Economic Reform Today
No. 37/2001

Paying taxes: dialog between entrepreneurs and power

The Order of Discharging of Liabilities to Budget and State Special Purpose Funds by Taxpayers
Analysis of Draft Tax Code of Ukraine
EQUITY IN TAXATION OF CITIZENS' INCOMES IN UKRAINE.
LEGAL REGULATION OF INSPECTIONS CARRIED OUT BY GOVERNMENT AGENCIES
TAX EVASION AS A SOURCE OF DIRTY MONEY.

Contents

From the editor

As they say, in this world nothing can beEC said to be certain except death and taxes. Everybody should pay taxes and everybody wants to make it easily, comfortably and safely.

Upon adoption of the Budget and Land Codes, carrying out of a "small" court reform, partial implementation of administrative and agrarian reforms, the problem of adoption of a tax code by Ukraine and adjusting of the system of administrative regulation of taxes appears to be central now.

On December 12, 2000 the Verkhovna Rada of Ukraine made efforts to improve the legal basis for tax administration by adopting the bill "On Order of Discharging of Liabilities to Budget and State Special

Purpose Funds by Taxpayers". The law was to set forth a new ideology of relations between a taxpayer and tax institutions, unify procedures of taxes payments and provide a taxpayer with an opportunity to defend his own rights and interests. However, the new law has provoked more questions than answers. You may find contributions by Oleksandr Tatarevsky and Vitaliy Margulis analyzing advantages and shortcomings of the new law and there idea of solutions of the problems existing.

You are welcome to find a comprehensive analysis of the draft tax code of Ukraine presented by the Cabinet of Ministers of Ukraine and adopted upon the first reading, as well as, get acquainted with proposals for improvement voiced by experts.

The problem of "dirty" money amassed through avoiding taxes is considered by Oleksandr Baranovsky. Opinion polls of representatives of domestic small and medium-scale businesses have revealed that now, for each legally earned UAH1 there is USD1.5 given "in an envelope". The author tells about schemes of avoiding taxes that are typical for different countries of the world and involvement of "dirty" Ukrainian capital in these manipulations.

Director of the Center for International Private Enterprise John Sallivan analyses the factors that could ensure long-term economical growth and social development of a country. These factors include, first, a stable democratic system, second, an efficient, responsible and transparent administrative system, third, availability of operable legislation and regulatory codes allowing efficient functioning of market economy.

In Ukraine, as reported by the State Committee for Regulatory Policy and Enterprise Development of November 15, 1998, there were 100 bodies entitled to check, inspect or otherwise control activities of economic entities. Such a big army of controllers and absence of clear control procedures have heavily hampered business development. Oleg Ivchenko highlights this problem making a comparative analysis of two bills aimed at its solving, namely "On Basic Principles of Inspection of Economic Entities by Controlling Bodies" and "On Uniform Methods of Inspection of Economic Entities by Controlling Bodies in Ukraine".

We hope, that the contributions that you may find in our magazine will help you to better understand the current situation with reformation of the taxation system of Ukraine and to make your own opinion on this matter.

Regards,
Maksym Latsyba,
The Editor

Advantages and Shortcomings of the Law "On Order of Discharging of Liabilities to Budget and State Special Purpose Funds by Taxpayers"

Olexandr Tatarevsky

Olexandr Tatarevsky – "Milari" Firm, Accountant

The Law of Ukraine "On Order of Discharging of Liabilities to Budget and State Special Purpose Funds by Taxpayers " No. 2181—III dated December 21, 2000, actually has become the first attempt to generally regulate administration of taxes and duties (compulsory payments) by Ukrainian legislation.

The need in such a law is urgent, as absence of transparent and operable system regulating relations between taxpayers and representatives of inspection bodies when implementing regulations in taxation sphere, is along with high tax rates an obstacle hampering development of business. So, businessmen have had much hope of the law to set clear and understandable to everyone "rules of the game".

Unfortunately, more than a half-year usage of the law has revealed a great deal of drawbacks along with advantages.

So, let's try, step by step, to analyze some provisions of the Law "On Order of Discharging of Liabilities to Budgets and State Special Purpose Funds by Taxpayers" and think of positive or negative effects they could result in.

Inspection Bodies

The very first articles of the law can appear astonishing to some taxpayers, in particular to those, who often have to contact representatives of different inspection bodies.

Thus, upon perusal of articles 1 and 2 one might think, that we finally have received a comprehensive and rather limited list of state authorities, entitled to control timely, proper and full levying of taxes and duties (compulsory payments) and covering tax liabilities and tax indebtedness. And if to regard the fact, that along with this, the Law outlines the scope of inspection bodies, as well as prohibits other state authorities from inspecting economic entities, one can draw a conclusion that from no on there will be less inspections and undesirable for a businessmen "visitors".

Though, a more detailed analysis of the above mentioned provisions of the Law says that it is not quite so.

