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VAT in Agriculture: Ukrainian experience and international evidence

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About the Project "German-Ukrainian Agricultural Policy Dialogue" (APD)

The German-Ukrainian Agricultural Policy Dialogue provides policy advice to Ukrainian state authorities and business associations on reforming agricultural policy and legislation in accordance with principles of a market economy. In our advisory work, we take into account relevant German as well as international experience and practice (EU, WTO). The project is funded by the German Federal Ministry of Food and Agriculture under its Cooperation Program through GFA Consulting Group GmbH as the mandatary as well as IAK AGRAR CONSULTING GmbH and the Leibniz Institute of Agricultural Development in Transition Economies (IAMO) as project developers.



ABSTRACT

This paper contributes to the discussion of the value added taxation of agriculture in Ukraine. Special VAT regime for agriculture is currently in place in Ukraine. It allows agricultural producers to accumulate VAT at special accounts and spend these funds for production purposes without transferring to the budget. However, such taxation regime *de facto* leads to lower farm-gate prices and smaller investment incentives for companies. Still, it is perceived by agricultural companies as a major state aid measure against the background of low and inefficient direct fiscal support. However, the assessment indicates that Ukrainian agricultural companies and the Government would win from the introduction of VAT on a regular basis for large agrarian companies (with a rate of 20%) with possible special VAT regime for small companies as it would improve financial position of companies. Fiscal revenues from agriculture will also grow with increasing agricultural production. The introduction of a regular VAT regime for agriculture should be complemented with other policy steps, which include fiscal consolidation, anticorruption measures, and reform of direct state aid to agriculture.

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EXECUTIVE SUMMARY

1. Ukraine introduced value added tax (VAT), which is one of the essential sources of fiscal revenues in many countries, in 1992. The tax became important for Ukraine's economy as it brings about one third of consolidated fiscal revenues and accounts for near 10% of GDP. However, with years the tax became known for poor administration and fraud. Some loopholes in the administration relate to numerous VAT privileges and exemptions.
2. State support to agricultural producers is mainly based on the indirect support in the form of special tax treatment and tax exemption: VAT and special VAT regime. Agricultural companies have a right to transfer due VAT to a special account and use this sum as a tax credit and for financing other production purposes. However, the system is unfair and inefficient as at times of good performance of agriculture it creates significant fiscal pressure and makes entire support system of the sector unsustainable. High fiscal pressure results in VAT refund arrears, which put additional pressure on agricultural producers in the form of lower farm-gate prices. Moreover, special VAT regime harms agricultural companies that make higher investments.
3. Application of indirect support measures of agriculture in Ukraine is explained by a lack of financing for direct support. Moreover, some policy makers state that agriculture cannot be fully taxed.
4. In turn, agricultural companies in the EU are supported through direct fiscal support made in the framework of the Common Agricultural Policy. In terms of value added taxation these companies are considered mostly as a regular business. Special taxation treatment frequently refers to small farms. In particular, several member states apply flat-rate scheme for farmers. Most countries apply reduced VAT rates for agricultural and food products to stimulate their higher consumption. Overall, special VAT treatment is not considered in the EU as a state aid measure.
5. Over nearest future Ukraine should reform value added taxation according to its international obligations. The signed Association Agreement with the EU envisages the obligation of Ukraine to harmonize tax legislation, in particular, concerning VAT. In particular, during next five years Ukraine should approve special VAT regimes, which would comply with the EU standards. The IMF Program stipulates the promise of the

Government to bring preferential VAT treatment of agriculture closer to the general VAT regime.

6. Regular VAT system for agricultural producers with an option for small companies to maintain special VAT regime is likely to be the first best solution. It is expected to result in better financial position of companies and higher fiscal sustainability. Companies will receive higher farm-gate prices, which will contribute to further increase in agricultural production. Expected increase in efficiency and size of direct state support would favour development of effective agricultural companies. Moreover, introduction of regular value added taxation of agriculture is likely to have second-round effects including improved investment climate through clear taxation rules and higher public investments in infrastructure.
7. The possible changes in the taxation treatment of agriculture might have inevitable results if introduced without other measures. To ensure the agricultural development the reform of the VAT system for the sector requires complex measures and, thus, cannot be implemented ad hoc. In particular, the introduction of a regular VAT regime for agriculture should be complemented with other policy steps which include fiscal consolidation, anticorruption measures, and reform of direct state aid to agriculture.

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LIST OF ABBREVIATIONS

AMS	aggregate measures of support
CAP	Common Agricultural Policy
EU	European Union
FAT	Fixed Agricultural Tax
OECD	Organisation for Economic Co-operation and Development
UAH	Ukrainian Hryvnia
USD	United States Dollar
VAT	Value Added Tax
WTO	World Trade Organisation

1 INTRODUCTION

"The rapid and seemingly irresistible rise of the value-added tax (VAT) is probably the most important tax development of the latter twentieth century, and certainly the most breathtaking. Forty years ago, the tax was little known outside dull treatises. Today it is a key source of government revenue in over 120 countries. About 4 billion people, 70 percent of the world's population, now live in countries with a VAT, and it raises about \$18 trillion in tax revenue—roughly one-quarter of all government revenue. Much of the spread of the VAT, moreover, has taken place over the last ten years. From having been largely the preserve of more developed economies in Europe and Latin America, it has become a pivotal component of the tax systems of both developing and transition economies."

The Modern VAT, Ed. Ebrill L., Keen M., Bodin J., and Summers V., 2001

International Monetary Fund

Value added tax (VAT) is one of the essential sources of fiscal revenues in many countries. Ukraine introduced this tax in 1992 mostly on the basis of the legislation of European countries. During years the tax became known for poor administration and fraud. The large problem for business relates to VAT refund arrears, which hamper exports and competition among business. As a result, the trade-off between improvement of VAT administration and substitution of this tax with an alternative is often discussed.

Some loopholes in the administration relate to numerous VAT privileges and exemptions. Over years, consecutive Ukrainian governments used tax privileges as a major state aid measures particularly for agriculture, whose development is important for country's economy. In particular, standard VAT regime was replaced by special VAT scheme, which allowed agricultural companies to spend the accrued VAT to finance their production costs without its payment to the budget. Besides, the fixed agricultural tax was introduced to substitute enterprise profit tax. At the same time, direct fiscal support of the sector remained low, inefficient and unfair. As a result, agricultural producers consider special VAT regime as a major state aid measure and, thus, they critically assess attempts of the Government to change the system.

In this paper we try to assess current value added taxation of agriculture. Taking into account obligations of Ukraine in the framework of signed Association Agreement with the EU we first provide description of value added taxation in the EU (Chapter 2). Then

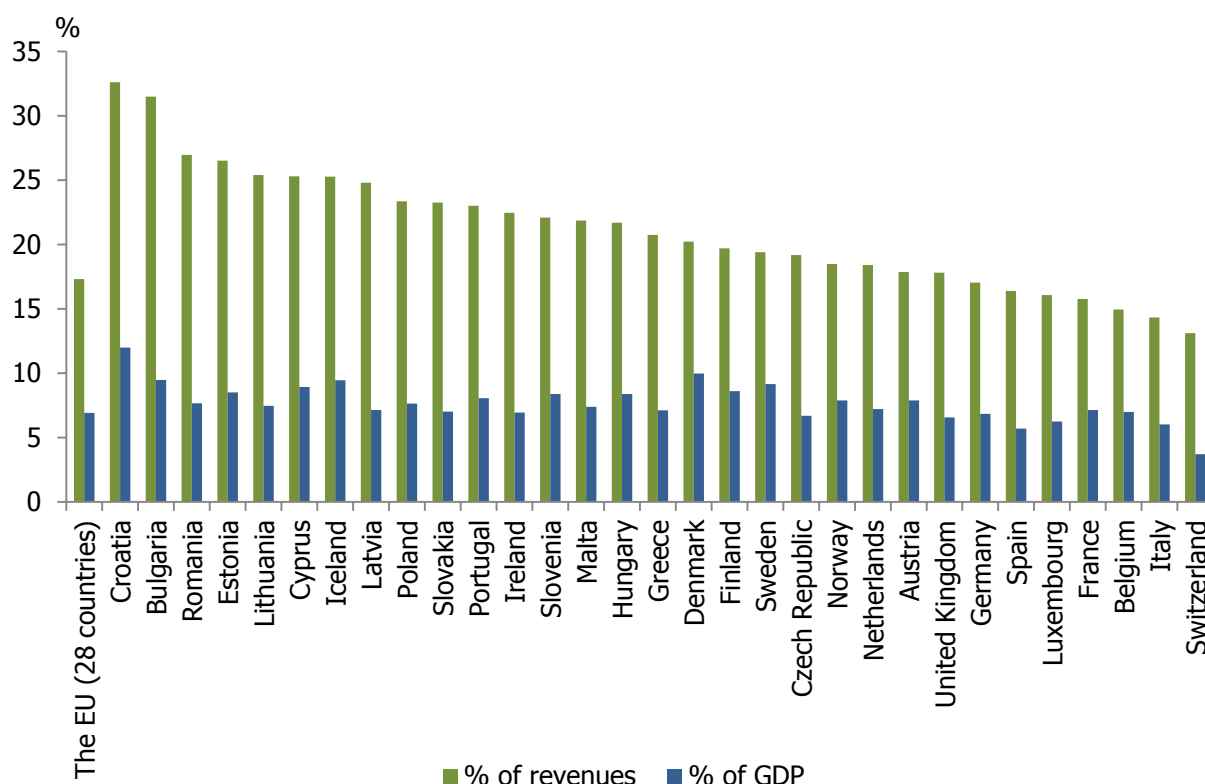
the VAT in Ukraine and particularly in agriculture is assessed (Chapter 3 and Chapter 4, respectively). In Chapter 5 we try to assess possible initiatives for the changes in the system. We outline key policy recommendations in the last chapter.

