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EFFECTS AND ALTERNATIVE IDEAS OF TAX REFORM IN UKRAINE

Summary. The authors analyse the main changes in tax system of Ukraine during 2014–2015 concerning the number of taxes, tax ratio and tax burden structure, assess the effects of these changes, compare the new concepts of tax system reforming and suggest their own alternative ideas of tax reforming.

Key words: tax, tax system, tax burden, tax reform, tax ratio.

Introduction. Tax reform carried out in 2014–2015 by the Government of Ukraine was not successful. That's why the new ideas concerning the tax system improvement are necessary. The Ministry of Finance and the Budget committee suggested two different concepts of tax system reforming [1, 2] but both of them have strengths and weaknesses, so they should be improved before being implemented. The new mistakes shouldn't be made and the old ones must be avoided. Before suggesting recommendations the taxation trends and reasons of previous tax reform failures should be analysed.

The first thing to be focused on is changes in the number of taxes and their main kinds (figure 1). These aspects are important especially taking into consideration their

relationships with the tax burden, time for tax returns filing and tax administration.

The number of taxes has been constantly reduced from 41 before the Tax Code adoption (before 2010) to 11 since 2015. But it should be mentioned that the number of taxes has really been cut down only with the Tax Code adoption [3]. As the result of the tax reform of 2015 the number of taxes actually was not reduced because most of taxes were combined but they still continue to function as separate taxes (figure 2). For example, rental fee now includes five objects of taxation. Each of them has its own rules concerning terms of payments, tax statements and calculations. In fact only two taxes have been cancelled since 2015. After adopting the changes in the tax Code



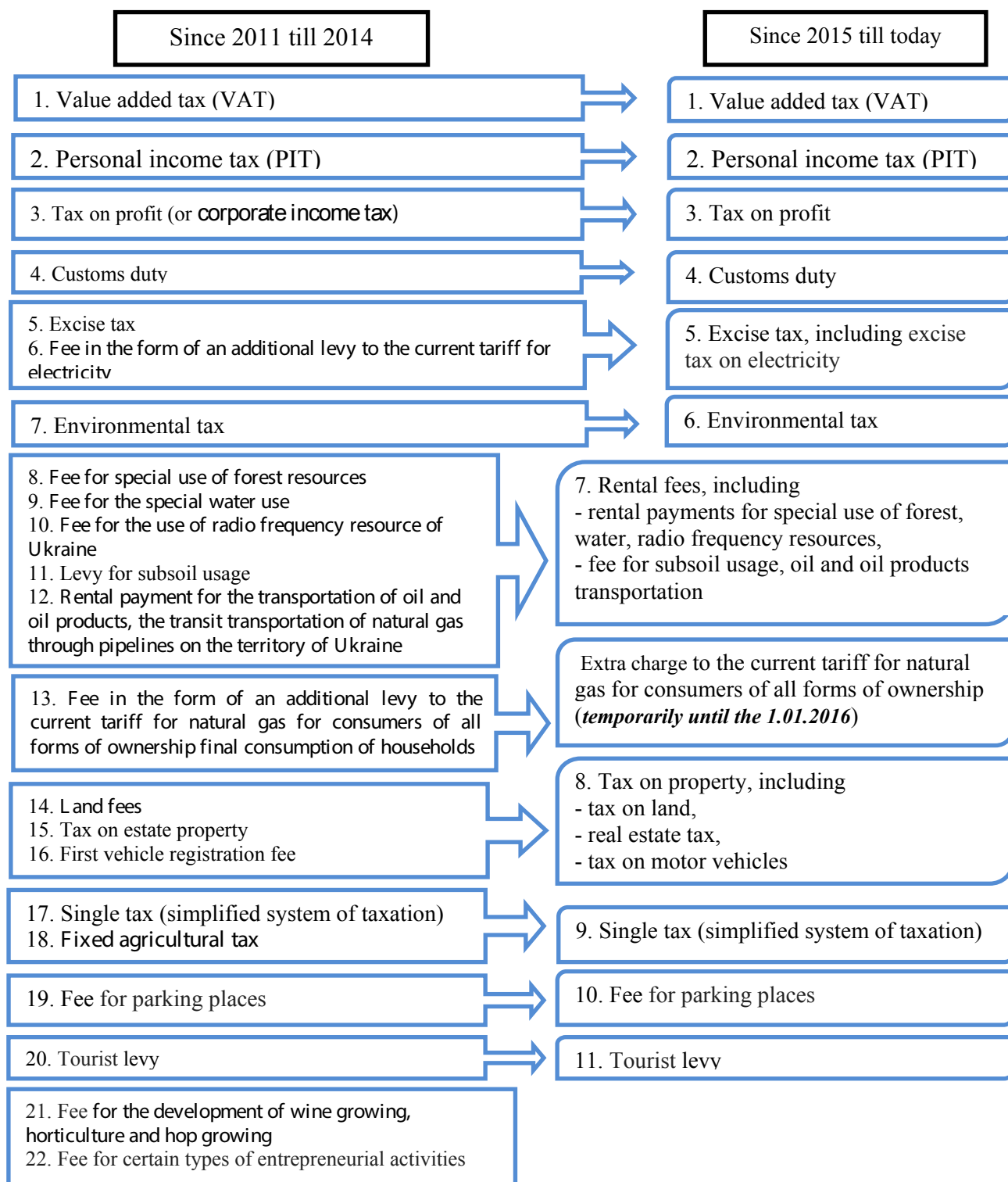
Remark: created by authors according to the Tax code of Ukraine [3]

