



## Presumptive Taxation of Agriculture: International Experience and Implications for Belarus

### Summary

Presumptive taxation is employed primarily when specific groups of taxpayers are hard to tax and administrative resources are scarce. This type of taxation is considered as optimal method of curbing widespread non-compliance without employing excessive government resources. At the same time, it provides taxpayers with a simplified option for tax compliance without requiring full financial transparency.

The three hard-to-tax sectors of the economy are conventionally taken to be small business, services, and agriculture. Agriculture is commonly rated the hardest of all hard-to-tax sectors. The result is that the government assesses or presumes the appropriate income on which taxes should be levied.

This paper focuses on the presumptive taxation of agriculture in Belarus. We show that the existing single agricultural tax doesn't meet the requirements of an efficient and equitable tax system. In our view, this tax should be abolished for large agricultural enterprises, which are capable of keeping accounts properly and should do so in their own best interests. Instead, the single agricultural tax should be obligatory for private farmers only. Furthermore, we propose to change the system of presumptive taxation for this type of entity from gross turnover taxation to land taxation.

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## 1. Introduction

There are many ways to tax individuals and enterprises. Taxes may be levied on consumption (e.g., value-added tax, excises), income (e.g., profit tax, personal income tax), or wealth and assets (e.g., land tax, real estate tax). In fact, the tax system in most countries is a combination of these different types of taxation. Developed countries tend to tax individuals and enterprises according to relatively complex structures, which utilize sophisticated accounting, record keeping, and tax administration in order to balance the various goals of taxation including efficiency and equity.

However, some individuals and enterprises remain outside of the tax system through use of different types of tax evasion or tax avoidance. In many cases, it is easier for them to remain outside of the tax net for the simple reason that they can remain inconspicuous to tax authorities. For these types of entities, complicated and administratively burdensome tax systems further discourage compliance with the tax laws.

These factors have led many countries to adopt specific tax regimes to counter these problems. Presumptive taxation has traditionally been used as a way to get some tax revenue from taxpayers who might otherwise go completely untaxed. These systems calculate the tax base via easy-to-obtain indicators or other methods, instead of relying on taxpayer self-assessment. This method of taxation can accomplish two things: it can reduce the cost of compliance by the taxpayer as its tax base is easier to calculate than that of the personal income tax or profit tax, and, once the system is determined, it reduces the costs of tax administration. Once part of the simplified system, it theoretically becomes more difficult to 'disappear' from the view of tax authorities by going to the shadow economy. Therefore, presumptive taxation is often regarded as a stepping-stone to the regular tax system, such that a taxpayer would be subject to this simplified regime for a limited period of time and then become part of the regular tax system.

The three hard-to-tax sectors of the economy are conventionally taken to be small business, services, and agriculture. Agriculture is commonly rated the hardest of all hard-to-tax sectors. The following factors contribute to its being hard to tax: (i) the common absence of standard accounting and record keeping, (ii) the practice of payments in cash or kind. Together, these factors contribute to an information vacuum in which self-declared incomes are very difficult to verify. As a result, governments that tax agricultural output have adopted presumptive taxation. This is also the case in Belarus where presumptive taxation of agriculture was introduced by the Decree of the President of July 13, 1999 No. 27 "On Introduction of the Single Agricultural Tax".<sup>1</sup>

The purpose of this paper is to evaluate the Belarusian system of presumptive taxation of agriculture and provide policy recommendations aimed at addressing some of the efficiency and equity deficits of the existing system. The structure of the paper is as follows. First, we consider the overall architecture of presumptive taxation. Second, we review the international experiences with presumptive taxation of agriculture and, in particular, the experiences of Ukraine and Russia. Then, we analyze the existing single agricultural tax in Belarus. The paper concludes with recommendations for the future taxation of agriculture in Belarus.

## 2. Overall Architecture of Presumptive Taxation

The appropriate role for presumptive taxation of agriculture depends on its place in the tax system. This section considers some relevant issues of how presumptive taxation can fit in with the rest of the tax system.

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<sup>1</sup> The same system of presumptive taxation of agriculture has been retained in a draft of the Special Part of the Tax Code (Chapter 26. The Special Regimes of Taxation. §5. The Single Agricultural Tax).

## 2.1. Taxpayers Eligible for Presumptive Taxation

Definitions of taxpayers that are eligible for presumptive taxation need to be carefully structured to avoid including taxpayers with higher incomes and those who are or should be capable of keeping accounts properly.

