

Challenges and Strategies in Increasing Property Tax Revenue in Medan City, Indonesia

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Abstract: Local revenues are very important for development. However, for the community, investing in property sometimes poses incriminating tax expenses. Rural-Urban Land and Building Tax (RU L&B Tax) was originally central government tax, but now it is local tax. The objective of this study is to formulate the strategies in increasing the local revenues from tax in Medan City, Indonesia. The respondents of this research are taxpayer society, Medan City tax authority, and lecturers in taxation. The results show that the right strategies for Medan City are to generate public awareness and increase collection efforts.

1 INTRODUCTION

The financial strength lies in the ability to generate revenues and liquidity and is associated with the loss of an entity (Ames, et al., 2014). The financial strength of a regions is very important to make them be able to provide good public services. Increased tax revenues can increase financial strength. Bahl and Lin (2014) said that property taxes are very important in developing urban strategies to support sustainable growth. In some developed countries, property taxes are used to finance local authorities (Babawale, 2013). In United States of America, despite a lot of critics over property taxes, the government will continue to play an important role in government finance (Spelman and Spelman, 2003).

In Indonesia, there are two types of taxes, namely central taxes and local taxes. Rural-Urban Land and Building Tax (RU L&B Tax) was originally a central government tax. However, under the Law No. 28/2009, valid from January 1st, 2011, the government transferred RU L&B Tax into local government. Hereafter RU L&B Tax referred as L&B Tax only. RU L&B Tax is included in property tax. Abbott (2008) says that property tax is a tax that is levied on deemed value or against income arising from the property. The tax is traditionally associated with local governments

(Babawale, 2013). This alteration becomes a challenge for Medan City Government to increase local own source revenue.

Variable that can be controlled by the local government is to determine the amount of tax object sales value or land and building tax imposition base. This base which was the basis of tax imposition in 2011 is still low and has not shown the market values. Therefore, starting in 2014, the government of Medan City increased the sales value of this tax object to fit the market value up to 400% from the previous one. Many people have objected and did not pay for it until now. In addition, L&B Tax payments are also constrained due to internet connection problems.

The L&B Tax payment delinquency is not only done by the object of personal tax, but it is also done by hotels, educational institutions, entertainment venues, and malls. Even, there is a large mall that has not paid L&B Tax for 5 years. Whereas, Campaign to Protect Rural England says that investment in housing is relatively lightly taxed compared to other investments.

Taxpayers do the investment in their house. Investment will generate return, either in the form of capital gain or yield (Fachrudin and Fachrudin, 2017), but the homeowners must pay the L&B tax. Taxpayers' opinion on the tax increase is also important to determine the strategy to be implemented.

The valuation method of land and building tax imposition base generally uses mass appraisal and individual appraisals. Mass appraisal is used for big amount of, homogeneous, not special characteristic, and not high value tax objects. In mass appraisal, land tax imposition base is calculated based on the average indicative value contained in each land value zone. Building tax imposition base of building is calculated based on the list of building component costs reduced by the physical depreciation. Meanwhile, individual assessment is performed for tax objects that have special characteristics, high economic value, various type and size, high-rise building, and multi-ownership. This method has not been fully implemented by the Medan City government due to resource constraints.

Hanoi and Vietnam find the same difficulties in determining market value. In Vietnam, tax is not calculated on market value, but rather is area-based considering the location of property within a particular zone of a city (Loan and Mccluskey, 2012). Loan and Mccluskey (2012) also summarize the tax based in some countries, namely Estonia and Latvia using market value. In Lithuania, land valuation is carried out based on normative value, while building is rated based on average market value. Hanoi and Vietnam are based on land categories multiplied by coefficient and rice price.

Medan City Government requires a tax collection strategies which is, currently, not optimal. If land and building tax imposition base is set at market value, the target of tax revenue will be achieved. However, some people object it. If it is lower than land and building tax imposition base, it may not lead the tax target revenue to be met. The preparation of local government to establish the value of taxable objects based on market value is also a challenge due to the readiness of different human resources both at central and local governments.

The objective of this study is to answer this challenge and to formulate strategies to improve the financial strength of Medan City, such as how to find the strategies to make public pay L&B tax, how to get businessman pay L&B Tax, and how to make land and building tax imposition base can be determined at market value.

2 METHOD

This research is a qualitative research. Data obtained through in-depth interviews. Respondent consists of

60 L&B tax payers taken from an University in Medan alumni database and willing to be interviewed, 5 lecturers in taxation subject, 2 central tax officials, and 1 local tax official. Determination of the lecturers and the tax officials is by looking at their capabilities. Data was analyzed by inductive reasoning, namely decision making which begins with a specific statement to compile general arguments.