2 VAT IN THE EU

2.1 Evidence from the EU

In all EU countries VAT is a main source of fiscal revenues. Between 2002 and 2012 VAT revenues accounted on average for 17.3% of total general government revenues or 6.9% of GDP. The level of VAT revenues depends on applied VAT rate (standard and reduced) and provided exemptions.

Figure 1: VAT revenues in the EU, 2002-2012



Source: Eurostat

Key regulation of the value added taxation is defined in the Directive 2006/112/EC on *Common system of value added tax*.¹ According to the Directive 'VAT is a general tax on consumption applied to commercial activities involving the production and distribu-

¹ Common system of value added tax (VAT) ('the VAT Directive'), Council Directive 2006/112/EC of 28 November 2006, <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:02006L0112-20140101>

tion of goods and the provision of services'.² VAT applies to the production and distribution of goods and services bought and sold for consumption within the EU. Taxpayers may deduct the amount of VAT from their VAT account, which was already paid. As a result, VAT is a tax paid by final consumer. VAT is considered to have a neutral impact for the competition between producers in different EU countries.

National states define VAT rates within boundaries envisaged in the VAT Directive. In particular, the Directive sets minimum standard VAT rate at 15% (until December 31, 2015) and allows for one or two reduced rates of not less than 5% for defined in the Directive list of goods and services.³ The list includes food products, pharmaceuticals, books, newspapers, medical equipment, transport services. Besides some additional derogations were grandfathered in member states, such as exemptions, zero rates and very low reduced rates to certain goods. In particular, some countries that joined the EU in 2004 were able to maintain reduced or zero rates for certain products by the end of 2010, which was defined in the act of their accession to the EU.⁴

During recent years there is a trend in the EU towards increase in standard or/and reduced VAT rates to raise fiscal revenues. Currently standard VAT rates vary from 15% to 27% with average at 22% (see Annex 1 for VAT rates in the EU). As all countries apply reduced rates weighted average household rate is substantially lower than standard (from near 8% to almost 16%).⁵ Zero rate to exports is in force in all member states.

Member states also cut VAT exemptions during recent years. In particular, tax base was broadened in several countries, while the scope of application of reduced rates was

² http://europa.eu/legislation_summaries/taxation/l31057_en.htm

³ In addition, after consultation with the VAT Committee, each member state may apply a reduced rate to the supply of natural gas, electricity or district heating (article 102 of the Directive)

⁴ According to the VAT Directive the following goods and services are to be exempted in Member states: certain activities of general interest (such as hospital and medical care, goods and services linked to welfare and social security work, school and university education and certain cultural services); certain transactions including insurance, the granting of credit, certain banking services, supplies of postage stamps, lotteries and gambling and certain supplies of immovable property. These exemptions might be restricted by Member states (number of events, amounts, etc.)

⁵ *Study to quantify and analyse the VAT Gap in the EU-27 Member States. Final Report.* TAXUD/2012/DE/316, FWC No. TAXUD/2010/CC/104, CASE and CPB Netherlands Bureau for Economic Policy Analysis, Warsaw, July 2013.

lowered.⁶ In 2012 share of total intermediate consumption purchased by exempt industries varied from 9.5% to 54%. This signals about lower efficiency of VAT as respective economic agents cannot reclaim VAT on inputs, which makes production more expensive.

Overall, VAT regulation in the EU grants member states with high flexibility on establishing rates as well as implementation of special taxation schemes.

2.2 Common flat-rate scheme for farmers

The Directive (in Chapter 2 of Title XII) stipulates a special VAT scheme for farmers, which may be applied by Member States - *common flat-rate scheme for farmers*. This scheme is designed to offset the VAT charged on purchases of goods and services made by the flat-rate farmers. It helps small farmers unable to comply with the obligations imposed by the standard Community VAT system. For VAT purposes a farmer means a person who engages in the agricultural production activities in the State listed in Appendix VII of the Directive (Reproduced in Annex 2 to this Paper).

In the framework of this scheme Member States may fix the flat-rate compensation percentages, which is to be calculated on the basis of macro-economic statistics for flat-rate farmers alone for the preceding three years. The flat-rate compensation percentages should be applied to the prices, exclusive of VAT. The compensation should (approximately) equal VAT that farmers paid in inputs.⁷ Such compensation is to be paid either by customer or public authorities. If the taxable customer pays flat-rate compensation, he shall be entitled to deduct the compensation amount from the VAT for which he is liable.

According to the Directive, farmer does not have to register as a VAT payer and issue invoices. VAT on input paid is compensated by a flat rate increase charged to taxable customers. However, each Member State 'may exclude from the flat-rate scheme certain categories of farmers, as well as farmers for whom application of the normal VAT

⁶ *Tax reforms in EU Member States. Tax policy challenges for economic growth and fiscal sustainability.* 2012 Report. Working Paper N.34 – 2012, Directorate General for Taxation and Customs Union, Directorate General for Economic and Financial Affairs.

⁷ If the defined by Member States compensation rate (defined as a share of the value of farmer's sales) is lower than VAT prepaid by farmer, the farmer typically has a right to opt for the statutory VAT regulation.

arrangements, or of the simplified procedures, is not likely to give rise to administrative difficulties’.

The European Commission is responsible for monitoring use of flat-rate schemes for farmers.

Box. Flat-rate farmers: Ireland

For VAT purposes a farmer means a person who engages in at least one of the agricultural production activities in Ireland listed in Appendix [See appendix 2 to this paper] and whose supplies consist exclusively of either or both:

- *agricultural produce (other than bovine semen and nursery stock), or*
- *agricultural services (other than agricultural contracting services), or*

whose supplies consist exclusively of either or both agricultural produce and/or agricultural services and of one or more of the following:

- *machinery, plant or equipment which s/he has used for his/her farming activity;*
- *racehorse training services for which the annual turnover does not exceed and is not likely to exceed €37,500;*
- *goods, other than those referred to above, for which the annual turnover does not exceed and is not likely to exceed €75,000 or services, other than those referred to above, for which the annual turnover does not exceed and is not likely to exceed €37,500.*

Overall, it means that farmer engaged in defined list of agricultural production with a non-agricultural turnover below set threshold is eligible for flat-rate scheme and, thus, does not have to register for VAT. However, such farmer may voluntarily register for VAT.

In order to compensate for VAT paid on supplies to him/her, a flat-rate farmer is entitled to a flat-rate addition (at present 5.2%) to the prices at which his/her agricultural produce or agricultural services are supplied to VAT-registered persons including marts, agricultural co-operatives and meat factories. A flat-rate farmer is also entitled to reclaim VAT incurred in respect of the construction, extension, alteration or reconstruction of farm buildings, and land drainage, from the VAT Repayment (Unregistered) Section.

*Source: Farmers & Intra-EU Transactions,
<http://www.revenue.ie/en/tax/vat/leaflets/farmers.html>*

Among countries that apply flat-rate scheme for farmers are Germany, France, Ireland, and the Netherlands, which are important agricultural producers. However, the share of farmers on flat-rate system differs by country depending on the level of flat-rate compensation percentage and the ceiling on turnover.

2.3 Reduced VAT rates for agriculture related goods

Many Member States envisage reduced VAT rates for food products as well as food products (see the Appendix 3, which provides data for VAT rates for agriculture related goods). Such policy is explained by attempts of countries to increase food consumption, which becomes more competitive due to lower VAT rate. Then increase in consumption leads to higher production and employment, which are high priorities in any policy agenda (especially in relation to social policies).

To stimulate modernization of agriculture some countries envisage reduced VAT rates for agricultural machinery.⁸ Such policy step is rather challenging as many machinery do not only have agricultural purposes, and, thus, some fraud might be expected.

Overall, old Member States more often treat farmers like other registered business with exemptions for small business. At the same time, state aid to agricultural producers is provided with other means within the framework of Common Agricultural Policy.

2.4 Summing up

Overall, international evidence shows that several approaches towards value added taxation of agriculture are used. Some countries consider agricultural producers as a regular business and may apply exemptions for small business, while others implement special treatment for the producers in the sector. However, the country the registration and refund for VAT seem necessary if one of the following observations is present in:⁹

⁸ In particular, in Portugal the parking rate of 13% applies to Agricultural tools and utensils, mobile silos, tractors, pumps and other machinery designed exclusively or mainly for the purpose of agriculture, cattle breeding or forestry.

⁹ Cit. from *Value-Added Taxes in Central and Eastern European Countries. A Comparative Survey and Evaluation*. p. 120, OECD, European Union. Publication Date: 09 Oct 1998.

- "if the products of a particular sector are a major export, the maintenance of competitive conditions requires that the VAT on inputs be eliminated to the fullest extent possible; this can only be achieved through registration and refund of prior-stage VAT;
- special schemes will not ensure equal treatment if expenditures on feed, seed, fertiliser, pesticides, machinery and equipment are an important share of farm costs and if input/output ratios vary widely;
- if marketing and supply cooperatives play a pivotal role in selling farm produce and in purchasing major inputs, they should be integrated in the VAT system."

