, On the other hand the policy can also instigate decreases in the growth of entrepreneurship in Indonesia because at the beginning of their business, the entrepreneurs require a quite large amount of operating funds including VAT (10%). The fact that the input VAT can be credited for other than capital goods would greatly smooth entrepreneur's capital. If it can't be credited, the cost of establishing and running a business in Indonesia would lead to a high cost. Thus, it can be estimated that Taxable Enterprises which could survive would be those with a big capital, while those having a little capital would face difficulties.

Indonesian Chamber of Commerce and Industry (Kadin) regards the VAT Law less supportive to the target of economic growth since it can impede the growth of new investment. The restriction in crediting Input VAT by Article 9 Paragraph (2a) in the VAT Law has the potential to cause high economic cost and burden the investment because of the additional VAT, whereas Article 9 Paragraph (2a) on the old law is better, since the Input VAT

can be credited even though there is no Output VAT.

For the obedient and honest manufacturing Taxable Enterprise, Refund Policy of PMM according to Article 9 paragraph (6a) Law No. 42 of 2009 is a counterproductive policy. It was submitted by the Chamber of Commerce, practitioners, even by the taxpayers themselves who work hard with risk of failure, including production failure. The provisions of Article 9 Paragraph (2a) are indeed encouraging manufacturing Taxable Enterprises to do their best to be successful. Nevertheless there are also many less successful enterprises which experience, for example, production failure, so after they get bankrupt, they still have to return the VAT that has been restituted plus the interest penalty. To encourage entrepreneurship, especially for SMEs (Small, Medium Enterprises), in order to overcome the unemployment, it may be necessary to find policies that ease the repayment of Input VAT restitution beside the inability caused by natural disasters.

Furthermore, there are many people who believe that potential problems may arise in connection with the enforcement of the policy. From the result of the interview with various parties, several potential problems which may engender disputes in the realm are found.

The first problem is a disincentive for new and specific industries. VAT Law contains a provision for Taxable Enterprises crediting and restituting their Input VAT by Output VAT. If the taxable enterprise had failed to produce, the cash refunded has to be paid back. It is noticeable that the possible emerging problem is the difficulty to do the billing. This is because, when a certain taxable enterprise experiences production failure, it also automatically suffers from losses, which mean it does not have a cash flow.

Policy of Article 9 paragraph (6a) of Law No. 42 of 2009 shows that the policy is a disincentive for new industries or newly established company and not yet in production. Taxable enterprises were afraid to invest in Indonesia, because the failure is one of the business risks. Taxable enterprises suffered from financial losses are again punished by the return of the Input VAT which has been restituted in consort with its penalties.

The second emerging problem is the dispute occurring in the realm because the definition of capital goods is less clear. In the provision of Article 9 paragraph (2a) which allow Input VAT crediting for the acquisition/import of capital goods (although there is no Output VAT) is proven to be inconsistent, since the policy of Article 9 paragraph (2) states that it can only be credited if there is an Output VAT.

The House of Representatives as the formulator of the policy also has its own considerations on the amendment of Article 9 Paragraph (2a) VAT Law. Allowing Input VAT

crediting for the acquisition or import of capital goods is somewhat related to the mining industry, particularly oil and natural gas that requires a lot of capital to produce, considering a very expensive cost of capital goods acquisition. The Input VAT crediting policy for Taxable Enterprises with no production failure is expected to help the cash flow of the taxable enterprises. In addition, another reason of the selection of capital goods is that capital goods have an effect for the future so that it should be given incentives in the form of input VAT crediting.

If the Input VAT that may be credited by the Taxable Enterprises not yet in production is the Input VAT for the acquisition/import of capital goods, then the scope of capital goods in question should also be clear. The clarity is important to avoid disputes in the realm. In Article 1 (3) of the Regulation of Finance Minister 81/2010, it is stated that the capital goods either for the manufacturer or other taxable enterprise are tangible properties that has an economic life of more than one year, and their original purpose is not for sale.