The dividing line that probably makes the most sense is turnover. Conceptually this is relatively simple, but there is a problem that many of the agricultural taxpayers we are concerned about do not keep reliable track of their turnover. Therefore, in addition to turnover, legislation can specify other criteria that define eligibility for presumptive taxation. One of these is the number of employees. Presumptive regimes designed for the very smallest taxpayers might even exclude taxpayers with employees altogether. Regimes that are designed for slightly larger taxpayers might limit the number of employees that a taxpayer can have. Another possible criterion for defining eligibility for presumptive taxation would be total net worth or ownership of high-value assets. In general, one could use criteria similar to those used in taxation on the basis of visible signs of wealth to exclude taxpayers from application of presumptive regimes. A net worth limit can also be set, although it might be difficult to enforce if taxpayers can hide their wealth.

Taxpayers can also be excluded from presumptive regimes on the basis of their ability to maintain records. In some countries, all corporations are required by commercial law to keep double-entry accounts. In such countries, corporations should presumably be excluded from presumptive regimes. If entrepreneurs are not prepared to keep double-entry accounts, they should not incorporate. Another class of taxpayers who can be expected to be able to keep proper accounts includes those who are registered as VAT taxpayers. For example, a taxpayer whose turnover is low might be voluntarily registered for VAT. Since a VAT taxpayer has an obligation to keep careful records, it can be appropriately excluded from presumptive regimes.

## 2.2. Presumptive Tax Base and Tax Rates

The purpose of presumptive taxation is to provide alternative methods of assessing taxpayers who do not keep adequate accounts. Hence, presumptive taxation should replace those taxes that are based on bookkeeping, but no others. Besides, the presumptive tax rates should be comparable to those under the regular regime of taxation. Incomparability will create distortions between and within different sectors of the economy.

The usual approach of presumptive taxation in agriculture is to base the tax on the area of land and its quality. An estimate is made of the normal income that can be earned, given the productivity of that type of land, average costs of production, and the prices of agricultural products. Relief may be provided when the harvest in an area is bad, but great care must be taken to avoid creating moral hazard problems (e.g., farmers who do not care for their crops appropriately because they expect any shortfall to be compensated via the tax system) or the need for very costly and intrusive administration to monitor actual yields (as farmers might try to hide production to qualify for tax relief).

Application of such a system requires good information about land quality. While this does not involve the same degree of complexity as determining the fair market value of land, it still presents a substantial challenge. The question is whether a simple system based on categories of land quality is robust enough so as to produce a sufficiently fair result in terms of presumed income. The other possible approaches of presumptive taxation of agriculture are gross turnover taxation, cash-flow taxation, etc.<sup>2</sup>

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<sup>2</sup> See, e.g., Valevich, Y., Bach, S. (2004) Reform of the Simplified System of Taxation for Small Business in Belarus, *IPM–GET Policy Paper*, PP/06/04, May, <http://ipm.by/pdf/pp604e.pdf>.

### **3. Presumptive Taxation of Agriculture: International Experiences**

There are about as many different systems of presumptive taxation of agriculture as countries that have used them. Differences are due to eligibility requirements (size of taxpayers defined by turnover, number of employees, net worth, assets, etc.), taxes that are replaced by the system (in some countries, only income and wealth taxes are covered; in other countries, consumption taxes are also a part of the presumptive system), and tax bases (some countries use turnover, others the area of land and its quality). Yet, given this diversity, there are some obvious lessons to be drawn from experiences in other countries. In the following, we review the experiences of Ukraine and Russia. These countries were among the first in the CIS to introduce presumptive taxation of agriculture. Moreover, the structure of agricultural production in these countries is similar to that in Belarus. In this context, experiences in these countries are unique and especially relevant to our country.

#### **3.1. The Case of Ukraine**

The fixed agricultural tax was introduced as an experiment in 1998. In 2003, the term of this experiment was extended until 2010. According to the legislation, the presumptive taxation is optional for agricultural producers with more than 75% of gross turnover derived from the sale of agricultural products (it was 50% in the original legislation of 1998 and increased to 75% in 2003).

The tax base is the value of agricultural land as determined by using the quality and potential productivity characteristics of the land plots. The tax rates are specified for three types of the agricultural land: (i) 0.5% for arable land, hayfields, and pastures; (ii) 0.3% for perennials; and (iii) 1.5% for bodies of water. The fixed agricultural tax replaced ten taxes previously paid by agricultural producers – profit tax, land tax, tax on the owners of transport vehicles, communal tax, charges for prospecting, contributions to the Social Insurance Fund, contributions to the Construction Fund, contributions to the Pension Fund, payments for trade patents, and charges for the special use of natural resources.