Firstly, let's focus on article 2 of the Law, which, in particular, reads that payments to the Social Insurance Fund of Ukraine areas controlled by the bodies of the same fund. But a payment to the Social Insurance Fund of Ukraine is not the only one "social" payment. Along with it, payments to State Mandatory Unemployment Insurance Fund of Ukraine and the Social Insurance Fund dealing with accidents at work and industrial diseases should be done. Unfortunately, the Law does not specify, what authorities should control these general compulsory payments.

So, what authorities will undertake control functions over the mentioned above "social" payments remains uncertain, but having enough imagination, one could say that both officers of tax institutions and structures of the Social Insurance Fund of Ukraine could be such controllers.

Secondly, the law banns carrying out inspections by =state= authorities only. So, as both the State Mandatory Unemployment Social Insurance Fund and the Social Insurance Fund of Ukraine could not be reckoned state authorities, this they are not deprived of the right to control respective "social" payments and will want to exercise it.

So, the full list of controlling institutions is not that full, as it seems.

Tax Levying Institutions and Forced Withdrawal of Assets

One of the breakthroughs of the Law is the fact, that it qualifies tax bodies as the only bodies, which have the right to levy taxes.

Taxpayers can be happy, for the range of tax levying bodies has narrowed. At the same time, there is only a faint hope for liberalization of the procedure of forced withdrawal of assets.

For many years withdrawal of owned by taxpayers property normally needed no court judgement (as it should be in a lad-dominated state) and was decided by state tax institutions. Therefore, from the first glance the regulation set force by article 3 appears progressive, emphasizing that taxpayer's assets are subject for collection in order to cover his tax liabilities on the basis of a court judgement =only=. Though, detailed analysis of the law proves this positive impression to be too optimistic. The thing is, that article 3 reads about forcedly collection assets of taxpayers for covering his =tax liabilities=. Unfortunately, lawmakers have somewhat confused the notions. As it could be judged from explanation of forcedly collection provided by article 1 of this Law, assets of taxpayers are forcedly collected for covering of =tax debts=, but not tax liabilities. Despite connection existing between these notions, they still have different meaning in terms of law, thus they could not be perceived as identical. This means, the presumably progressive provision set by article 3 changes nothing in the existing situation, as it does not ban forcedly collection of taxpayers' assets for covering tax indebtedness (which along with overdue tax amount includes fine plus penalty) without a respective court judgement.

This could be further proved by the following law provisions. Thus, article 10 reads that, in order to cover a tax debt, a tax body can sell taxpayer' assets, and specifies the sail procedure itself. At that, the sail proceeds on the basis of a =resolution by a tax body=. This article mentions no court judgement. Following this, under article 10 property of any taxpayers, including individuals (citizens), can be sold without a court judgement.

As far as funds owned by taxpayers are concerned, they can also be collected without a court judgement, Tax bodies can demand payment of a taxpayer' debt or its part from the taxpayer's bank or banks.

As the above provisions of the Law conflict with the Constitution of Ukraine, they should be changed. It is necessary to set provisions in articles 3 and 10, specifying that forced collection of taxpayer' assets for covering his =tax debts= could be done solely by a tax body on the basis of a respective court judgement.

Submission of Tax Declarations and Discharging Tax Liabilities

Accountants and businessmen might have phrased provisions set by articles 4 and 5 of this Law, setting uniform terms for submitting tax declarations, and, what is more important – for discharging tax

liabilities. Though, for the being these law provisions remain rather a "declaration on intentions". One can make such a conclusion having red definitions for "tax liability" and "tax declaration" set forth by article 1. They provide regulation of the terms for submission of declarations and discharging tax liabilities not only by the Law of Ukraine "On Order of Discharging of Liabilities to Budget and State Special Purpose Funds by Taxpayers", but by other laws of Ukraine as well.

Thus, the logic of lawmakers is hard to perceive. If the Law "On Order of Discharging Liabilities…", as its preamble reads, is a =special law=, then, what other laws could be referred to here? If lawmakers believe, that setting uniform terms for submission of declarations and payment of taxes is not that reasonable, then why to set such provisions? This uncertainty results not only in chaos during submission of reports and paying taxes by taxpayers, but in internal conflicts in the law itself.

For example, let's consider article 18, where tax pledge procedure is described. Specifically, failure to pay the amount of tax liabilities evaluated by a taxpayer or a controlling body within the terms =set forth by this Law= is the basis for application of the tax pledge procedure. But, as it was put before, the Law also provides for regulation of terms for discharging tax liabilities by other laws of Ukraine. Thus, under the Law of Ukraine "On Taxation of Income of Enterprises" the income tax on outcomes of activities for the I accounting quarter should be paid by April 20, and under to the Law of Ukraine "On Order of Discharging of Liabilities to Budget and State Special Purpose Funds by Taxpayers" - by March 20. So, there is a question: if the tax pledge procedure should be applied, if income tax is paid, for instance, on March 10? There is no clear answer to this vitally important question, though application of the tax pledge procedure to certain extent fetters a taxpayer in terms of operations with his assets.