Figure 1. The number of taxes in the tax system of Ukraine

in December 2015 [4], the number of taxes has remained unchanged since 2016.

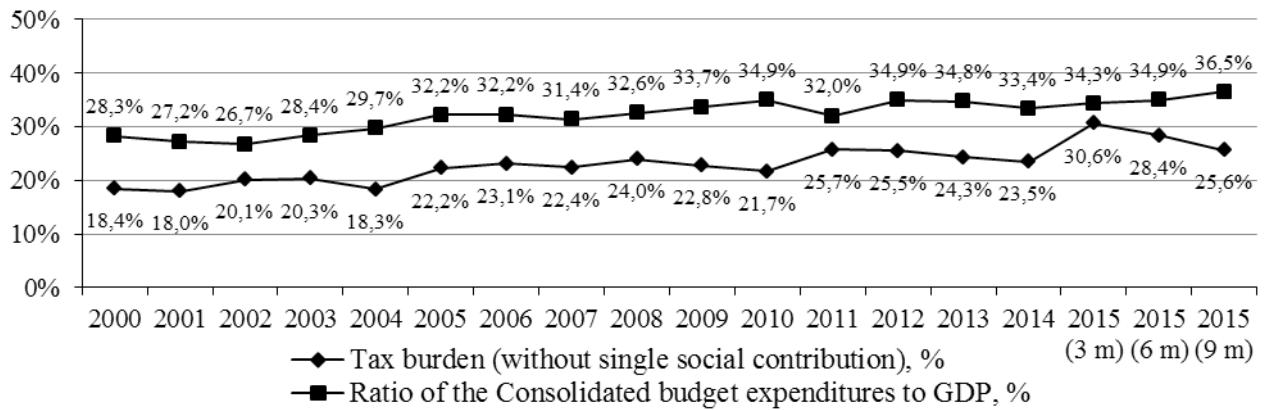
It is important to analyse the way the tax burden has changed (fig. 3), taking into consideration the fiscal role of taxes as an instrument of state functions financial providing.

In the analysed period the fiscal gap between tax revenues and budget expenditures is big enough. Only in the first quarter of 2015 the problem of fiscal consolidation was solved partially (Fig. 3). It should be mentioned, that it was not as the result of the budget expenditures share in GDP reduction, but as the result of the tax burden on



Remark. Compiled by the authors according to the Tax code of Ukraine [3]

Figure 2. The number and types of taxes and other compulsory payments in Ukraine before and after tax reform of 2014–2015



Remark. Created by the authors according to the Ukraine State Treasury Service Data

Figure 3. Dynamics of the Budget Expenditures share in GDP and tax burden in 2000–2015

the taxpayers increase (table 1). So it is important to understand what kinds of taxes had the greatest influence on the tax burden rise.