Because if we refer to various regulations or taxation laws that existed before the enactment of the Regulation of Finance Minister No. 81/PMK.03/2010, what is meant by capital goods is limited to attached or detached machinery and factory equipments that are required for the process of generating taxable goods, so it excludes spare parts according to the Article 1 KMK No.: 252/KMK.04/1998. Whereas if you look at the definition in the Regulation of Finance Minister No. 81/PMK.03/2010, the understanding of capital goods itself refers more to the assets in accounting terms.

The capital goods whose acquisitions and imports can be credited must be the taxable goods related to direct business activities of the taxable enterprise. Expenses which are directly related to business activities are expenditures for production, distribution, marketing and management activities. This provision applies to all areas of business. So, as long as the acquisition of capital goods is intended to the business' direct activities of the taxable enterprise, it can be credited, except for the acquisition of capital goods itself, the input VAT cannot be credited in accordance with Article 9 paragraph (8) of Law No. 42 of 2009.

The third possible problem is a violation of taxable enterprise's rights according to the VAT Law. In Law No. 42 of 2009 there are additional articles, namely Article 9 paragraph (6a), which states that the "Input VAT that has been credited as mentioned in paragraph (2a) and that has been refunded must be repaid by the Taxable Entrepreneur in the case that the Taxable Entrepreneur experiences failure to produce within a maximum of three (3) years from the start of the Tax Period when the Input

VAT was credited."

These regulations are prepared due to the fact that Taxable Enterprises have enjoyed but have not optimally made use of the convenience provided in Article 9 Paragraph (2a), in other words they don't immediately make production so that they do not have to return the VAT payable, because the Input VAT can only be credited if there is an Output VAT. The policy in Article 9 paragraph (6a) is also intended to avoid the abuse of VAT restitution.

It is also a threat for those who do not seriously invest. But we need to pay attention to the taxable enterprises that really exert their effort to perform the production process but still unable to produce. This policy provides an equal treatment for all taxable enterprises or in the other words, generalizes the provisions to all taxable enterprises.

The fourth phenomenon that can emerge is the affirmation of VAT type applied in Indonesia. In the case of taxable enterprise that had failed to produce, there is no VAT payable submission so there is no Output VAT which enables Input VAT be credited. Therefore, as a consequence, the Input VAT on imports and or acquisition of capital goods which have been refunded has to be paid back. Taxable enterprises experiencing production failure are regarded as the final consumer of the goods and services they acquired, because the production and distribution chain does not run well and lost in the enterprise experiencing production failure.

The basic principle of VAT is a tax on consumption expenditures that are charged to the final consumers. Taxable enterprises buying goods for production purpose are not VAT-able, because they are not the consumers but rather those who are given the obligation to collect and deposit the VAT on the value-added. Thus, if the enterprises failed to produce, then principally there is no VAT to be collected and deposited (Darussalam and Septriadi, 2006). Because when buying goods which are not intended for consumption, but for production it may be necessary to question whether in the condition of being failed to produce, the function of the capital goods which have been purchased is switched into consumption goods/expenditure. Being failed to produce is an undesirable condition.

According to the imposition of VAT on capital goods, Indonesia adhere the Consumption Type Value Added Tax on the acquisition of capital goods. According to Schenk (2007):

"A consumption VAT allows the capital goods purchaser to claim input credits for VAT on capital purchases immediately and in full in the period in which the capital goods are purchased."

In this type, the tax is levied only on consumer goods which are usually consumed by final consumers so that

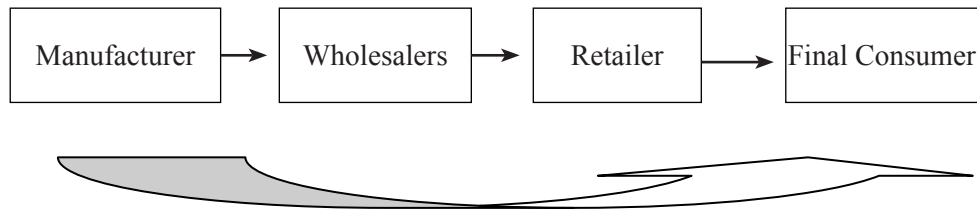


Figure 1. The Chain of VAT Imposition

Annotation:

The manufacturer taxable enterprise is regarded as the final consumer if the enterprise experiences failures in production.

the capital goods (investment) are not taxed, either by way of exemption or by crediting. In other words, taxes paid on the purchase of capital goods can be credited like crediting the purchase of raw materials, and others. In this type of consumption, the possibility of double taxation on capital goods can be avoided so that it can encourage every VAT-able entrepreneur to do “rejuvenations” to their capital goods at regular intervals.