Adding irregularities to the domestic legislation, which could hardly be called transparent anyway, does harm to both the state and taxpayers. So, legislators should determine: if the Law "On Order of Discharging of Liabilities …" is really the "special" one, so it sets uniform terms for submission of declarations and tax payment; or it is better to keep up the order, which has formed and functioned prior to adoption of this law. It is hard to say, what decision would be proper, but anyway, things need changing.

Evaluation of Tax Liabilities by Inspection Body

The Law specifies cases, when tax liabilities are to be evaluated by an inspection body, which could also be recognized as one of its merits.

Theoretically, everything seems perfect and understandable. An inspection body has power to evaluate tax liabilities if:

- a taxpayer fails to submit a tax declaration in duly terms;
- the data of inspections of taxpayer's activities disclose underestimation or overestimation of his tax liabilities, pointed in his tax declarations;
- an inspection body discloses arithmetical or methodological mistakes in the submitted by a taxpayer declaration, which resulted in underestimation or overestimation of tax liabilities;
- an inspection body is responsible for levying of a specific tax under laws on taxation.

A number of question arise when implementing the mentioned provisions.

Three of the mentioned four cases are somehow related to a tax declaration. Article 1 of the Law reads that a tax declaration is a document submitted by a taxpayer to an inspection body on the basis of which =levying and/or paying= of a tax, duty (compulsory payment) is performed.

This definition matches the ideology implied by the Law. Accordingly, evaluation of tax liabilities is to be done on the basis of tax declarations, then it is paid, provided tax amounts to be paid are agreed (i.e. upon submission of a tax declaration). Nonetheless, the integrity of this ideology is breached by awkward definitions of "tax declaration" and "tax liability", which allow regulation of this matters by other legal acts as well.

Today, levying of many taxes and duties (compulsory payments) is not declaration-based. Instead, it bases on requirements set by some legal acts, as well as, accounting data and tax reports. Following this, discharging (payment) of tax liabilities often precedes submission of a tax declaration. This, for instance, relates to payments to the Pension Fund and other "social" funds.

Thus, majority of tax reports submitted by taxpayers now does not correspond to the definition of a tax declaration, as no tax or duty (compulsory payment) is levied on the basis of these reports. Reports submitted to the Pension Fund, Social Insurance Fund, reports on income tax could serve as an example. All of them are submitted upon evaluation and payment of the corresponding taxes, and thus they cannot be called tax declarations in terms of this Law.

What does it mean? Amazing, but this means that an inspection body have no power to evaluate tax liabilities for such taxes and duties (compulsory payments) for instance, basing on the results of inspection.

Under this Law, an inspection body has power to independently evaluate tax liabilities, as it was already mentioned, only if it founds any arithmetical or methodological mistakes, discloses underestimation (overestimation) of tax liabilities in tax declarations or if a taxpayer fails to submit a tax declaration in duly terms. So, how one could find mistakes in a tax declaration, if declarations (in terms of the law) on some taxes and payments are not =submitted= at all? Thus, inspection bodies have no power to evaluate tax liabilities for some taxes and duties (compulsory payments).

Today, the problem connected with improper definition of the term "tax declaration" is not that acute, as all forms of mandatory tax reports submitted by taxpayers to the corresponding control bodies are conventionally regarded as tax declarations. But, if to consider the Law provisions from the formal view point, the problem will emerge in the future.

This situation is abnormal. But one could think taxpayers benefit from it, as it limits opportunities for evaluation of amounts of tax liabilities by inspection bodies. Representatives of inspection bodies though are of different opinion on this matter. Thus, one could say that the Law not only fails to set the "rules of the game", but also brings confusion in relations between taxpayers and inspection bodies.

Besides, this problem can directly impact taxpayers. Specifically, improper definition of "tax declaration" can influence tax indebtedness limit terms at evaluating tax liabilities by a tax body, as provided by article 15. If to refer to the text of the Law, one could see, that such limit terms are counted down from the date of submission of a declaration by a taxpayer. So, if there is no tax declaration – no limitation.

As far as tax limitation is concerned, it should be noted, that for some reason lawmakers gave an opportunity to apply it for tax bodies only. Though there other inspection bodies, including the Pension Fund and Social Insurance Fund of Ukraine, which can also independently evaluate (surcharge) taxes. That is why in Article 15 of the Law it would be proper to use the term "inspection body", rather than "tax body".

Concerning evaluation of taxes by inspection bodies, I would like to point out that disclosing of methodological mistakes by an inspection body in the submitted by a taxpayer declaration is one of its grounds. Unfortunately, lawmakers have made no efforts to determine, what a methodological mistake is. As a result, inspection bodies abide by their own understanding of this term, which, as a rule, does not coincide with that of taxpayers. And this, in its turn, results in new disputes between businessmen and representatives of inspection bodies. Therefore it is necessary, that lawmakers stipulate their understanding of the term "methodological mistake", when passing amendments to the Law, which could be further pursued by inspection institutions and taxpayers.

Indirect Methods

One of the ways of evaluation of tax liabilities by inspection bodies are indirect methods. The Law describes several situations, when indirect methods are applicable. Disregarding the fact, that indirect methods are very painful for taxpayers, lawmakers have failed to transparently explain them, which is unfavorable for businesses and citizens.