The data illustrate that the tax burden has increased mostly due to the consumption and income taxation, while property taxation has remained unchanged (table 1). Comparing changes in the tax burden structure (in % to GDP) in Ukraine and European Countries, we can conclude:

1. The total tax burden in Ukraine is higher than in EU countries, especially EU-11 (28.35% vs 20.5%). It is worth mentioning that we can compare the tax burden in Ukraine only with the tax burden of the post socialist countries in European Union, EU-11, because these countries had more or less similar starting positions of

economic development after 1991. Since 2000 till 2015 the total tax ratio in Ukraine increased more than 1.5 times, especially after the Tax Code adoption and the tax reform of 2014–2015. At the same time the tax burden in EU-11 decreased during the analysed period.

2. The tax burden structure in Ukraine in 2015 differs from that of EU countries, but we should say that in Ukraine the same as in EU countries VAT and PIT take the first and the second place accordingly. Moreover, comparing Ukraine and the post socialist EU countries, we can see almost the same ratio between these two taxes (8,4% and 4,3% to GDP in EU-11 countries vs 10,4% and 5,5% to GDP in Ukraine) [5, 7].

3. The third position in EU countries is taken by the Environmental tax, but in Ukraine – by the Excises. But

Table 1

The structure of Tax Burden in Ukraine and EU-11 countries (Percentage of GDP)

Types of taxes	Ukraine								EU – 11	
	2000	2010	2011	2012	2013	2014	2015	2015	2000	2012
							(3 m)	(6 m)		
VAT	5,5	7,9	10,0	9,8	8,8	8,9	11,7	10,4	7,50	8,40
PIT	3,8	4,7	4,6	4,8	5,0	4,8	5,6	5,5	5,30	4,30
Profit Tax	4,5	3,7	4,2	4,0	3,8	2,6	4,5	3,0	2,10	1,90
Excise, total - including excise duties on tobacco, alcohol	1,3 n/a	2,6 1,9	2,6 1,81	2,7 1,83	2,5 1,85	2,9 1,77	3,4 1,73	3,4 1,73	n/a 1,20	n/a 1,70
Custom	0,9	0,8	0,8	0,9	0,9	0,8	1,7	1,9	n/a	n/a
Property taxes	0,3	0,18	0,05	0,05	0,04	0,8	0,9	0,9	0,50	0,50
Environmental tax	n/i	0,2	0,2	0,4	0,3	0,3	0,2	0,2	2,50	2,50
Other taxes	2,1	2,92	3,45	2,85	3,06	2,41	2,61	3,05	1,70	1,20
Tax revenues (total)	18,4	22,8	25,7	25,5	24,4	23,51	30,61	28,35	20,80	20,50

Remark. 1. Before 01.01.2011 environmental tax was not included into tax revenues

2. In 2015 in Ukraine custom receipt included temporary custom fee on import, which share was equal 1,1% of GDP.

Source: compiled and calculated by the authors according to Ukraine State treasury Service statements [5, 6, 7]

we should note that excise rates on tobacco and alcohol production in Ukraine are much lower than in EU countries and at the same time the share of excise on these products in GDP in Ukraine is almost the same as in EU countries (1.7%). According to the Association agreement between Ukraine and the European Union [8] the excise ratios on tobacco and alcohol in Ukraine should be increased, so in the near future it will bring the increase of the excise share in GDP of Ukraine.

4. Although the profit tax in Ukraine takes the same position as in EU-11 countries the share of this tax in GDP of Ukraine is higher.

5. The share of property tax in the tax burden structure of Ukraine is too small, comparing with that of EU-11 countries (0.03% of GDP and 0.5% of GDP accordingly). We consider that it to be one of the failures of Ukraine's tax system. Individuals' property status reflects the level of their income and welfare. Taking into consideration that the significant part of personal incomes is untaxed in Ukraine because of tax evasion the property taxation can be used to balance taxation disproportions. Moreover the property taxes can be an additional resource of the local budgets that is especially important taking into account the fiscal decentralization processes in Ukraine.

To continue our analysis, attention should be paid to the tax burden distribution between different groups of taxpayers. It is important to focus ourselves on the large taxpayers and individuals employed in budget sector.

The share of large taxpayers in the total number of taxpayers in Ukraine is less than 1% (in 2010–1497, 2011–1152, 2013–1486, 2014–2131, 2015–1978 enterprises¹) [9]. But they provide almost 70% of the total tax revenues of the State budget. In 2014 the large taxpayers paid 57.9% of tax on profit, 55.2% of VAT and 81.7% of excise on produced goods in Ukraine. In the first half of 2015 they paid 54.9%, 59.7% and 86.5% accordingly [10]. The fiscal role of large taxpayers in Ukraine is rather significant; it increased after the Tax Code adoption. But at the same time there are some problems worth mentioning:

1. Among the large taxpayers less than 30% of them can be considered as stable or constant taxpayers, i.e. those, who have been included into the Register of Large Taxpayers since 2010.