The tax is paid monthly, but the payment rates vary on a quarterly basis in order to take into account seasonal variations in cash flow and liquidity in agriculture. Tax payments are distributed among the quarters in the following way: in the first quarter – 10% of the annual tax payment; in the second quarter – 10%; in the third quarter – 50%; and in the fourth quarter – 30%.

#### **3.2. The Case of Russia**

The existing single agricultural tax became effective in 2004. According to the legislation, presumptive taxation is optional for agricultural producers with more than 70% of gross turnover derived from the sale of agricultural products.

The tax base is net turnover that is a difference between revenue from sales and input costs of goods and services. Unlike profit taxation, not only current operating expenditures but also capital investments are deducted from the tax base (immediate write-off), making this a system of cash-flow taxation. Furthermore, agricultural producers are allowed to carry losses forward (within the set limits). The tax rate is 6%. The single agricultural tax replaced four taxes – profit tax, value-added tax, wealth tax, and single social tax.

The tax is paid semiannually. After the first half of a year, agricultural producers make an advance payment based on the actual net turnover. This advance tax payment is set off when assessing the final tax after the end of the year.

### **3.3. Lessons Learned from International Experiences**

The results of presumptive taxation of agriculture used in Ukraine and Russia are difficult to quantify. However, there are some general lessons that pertain among these countries.

- The simplification of taxation, bookkeeping, and reporting is sometimes mentioned as an argument in favor of presumptive taxation in Ukraine and Russia. However, this is a specious argument. In these countries, the principal agricultural producers are large-scale agricultural enterprises. Such enterprises cannot seriously expect to operate in an efficient and modern manner without keeping adequate books of account that can also be used for tax calculation purposes. Certainly, if they fail to keep such books, the large farms cannot reasonably expect to obtain desperately needed commercial credits.
- The introduction of presumptive taxation in Ukraine and Russia effectively reduced the tax burden on agriculture as it coincided with a reduction in tax rates. For example, in 1998 after the introduction of presumptive taxation, the tax burden for agricultural producers in Ukraine was three times lower than before in 1997.
- The favored treatment of agricultural in contrast with non-agricultural production contributes to sectoral and inter-sectoral distortions. First, it leads to a shift in resource use from the more efficient services and manufacturing sectors to the less efficient agricultural sector. Second, it is an incentive to retain agriculture as a fundamental feature of the production structure, even though market demand might require a shift into services or other kinds of production. Some enterprises that have little or nothing to do with agriculture have become active in agriculture or retained unprofitable agricultural activities simply to qualify for (low) presumptive taxation. Third, presumptive taxation creates distortions within agriculture. Basing taxation on land use in Ukraine, for example, means that agricultural enterprises that use very little land (intensive poultry or pork operations, for example) pay very little tax, regardless of their profitability.
- The introduction of presumptive taxation in Ukraine initially increased government tax revenues despite the associated reduction in the tax burden, because increased compliance outweighed the reduction in tax rates. However, total tax revenues will likely decline in the long-run, especially if resources shift from other sectors into agriculture to take advantage of lower taxation there.
- The primary goal of most governments that introduce presumptive taxation is to broaden the country's tax base. However, presumptive taxation may undermine this goal if taxpayers remain in presumptive taxation regimes indefinitely or regress from regular taxation to presumptive taxation. In Ukraine, this goal is accomplished by imposing a time-limit regarding presumptive taxation of agriculture. However, this time limit has been extended once already.

### **4. Evaluation of the Single Agricultural Tax in Belarus**

In Belarus, the presumptive taxation is optional for agricultural producers with more than 70% of gross turnover derived from the sale of agricultural products. Agricultural producers who are subject to presumptive taxation pay the so-called 'single agricultural tax' (see below). Furthermore, private farmers who apply to be subject to presumptive taxation are initially exempt from this single agricultural tax for three years from the date of state registration.

The tax base is gross turnover derived from both agricultural and non-agricultural production. The tax rate is 2% and the tax is paid monthly into regional budgets. The single agricultural tax replaced the following taxes: profit tax, land tax, tax on the use

of natural resources, real estate tax, and local taxes and duties. All other taxes are paid according to the regular rules (see Table).