Thus, the Law sets forth that indirect methods are applicable if a taxpayer keeps no =accounting= . It should be mentioned here, that under Ukrainian laws, it is a duty of taxpayers to maintain accounting. No tax reporting is mentioned there. At that, the Ukrainian legislation does not explain, what tax reporting is, though it has existed for several years already. And here a question comes, how could one punish (indirect methods could be certainly regarded as a kind of "sanctions") for failure to keep tax reporting, if such reporting is not provided by Ukrainian laws at all? And what about the constitutional principle of domination of law?

The other ground for application of indirect methods under the law is absence of primary documents it requires. Here simplified taxation schemes (plans) should be mentioned. Today's legislation does not provide the list of primary documents, which taxpayers under simplified taxation plans schemes should adhere to. And, as taxation is "simplified", people using such schemes often do not need any kind of primary documents. Indeed, why such a taxpayer should want an initial document, confirming the fact of spending (for instance, for purchase of fixed assets, services etc.)? As for simplified schemes, here income of a taxpayer is important rather than his spending. Nonetheless, under this Law unavailability of primary documents, confirming the fact spending by a taxpayer, who is taxed under the simplified scheme, can theoretically be the ground for application of indirect methods.

Avoiding submission of the data required by the legislation by taxpayers or leaders of enterprises could also be the ground for indirect methods. This provision is also ill-formulated. It is a known fact, that the

term “legislation” comprises not only Ukrainian laws, but also legal acts passed by state institutions. Following this, for instance, the State Tax Administration (or other inspection body) could pass its resolution demanding mandatory submission by leaders of enterprises of any information, including the data constituting commercial or bank secret or not related to economic activities of enterprise. And failure to submit such data would be regarded as the basis for indirect methods.

To avoid similar situations, the law should provide the list of information, failure to submit which constitutes the grounds for indirect methods.

It is difficult to judge from the text of the law, what is implied under “avoiding” submission of data. For instance, should the case, when a taxpayer requests a representative of an inspection body to present a written demand for submission information and specify the grounds, be regarded as avoiding? Thus, an inspection body will rather perceive such instances as “avoiding” submission of data with all the consequences. Maybe, it would be more sound to use the term “failure to submit” instead “avoiding”. Thus indirect methods would be applicable, if a taxpayer =failed to submit= the required by the law data.

So, analyzing the provisions of the Law, one may say that indirect methods for evaluation of tax liabilities can result in brutal malpractice against taxpayers.

On my opinion, introduction of indirect methods on this stage is absolutely premature. Such methods should be introduced along with adoption of a tax code. Therefore, the Law should provide not only the list of instances, when indirect methods are applicable, but to specify methods of their application.

Appealing and Conflict of Interests

The procedure for settlement of disputes as to tax liabilities evaluated, namely, appealing is certainly one of the advantages of the Law. Even if to assume, that taxpayers will benefit much from it, its very existing, as the Law reads it, enables businessmen to properly prepare for disputing actions by inspection bodies in court. Besides, within appealing process, one can use such a new for the Ukrainian legislation concept as “conflict of interests”.

Ambiguity of interpretation of terms and concepts is inherent to the legislation of Ukraine. This results in numerous disputes between tax collectors and taxpayers. Therefore, introduction by the Law of the concept “conflict of interests” was welcomed by all economic entities. Thought, we should state that this provision of the Law has its faults. Thus, under the law, should a conflict of interests occur, a decision in favor of taxpayers is taken upon = appellate agreement= only. This means, a court may (but it is not bound), when considering disputes between a taxpayer and a tax body, to decide in favor of a taxpayer, if there is conflict of interest.

Regarding this, there is only a faintest hope that conflict of interests will be widely used within appealing procedure. One should first prove it to tax collectors, that “conflict of interests” really takes place. Tax services, as a rule, rather clear and unambiguously interpret provisions of tax legislation, but remain reluctant to here alternative interpretations. Second, a tax service body is not bound to decide in favor of a taxpayer, even when conflict of interests is present. No sanctions provided for it. Certainly, such a decision could be disputed in court, but, as it was mentioned before, the court is not bound to take decision in favor of a taxpayer, grounding conflict of interests only. Thus, everything remains, as it was before.

Using the notion of conflict of interests when disputing of actions and decisions of tax institutions in court would be in fact a breakthrough. As only a court, being a neutral party in disputes between taxpayers and tax institutions, can determine, if a conflict of interests exists and decide fairly.

I would also like to note that despite of a “positive character” of the stipulated by the Law procedure of appellate agreement as to tax liabilities, formal approach to it could result in serious disputes between inspection bodies and taxpayers. This is because the Law does not provide the uniform order of paying taxes and duties, allowing its regulation by other Ukrainian laws.

I will proof my opinion. As the Law reads, tax liabilities, estimated by a taxpayer himself in a =tax declaration= are deemed to be agreed from the date such tax declaration was submitted. Though, as it was noted earlier, for today declarations (as the Law implies it) are not submitted for all taxes and duties (compulsory payments). So, if there is no tax declaration, there is no agreed tax liabilities with all its aftereffects. Thus, literal pursuing of the Law can result in creation of absurd situations. But, if not pursue the Law, then who need it?