However, by the regulation of refunding the VAT Restitution for Taxable Enterprises experiencing production failure, the capital goods obtained by those enterprises are regarded as consumer goods; therefore the restituted input VATes which have been credited must be refunded. Thus, it appears that the application of the provisions of Article 9 paragraph (6a) makes the VAT switch principally from Consumption Type VAT to a Product Type VAT which imposes VAT on capital goods.

The fifth problem is the confusion among employers because of the absence of transitional rules. Article 9 Paragraph (2a) of Law No. 18 of 2000 mention the case of taxable enterprise that is not yet in production, or has not made the consignment of taxable goods or services, or taxable goods exports resulting in zero for input VAT. Thus, the input VAT that has been paid by the taxable enterprises on the acquisition of taxable goods, or the reception of taxable services, or the utilization of taxable services from outside and inside the Customs Zone, or the utilization of Intangible taxable goods, or taxable goods imports still can be credited in accordance with Article 9 paragraph (2), except for the input text as referred to in Article 9 paragraph (8). Meanwhile, Article 9 Paragraph (2a) of Law No. 42 of 2009 has similarities to Article 9 Paragraph (2a) of the old, namely, the Input VAT crediting on the acquisition or import of capital goods can be credited by the taxable enterprise which is not yet in production.

Many people have been inquiring whether the Input VAT on the acquisition or import of capital goods which has been restituted and credited before the Law No. 42 of 2009 and the regulation of Finance Minister No. 81/PMK.03/2010 was applied on April 1, 2010, will be subjected to the provi-

sions of Article 9 paragraph (6a) of Law No. 42 of 2009 or not, considering the lack of transitional provisions. The absence of transitional provisions providing an affirmation to the taxable enterprises which are not yet in production will of course, at the time of its execution cause disputes in the field. Transitional provision is important, because it provides certainty for the taxable enterprises.

The sixth problem is the vague criteria for Taxable Enterprises experiencing production failure. Many parties, especially the tax consultant, have questioned the criteria of a taxable enterprise experiencing production failure. For example, there was a taxable enterprise that had start producing but then stopped his project. Since 2003, the mentioned enterprise still continued buying capital goods and credited its input VAT and applied for restitution. From this example can the enterprise be categorized as experiencing production failure? Thus the clarity of the production failure criteria is necessary, because otherwise it may cause quite disturbing disputes.

The seventh challenge is the absence of incentives for the cooperative taxable enterprises. The provision states that if within three years for the taxable enterprise as a producer and one year for the non-producer taxable cannot perform taxable goods and services consignment, taxable goods and services export, the enterprise is thus declared to experience production failure. However, the capital goods can still be used to perform production activities because the capital goods are tangible property that has an economic life of more than one year, whose original purpose is not for sale, therefore when the capital goods can be used to perform production activity after a period of either one year or three years, the enterprise is still regarded as fail to produce.

It would be better if there are incentives given to taxable enterprises that exert their power and efforts to revive and perform the production activities. If it is carried out, the taxable enterprise will continue to maintain its business activities and make an effort to continuously producing. The incentives can be either a reduction or elimination of administrative sanctions, so that it can help the enter-