2. There is a constant problem of tax overpayments. The average level of overpayments made 163% of accrued taxes in 2010 and 135% in 2013. According to the types of taxes the level of overpayments made 390% of VAT in 2010 and 302% in 2013; 106% and 111% of excise tax and 546% and 180% of other taxes in 2010 and 2013 correspondingly. At the same time till 2013 there were no tax

¹ According to Ukraine legislation only legal entities can be large taxpayers

on profit overpayments among large taxpayers, they appeared in 2014. The main reason was the introduction of advance payments which depend on the profits received in the previous year.

3. During 2014–2015 large taxpayers' tax debt increased 3.8 times and the number of tax debtors among large taxpayers increased 4.4 times. The negative trend continued in 2015 and in the middle of 2015 the share of large taxpayers' tax debt in the total tax arrears in Ukraine made 90% [9]. It demonstrates worsening of the situation in the economy, because the payers, who were considered the main entities paying taxes to the treasury, had no money to pay tax obligations or deliberately postponed the deadline for paying taxes trying to "earn" on exchange rate fluctuations.

As the personal income tax ranked the second, some attention should be paid to real payers of this tax, especially those employed in the public sector. Despite some decrease of PIT on salary share in total revenues from PIT in 2010–2014 (table 2), it still remains significant enough. At the same time nearly 30% of PIT revenues is constantly provided by the individuals employed in the public sector. But the share of public sector salaries in the total sum of salaries is less than 20%. It reflects an uneven tax burden distribution between different categories of taxpayers. The individuals employed in the public sector receive a smaller salary than the average salary in Ukraine (3490 UAH per month in 2014) [11].

As a result of the analysis it can be summarized that the tax reform of 2014–2015 had some partial and temporary effect on fiscal consolidation but at the same time taxes became an additional instrument of strengthening economic crisis in Ukraine. Reduction of demand as a result of the individuals incomes lowering caused losses of business (financial results before taxation in the middle of 2015 was –224.4 bln UAH, in 2014 – –523.5 bln UAH, to compare with 2013 when it was +29.3 bln UAH) [12], bankruptcy of enterprises (in 2014 compared with 2013, the number of business entities in Ukraine as a whole fell down by 13.3%: every fourth large, every sixth medium-sized enterprise and almost every eighth small enterprise were closed in 2014 (to compare, in 2013 their number increased by 7.8%, compared with 2012). All of these factors led to decrease of GDP and lowering the level of welfare.

So, the tax reform of 2014–2015 didn't create the necessary conditions for the economic growth; the financial problems for government remained the same. Will the new concepts of the tax system reforming be able to solve this problem? To answer this question the concepts of the Ministry of Finance and the Budget committee should be compared. First of all it is necessary to take into consideration both concepts priorities (table 3).

Table 2

Structure of personal income tax and the population income in Ukraine

Years	Consolidated budget revenues from personal income tax (PIT), total, bln UAH	PIT revenues from salaries		The share of salaries in the total income of population, %	The share of employed in the public sector individuals salaries in total salaries of population, %	PIT paid by the individuals employed in the public sector to the consolidated budget, %	
		bln UAH	The share in total, %			bln UAH	in% to PIT paid from salaries
2010	51,03	46,54	91,20	40,08	21,42	26,16	28,68
2011	60,22	53,22	88,38	41,72	19,89	24,24	27,43
2012	68,09	59,32	87,12	41,94	20,07	24,92	28,61
2013	72,20	61,96	85,82	40,90	20,65	25,01	29,14
2014*	75,20	59,86	79,60	39,95	19,82	23,33	29,31

Source: calculated and compiled by the authors according to [5, 6, 12]

These concepts have both common and different issues. Common issues concern tax legislation, business legalization and tax burden on employees' salary. Despite the common issues, these concepts are based on different approaches and ideology of tax reforming. The BC concept suggests reducing tax rates as the main condition for business development. The other concept suggests equal rates for four main types of taxes (VAT, PIT, tax on profit and Single social contribution) (table 4). It means that the MF concept is directed at further increase of tax burden on business, labour and consumption, especially medical goods. But as a result of the latest amendments to the Tax Code (24.12.2015) the real change in the rates of the main taxes has not occurred.