We are only to hope that lawmakers will remove the above-described irregularities.

Penalty

The uniform order of charging penalty and imposing fines for all taxes and duties (compulsory payments) is certainly one of the advantages of the Law. Though, very few would call the order set by the Law an advantage.

First, it is to note that according to the new order, penalty is charged not only on the amount of tax indebtedness, but on the fine amount as well. Such an approach is seen unreasonable, and at the same time, it violates transparency of the Law. As the Law reads, a fine is a payment in a =fixed amount= or as percentage from tax liabilities, which is collected from a taxpayer for violation of taxation rules. But in contrast to the definition, the order stipulated by article 16 of the Law provides for charging of penalty on the fine amount. I.e., the fine amount is no longer fixed and can grow.

On my opinion, penalty, as a measure of recovery of losses, incurred by the state from unduly payment of taxes, should be charged on the amount of tax liabilities only. A fine, from the view point of the state, is a kind of punishment for violation of legislation in the sphere of taxation, which is aimed to provide for meeting requirements of the legislation, but not for getting recovery of losses. Therefore, its rate, as provided by article 1 of the Law, should be fixed.

Besides, there are certain problems (which this Law fails to remove) as to charging penalty on fine amounts. Thus, the Law does not specify, from what moment penalty should be charged on the fine amount: is it from the moment when a tax body imposes fine, or from the moment the grounds for fining emerge. Obviously, this moments do not coincide in time. Thus, underestimation of tax liabilities by a taxpayer is, under the law, the grounds for imposing of fine, but it will be actually imposed only when a tax body discloses the said violation.

But charging of penalty on fine is just a trifle. Article 16 of the Law provides for charging penalty on the amount of tax indebtedness. Under the definition given in article 1, a tax indebtedness (debt), along with tax liabilities and fine also includes =penalty= charged. Here we are: penalty is charged on penalty. No comment, as they say.

There are still more problems connected with charging penalty. There are certain difficulties when defining of the moment of emerging of a tax debt (i.e. the moment, from which penalty is charged). This will be specified later.

To change the situation with charging of penalty, the Law should clearly read that penalty is to be charged only on the amount evaluated tax liabilities, which was agreed by taxpayer, but unpaid within duly terms.

Pardoning Tax Debt and Liquidation Indebtedness Books

Pardoning of tax debts and liquidation of tax indebtedness books have been the most desirable things for many taxpayers.

According to article 18 of the Law, a debt, which have existed from December 31, 1999 and have not been paid until the date this article has come in force, is subject for pardoning. From the first glance, there should be no problems with this provision. But using this Law in practice has revealed the opposite.

Having pardoned the tax debts, which have been booked by tax bodies in personal accounts of taxpayers, tax collectors have refused (namely, by Resolution of STIU No. 1 dated March 1, 2001) from pardoning tax indebtedness, which will be disclosed upon inspection of taxpayers' documents for the previous years.

This problem may really have certain grounds. One of them is the fact, that the Law does not qualify the moment, when tax indebtedness emerges. That has enabled tax bodies to assert, that, when underestimation of tax liabilities by taxpayers for the previous years is disclosed, tax debt emerges. In other words, if inspection a taxpayer's activities and documents for 1999 is carried out in 2001, tax debt also emerges in 2001 (if facts of underestimation of tax liabilities in 1999 are disclosed).

In such a case, arguments of inspection bodies could be rather simple. Under article 1 of the Law, tax debt is amount of tax liabilities, =agreed= by a taxpayer or estimated by court procedures, unpaid in due terms. In case tax liabilities are evaluated by an inspection body (for instance, upon inspection) they are is deemed to be agreed with a taxpayer when receives a tax notification (under article 5 of the Law). Thus, tax liabilities of 1999, evaluated by a tax body in 2001, will be considered agreed in 2001, as a taxpayer receives tax notification in 2001. And respectively, a tax debt could emerge in 2001.

Opinion of inspection bodies in such a case could be disputed. The opposite position could be also justified by another provisions of the Law. But this will not solve the problem. It could be solved by amending

the law only. Thus, there should be a uniform approach to all taxpayers: to those, whose tax debt has been booked and those, whose debts will be disclosed upon inspecting activities for the previous years.

The uniform approach to all taxpayers is one of the main principles of the taxation system of Ukraine.

The said problem could be solved in several ways: the Law should either specify the moment of emerging of tax debt, or provide pardoning of all tax debts (including those in the books of tax bodies and those, which could be revealed upon inspection for previous years).

The list advantages and shortcomings of the Law of Ukraine "On Order of Discharging of Liabilities to Budgets and State Special Purpose Funds by Taxpayers" is possible to continue. Some of its drawbacks will be revealed in further practice.

