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Improving the tax regulation of agricultural activities

Introduction. Taxation is an important instrument of state regulation since it determines the competitiveness of domestic products on world markets. Any functioning tax system should strike a compromise between state and private sector interests including those relating to agriculture (Serova, Hramov, Maslennykova, 2001; Varnaliy, 2008; Efimenko, 2011.

Throughout the period of agricultural reforms the newly independent Ukrainian government tried to create a mechanism for the creation of a fair agricultural commodity tax, which would take into account most features of agricultural production (Demyanenko and Zorya, 2002; Demyanchuk and Seperovich, 2005). Since the late 1990's the mechanism of taxation in agriculture focused on the implementation of a specific task – to stimulate the development of agriculture by creating a favourable tax environment, hereby creating a specific source of financial resources (by non-collection of agribusiness tax burdens) (Kobuta, 2008).

Among the scientific works on the problems of the system of direct taxation of agriculture should be allocated the works (Demyanenko, 2008; Kotlyarov, 2007; Pantsov, 2008; Zayats, 2007). However, new conditions and new prospects of economic development within the agricultural sector of Ukraine in international integration requires strengthening scientific research in areas of study to further the development of a tax policy for agriculture and the creation of new tools for assessment of agricultural producers (Ostashko, 2007).

The current practice of taxation in this sector of the economy bares a special relationship between state and private sector, poorly corresponding with the existing system of taxation (Veen, 2007). This system has special tax instruments, special tax regimes that simplify tax procedures and stimulate the development of economic activity in the agricultural sector to ensure food security (Zorya, 2006).

This article aims to provide a scientific assessment of the current state and justification of future directions of improvement in the assessment tools in agriculture, which provides a balance in the interests of all participants in economic processes in this important sector of the national economy.

Exposition of research results. Specifically, financial relations in agriculture require an adequate reflection of the formation mechanism of tax (The conception, 2007). First of all we must provide a framework for the components (tools) of compulsory state payments in relation to agricultural enterprises.

In summary, it is represented by four groups of charges all different in nature:

Direct taxes – income (profits), assets (assets), land, vehicles, and often these taxes can be combined within an integrated agricultural tax;

Indirect taxes, which are represented primarily in the form of universal excise value-added tax (VAT), with possible special treatment in the charging of different categories of producers;

Social taxes (contributions), which are characterised by an insurance nature, therefore they are considered as compensation for labour to provide social benefits in the case of social problems (old age, sickness, unemployment, etc.);

Resource payments – water, mineral resources, exploration, environmental pollution and use of natural resources.

In this study we consider only the first group of compulsory payments - direct taxes, which are a key component of the system of taxation of agricultural producers.

The question of how to reform the tax mechanism in agriculture is predominant now in Ukraine. That mechanism should provide not only the optimal size of any tax burden, but should be responsible for the structure of charges and applicable tax instruments in response to any current level of economic development in Ukraine in general and agriculture in particular. Thus it should be based on universally accepted principles of taxation and qualifications required by the World Trade Organization (Seperovich, 2009).

The current mechanism of agricultural taxation is directed only to encourage the development of agricultural production and the formation of specific sources of additional finances through enterprise taxes. Optimal distribution of the tax and the alignment of economic conditions today in taxation is not considered.

However, in light of modern integration processes in the reform of the domestic tax system it should be based on the fact that one of the basic principles of the WTO is no tax discrimination. It provides for a national tax regime, in which imported goods must have the same tax conditions as domestic products. Specifically, Article III of GATT "national treatment on internal taxation and regulation" states that imported goods should not be subject, directly or indirectly, to internal taxes in excess of taxes applied to similiar domestic products (Appendixes to protocol, 2008).

Accordingly, the existing conflict necessitates bringing the current system of taxation of agricultural producers up to WTO requirements, removal of any tax discrimination against imported goods and the economic distortions that occur due to indirect financial support through the use of special tax arrangements.

Describing the structure of the financial support of agricultural production in recent years, it is worth highlighting the significant predominance of indirect support through special tax regimes and mechanisms of direct funding. This proved to be especially noticeable in the crisis of 2009, when the amount of financial support (funded through the use of special tax regimes) far exceeded agricultural development budgets (Juk, 2011).