The EU evidence shows that Member States often consider agriculture as a regular business in terms of value added taxation. Special taxation treatment for VAT purposes is applied by many countries in respect to small farms. In particular, member states introduce flat-rate scheme for farmers, which is often not favourable for large companies and companies that implement investment projects. Most countries introduced reduced VAT rates for agricultural and food products to stimulate their higher consumption.

It should be noted, that special VAT treatment is not considered in the EU as a state aid measure. Instead, the comprehensive Common Agricultural Policy is in place,¹⁰ which favors development of companies in the sector through provision of direct fiscal support.

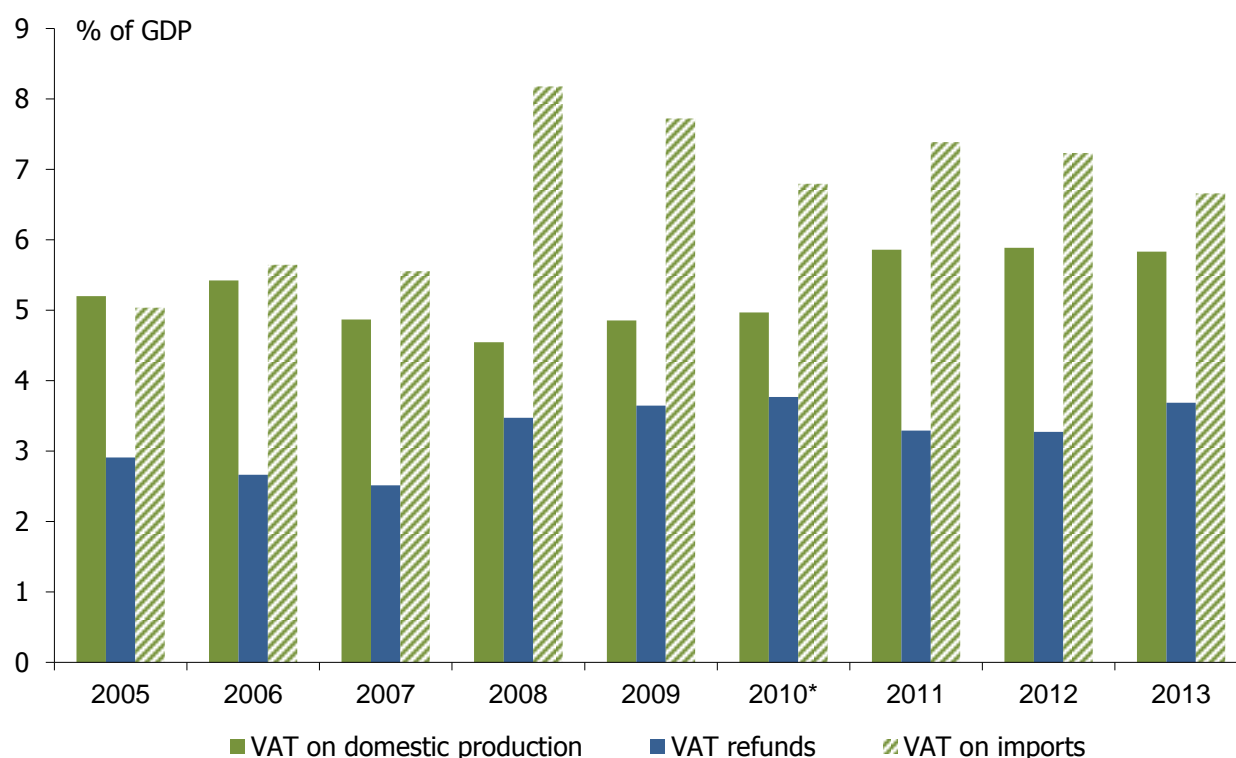
¹⁰ http://ec.europa.eu/agriculture/statistics/index_en.htm

3 VAT IN UKRAINE: GENERAL SYSTEM

3.1 VAT: regulation and problems

VAT was introduced in Ukraine in 1992 and replaced the previous, Soviet-type turnover tax. The initial VAT Law mostly followed the European legislation.¹¹ The tax became important for Ukrainian economy as it currently brings about one third of consolidated fiscal revenues and accounts for near 10% of GDP.

Figure 2: VAT revenues in Ukraine, 2005-2013



Source: State Treasury, Ukrstat

Several VAT rates are applied in Ukraine:¹²

- 1) Standard rate at 20%,¹³

¹¹ The VAT initially was introduced in 1992 by the Law of Ukraine on VAT (from 20 December 1991), which envisaged VAT rate at 28%. The Law was replaced by the Decree of the Cabinet of Ministers (No.14-92, from December 26 1992), which set VAT rate at 20%, which was then replaced by the Law of Ukraine in 1997 (No.168/97-BP, from April 3, 1997). At the moment, the VAT regulation is stipulated in the Chapter V of the Tax Code (2755-VI, from December 2, 2010).

¹² Chapter V of the Tax Code of Ukraine (No. 2755-VI, from December 2, 2010).

- 2) 0%,
- 3) 7% on medicines and medical products (introduced in 2014).
- 4) Besides, there are number of tax exemptions.

As in all countries with VAT exports is subject to zero-rate VAT to avoid double taxation of exporters. However, timely and full VAT refunds remain a traditional problem putting additional costs for exporters and reducing their competitiveness.¹⁴ To solve the issue the automatic VAT refund mechanism was introduced in March 2011. However, by the end of 2013 only near 40% of refunds were made automatically. This mechanism still did not help to avoid accumulation of VAT refund arrears due to high fiscal gap.

At the same time, VAT administration is perceived as expensive and complicated, which makes business operation more costly. The evidence suggests that VAT is vulnerable to fraud and tax evasion, which undermines fiscal revenues. The major reasons for this are identified by international experience:¹⁵

- Non-registration for VAT.
- VAT credit is claimed for non-creditable purchases, such as a car used for non-business purposes.
- Understated sales.
- Inflated claims for VAT paid on inputs.
- Credit is claimed for tax paid on inputs used in producing goods exempt from VAT. This is especially possible if a firm sells both exempt and non-exempt goods and services, since it is not always possible to link specific inputs to specific outputs.
- Zero-rated exports are diverted to the domestic market. The producer obtains export papers, claims a refund, and then sells the goods locally.
- VAT is collected by a firm, which does not transfer it to the fiscal office, and then disappears. In Ukraine such firms are known as one-day-survive firms.

¹³ There was a plan to reduce VAT rate to 17% from 2014. However, this decision was cancelled due to high fiscal pressure.

¹⁴ See: *VAT Refund Arrears in Ukraine. Analysis and Recommendations on How to Solve the Problem, With a Special Focus on Agriculture*. 2010 BE Berlin Economics.

¹⁵ See Policy Paper T36, *VAT replacement or better administration?* German Advisory Group and Institute for Economic Research and Policy Consulting (IER), 2004.

Moreover, high share of shadow economy (estimate by the Ministry of Economic Development and Trade at over 34% of GDP) results in large lost fiscal revenues due to tax evasion.

All these problems raise issue to substitute VAT with another tax (e.g. sales tax or turnover tax), which is assessed to be inefficient and unjustified.¹⁶ Therefore, Ukrainian Government should improve VAT administration and timely refund VAT, which is due to improve business environment.

3.2 International obligations of Ukraine

According to the WTO obligations Ukraine is required to ensure equal treatment of domestic companies and importers in terms of taxation.

The signed Association Agreement with the EU¹⁷ envisages the obligation of Ukraine to harmonize tax legislation. The VAT regulation should mostly comply with the EU Directive #2006/112/EC. Within five years of provisional application of Association Agreement (i.e by 2020) VAT legislation should be harmonized with EU rules on special taxation schemes among other things. The Government should attempt to ensure timely and full VAT refunds.

One of the obligations taken by Ukrainian Government within cooperation with the IMF also relates to VAT. In particular, the IMF program signed in 2014 envisages reduction in tax exemptions. In particular, reform of agricultural taxation is to be conducted. The Program stipulates the intent of Ukrainian Government to bring preferential VAT treatment of this sector closer to the general VAT regime.¹⁸

¹⁶ O. Betliy, R. Giucci, R. Kirchner. *VAT in Ukraine: Would other indirect taxes perform better?* Policy Paper Series [PP/02/2013], IER/GAG.