As figure 4 illustrates consumption is being cut down. The main reasons for such dynamics were currency de-

valuation, high level of unemployment, increase in tax burden on salary, and lowering of real personal incomes, inflation. Most of the above mentioned reasons will occur in 2016. Under these circumstances increase of tax burden on salary and consumption will further reduce the aggregate demand and not stimulate stabilization and recovering of economy.

In conditions of unequal GDP distribution between individuals and high level of shadow economy, that it is observed in Ukraine, the use of equal tax rates is not fair. At the same time, reducing of tax rates is attractive for taxpayers, but hardly business can live up only because of tax rates decrease. The level of business activity is highly correlated with the level of aggregate demand in the country. If the latter remains low it inhibits business development. In this case the tax rate reducing will de-

Table 3

Main issues of tax system reforming concepts

The Budget Committee concept (BCc)	The Ministry of Finance concept (MFC)
To solve the most serious problems of taxation (tax burden on employees' salary should be no more than 30%)	To reduce tax burden on employees' salary
To decrease the level of shadow economy	To stimulate business legalization and reduce the level of contraband
To provide stable and predictable tax legislation	To introduce the moratorium on tax legislation changes
To improve the investment climate	
To form <i>unique fiscal</i> conditions for business development and economy recovering	
	To form <i>equal conditions</i> of taxation, improve simplified system of taxation
	To introduce long-term predictable excise policy, constant increase of excise rates
	To cancel additional import duty since the 1 of January of 2016
	To improve tax administration, introduce tax services and simplify tax statement.

Source: compiled by the authors according to [1, 2]

Table 4

Tax Rates according to tax reforming concepts

Type of tax	According to the Tax Code	The Budget Committee concept (BCe)	The Ministry of Finance concept (MFe)	According to the changes to the Tax Code (2016)
VAT	20%, 7%	20%	15%	20%, 7%
Tax on profit	18%	20%	15%	18%
PIT	15%, 17%	20%	10%	18%
Single social contribution	41% (average)	20%	20%	22%

Source: compiled by the authors according to [1, 2, 3, 4]

crease budgetary revenues. Introduction of single social contribution rate at 20% (or 22% as it was adopted at the end of 2015) will hardly lead to legalization of salary, but most probably will have a negative influence on the Pension fund incomes.

There is a wrong opinion that lowering of tax rates leads to income legalization. It is not an automatic process. In conditions of inefficient control and low of tax responsibility, the government can hardly expect a high level of tax compliance even if the tax rates are cut.

None of these concepts was supported by Parliament of Ukraine. That's why the authors of both concepts started to look for some compromises. As a result the adopted decisions reflect the main issues of the current Tax Code of Ukraine. In general nothing has been changed. Under these circumstances we can expect the tax impacts will remain unchanged in future.

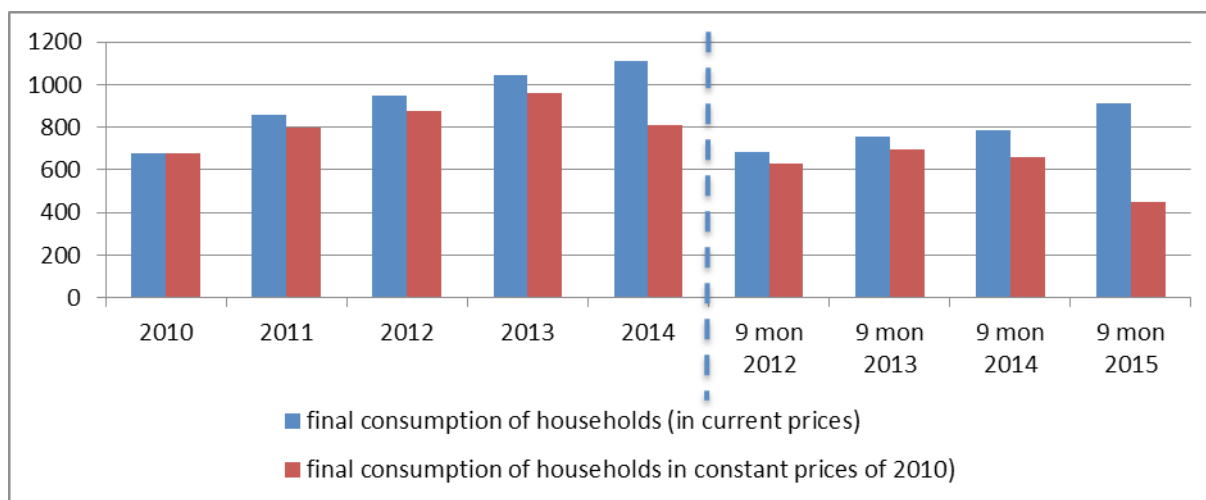
To substantiate proposals concerning the tax system reform the following statements should be taken into consideration.