**Table. Taxes and Nontax Payments  
under the Single Agricultural Tax in Belarus**

<b>Taxes and Nontax Payments</b>	<b>Exemption from Taxation</b>
<b>Mixed taxes and nontax payments</b>	
Land tax	yes
Tax on the use of natural resources (within the set limits)	yes
Contributions to the State Employment Fund	no
Contributions to the Social Protection Fund	no
<b>Direct taxes and nontax payments</b>	
Real estate tax	yes
Profit tax	yes
Income tax on legal entities	no
Tax on the use of natural resources (over the set limits)	yes
State fees	no
License and registration fees	no
Local taxes and duties	yes
<b>Indirect taxes and nontax payments</b>	
Value-added tax	no
Excises	no
Custom payments	no
Local taxes	yes

What are the consequences of the single agricultural tax?

(i) Because agricultural producers who use the presumptive taxation don't pay the main taxes, they do not need to produce tax calculations, tax declarations, and so on. Thus, unlike the regular system of taxation, the single agricultural tax leads to simplification of taxation, bookkeeping, and reporting. But, as outlined above, this is of dubious value, as large-scale agricultural enterprises can be expected to keep books and indeed need these to obtain credits and manage their complex operations successfully.

(ii) Calculations on the basis of data from the Ministry of Statistics and Analysis show that the effective tax rate for agricultural producers under the regular system of taxation is about 3.4% of gross turnover. Hence, the statutory tax rate of 2% under the presumptive taxation is comparatively low for agricultural producers. It therefore comes as no surprise that in 2003, about 85% of the eligible agricultural producers opted for the presumptive tax.

(iii) The gross turnover tax creates unequal conditions for different agricultural producers and therefore violates the principles of tax efficiency and equity. The reason is that profits of different types of agricultural producers (i.e. crop vs. livestock production) vary as a share of gross turnover. It would be possible to introduce different tax rates for different types of agricultural production according to their different input ratios. But this might provoke tax-saving adjustments by agricultural producers that are inefficient from an economy-wide point of view. Furthermore, the tax authorities would have to deal with complex problems of determining an enterprise's center of activity (i.e. whether it is agricultural or not, and what type of agricultural focus it has for tax purposes). Finally, policymakers would probably be subjected to a great deal of pressure by specific groups of agricultural producers seeking advantageous tax rates for their specific lines of business.

(iv) The presumptive tax raises some revenue because the tax base doesn't depend on actual financial performance of agricultural producers. However, the basic audit problem of determining gross turnover is not addressed by this type of tax (as well as

by the cash-flow tax in Russia). Accordingly, it is not likely to be effective in raising revenue from the types of taxpayers whose gross turnover is difficult to ascertain and it is more likely to impinge on those taxpayers who cannot hide their gross turnover.

(v) If a goal of presumptive taxation is to ease taxpayers into the tax net and to move them to the regular system of taxation, the tax legislation needs to take this into account. This might be accomplished by setting tax rates under the presumptive system at a reasonable rate (not too high nor too low compared to the regular taxation) and creating incentives to move to the regular system (e.g., allowing certain deductions only under the regular taxation), or imposing a limit regarding the number of years that a taxpayer may use the presumptive taxation. This isn't the case in Belarus.

## **5. Conclusions and Policy Recommendations**

As shown above, the existing system of presumptive taxation of agriculture in Belarus doesn't meet the requirements of an efficient and equitable tax system. To improve the situation we propose the following.

First, presumptive taxation should be abolished for large agricultural enterprises. These enterprises are capable of keeping accounts properly and should do so in their own best interests. The single agricultural tax should be obligatory only for private farms that are family-owned and operated, and too small to afford specialized accounting services. The obligation of presumptive taxation would eliminate any possibilities to minimize their tax burdens by switching to/from paying the single agricultural tax.

Second, the presumptive tax base for this type of entity should be determined according to the area of agricultural land it farms and productivity ratings depending on the quality of this land. The tax rates should be comparable to those under the regular system of taxation.

Third, the single agricultural tax should be paid according to seasonality of agricultural production, i.e. the largest tax payments should be due in the second half of the year as is the case in Ukraine. Moreover, if a natural disaster leads to crop loss in a region, then agricultural producers who suffer may apply for a reduction in the tax on that basis. To avoid moral hazard problems, however, the existence of a 'natural disaster' must be determined using regional average yields/production and not an individual farm's yields/production.

In our view, aside from generating additional fiscal revenue, which is desirable in itself, such a system of presumptive taxation would make taxation more efficient and equitable.

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