¹⁷ Annex XXVIII, Chapter 4: Taxation of Title V: Economic and Sector Cooperation Indirect taxation, Association Agreement between the European Union and the European Atomic Energy Community and their Member States, of the one part, and Ukraine, of the other part OJ EU L 161, 29.5.2014, p. 1945 <http://eur-lex.europa.eu/legal-content/EN/AUTO/?uri=uriserv:OJ.L .2014.161.01.0003.01.ENG>

¹⁸ Ukraine: First Review Under the Stand-By Arrangement, Requests for Waivers of Nonobservance and Applicability of Performance Criteria, and a Request for Rephrasing of the Arrangement; staff Statement; Press Release; and Statement by the Executive Director for Ukraine. September 02, 2014. <http://www.imf.org/external/pubs/cat/longres.aspx?sk=41878.0>

4. TAXATION OF AGRICULTURE IN UKRAINE

While in the EU Member States state aid to agriculture is predominantly provided as a budget support in the framework of Common Agricultural Policy, in Ukraine state aid to agriculture is basically narrowed to VAT benefits and fixed agricultural tax. At the same time, direct fiscal support remains low, inefficient and unfair.¹⁹

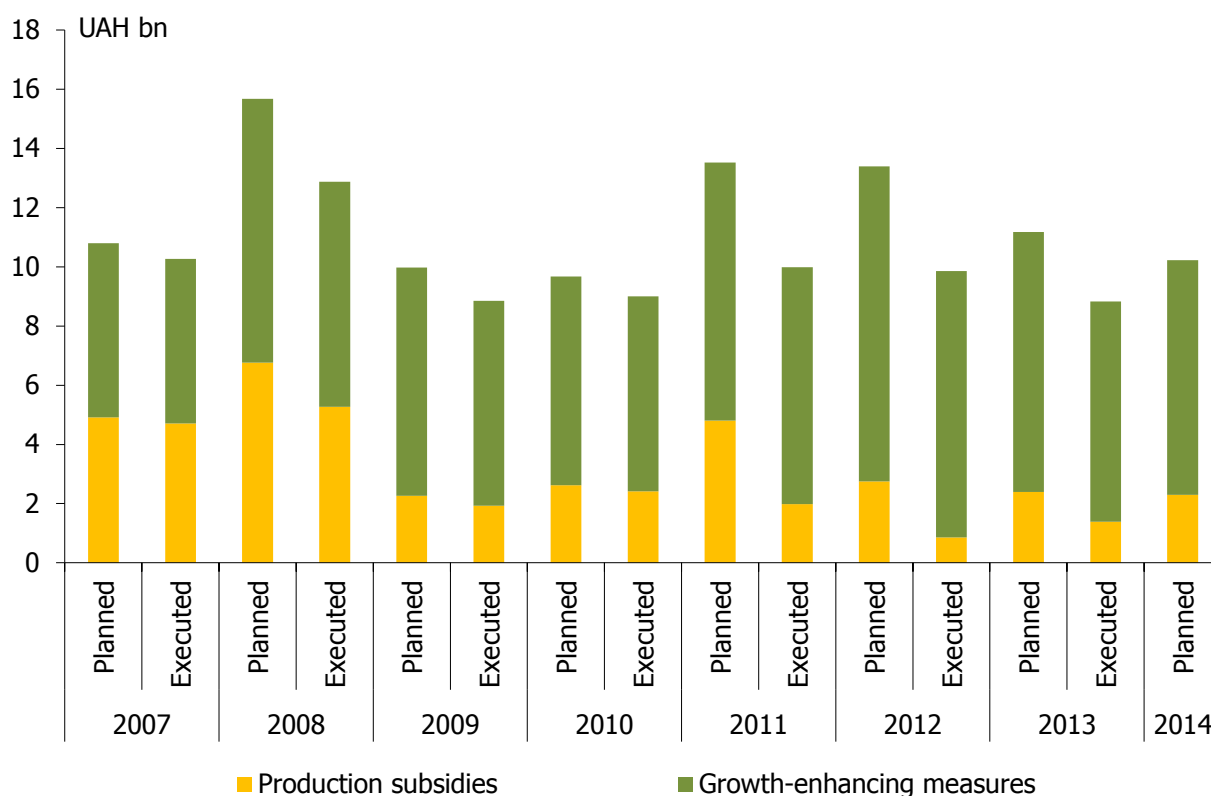
4.1 Support of agriculture

In Ukraine direct state aid to agriculture remains low as compared to the EU countries.²⁰ During recent years, though, there is a favourable trend of increasing share of growth-enhancing measures (green box measures), while financing of production subsidies (amber box measures) reduced. Among amber box measures, which are considered to be market distorting, more than half of fiscal expenditures are allocated for financial support (e.g. state subsidies to livestock and crop sectors), while the rest is mostly spent for support to horticulture, wine grapes and hops and food security. The largest shares of spending for growth-enhancing measures are allocated for administrative costs (near 40%) and education (30%). However, administrative costs do not always translate into efficient support of agriculture, while education related to agriculture should be reformed as agrarian companies often complain about the low qualification of graduates who do not required skills for work. Executed subsidies are traditionally lower than planned targets of fiscal support, which might indicate the lack of priority for agriculture development in policy agenda.

¹⁹ This is indicated in the results of inspections and audits of respective state programs by the Accounting Chamber of Ukraine as well as in statements made by the agribusiness.

²⁰ According to the OECD data state support of agricultural producers accounts for near 20% of agricultural production on average in OECD countries (as well as in EU-27) and remains below 10% in Ukraine.

Figure 3. Government expenditures in agricultural sector



Source: Ogarenko Y., *Government Spending in Agricultural Sector of Ukraine: High on Promise but Low on Delivery*, Agri-food Policy Review, Issue No.01/2014, German-Ukrainian Agricultural Policy Dialogue, http://apd-ukraine.de/images/APD_AFPR_01_2014_eng.pdf

Direct state support to agriculture remains low due to high fiscal pressure. Moreover, it is perceived to be rather unfair and inefficient. Such support was somewhat balanced by indirect state aid to the sector provided through special taxation schemes for agricultural companies:

- Fixed agricultural tax (FAT).²¹ It is important for agricultural producers as it exempts companies from paying enterprise profit tax (*see Appendix 5* for the description of FAT).²²
- Special VAT regime.²³

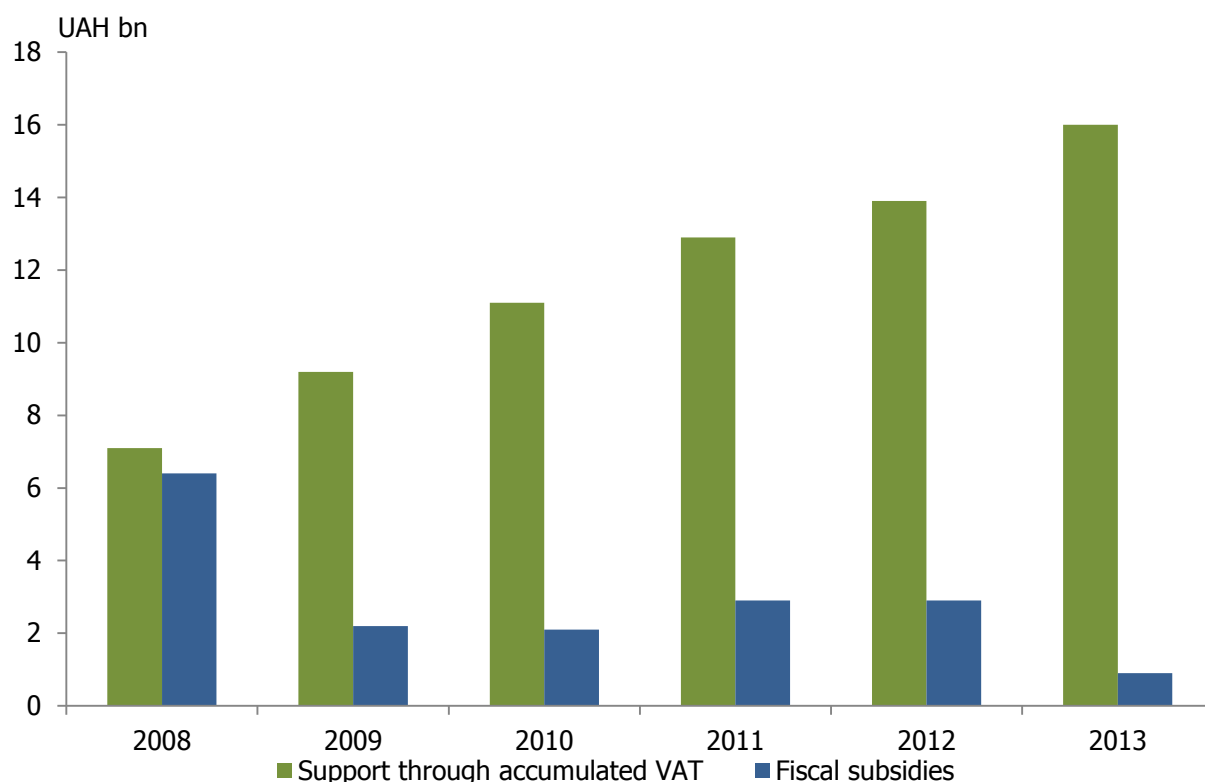
²¹ Chapter XIV, Section 2 of the Tax Code of Ukraine (No. 2755-VI, from December 2, 2010).

²² In this paper we do not assess the support of agriculture through FAT. Thus, FAT reform remains out of scope of this paper.

²³ Article 209 (Chapter V) of the Tax Code of Ukraine, (No. 2755-VI, from December 2, 2010)

In nominal terms, the volume of these benefits grew from UAH 1.5 billion in 2001 up to over UAH 18 billion in 2012.²⁴ However, the share of tax benefits in the gross output decreased from 6% in 2001 to 3% in 2012 due to changes in the application of these taxes²⁵ as well as growth of agricultural production.