1. There is the President's Program determining the main key indicators. According to the subject of the given research special attention should be paid to the GDP per capita indicator which is expected to make 16000\$ per capita in 2020 [13]. It means that the amount of total

GDP should achieve nearly 640 bln \$. The latter was 130 bln \$ in 2014. So during the nearest five years the GDP should increase almost 5 times. It is hardly possible but in this context taxes should be the encouraging economic development instruments.

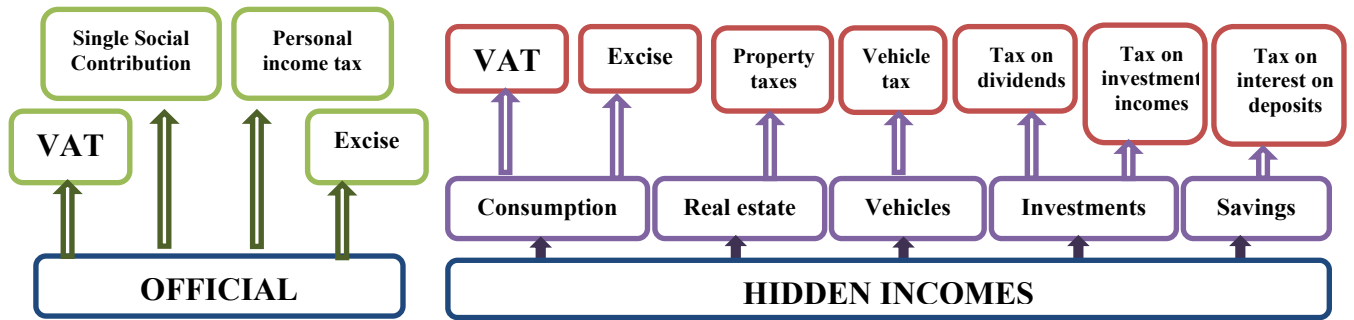
2. Despite the determined key indicators there are no real tactical measures to achieve them. The constitutional reform is not completed. So, the state functions are not determined exactly, thus it is impossible to determine the budgetary expenditures. The latter are the foundation for substantiation of the tax burden. The budgetary expenditures for 2000–2014 were analysed and the conclusion was made that state provides neither a competitive salary for the budgetary employees, nor the qualitative public goods and services. This is the result of the inefficient redistribution of budget resources, embezzlement them through the corruption schemes. That is why the share of the state in GDP distribution should not grow but even should decrease. It will give an opportunity to reach the level of the tax burden the average level among the EU – 11 countries, which is 21.5%.

3. There is an unequal distribution of GDP in Ukraine (according to experts' assessments, the property ratio of the richest and poorest segments of the population in Ukraine is 40:1) [14]. That is why taxation should



Source: calculated and compiled by the authors according to [12]

Figure 4. Dynamics of household final consumption in 2010–2015.



Source: created by the authors

Figure 5. Ways of official and hidden personal incomes taxation

encourage incomes equalization that will respond to the principle of social justice. The tax burden distribution among the categories of taxpayers, consumption, income and assets should encourage increase of consumer demand, business activity and, as the result, the growth of GDP and population social standards.

4. There is a high level of shadow incomes in Ukraine that are not imposed by direct taxes. Taking into consideration a poor level of tax control it is rather difficult to detect hidden incomes. That's why other ways of hidden incomes taxation should be discovered. For this purpose it is necessary to realise how these hidden incomes are used (figure 5).