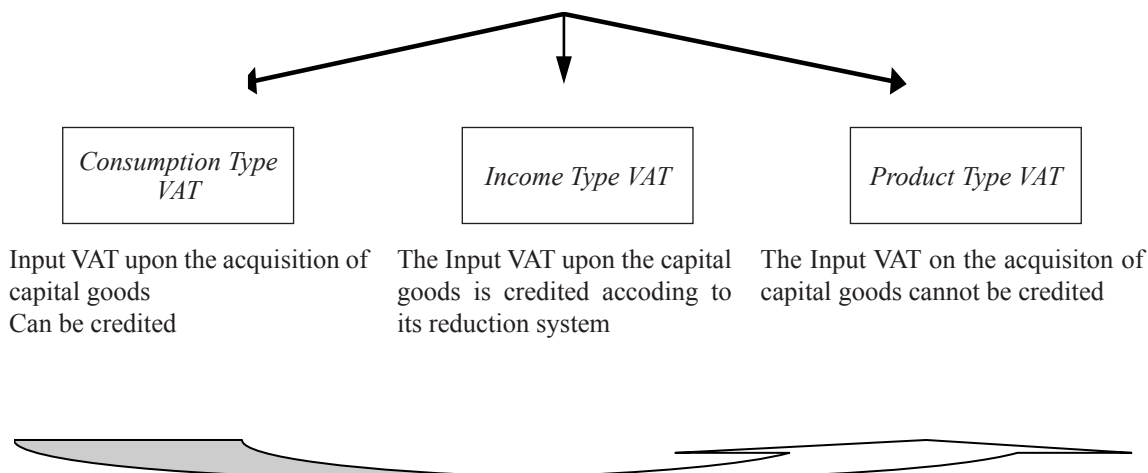


Figure 2 Type of VAT Based on The Acquisition of Capital Goods

Annotation:

Consumption type VAT which is adhered by Indonesia will turn to Product Type VAT if the taxable enterprises experiences production failure due to the Input VAT on capital goods acquisition that cannot be credited.

prises' cash flow.

Moreover, there is the possibility that the taxable enterprise will close his business and sell all of its capital goods to other parties. The selling of those capital goods cause their submission to be VAT payable, pursuant to Article 16D, without seeing whether the Input VAT from the acquisition of the capital goods can be credited or not. Article 16D of Law No. 42 of 2009 states that the "Value Added Tax shall be imposed on the delivery of Taxable Goods in the form of assets that were not originally intended to be traded by the Taxable Entrepreneur, except for deliveries of assets whose Input VAT is not creditable as mentioned in Article 9 paragraph (8) letter b and letter c." Therefore, to avoid the return of input VATes which have been restituted, the manufacturer whose production process comes to a halt will sell its capital goods before the end of the third year. Problems will occur if the sale is made after the third year.

The eighth challenge is the definition of "production failure" for the VAT purpose which is different from the general rule. Production management expert, Sofjan Assauri (2004), explains that the production is widely interpreted as an activity that transform inputs into outputs that encompasses all of the activities of producing goods and services as well as other activities that support the efforts to produce the products. Nevertheless, in the regulation of Finance Ministry No. 81/PMK.03/2010 the definition of production failure refers to the word "submission". This is certainly averse to the general rule even though in a sense, the definition in regulation No. 81 is similar to Article 9 Paragraph (2a) that is altogether a submission.

When referring to the regulation of Finance Minister, the definition of production failure leads to capital goods

which are not used for its original purpose so it could not make a taxable submission. In fact, the production failure itself is basically not an intentional deed performed by taxable enterprises thence the term 'production failure is not appropriate if it is associated with the enterprises that do not utilize capital goods for its original intention. Therefore analysis of the accuracy in using the term production failure is necessary. Meanwhile, the DGT argued that the use of the term production failed is caused by the difficulty to find the synonymous terms for "no Output VAT".

The potential problem that might occur is the possible condition where a certain taxable enterprise have performed the production activities but has not made a VAT payable submission because there are not any counterparties or buyers of their product. In this case, the enterprise will be included in the criteria of those having production failure. If we consider again the notion that production is the process of transforming the input into output in the form of goods and services, actually the taxable enterprise does not experience production failure because the enterprise have actually performed a production activity and have produced Taxable Goods or Services, but with the provisions of this regulation the enterprise is still considered to experience production failure.