Taxation methods for agriculture in Ukraine are directed only at stimulating the economic activity of agricultural businesses and the tax burden is kept to as minimum as possible. Non-collection of agribusiness tax creates a specific source of funding in considerable amounts.

Support for the development of agricultural production in Ukraine is provided by the special operation modes of direct and indirect taxation:

A special regime of direct taxation – the fixed agricultural tax (FAT), which provides a low direct tax burden on manufacturers – in 0,5-1,0% of average earnings;

Operation of special modes and mechanisms of charging VAT in agriculture (in Ukraine there are three special tax regimes charging VAT in agricultural production), which provide an additional source of financial resources (in recent years, VAT support is 4,5-5,0 % of gross agricultural product).

Direct taxation in agriculture represents property and income taxes, which, however, may be included in the comprehensive agricultural tax, which combines a number of compulsory payments (usually direct taxes, resource payments and certain types of fees) to facilitate the functioning of the tax mechanism in agriculture.

Thus the formation of tax instruments at the end of the 1990’s introduced a fixed agricultural tax (FAT). Since its introduction FAT constituted virtually the only form of relationship with the state agricultural commodity (excluding indirect taxes), but in 2005 the number of tax payments, which are part of the FAT, significantly reduced (from twelve to five). Consequently, the present tax regime has lost its original ideology.

The current practice of direct taxation does not meet the existing trends of agricultural business in Ukraine. FAT was considered to be the introduction of a supporting mechanism for agricultural producers in the early years of the reform of the agricultural sector. During its functioning there were significant changes in the agrarian economy - the process of concentration of capital intensified as new forms of business formed – predominantly agribusiness holdings, which do not have any social responsibility towards villages or the state preservation of agricultural land (mutual funds), as was the previous case of former collective farms.

With the initial implementation of FAT, tax rates were established to provide a level of tax burden comparable with that which existed in previous years. For this reason increasing coefficient was applied. In terms of inflation, when the amount of tax is constant over the past years, income from charging the tax is not enough to provide land protection at least at minimum level.

Tax rates, determined as a percentage of monetary value of agricultural land, were fixed as of 1st July 1995. Indexation of the tax base was not provided and as a result the amount of FAT on average in Ukraine is less than 6 hryvna on hectare (hr / ha). As a result, rates of FSN in 2005 were significantly lower than the rate of land tax paid on account which is now the operating mode of direct taxation.

In 2012, when only land tax was payable, the amount of tax liability of farms would be almost four times higher, which would provide more opportunities for land protection and some measures to improve the revenue base of local budgets.

Today, the tax burden of FAT on farms is negligible - based on the average of the results of growing grain in the last three years, gives the state farms a FAT of only 0,2-0,3% obtained from a hectare of proceeds from their sale, and the relevant amount payable per hectare amounts to FAT profit gained of 1,4-1,8%. It should be noted that the tax burden for industrial enterprises are at least several times higher (the minimum load is 1% of gross income).

Through the continuing validity of the FAT the state provides significant benefits to agricultural enterprises (in 2012 they were estimated at 3.5 billion USD). This affected local budgets that were losing significant revenue sources.

In addition, charging tax in the current form is separated from the economic activities of individual agricultural enterprises, who do not require agricultural land that is subject to FAT - for example companies that specialize in growing greenhouse plants (glasshouse complexes) and animal farms (primarily poultry factory).

Use of this mode for these farms is unacceptable because they have the opportunity first to independently regulate the level of taxation of their income by changing the value of agricultural land and secondly to regulate the level of their income to finance the development of local infrastructure. FAT was developed for plant growing enterprises and the application of its industrial-type agricultural enterprises (hothouse plants and poultry) is unacceptable because the result in unproductive budget losses.

Thus, an important aspect of improving the instruments of direct taxation is to establish objective criteria for limiting the application of special mode direct taxation based on the monetary value of agricultural entities in which such lands are not the main means of production.

An important part of compulsory payments of agricultural enterprises are state social taxes (more accurately - contributions to social funds). They are a specific part of obligatory payments of businesses and, having an insurance element, are considered as additional fees for labour to form the source of social benefits in case of social risks (primarily for payment of pensions to people who have reached retirement age).

Since the introduction of FAT, this group of obligatory payments went to warehouses, but in 2005 was excluded from it and was payable on general principles (excluding pension contributions). Pension contributions paid by enterprises in the agriculture of special order (at a special rate of compensation for loss of pension fund in the appropriate program budget).