3 RESULTS AND DISCUSSION

Based on results of interviews with the taxpayers, an unexpected result is obtained i.e. people who have property valuation knowledge background (30%) tend not to have reluctance with the amount of taxes to be paid. Meanwhile, people without knowledge of property valuation (60%) tend to find that since 2014 the amount of tax to be paid is very expensive, it is unclear how to calculate the tax amounts, and it is unfair and lead them to be in tax arrears. They do not feel the impact of taxes paid, for example, the width of the road in front of his house remains unchanged even though they pay taxes. Actually, the property tax is a direct tax, but the public benefits received from the tax are often indirect (Palmon and Smith, 1998). As much as 2% of them think that the increase of land and building tax imposition base 2014 is to make people increasingly unable to stay in strategic areas and those areas will be controlled by capitalists. However, these are preliminary findings that still require further study as they relate to the results of Mukasa (2011) and Mukhlis, et al. (2010). Mukasa (2011) found that perceived fairness taxes and tax knowledge are related to tax compliance. Mukhlis, et al. (2015) also found that tax compliance will increase by increasing tax knowledge gained from tax education.

As much as 10% of respondents complain about having to pay L&B Tax when they are retired. From the results of interviews with local government, they said that retired tax object can actually apply for relief. However, some people find it difficult in the filing procedures. This is matches with Sulija and Sulija (2005) in Babawale (2013) which said the principle of equality is that taxes must be calculated based on the ability of taxpayers to pay rather than based on the highest and best use of property.

From the results of interviews with local tax officials regarding tax payment constraints, it can be seen that the local government has mere cooperation with local banks. In the future, cooperation will

connect them to national banks to make it easier for people due to the better national bank facilities.

For corporates which have not paid their RU L&B Tax due to unclear ownership issues, the government has asserted that tax payers are those who take benefits of the land and buildings, instead of the ones who own it. For mall which has not paid its L&B tax for 5 years, the local tax authority cooperates with the Corruption Eradication Commission (KPK) and the Supreme Audit Institution (BPK) to collect it.

When L&B was still a central tax, the tax object data have been good. However, due to the rampant construction, the data must be renewed. Validation of tax object data must be performed. The local government is still setting the value of land based on the position, instead of the real market value.

Based on the interview results with the officials, there have been a lot of strategies performed to optimize tax revenue, namely awarding the entrepreneurs who pay property taxes on time, cooperating with the BPK and KPK, socializing it by holding L&B Tax Fair in 2015 and 2017 to increase people enthusiasm to pay taxes, waiving a fine of the last 5 years L&B delinquent, and validating tax object data. Pinto and Tome (2017) find that tax literacy has a positive influence on fiscal performance. Based on this circumstance, it is suggested that the government create activities to increase the tax literacy of the community.

Another strategies planned by the Medan City tax authorities are to strengthen cooperation among agencies, e.g. 1) with the licensing section, not to grant permission for those who have not paid L&B Tax, 2) immigration, i.e. to blacklist big companies which have not paid taxes, 3) tax law enforcement needs to be more emphasized such as by suspending bank account and shutting down the business run by delinquent taxpayers. However, these three suggestions should be further examined for implementation; it is the challenge.

The results of interviews with lecturers in taxation and central tax officials show that the database of the tax object, the land and building tax imposition base, and the status of land ownership should always be updated. Local governments must also firmly impose sanctions for those who do not pay taxes.

4 CONCLUSIONS

People who do not have the background knowledge in property valuation tend to feel that the property tax to be paid is very expensive and it is unclear why

the amount to be paid increased since 2014. Meanwhile, for those who have background knowledge in property valuation will understand the deemed values and income earned from the property and will have no objection to the amount of tax to be paid. Therefore, it is recommended that the Medan City government socialize the tax bases and explain the economic value of the land they occupy to make it reasonable and people is aware that property tax is important for development. Fachrudin and Fachrudin (2016) found that financial literacy has a great tendency in influencing investment decision. Future research should study about effect of tax literacy on the decision to pay taxes.

Many businessmen who have the awareness to pay taxes, however, they are tax delinquents. The strategy is to reward the obedient and sanctioned for the delinquent.

Another strategy is to update the database of tax objects and the land and building tax imposition base based on market value. The local government can heartily work with appraiser to avoid confusion from the community and to provide an appraisal education for its employees.

For people who cannot afford the tax amount, tax deduction should be done in accordance with their ability and in an easy procedure. For payment process, the local governments should also cooperate with banks that have better facilities.

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