Figure 4. State aid to agriculture



Source: Ukrainian Agrarian Confederation

According to the Ministry of Agrarian Policy and Food indirect state support to the agriculture in the form of special tax system accounts for near 90% of total state aid to the agricultural producers. Between 2008 and 2013 total amount of indirect support through special VAT regime reached near UAH 70 bn, which are *de facto* forgone fiscal

²⁴ Productivity and Efficiency of Ukrainian Agricultural Enterprises (Alfons Balmann, Jarmila Curtiss, Taras Gagalyuk, Vlodymyr Lapa, Anna Bondarenko, Karin Kataria, Franziska Schaft), Agriculture Policy Report APD/APR/06/2013, Kyiv, December 2013

²⁵ Substantial reduction of benefits from the FAT occurred between 2005 and 2010, when exemption from compulsory pension insurance contribution was gradually taken from the list of taxes and duties replaced by FAT. As a result, since 2010 agricultural companies starting paying regular payroll tax as any other business. While it is a correct step from point of view of social security system, it increased tax burden related to labour costs of agricultural companies.

revenues.²⁶ At the same time, efficiency of such support is arguable (see assessment below). As a result, the consecutive governments attempt to change the system especially at time of high fiscal pressure and need for fiscal consolidation.

According to the WTO obligations Ukraine is required to limit production subsidies (amber box measures) in agriculture to aggregate measures of support (AMS) at UAH 3043.4 m. Currently, the financing of these measures is below the threshold. The support of agricultural companies through special VAT regime for agricultural producers²⁷ is not included into the amount of state support reported to the WTO according to the *de minimis* criteria.²⁸

4.2 Special VAT regime for agricultural producers

The Article 209 of the Tax Code stipulates that agricultural producers²⁹ may choose special system of taxation by VAT. According to this system VAT receivable by producers is accumulated by companies at special account for the refund of VAT payable, while the difference is to be used for other production purposes.³⁰ The regular rate of 20% is applied for agricultural products (with an exemptions for some operations, see *Section 4.3*).³¹

The special system of taxation by VAT can be used by agricultural produces provided that:

- Main activity of an enterprise is the supply of own agricultural output (goods or/and services) produced at its own or leased production facilities, including tolling schemes;
- The share of agricultural output (goods and/or services) makes up at least 75% of the total value of all goods and/ or services produced and/or provided during 12 preceding consecutive reporting periods in aggregate.

²⁶ Actual amount of benefits due to special VAT regime was lower as part of the accrued VAT for agricultural producers is directed to refund VAT payable.

²⁷ Special VAT regime of agriculture is considered as a non-product-specific AMS.

²⁸ According to the *de minimis* support criteria support measures are not included in the AMS set by the WTO if they account for less than 5% of value of agricultural production.

²⁹ Agricultural producers include enterprise operating in the fields of agriculture, forestry or fisheries.

³⁰ Agricultural companies enjoy the possibility to keep VAT since 1999.

³¹ Between 1999 and 2008 VAT privileges for milk and meat producers in the form of zero tax rate was applied.

According to the Tax Code this system of taxation is to be in force until 2018. However, the discussion on its elimination or introduction of reduced tax rates are currently ongoing (see *Chapter 5*). The pressure for the change in the system is explained by the increasing gap between VAT inflow to the budget and VAT outflow to agricultural companies, which is especially a concern in the years of good performance of agriculture due to pro-cyclical nature of this state support. As a result, the better performance of the sector in terms of output and exports leads to higher forgone fiscal revenues due to increase in state support of the sector.

However, outcome of this support is rather arguable as it does not necessarily lead to higher investments, which was an initial aim of such special VAT treatment. On the opposite, incentives to invest decline as agricultural producers cannot deduct VAT payables from their tax bills and receive VAT refund on negative net VAT liabilities.³² Moreover, as any privilege the special VAT regime also results in fraudulent behavior of some large companies, which are not typical agricultural companies (e.g. have large processing capacities).

In 2010 agriculture was among the sectors that suffered the most from VAT refund arrears. However, processor and traders rolled over higher risks due to non-refundable VAT to producers by paying lower prices. As a result, farm-gate prices for grains were likely by 15%-20% lower than they would be with timely and full VAT refunds.³³ Lower prices led to losses of agricultural producers, which were about the same as state support provided through special VAT treatment.

Due to its importance, the problem with VAT refunds arrears in the sector obtained a special focus of officials taking into account special VAT regime of agrarian companies. As a result, VAT refund rules for grain, which is the major agricultural commodity in exports, have changed for several times during recent years (see *Section 4.3*).

³² Overall increase in investments into agriculture over last years is not likely attributed to special VAT regime for agricultural producers. It was partially attributed to VAT introduction. Moreover, investment increase is more likely attributed to need for modernisation of the agricultural companies after years of under-investments to ensure higher competitiveness of companies.

³³ See: *VAT Refund Arrears in Ukraine. Analysis and Recommendations on How to Solve the Problem, With a Special Focus on Agriculture*. 2010 BE Berlin Economics.

4.3 Special VAT system for supply of grain and technical crops

VAT rates on operations with grain were changed for several times during recent years. In particular, from July 2011 the following transactions were exempt from VAT:

- supplies of grain crops relating to commodity items 1001-1008 (except for commodity item 1006 and commodity sub-item 1008 10 00 00);
- supplies of technical crops relating to commodity items 1205 and 1206, except for the first supply performed by agricultural producers;
- supply of wood relating to commodity items 4401, 4403, 4404.

Exports of such products became also exempt from VAT. As a result, VAT at exports of grain was not reimbursed, which led to decrease of purchase prices at over UAH 9 bn in total.³⁴ The VAT exemption of exports was explained by an attempt of the Government to tackle the issue of high VAT refunds arrears on grain exports at high grain prices at world market against the background of high fiscal pressure.

Only in the beginning of 2014, these exemptions were partially revised. In particular, exception was made for supply of grain by agricultural producers that export grain, which they produce on own land, as well as companies that directly purchased grain from such producers. Zero-rate VAT on exports, and, thus, VAT refunds was allowed only for agricultural companies that harvest grain on own land. This provision did not relate to many firms as most agricultural holdings rent the land. The respective regulation was partially revised since August 2014, when its enforcement was broadened to producers that use rented land.

However, this regulation creates more favourable treatment for agricultural producers and eliminates excessive intermediaries from grain market. On the other hand, not all producers have capacities to enter external markets without known grain traders.³⁵ As a result, they will be further punished by lower prices paid by grain traders who do not receive VAT refunds.

According to current legislation the respective provisions for VAT for supply of grain and technical crops is to be effective till the end of 2014. They are likely to remain effective

³⁴ Productivity and Efficiency of Ukrainian Agricultural Enterprises (Alfons Balmann, Jarmila Curtiss, Taras Gagalyuk, Vlodymyr Lapa, Anna Bondarenko, Karin Kataria, Franziska Schaft), Agriculture Policy Report APD/APR/06/2013, Kyiv, December 2013

³⁵ 25% of agricultural companies export their produce themselves. The rest is exported by traders.

in 2015 as respective draft amendments to the Tax Code were already submitted to the Verkhovna Rada.

Overall, exemptions of exports of grain and technical crops from VAT is typically explained by lack of financing of VAT refunds for exporters, special VAT regime for agricultural producers as well as fraudulent behavior of exporters. None of these explanations could be judged as an adequate justification for the exemption as these issues could be treated otherwise through improvement of tax administration and fiscal consolidation.

4.4 Special VAT system for meat and dairy producers

In 1998 the special VAT system for meat-packing and dairy producers was established. Its aim was to ensure timely subsidy payments to livestock companies. According to the respective provision the special VAT system meat-packing and dairy producers transferred due VAT to the special (non-budgetary) accounts and this accrued VAT was used for subsidies to agricultural producers that sold raw milk and meat (in live weight). Only immediate producer of meat and milk could receive a respective subsidy, which was to be used for the development of livestock production. However, control over use of these subsidies is not really in place.

In 2010 and 2011 meat-packing and dairy producers paid VAT to the special fund of the Central budget. Then milk and meat producers shall receive the VAT from the budget - and not directly for processing firms as before - in the form of "per cattle head" subsidies (from April 2011 – on per kilo of milk basis).

Since 2012 the system was partially changed for meat-packing and dairy producers as they had to pay VAT to special fund of Central budget and special account (share of VAT to be directed to special fund of the Central budget was set at 20% in 2012, 40% in 2013 and 50% in 2014). VAT transferred to special fund of the budget are earmarked for financing measures in the framework of state program of livestock support. As previously VAT accrued on special non-budgetary accounts of meat-packing and dairy producers is to be directed to subsidies to livestock companies. Such changes were explained by the necessity to ensure financing of subsidies to livestock companies at times of high fiscal pressure. Since 2015 VAT of meat-packing and dairy producers is again to be fully paid to the special fund of Central budget.

4.5 Summing up

State support to agricultural producers is mainly based on the indirect support in the form of special tax treatment and tax exemption: FAT and special VAT regime. In particular, agricultural companies have a right to transfer VAT on a special account (instead of transferring this sum to the budget) and use accumulated sum as a tax credit and for financing other production purposes. This support system is explained by lack of financing for direct support as well as an assumption that agriculture cannot be fully taxed. Moreover, the Government does not ensure timely and full VAT refunds on exports, which puts additional pressure on agricultural producers in the form of lower farm-gate prices. However, the system is unfair and inefficient. At times of good performance of agriculture it creates significant fiscal pressure and makes entire support system of the sector unsustainable. Moreover, the system harms agricultural companies that make higher investments as they cannot receive refunds for negative VAT liabilities.³⁶

At the same time, current special VAT regime for agricultural companies has an advantage of simplified tax administration. According to the estimates of Ukrainian Agribusiness Club tax benefits to agricultural companies (both FAT and special VAT scheme) ensure near 50% of total profitability of agricultural companies.