The ninth problem that occurs from the existence of this regulation is the emergence of a restitution process that does not help increase the cash flow of the Taxable Enterprise. Restitution for Taxable Enterprise that are not yet in production can be done at the end of the tax period in accordance with the provision in Article 9 paragraph (4b) of Law no. 42 of 2009. The process of restitution is performed through examination executed within 12

(twelve) months. The purpose of the restitution that can be made at the end of the tax period is actually to help increase the cash flow of Taxable Enterprises, but since the process of the restitution is carried out through a quite long examination, the purpose to help increase the cash flow thus has not yet been achieved.

There are 6 (six) particular Taxable Enterprises that can apply for restitution at any Tax Period, including the Taxable Enterprises that are not yet in production stage. Compared to the other five Taxable Enterprises that are allowed to apply for the restitution on any tax period as regulated in Article 9 paragraph (4b) Law No. 42 of 2009, the process of restitution of the five Taxable Enterprises was carried out through a certain research that only takes a month and done by returning the tax excess preliminary which is regulated in Article 9 paragraph (4c) to help the cash flow of the Taxable Enterprises and this restitution process can be aligned with the five Taxable Enterprises mentioned.

Apart from the obstacles that may emerge in connection with the application of the regulation of refunding VAT restitution for Taxable Enterprise experiencing production failure, the regulation can also have a positive impact because this policy will stimulate the Taxable Enterprise to be able to produce immediately and to be serious in investing. Moreover, this policy is intended to encourage Taxable Enterprises to make every effort to produce as much as possible in order to succeed in producing Taxable Services and Goods as well as an encouragement for the Taxable Enterprise to increase the national production in order to provide employment and improve social welfare.

Besides, in relation to the state revenue, the refund policy of Input VAT for Taxable Enterprises experiencing production failure has a crucial role. The presence of the cancellation of the Input VAT that should be refunded to the Taxable Enterprise can increase the state revenue. This is in line with one of the tax functions, namely as a budgeter (revenue).

CONCLUSION

According to the above analyses and descriptions, it can be concluded that:

1. There are theoretical and tactical reasons leading to the emergence of the Input VAT refund policy for Taxable Enterprises experiencing production failure. The first theoretical reason is because the regulation in Article 9 Paragraph (2a) of the VAT Law is an exception of Article 9 paragraph (2), therefore an additional rule is issued, namely the Article 9 Paragraph (8) letter f and Article 9 paragraph (6a). To set more specifically the policy in

Article 9 paragraph (6a) concerning the VAT refund, the Minister of Finance Regulation (PMK) No. 81/PMK.03/2010 is issued. Meanwhile, the tactical reasons for the issuance of the regulation is to prevent abuses of the VAT restitution which may reduce the revenues.

2. Potential issues that will emerge in connection with the enforcement of the policy include: (a) Disincentive for new and certain industries; (b) A vague definition of capital goods encompassment ; (c) Taxable Enterprises' rights violations based on the VAT Law ; (d) The alteration of VAT type imposed in Indonesia ; (e) Confusion among entrepreneurs because of the absence of transitional rules ; (f) Vague criteria for Taxable Enterprise experiencing production failure ; (g) The absence of incentives for the cooperative Taxable Enterprises ; (h) Errors in defining production failure ; (i) Restitution process that does not help increase the cashflow of Taxable Enterprises

3. The driving effects of the payment policy of VAT restitution refund for production failure are (1) encouraging Taxable Enterprises in order to successfully produce goods for social purpose thereby stimulating the economic activities that bring prosperity, (2) clarifying the criteria for non VAT-able capital goods based on the function, not the type/character of the goods, (3) closing the loop holes misuse of tax refund mechanism, and (4) strengthening the function of tax revenues beside the positive yet punitive regulation.