The Law is far from being perfect, still it does not mean that it is bad a priori. On the contrary, from the ideological viewpoint it seems rather attractive. Tough, to set the uniform rules of the game in the sphere of administration of taxes and dues, the law needs amending. And from my point of view, lawmakers should decide, if this law is a =special= one, or the sphere of tax administration is regulated by a number of other laws and legal acts related to taxation. Yet, if this law is special one, it would be reasonable to involve economic entities in the process of its amending, as they are to carry out the law provisions in their activities.

Advantages and Shortcomings of the Law "On the Order of Discharging of Liabilities to Budgets and State Special Purpose Funds by Taxpayers"

Summary of Focus Group Research

On September 28, 200, in the framework of the Information for Reforms Program, the Ukrainian Center for Independent Political Research and the Center for International Private Enterprise in cooperation with the Institute for Competitive Society carried out a focus group research on "Advantages and Shortcomings of the Law "On the Order of Discharging of Liabilities to Budgets and State Special Purpose Funds by Taxpayers".

The focus group research objectives were as follows: to evaluate the present situation in the system of administration of taxes; define main achievements and shortcomings of the Law "On the Order of Discharging..." and to formulate amendments that are necessary to move.

The research was carried out using deep conjoint interviewing (a focus groups method) and expert assessments. By the snow ball method a group of 7 participants was composed, which included experts in legislation as to the system of tax administration. Specialists representing different society sectors were involved in this group: entrepreneurs, state officials, researchers, lawyers, accountants and independent analysts, which made possible carrying out of thorough and comprehensive study of problems on the agenda.

The focus group participants

Volodymyr Dmytryshyn, the Council of Business Associations of Ukraine at the Cabinet of Ministers of Ukraine

Kseniya Lyapina, project coordinator at the Institute for Competitive Society

Oleksandr Mostovenko, head of the taxpayers department of the State Tax Administration of Ukraine

Antonina Palamarchuk, vice-president of the Association of Ukrainian Banks

Sergiy Seheda, lawyer at the International Center for Prospective Researches

Valentyna Sirenko, deputy head of the general tax indebtedness department at the State Tax Administration of Ukraine

Oleksandr Tatarevsky, accountant of "Milari" Firm

The research gave a great deal of reliable information, enabling to formulate key problems of the system of tax administration, point out advantages and shortcomings of the Law "On the Order of Discharging …", as well as specify recommendations for improvement.

The obtained research materials are reliable and can be used in practice for further quantitative researches and scientific analysis of the given problem.

The research findings could be of interest to lawmakers, representatives of respective authorities, entrepreneurs, academicians, journalists and the public.

Research Summary

The research participants pointed out the following key problems of the system of administration of taxes:

- Poor legal basis in this sphere, absence of clear regulation as to levying and payment of taxes
- Inefficient control system over correctness of levying and payment of taxes
- Arbitrary interpretation of regulations by some state agencies, which results in conflicts and violations of law
- The Tax Code made efforts to provide regulation for procedures of tax administration, though procedural norms should be regulated by legal acts
- A priori acknowledgement of a conflict existing between an entrepreneur and a tax institution officer
- Regulations stipulated by the Law "On the Order of Discharging…" are in fact unfamiliar to the vast majority of entrepreneurs
- There is a problem of confusion over of the concepts of tax administration and forced collection of taxes

The research participants pointed out the following advantages of the Law "On the Order of Discharging…"

- The Law sets forth positive ideology of respecting a taxpayer and his interests
- The "books" of tax indebtedness by enterprises-debtors to the national budget were liquidated
- The Law introduces the concept of "conflict of interests"
- The Law made efforts to provide the unified procedure and terms of submission of declarations and tax payment
- The Law provides the uniform order of imposing fine and charging penalty
- Introduction of the appealing procedure enables a taxpayer through corresponding with to better understand the opinion and demands of the Tax Administration and provides time to get prepared for disputing the decision taken by it in court
- The Law introduces new positive procedures, as tax compromise, overdue debt, tax pledge and other ways of prolonging of tax payment
- The Law provides the uniform order of imposing of fine and penalty and cut their rates, having set brackets of 5%, 25% and 50%
- Introduction of taxation notifications and taxation demands gives a taxpayer time for voluntary payment of the taxes imposed. Earlier, if there were any tax debts, the money was immediately withdrawn from a taxpayer's account or the account was closed without any preliminary negotiation. From now on, it is possible to keep up rather lasting correspondence with a tax institution, during which a taxpayer can either pay his taxes, arrive at tax compromise, or dispute the decision by a tax institution in court
- The Law provides the list of property, which cannot be used for covering tax indebtedness
- The Law made efforts to give a comprehensive list of inspection and fiscal bodies
- The Law includes the regulation providing possibility to take decisions in favor of a taxpayer in case of ambiguous interpretation of terms
- Tax shifting was legalized
- The present Law has strengthened and expanded the provision of the Presidential Decree "On Some Deregulating Measures" and removed some discrepancies with the Law "On the State Tax Service".
- In case of tax indebtedness, the Law provides a taxpayer with ten days for voluntary discharging of tax liabilities without charging a penalty
- The Law provides a taxpayer with forty-day term for covering his tax indebtedness. It also prohibits tax institutions and court officers from applying tax pledge or carry out any other operations with the debtor's money assets during this period
- Regulation, according to which tax institutions are bound to pardon hopeful debt to the budget was first introduced
- Regulation, according to which tax prolongation can exceed a budget year was provided
- The Law sets the regulation, according to which capital assets of a state enterprises and enterprises of communal ownership can be sold by the State Property Fund only. No other tax institutions, executive bodies or "Ukrspezyust" have a power to do so