The possible changes in the taxation treatment of agriculture might have inevitable results. In particular, according to the estimates of agribusiness associations the agricultural production might decline. However, high fiscal gap requires for additional fiscal consolidation measures, one of which is a decline in tax exemptions particularly for the agriculture. The solution of this trade-off is not simple, but should be found.

³⁶ Over years investments into agriculture increased partially due to the special taxation treatment (both FAT and special VAT regime). Other important reasons for growth of investments into the sector were likely increasing demand for agricultural products in domestic and external markets and favourable world conjuncture. Worn-out fixed assets urgently required investments into modernisation to compete at the market. Moreover, small initial statistical base should be taken into account while analysing investment trend.

5 INITIATIVES FOR CHANGES IN VAT FOR AGRICULTURE

5.1 Government intensions regarding special VAT regime in agriculture

Officials of the Ministry of Agrarian Policy and Food stipulate necessity to retain special tax treatment of agriculture as this is believed to be an efficient state aid, which helps the sector to develop. The Prime-Minister Arseniy Yatseniuk in the end of October also argued that special VAT regime is essential for the support of agricultural producers and, thus, it should be kept for 2015. However, he suggests substituting the system with direct fiscal transfers after 2015.

According to submitted by the Government in September 2014 draft law on Amendments to the Tax Code, the special VAT regime for agricultural companies is to be kept for 2015, while fixed agricultural tax will be transformed into a single tax (without much differences).

5.2 Views of business

Special VAT regime for agriculture (along with FAT) is perceived by business as the only system of state support of the sector in Ukraine due to the lack of sufficient direct state assistance. So, agricultural companies mainly suggest keeping special VAT scheme and FAT at least until 2018.³⁷ At the same time, they stress the importance of ensured automatic VAT refunds for agricultural exports.

One of the ideas, which was recently discussed and is supported by some grain traders, is to transform special VAT regime to introduce reverse method to accrue VAT. According to this idea the VAT will not be accrued until the processed agricultural products are sold to final consumers.³⁸ Even though this system would be favourable for exporters (as eliminates a problem with VAT refund arrears for them), it has doubtful benefits for agricultural producers, who will lose support through special VAT regime and do not receive VAT to cover VAT payable for inputs.

³⁷ http://www.ucab.ua/ua/pres_sluzhba/blog/lissitsa_aleks_mikolayovich/agrarniy_poryadok_denniy_dly_a_novoi_koalitsii_ta_uryadu_vid_asotsiatsii_ukrainskiy_klub_agrarnogo_biznesu/

³⁸ In this case VAT will rather perform as a sales tax with all drawbacks of the latter.

5.3 Possible changes of special VAT scheme for the discussion

Over years different ideas on changes in the taxation of agriculture were discussed. In particular, in April 2014 the Ministry of Finance put for the discussion several options for the future reform of VAT in agriculture:³⁹

- VAT of agricultural companies on regular basis with a taxation at 20% rate and refund of negative VAT liabilities;
- Amendments to the special VAT regime with 50% of due VAT is to be transferred to special fund of the Central budget and 50% will be further accumulated at special accounts of companies;
- Special VAT regime with reduced VAT rate for agricultural producers: 11% (9% for forestry and fishery);⁴⁰
- VAT on regular basis (with a rate of 20%) for large agrarian companies and special VAT regime for small and medium companies.

These changes were discussed in the framework of fiscal consolidation measures. All of these changes have *pros* and *cons*.

Table 1: Options of VAT reform

Option	Pros	Cons
Status quo	- known regulation	- contradicts the obligations taken according to the IMF Program - lack of incentives for investments - fraud
VAT of agricultural companies on regular basis with a taxation at 20% rate (with a refund of negative VAT liabilities)	- improved financial state of companies due to increase in farm-gate prices ¹ (under an assumption of full and timely VAT refunds) ² - complies with the IMF program - legislation will be closer the EU provisions - complies with a consensus that all sectors of economy should be treated equally to allow for optimal allocation of scarce capital ⁴ - increase in fiscal sustainability	- decline in state support of agricultural companies might reduce competitiveness of Ukrainian agribusiness (<i>if the direct state aid is not increased and made more efficient</i>) ³ - requires additional state administration as well as professional bookkeeping for small farmers, which would increase costs - possible higher pressure on the budget due to higher refunds
VAT on regular basis (with a rate of 20%) for large agrarian companies	- improved financial state of companies as agricultural producers	- possible higher pressure on the budget due to higher refunds

³⁹ The copy of the respective MinFin letter is available at <http://agroconf.org/content/agrosektor-listu-minfinu-pro-pdv-pilgi-prisvyachuietsya>

⁴⁰ Other rates were also discussed over recent years (e.g. 5% and 7% for all agricultural products).

Option	Pros	Cons
an companies (with a refund of negative VAT liabilities) and special VAT regime for small and medium companies	<p>will finally receive fair prices¹ (under an assumption of full and timely VAT refunds)²</p> <ul style="list-style-type: none"> -more fair treatment of companies that make higher incentives (under the assumption of timely and full refund of negative VAT liabilities) -no increase in administration costs for small and medium companies -possible increase in fiscal sustainability⁴ 	<ul style="list-style-type: none"> -possible fraud of large companies⁵
Special VAT regime with reduced VAT rate for agricultural producers at 11% ⁶	<ul style="list-style-type: none"> -lower VAT rate leads to lower incentives for fraud -more fair treatment of companies that make higher incentives (under the assumption of timely and full refund of negative VAT liabilities) -improved financial state of companies due to higher farm-gate prices under an assumption of full and timely VAT refunds 	<ul style="list-style-type: none"> -lower food prices under the assumption of full and timely refunds (however, it is not likely taking into rule that 'prices are sticky' as well as high current inflation rate) -likely lower state support of agriculture, which might reduce competitiveness of Ukrainian agribusiness -higher fiscal pressure as VAT payable will be with a rate 20%, while received VAT with a reduced rate. As a result, gap between VAT payable and VAT receivable might be negative. -requires professional bookkeepers for small farmers
Amendments to the special VAT regime with 50% of due VAT is to be transferred to special fund of the Central budget and 50% will be further accumulated at special accounts of companies	<ul style="list-style-type: none"> -improved financial position of companies under an assumption of full and timely VAT refunds -improved financial position of effective companies due to increase in direct fiscal support (under the assumption of state aid reform) 	<ul style="list-style-type: none"> -decline in state support of agricultural companies, which would reduce competitiveness of Ukrainian agribusiness (<i>if the direct state aid is not made more efficient</i>) -complex bookkeeping and reporting

Notes:

- ¹ Rough estimates indicate that grain producers alone in 2013 could have received additional revenues at UAH 7 bn hryvnia only due to increase in farm-gate prices by 10-15%.⁴¹
- ² According to estimates net tax liabilities of agricultural companies at the VAT rate of 20% might turn negative if company implements large investment projects. Therefore, possibility for companies to receive refunds of negative net VAT liabilities will create additional incentives for investments (which do not exist under special VAT regime).

⁴¹ According to some estimates this gap in revenues is higher (see: Alfons Balmann, Jarmila Curtiss, Taras Gagalyuk, Vlodymyr Lapa, Anna Bondarenko, Karin Kataria, Franziska Schaft), Agriculture Policy Report APD/APR/06/2013, Kyiv, December 2013)

- ³ Decline in state support to agriculture received due to accumulated VAT is estimated to be counterweighted by higher farm-gate prices. Moreover, actual state aid in the form of special VAT regime is lower than officially reported as companies also net out VAT payables from the amounts of accumulated VAT.
- ⁴ Fiscal revenues from agriculture will grow with increasing agricultural production and exports.
- ⁵ A possible drawback of this system might relate to the possible segmentation of large companies into smaller ones to enjoy special VAT regime. However, the risk is lower than it could be assumed as large companies require financing from banks in Ukraine and abroad as well as enter IPO, which requires them to show higher and better performance outcomes.
- ⁶ According to rough estimates under tax rate of 5% and 7% net tax liabilities of agricultural producers will be negative, which would require the Government to refund them.

Overall, regular VAT system for agricultural producers with an option for small companies to maintain special VAT regime⁴² is likely to be the first best solution. It is expected to result in better financial position of companies through higher farm-gate prices under the assumption of timely and full VAT refunds. This requires as a precondition a fair direct state support, which should favour development of effective agricultural companies. Moreover, such approach of taxing agricultural producers would have other positive spillovers. In particular, introduction of regular VAT rate is likely to result in higher tax revenues from agriculture (even under the assumption of full and timely VAT refunds). Second-round effects may include improved investment climate through stable and clear taxation rules and higher public investments in infrastructure.

5.4 Summing up

State support to agriculture in the form of special VAT regime is predominantly explained by the lack of financing for direct state support (which remains very low as compared to the EU) as well as lack of financing for VAT refunds. However, such arguments are not self-sustainable. The OECD research reveals that agriculture should be taxed as a regular business especially taking into account high share of agricultural exports as well as high share of expenditures on inputs in farms' costs.⁴³ Taking into ac-

⁴² Taking into account Ukraine's obligations in terms of application of the Association Agreement the Government should opt for making special VAT regime for small farmers closer to fixed-rate scheme.