In 2010 ended the grace period for agricultural enterprises of the collection of payments in Pension Fund. The use of such a preferential mechanism enabled the alignment of figure salaries in the field relative to the average level of economic activities and industrial sectors to a small extent. Thus, if the 2004 ratio of average wages for one agricultural staff member in 2004 was only 50% of the average for economic activity and in 2005 52 %, then in 2008 it would be almost 60% and in 2010 it would be more than 64%.

Calculations show that the load on the payroll of agricultural enterprises under current law from 1st January 2010, is too high. This will affect the profitability of the cultivation of agricultural products, reduce the competitiveness of domestic agricultural production and investment attractiveness of the industry.

It should be borne in mind that in the countries of former USSR the rate of pension contributions for agricultural producers is significantly lower than that for other business sectors of the economy. In particular, in Russia in accordance with Article 24 Tax Code standard single social tax rate is 26%, while for agricultural enterprises it is 20% ie only 77% of the overall rate. Thus, the Pension Fund in accordance with Federal Law dated 15th December 2001 №167 "On mandatory pension insurance in the Russian Federation" standard rate of pension contribution is 14%, while for agricultural producers - only 10%, which is 73% of the overall rate.

We consider it expedient to implement such practices in Ukraine – therefore the law must provide the level of pension contribution rates for agricultural enterprises at below 25% of facility charges (payroll), representing 75% of the standard rate. Agrarian scientists and representatives of public organizations of agricultural producers also agree on this this especially when we consider that this group of obligatory payments (social contributions) should occasionally touch on the issue of uniform tax forms in agriculture (such as proposed in the use of a single land (agricultural) tax).

In considering possible introduction of a land tax for farmers one should first note the following:

compulsory state payments of businesses is a very wide system, components of which differ significantly by methodological approaches to charging and it is therefore impossible to merge them into one comprehensive tax (in particular, it relates to the VAT and other indirect taxes, individual income tax);

Inclusion of contributions to social funds is not possible due to the pension reform of 2004, the need to personalise pension contributions, maintain a minimum premium for each employee.

In relation to enabling the pension fund of the common agricultural (land) taxes and social contributions of charging, based on land area, there are two key questions:

To ensure uniformity in taxation - particularly connect employees (contributions to social funds) with an area of farmland;

Providing personalization paid within a single tax retirement contribution amounts in terms of individual employees.

However, studies show that it is impossible to bind the size of tax payments (single tax rate) to the area of land because it leads to distortion of the tax burden on manufacturers.

The second position also has no solution, because the total amount of the single tax paid now cannot be "extracted" from the retirement contribution (share) of a particular employee. Accordingly, employees of the pension fund cannot calculate the proper amount of pension payable to employees of agricultural enterprises under a single land tax.

Thus, the introduction of a single agricultural tax and its inclusion of social contributions would violate the competitive environment, resulting in the emergence of inequality in taxation and problems with employee pensions both of which are unacceptable. It is impossible to combine all the required payments in one way and hence the term "only" as specified in current tax law does not meet all necessary criteria and only addresses forms of direct taxation and resource payments.

Concluding remarks. Thus, in order to solve the problem of instruments of direct taxation in relation to agricultural enterprises it is necessary to gradually solve the following problems:

Determining the number of channels and tools for extraction companies to budget revenues, the formation of effective tax mechanism, establishing a relationship between the applicable tax forms;

The task of filling the appropriate local budgets for adequate funding of social infrastructure, forming a stable source of funding land protection measures;

Appropriate level of differentiation in taxation, compliance with the criterion of vertical equity in taxation;

Refusal of continuous use of FAT or similar special regime taxation, providing a differentiated approach to the formation mechanisms of tax depending on the particular commodity category;

Formation of a new subsystem of direct taxation on the basis of land tax, which provides more efficient rent withdrawal of businesses to meet the financial needs of local communities.

In addition, one of the key tasks of the new taxation of agricultural producers is to ensure the validity of tax regulators of rational use of farmland. The State through fiscal levers should be able to adjust the economic turn of agricultural land.

Reforming agricultural tax charging mechanisms should prevent the improper use of lands and eliminate the negative effects of FAT, such as significant reduction of revenues, the proper termination of funding for the improvement of land and the loss of opportunities to influence the processes of agricultural land.

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