REFERENCES

- _____. Law No. 42 of 2009 Regarding Value Added Tax On Goods And Services And Luxury Sales Tax.
- _____. Law No. 18 of 2000 Regarding Value Added Tax On Goods And Services And Luxury Sales Tax.
- _____. The Regulation of Finance Minister No. 81/PMK.03/2010 regarding The Calculation Time And The Procedures of The Refund of Credited Input VAT That Has Been Given The Restitution For Taxable Enterprise Experiencing Production failure
- Assauri, Sofjan. 2004. *Manajemen Produksi dan Operasi*. Jakarta: Lembaga Penerbit Fakultas Ekonomi Universitas Indonesia
- Boadway, Robin; Sato, Motohiro, 2009. Optimal Tax Design and Enforcement with an Informal Sector. *American Economic Journal*, Vol. 1 No. 1, page 1-27.
- Creswell, John. W. 1994. *Research Design : Qualitative and Quantitative Approach*. London: SAGE Publication.
- Darussalam and Danny Septriadi. 2006. *Kapita Selekt Perpajakan*. Jakarta: Salemba Empat.
- De La Feria, Rita; Walpole, Michael, 2009. Options for Taxing Financial Supplies in Value Added Tax: Eu Vat And Australian Gst Models Compared. *The*

- International and Comparative Law Quarterly*, Vol. 58 No. 4, page 897-932
- Hooper, Paul dan Karen A. Smith. 1997. *A Value-Added Tax in The U.S.: An Argument in Favor*. Business Horizon (May-June)
- Lin, Shuanglin. 2008. China's Value-added Tax Reform, Capital Accumulation, and Welfare Implications. *China Economic Review*, Vol. 19
- Mukhopadhyay, Sukumar. 2002. Value Added Tax: How Implementation Is Going Wrong. *Economic and Political Weekly*, Vol. 37 (September)
- Rahayu, Ning and Santoso, Iman. 2008. *Bunga Rampai Perpajakan*. Jakarta: Departemen Ilmu Administrasi FISIP UI.
- Redaksi. 2010. Pembatasan Pajak Masukan Bagi PKP yang Belum Berproduksi. *Indonesian Tax Review*. Vol. III / Edisi 03
- Redaksi. 2008. Dilema Pengaturan Pengusaha Gagal Produksi Dalam Pasal 14 UUNo.28 Tahun 2007 dengan Rancangan Undang-Undang Pajak Pertambahan Nilai (RUU PPN). *Inside Tax*. Edisi 11 (September)
- Redaksi. 2010. *Perusahaan Gagal Produksi Diusulkan Tidak Kena PPN*. <http://www.pajakonline.com/engine/artikel/art.php?artid=701>,
- Redaksi. 2010. *Keuangan Ekonomi Makro*. <http://web.bisnis.com/keuangan/ekonomi-makro/1id176157.html>,
- Rosdiana, Haula and Rasin Tarigan. *Perpajakan Teori dan Aplikasi*. Jakarta: Raja Grafindo Persada, 2005.
- _____. 2006. Implikasi Perluasan Definisi Royalti Terhadap Industri Telematika. *Jurnal Ilmu Administrasi dan Organisasi, Bisnis, dan Birokrasi*, Vol, 14, No. 3 (September)
- Ruback, R Barry; Cares, Alison C; Hoskins, Stacy N, 2010. Crime Victims' Perceptions of Restitution: The Importance of Payment and Understanding. *Violence and Victims*, Vol. 23 No. 6, page 697-710.
- Sandholtz, Wayne, 2010. Plunder, Restitution, and International Law. *International Journal of Cultural Property*, Vol. 17 No. 2, page 147-176.
- Schenk, Alan and Oldman, Oliver. 2007. *Value Added Tax A Comparative Approach*, United Kingdom: Cambridge University Press.
- Sukardji, Untung. (n.d). Analisis dan Dampak Perubahan Ketentuan UU PPN 1984 Bagi Dunia Usaha. *Seminar Sehari Perpajakan Implikasi UU PPN & PPnBM Nomor 42 Tahun 2009*.
- Tait, Alan. *Value Added Tax International Practice and Problems*. Washington DC: International Monetary Fund. 1988.
- Terra, Ben. 1988. *Sales Taxation: The Case of Value Added Tax in the European Community*. Deventer-Boston: Kluwer Law and Taxation Publishers.
- Zheng, Kexin; Zhang, Juan, 2010. on Enterprise Pre-Tax Deduction Ways for Charitable Donations. *Asian Social Science*, Vol. 6. No. 11, page 193-196.