⁴³ *Value-Added Taxes in Central and Eastern European Countries. A Comparative Survey and Evaluation*. p. 120, OECD, European Union. Publication Date: 09 Oct 1998.

count *pros* and *cons*, regular VAT system for agricultural producers with an option for small companies to maintain special VAT regime is likely to be the first best solution.

The change in the VAT system of agriculture requires complex measures and, thus, cannot be implemented ad hoc. In particular, the Government should ensure timely and full VAT refunds of negative VAT liabilities and on export operations. Besides, the corruption should be reduced in Ukraine.⁴⁴ Tax administration should be more transparent and unbiased. Direct state aid should also become more fair and effective and be earmarked to effective companies.

⁴⁴ Ukraine was ranked 144 out of 177 countries according to the Corruption Perception Index in 2013 (Corruption Perceptions Index measures the perceived levels of public sector corruption). Source: <http://www.transparency.org/cpi2013>

6 KEY POLICY RECOMMENDATIONS

Future agricultural growth in Ukraine is likely to be attributed to higher external demand, which requires more investments into the sector. Taking this into account VAT reform is required to ensure this growth.

As the OECD research reveals, countries with high agricultural exports should tax agriculture by VAT as a regular business. Our assessment also shows that the Government should consider introduction of VAT on regular basis for large agrarian companies with possible special VAT regime for small and medium companies⁴⁵. However, special VAT regime for small farmers should be harmonised with the European fixed-rate scheme for farmers.

Suggested VAT reform for agriculture would lead to higher investment incentives as companies will be eligible for refund of net VAT liabilities. Fiscal revenues from agriculture are expected to increase, which may lead to lower fiscal pressure and higher fiscal capital outlays into infrastructure. At the same time, the Government should ensure timely and full refunds of negative VAT liabilities and VAT on exports. As a result, farm-gate prices received by large companies are expected to increase, thus, financial position of companies will improve. Generally, the Government should ensure that these reforms do not harm further sustainable development of agriculture.

To ensure expected positive outcomes of VAT reform for agriculture the Government should first implement other more broad macroeconomic measures.

Fiscal consolidation measures should be finalised. Only sustainable and sound fiscal situation will allow the Government to refund fully and timely negative VAT liabilities of agricultural producers as well as VAT on exports. As a result, investment attractiveness of the sector will increase.

Moreover, the public governance should be improved. To become more attractive for investments agriculture as well as all other sectors requires *transparent, stable and predictable taxation rules*. Tax compliance should be strengthened to minimize fraud in the system. As corruption puts additional costs for agricultural producers and exporters, there is a need for *effective anticorruption measures*.

⁴⁵ Small and medium farmers should have an option to work either on special or regular VAT system.

*The system of state support of agriculture should be changed.*⁴⁶ In particular, the state aid should be reformed to ensure equal access to state support programs for agricultural companies. The list of clear requirements for agricultural companies to receive a state aid should be approved. Publicity and transparency of state aid provision should be ensured. Overall, such changes would result in harmonisation of Ukrainian legislation with the EU standards, which is a required step according to the Association Agreement.

Overall macroeconomic stability and financial sector reform will also favour agricultural development. They will ensure that the companies in the sector will enjoy *lower interest on bank lending*, which is essential to finance investments.

⁴⁶ For recommendations to the general system of state aid provision in Ukraine see: Betliy O., Kravchuk V., *Reforming state aid in Ukraine*, Policy paper, No.2, March, 2012, IER.

APPENDICES

Appendix 1. European Union VAT Rates (2014)

Country	Standards VAT rate	Reduced rates
Austria	20%	10% foodstuffs, books, pharmaceuticals, passenger transport, newspapers, admission to cultural and amusement events, hotels
Belgium	21%	12% restaurants 6% foodstuffs, books, water, pharmaceuticals, medical, books, newspapers, cultural and entertainment events, hotels
Bulgaria	20%	9% hotels
Croatia	25%	13% hotels and newspapers
Cyprus	19%	9% hotels, restaurants 5% foodstuffs, books, pharmaceuticals, medical, passenger transport, newspapers, admission to cultural entertainment and sporting events
Czech Republic	21%	15% foodstuffs, books, medical, pharmaceutical, passenger transport, newspapers, admission to cultural sporting and entertainment events, hotels
Denmark	25%	none
Estonia	20%	9% books, pharmaceuticals, medical, hotels
Finland	24%	14% foodstuffs, restaurants Reduced VAT rates: 10% books, pharmaceuticals, passenger transport, newspapers, admission to cultural sporting and entertainment events, hotels
France	20%	10% pharmaceuticals, passenger transport, admission to cultural sporting and entertainment events, hotels, accommodation, restaurants 5.5% medical, foodstuffs, ebooks, books 2.1% newspapers, pharmaceuticals
Germany	19%	7% foodstuffs, books, medical, passenger transport, newspapers, admission to cultural and entertainment events, hotels Two special rates under the farmer's flat rate scheme. A rate of 5.5 percent is applicable to supplies of forestry products which are not the products of

Country	Standards VAT rate	Reduced rates
Greece	23%	<p>saw mills (such as untrimmed timber). A rate of 10.7 percent is applicable to supplies of typical agricultural goods and services, as well as to specific supplies by sawmills.</p> <p>13% foodstuffs, pharmaceuticals, medical, admission to cultural sporting and entertainment events</p>
Hungary	27%	<p>Reduced VAT rates: 6.5% (Jan 2011) books, newspapers, hotels</p> <p>18% foodstuffs, hotels</p> <p>5% books, pharmaceuticals, medical</p> <p>Since July 2012 for a temporary 2-year period there were effective provisions the VAT reverse charge to the agricultural sector. In particular, the sale and purchase of certain agricultural products – corn, wheat, barley, rye, oats, sunflower seeds, rapeseed, triticale and soya-beans - were subject to VAT reverse charges. A special reporting liability arose in addition to the regular VAT return with respect to such transactions, including the date of the supply, the amount sold/purchased (kg) and the tax base, per supplier/customer and customs tariff code of the goods sold. In relation to certain products – for example, corn or sunflower seeds available in shops as well – attention was needed when checking whether the liability also concerned traders or entities other than the usual participants within the agricultural sector - based on the classifications according to the customs tariff code.</p>
Ireland	23%	<p>13.5% medical</p> <p>9% newspapers, admission to cultural sporting and entertainment events, hotels, restaurants</p> <p>4.8% foodstuffs</p> <p>nil% books, medical products, children's clothing</p> <p>Flat rate farmer's addition/levy available and this was reduced</p>

Country	Standards VAT rate	Reduced rates
Italy	22%	from 5.2% to 4.8% with effect from 1 January 2013 10% pharmaceuticals, passenger transport, admission to cultural and entertainment events, hotels, restaurants
Latvia	21%	4% foodstuffs, medical, books 12% (Jan 2011) books, pharmaceuticals, medical, newspapers, hotels
Lithuania	21%	9% books
Luxembourg	15%	5% pharmaceuticals, medical 6% bikes, domestic services 3% foodstuffs, books, pharmaceuticals, medical, passenger transport, newspapers, admission to cultural, sporting and entertainment events, hotels, restaurants
Malta	18%	7% hotels 5% books, medical, newspapers, admission to cultural events
Netherlands	21%	0% foodstuffs, pharmaceuticals 6% foodstuffs, books, pharmaceuticals, medical, passenger transport, admission to cultural and amusement events, hotels, accommodation, agricultural product/services
Poland	23%	8% pharmaceuticals, medical, passenger transport, newspapers, hotels, restaurants, admission to cultural sporting and entertainment events, certain agricultural related services
Portugal	23%	5% foodstuffs 13% foodstuffs, agricultural supplies 6% foodstuffs, books, pharmaceutical, medical, newspapers, hotels, passenger transport
Romania	24%	9% books, pharmaceuticals, medical, newspapers, admission to cultural and entertainment events, hotels Reduced VAT rates: 5% social housing
Slovakia	20%	10% books, foodstuffs, medical, pharmaceuticals, entrance to cultural and entertainment events
Slovenia	22%	9.5% foodstuffs, books, pharma-

Country	Standards VAT rate	Reduced rates
Spain	21%	<p>ceuticals, medical, newspapers, admission to sporting cultural and entertainment events, hotels, services for agricultural, forestry, and fishing use</p> <p>10% medical, pharmaceuticals, transport of passengers, admission to cultural sporting and entertainment events</p>
Sweden	25%	<p>4% foodstuffs, newspapers</p> <p>12% foodstuffs</p> <p>6% books</p>
United Kingdom (UK)	20%	<p>5% property renovations</p> <p>0% foodstuffs, books, pharmaceuticals, medical, passenger transport, newspapers, children's clothing</p> <p>The Agricultural Flat Rate Scheme allows small-scale farmers to charge a fixed levy of 4% on certain services to VAT registered customers.</p>

Source: <http://www.vatlive.com/vat-rates/european-vat-rates/eu-vat-rates/>,
<http://www.kpmg.com/global/en/issuesandinsights/articlespublications/vat-gst-essentials/Pages/default.aspx>

Appendix 2. Agricultural production activities for VAT purposes

2.1. Agricultural produce

According to the Article 295 and Annex VII of Council Directive No. 2006/112/EC of 28 November 2006 list of *agricultural production* activities includes:

- Crop Production
 - General agriculture, including viticulture.
 - Growing of fruit (including olives) and of vegetables, flowers and ornamental plants, both in the open and under glass.
 - Production of mushrooms, spices, seeds and propagating materials; nurseries.
- Stock Farming together with Cultivation
 - General stock farming
 - Poultry farming
 - Rabbit farming
 - Beekeeping
 - Silkworm farming
 - Snail farming
- Forestry
- Fisheries
 - Fresh-water fishing
 - Fish farming
 - Breeding of mussels, oysters and other molluscs and crustaceans
 - Frog farming

Where a farmer, processes, using means normally employed in an agricultural, forestry or fisheries undertaking, products deriving essentially from his agricultural production, such processing shall also be regarded as agricultural production.