The research participants pointed out the following shortcomings of the Law "On the Order of Discharging…":

- Regulation, providing the order for settlement of conflict of interest between a taxpayer and a tax institution is applicable only within the framework administrative agreement and is not applied when settling disputes in court
- Declaring plenty positive things, the Law, at the same time, lacks their proper formulation
- The Law does not regulate the problem related to liquidation of tax indebtedness "books" and pardoning of the debts, which remain disclosed today, but could be disclosed upon inspection of an enterprise's activities for the previous periods in future
- The Law introduces new procedures of tax payments and submission of tax declarations, but does not rule out the existing, which results in conflict between provisions of different laws
- Debts limit terms should be counted down from the moment of emerging of indebtedness, but not from submission of declarations
- The Law reads that the taxation administration, inspection and other bodies can practice tax surcharging in certain cases, including failure to submit a declaration, disclosure of irregularities or mistakes during an inspection. For today there are many reports submitted, which do not match the terms set by this Law for submission of declarations. Specifically, these are all reports submitted to social funds, which have no declaration status. Thus, a question arises, if tax inspections can surcharge taxes or duties should mistakes be disclosed in such cases.
- The Law does not specify, if its regulations are applicable to payers of the uniform tax
- The Law equals violations of tax pledge procedure by a taxpayer to deliberate avoiding tax payments, i.e. a criminal offense. At the same time, violation of tax pledge procedure is not always as harmful, as offense related to deliberate avoiding taxes
- Pardoning of tax debts will differently impact the macroeconomic situation in Ukraine
- Obviously, the tax administration officers are not ready psychologically for taking decisions on tax compromise, prolongation and paying of tax indebtedness by installments
- Tax pledge amount is not adequate to that of a tax debt
- Introduction of indirect methods is seen premature. Application of this methods will become possible only upon a deep tax reform, provision of transparent tax legislation and understandable well-formulated procedures of tax administration
- The Law does not specify the notion of methodological mistake
- Tax institutions have no authority to cancel a tax pledge, thus to enable an entrepreneur to withdraw a part of his property in order to receive a bank credit or bring in this property as a mortgage
- Under the Law, UAH14 bill. were pardoned and amount of prolonged indebtedness makes UAH4. This is the reason why the budget has failed to receive UAH 18 bill., which will impact carrying out of the budget in general
- The Law does not play a role of a defender of the budgetary interests
- Cancellation of tax indebtedness books regarding unregulated legislation and taxpayer's negative mentality makes it impossible for tax institutions to trace all money flows, which hampers settlement of payments
- The Law does not provide the mechanism for interaction of inspection bodies, tax bodies and banking institutions.

Participants of the discussion fount reasonable to move the following amendments to the given Law:

- The Law should qualify, to what payments its provisions are to apply
- It is advisable to specify the list of inspection institutions their powers, for instance, powers and methods of the Audit Commission, National Commission for Electrical Energy, the State Commission for Securities and Fund Market etc
- The Law should qualify relations between banks and tax institutions when withdrawing tax indebtedness from debtors' accounts
- The Law is to bound tax institution to register the fact of tax pledge
- The Law should specify and adjust its provisions to the existing special laws regulating some taxes
- It would be reasonable to enter a regulation, specifying tax debt amount, surpassing which will turn on the mechanism of tax pledge

- Terms of tax payments should be qualified (either under the new Law, or under those already existing)
- The Law is to qualify, if tax bodies are to sail property being tax pledge on their discretion, or on the basis of a court ruling

Analysis of Draft Tax Code of Ukraine and Proposals for Improvement

By Denis Yershakov

Denis Yershakov – expert at the Center for Development of Ukrainian Legislation

The tax legislation is one of weak points of the Ukrainian legislation, reformation of which has been expected by the business community for a long time. Despite the fact, that turbulent debates around the Tax Code and adoption of the so-called "Small Code" died in summer this year, when the parliament appeared unable to provide the process of budget estimation for the next year with a new tax base, it seems rather reasonable resume this discussion. Besides, accurate and balanced revising of such an important for economical stabilization basic document on taxation and effective reformation in taxation could be considered as a prime advantage during an election race.

Let's see, what the drafted by The Cabinet of Ministers of Ukraine and adopted in the first variant basic document on taxation lacks. For this, let's try to analyze some of the notorious five thousand amendments and proposals to the Tax Code and predict, what businessmen are to wait from the "tax constitution", when it is revised by lawmakers.