The government's main attention of should be focused on property and vehicle taxation.

Taking into consideration the above mentioned statements, the main changes in the tax system of Ukraine should be the following.

1. *The ratio of taxes.* As the modern tax system of Ukraine and the tax systems of the EU post socialist countries are based on indirect taxes, namely VAT, this tax should remain dominant in Ukraine's tax system. The tendency when the personal income tax exceeds the tax on profit has to be preserved. But the PIT structure should be changed. The PIT rates on passive incomes should be higher than these on labour income (but according to the Tax Code amendments, since 2016 the rates on passive and labor income will make 18%, moreover, the rate on dividends remains unchanged, 5%). The total tax burden on individuals' income has to be decreased. It will encourage the increase of the consumers demand and, as a result, the VAT returns will rise. The part of environmental tax and especially property tax should be raised. The volume of property reflects the level of individual income. If an individual does not pay PIT his income can partly be assessed by charging the property tax.

2. *The rates and objects of taxes.*

a. It is desirable to leave VAT ratio unchanged, 20%. A part of shadow incomes (in Ukraine it makes 60% of GDP) is spent for consumption, so it would be just if each person paid tax to the treasury proportional to his expen-

ditures. But even in this case, the principle of equality is not realized. 7% VAT on medical goods should be cancelled but under a strict government control over pricing. It is not fair to impose taxes on medical goods, because health and life of citizens, especially poor ones, depends on the price of them.

b. According to the association agreement between Ukraine and EU, excise duties rates should be raised. It is planned to raise excise duties on alcohol and tobacco goods in 2016. The attention should be paid to a feasibility of this governmental decision. At the present time we have a situation, when on the one hand a purchasing power declines, but on the other hand the necessity to consume these goods remains mostly at the same level. Under these circumstances the illegal supply will increase. It is likely to have a negative impact either on the budget revenues, or on the people's health. But at the same time the objects of excise taxation should be extended, for example by including into them jewellery and expensive watches.

c. The rates of tax on profit have to be reduced from 18% to 15% but at the same time the simplified system of taxation for legal entities should be preserved, despite its absence in the EU countries. Nowadays the tax compliance in Ukraine leaves much to be desired. That is why there are not necessary conditions for small business taxation according to the general rules. Cutting the rates of tax on profit tax may release money for investment.

d. Labour incomes should be taxed using the single rate, 15%, because legal salary is not too high and it is more or less equally distributed between employees. According to the official statistics data more than 90% of individuals in Ukraine receive less than 3360 UAH per month per capita [12]. Taking into consideration the unequal distribution of wealth between the physical persons on the one hand and the absence of a special category of large taxpayers – physical persons – as it is in EU countries on the other hand, the tax burden on passive incomes should be raised: 15% on dividends and royalty. The progressive scale of deposit incomes taxation should be introduced. The share of the property tax should be not less than 1% of GDP because this tax has to be an instrument

of hidden incomes taxation. The experts consider that the shadow salary is 170–200 bln UAH a year [15, p. 3] or 11–13% of GDP in 2014. In perspective the share of the property taxes can be raised, but more accurate assessments of it are possible only if the property register is formed. The latter will give us a possibility to make a deeper analysis of the particularities of the property distribution in Ukraine. In case of unequal distribution it is reasonable to introduce the progressive rates of property taxation. It will encourage the realization of the equity principle in taxation.

e. A return to the taxation of vehicles we believe is the correct measure considering the tax system reform of 2014–2015 in Ukraine. However, the data of 11 months of 2015 illustrate very low fiscal results of this tax levying (0.0004% of total tax revenues) [5]. However, the analysis of the present legislation in the part regulating the

charging of vehicle tax gives ground for conclusion of the possibility to increase the fiscal capacity of this tax by including vessels, helicopters and aircrafts in the object of taxation.

To summarise, the main ideas of all our suggestions are: taxes do not reduce consumption and not disturb business activity in Ukraine; the tax burden is equally distributed between the taxpayers. These proposals are meant for a short period of time and are aimed at improving the conditions for economic growth. They can be supplemented and corrected after working out the strategy of economic development in Ukraine and the tax reform concept that is based on this strategy. But the latest amendments to the tax code of Ukraine don't take into account the mentioned above requirements. So, we can't expect achieving the fiscal consolidation and stabilization of economy in the near future.

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