2.2. Agricultural services

According to the Article 295 and Annex VIII of Council Directive No. 2006/112/EC of 28 November 2006 supplies of *agricultural services* which normally play a part in agricul-

tural production shall be considered the supply of agricultural services, and include the following in particular:

- field work, reaping and mowing, threshing, baling, collecting, harvesting, sowing and planting.
- packing and preparation for market, for example drying, cleaning, grinding, disinfecting and ensilage of agricultural products.
- storage of agricultural products.
- stock minding, rearing and fattening.
- hiring out, for agricultural purposes, of equipment normally used in agricultural, forestry or fisheries undertakings.
- technical assistance.
- destruction of weeds and pests, dusting and spraying crops and land.
- operation of irrigation and drainage equipment.
- lopping, tree felling and other forestry services.

Appendix 3. Application of reduced VAT rates to foodstuff and agricultural inputs

Category	BE	BG	CZ	DK	DE	EE	EL	ES	FR	HR	IE	IT	CY	LV	LT	LU	HU	MT	NL	AT	PL	PT	RO	SI	SK	FI	SE	UK
Foodstuffs	6	20	15	25	7	20	13	4	5,5	5 ¹	0	4	5 ¹	21	21	3	18 ² 27	0 ³	6	10	5	6	9	9,5	20	14	12	0
	12				19			10	10	13 ⁴	4.5	10	19	12 ⁵							8	13				25	20	
	21								20	25	13,5	23									23	23						
Agricultural inputs	6	20	15	25	7	20	13	10	10	25	13,5	4	5	21	21	3	27	18	6	10	5	6	24	9,5	20	24	25	20
	12		21						20			10	19			15					8	13				14		
	21											22									23	23						
<i>Pesticides and plant protection materials</i>	12 ⁶	20	21	25	19	20	13	10	10	25	23	22	5	21	21	15	27	18	21	20	8	6	24	9,5	20	24	25	20
	21								20																			
<i>Fertilisers</i>	12 ⁶	20	21	25	19 ⁷	20	13	10	10	25	0 ⁸	4 ⁹	5	21	21	3 ¹⁰	27	18	21	10 ¹¹	8	6	24	9,5	20	24	25	20
	21								20		23										20							

Source: VAT Rates Applied in the Member States of the European Union. Situation at 1st July 2014, taxud.c.1(2014)2276174 – EN

Notes:

- ¹ HR: 5% applies to: all types of bread and milk (pasteurized, homogenized and condensed milk excluding chocolate milk and milk products) and substitute for mother's milk
- ² HU: As of 1 July 2009 a reduced rate of 18% applies to: milk and milk products (excluding mother's milk); Dairy products; Flavoured milk; and products containing cereals, flour, starch, or milk.
- ³ MT: Some confectionery is at 5%
- ⁴ HR: 13 % VAT rate is applicable to the edible animal or vegetable fats and oils, to the white, crystal sugar made of sugar beet and sugar cane, and to food for infants and processed cereal-based food for infants and young children
- ⁵ LV: Products for infants
- ⁶ BE: Reduced rate of 12% only on phytopharmaceutical products recognised by the Ministry of Agriculture
- ⁷ DE: Reduced rate of 7% on biological (not chemical) fertilizers
- ⁸ IE: 0% on supplies of certain fertilisers in units of not less than 10 kg
- ⁹ IT: Reduced rate of 4% on organisms used in organic agriculture
- ¹⁰ LU: Reduced rate of 15% on phytopharmaceutical products under the TARIC code 38.08, whereas super reduced rate of 3% to fertilisers under the TARIC codes 31.01 to 31.05
- ¹¹ AT: Reduced rate of 10% applies to animal or vegetable fertilisers (except guano), whether or not mixed together (but not chemically treated)

Appendix 4: VAT arrangements in agriculture (as of 2005)

Country and tax (VAT unless indicated otherwise)	Special schemes and treatments	Special rates under the normal scheme	Notes
Austria		Special arrangements for agriculture and forestry; rate 10%, or 12% for transaction business to business	Regarded as a hidden subsidy in some official documents
Belgium	Farmers do not have to keep VAT accounts and receive a lump sum as compensation. Normal system applies to company farms		Purchasers of agricultural products pay VAT but are reimbursed by the state.
Canada – Federal Goods and Services Tax and most Provinces		Major inputs purchased exclusively by farmers zero rated. Special sales tax treatment in some Provinces	
Denmark			No special VAT treatment mentioned
Finland		Reduced rate of VAT applied to food (17% in contrast to the general 22%)	
France	Two special separate schemes applied to agriculture, split by sales volume: (i) RFA (<i>remboursement forfaitaire</i>) – farmers pay VAT on inputs, but do not charged on outputs, fixed reimbursement from state related to sales (ii) RSA (<i>régime simplifié agricole</i>) – in effect a normal VAT system	RSA is in effect a normal VAT system	(i) RFA is not necessarily beneficial to all individuals, but official estimates give a positive net benefit to the sector (€58m in 2000)
Germany	Farmers eligible for the 'flat rate' system; some 90% are part of the 'simplified system'		The subsidy element of the simplified rules are thought to be quite low.
Ireland	Farmers below a certain size threshold may operate on a flat-rate basis. They are entitled to charge and retain 4.3% when selling.	Many agricultural outputs are zero rated	Flat-rate system is thought to result in some over-compensation
Italy	Special schemes for small traders and farmers		

Country and tax (VAT unless indicated otherwise)	Special schemes and treatments	Special rates under the normal scheme	Notes
Korea		Some reductions or exemptions	Main purpose is to not discourage agricultural production
Netherlands	The 'agricultural arrangement'; farmers may not charge VAT or deduct payments. Exemption. Purchasers from these farmers receive a fixed-rate deduction of 5.1%	Most agricultural products are charged at a concessionary rate (6% c.f. the normal 19%)	Full VAT registration is an option
New Zealand (Goods and Services Tax)			Agriculture treated as other industries.
Norway	Persons registered in agriculture, forestry and fisheries given longer to return VAT	Reduced rate applied to food (12% c.f. 24%).	
Slovak Republic		VAT applies to food at the standard rate (19%)	No special treatment of agriculture reported.
Spain	Special system for farmers – output taxed at 7% but they pay the standard rates	Reduced rates (7% c.f. 16%) applied inter alia to food and some inputs used in agriculture	It may be profitable to switch to the general VAT system before making investments
Sweden		Reduced rate applied to food (12% c.f. 25%)	
United Kingdom	A simplified system is offered to all businesses above the threshold for compulsory registration as an alternative to VAT accounting. Farmers may charge and keep a 4% addition.	Zero rate of VAT applied to almost all agricultural output	The 4% retained charge is assumed to compensate for losing the ability to reclaim input VAT on purchases. Limits apply.
United States – Sales Taxes and Use Taxes		Some goods and services used in agricultural production are not subject to sales tax.	

Source: Taxation and Social Security in Agriculture, OECD, Publication Date: 16 Nov 2005

Appendix 5: Fixed Agricultural Tax

Fixed Agricultural Tax (FAT) is a tax, which is estimated and collected in relation to a unit of land area as a percent of normative monetary value of land.⁴⁷ FAT replaces the following taxes, levies and contributions:

- tax on profit of enterprises, including advance payment at disbursement of dividends;
- land tax (for land used for agricultural production);
- contribution for special use of water resources;
- contribution for undertaking of some types of entrepreneurial activities (several trade activities).

All other taxes, duties, levies and contributions are paid on the usual terms and grounds including a single social contribution for social insurance.

FAT eligibility is subject to the following prerequisites:

- taxpayer is involved in production of agricultural products and/or breeding and catching of fish in lakes, ponds and artificial water reservoirs, processing of the said products with use of own or leased facilities and equipment, including tolling schemes;
- it uses agricultural lands (own or leased);
- a share of agricultural production in the previous year equals or exceeds 75%. This share comprises the income from agricultural production, processing and realization and relates to the overall income.

The following enterprises are not eligible for FAT:

- enterprises that earned over 50% of their income from selling ornamental plants, wild animals and birds, fur (with some exemptions);
- enterprises that produce and/or sell items subject to excise tax (except for sale of grape wine-making materials by enterprises of initial wine-making);
- enterprises that have tax debt as of January 1 of the reporting year, except for uncollectible debts as result of force majeure.

⁴⁷ The description of the FAT for this Appendix is taken from: *Doing Agribusiness in Ukraine 2013*. Ukrainian Agribusiness Club. It is based on the Section 2 of Chapter XIV of the Tax Code of Ukraine (No. 2755-VI, from December 2, 2010).

The following types of agricultural land owned by an agricultural producer are subject to FAT:

- Arable land;
- Hay-fields;
- Pastures;
- Perennial plantations;
- Land of water fund (internal water basins, lakes, ponds, water storage reservoirs).

The basis for calculation of FAT is the normative monetary value of one hectare of agricultural grounds as determined by July 1, 1995.