It's been a long time since the first discussion of alternative draft tax codes in the Verkhovna Rada, so let's try to call to memory the sequence of events and main positive changes achieved by introduction of the "new rules of the game" in taxation. In July 2000 the elaborated by the Cabinet of Ministers of Ukraine draft tax code with a number of reservations was taken as the basis for further working. And everyone agreed then with necessity to remove shortcomings and to amend the document. Thus, the Verkhovna Rada Committee for Finance and Banking and the Cabinet of Misters of Ukraine were entrusted to amend the draft code and submit it to the Parliament in the revised variant (this is fixed by the VR Resolution BP No.1868 dated July 13, 2000).

What should be the principles of amending? In general, the main objective of a tax code, as a legal document of direct action, consists of unification of all provisions regulating the order for levying and payment of taxes and duties in a state. A tax code should include (and harmonically unite) the legal basis, principles of building and functioning of a tax system, as well as, to qualify powers of all participants of taxation process, formulate the essence of all its elements and specify mechanisms for evaluation of national and local taxes and duties. Besides, the basic document on taxation should set the tax base, the procedure of payment of taxes and duties and any changes to it whatsoever, describe forms and methods of tax control, the procedure of punishing taxpayers and senior officials of tax institutions for violation of the tax legislation. To play the central role in creation of an operable and efficient taxation system in Ukraine, the code supposed to finally regulate tax relations in the state, should comply with modern requirements and principles of elaboration of an operable legal act.

Unfortunately, this document has a number of alterations when explaining concepts and notions. In some instances absolutely different approaches to levying the same taxes are provided. The style of some articles could not be deemed understandable for the wide strata of taxpayers. To avoid different understanding and ambiguous interpretation of the code provisions which could result in conflict situations, it would be reasonable to simplify the text of provisions in general and to adjust the text of the document to the uniform lexical and stylistic system conventional for the sphere of legislation. To some extent the poor systematization of the code could be explained by the fact that it was elaborated by several groups of specialist, who worked on particular sections of the code.

In some instances, insufficient requirements and simplified approach to systematization of different aspects of taxation, both in the existing tax legislation and amendments to it, have resulted in mechanical uniting of all legal acts regulating taxation into one. Within the process of regulation of the taxation and basing on the existing system of basic taxes (income tax, individual income tax, VAT etc.), it is necessary, first of all, to unify and adjust the rules of tax levying and payment. In particular, the style of the code provisions should correspond to the principle of interaction between all elements of the legitimate taxation mechanism, being an integral part of the legislation system on the whole.

As to amendments, according to the adopted first variant of the code, they can be passed no later than six month before the beginning of a new budget year, and they will come in force no earlier than from the beginning of a new budget year. At the same time, this means an opportunity to amend any kind of provisions in the code whatsoever, which brings the principle of stability of the taxation legislation to naught. Therefore, it appears necessary to prohibit for a certain period amending of those code provisions, which relate to basic elements of taxation – the list of taxes and duties, tax rates (less excises), levying principles and banning of non-agreed withdrawing of money from taxpayers' accounts. Besides, prohibition for executive authorities from introducing surtaxes, changing tax rates and granting privileges is a necessary prerequisite for creation of an integrated legislation system (as required by articles of the Constitution of Ukraine).

The Tax Code, being a fundamental legal act on taxation, should provide a systemized list of taxes and duties, which the adopted variant lacks. Besides, the code general provisions should set requirements for regulation and definition of each of the following elements: subject of taxation (range of taxpayers), object of taxation and tax base, taxation period, rates, order of tax levying and payments. When evaluating the individual income tax a tax-free minimal income of individuals should be considered. Thus provisions, regulating each specific tax are to be revised in order to avoid any irregularities possible.

Chaos in terminology of the draft code could be explained by the fact, that along with definition of terms provided in its separate article, each section has its own list of terms with their interpretation applicable to this section only. Thus, it would be reasonable to provide a unified and systemized list of terms with their interpretation to be applicable to the code on the whole. Including the definitions of the terms "income (gross income)" and "income (profit)" in one article is seen incorrect (section 26-28 p. 1013), as this categories are of different meaning (different constituent elements) when regulating, for instance, the income tax and the VAT, so, their definition should be given in the respective articles of the Tax Code separately. To avoid alterations and different interpretations, the code should work out uniform terminology. It would be reasonable to specify the meaning of each term immediately upon the first reference to it in the text and to adhere to it within the whole text of the code.

It should be noted, that the given draft code does not differentiate between the notions "tax" and "duty" as well, though from the economical viewpoint these terms are of different essence. The difference of a tax from a duty is that the first is "repayable" and the second is "non-repayable". The term "duty" means a compulsory payment for carrying out of some legal actions by state institutions or state officials. They include granting of certain rights, permissions and licenses, as well as, measures for functioning of the state social insurance and the state social welfare system.

The presented by the adopted draft system of taxes and duties is also far from being perfect. The somewhat irrational list of taxes and duties comprises, inter alia, the school tax (which is a kind of a turnover tax levied on the total from production sails at the rate 1-2% and creates additional burden on businesses), the duty for development of viniculture, gardening and hopping and national uniform duty levied at control points of Ukrainian state borders. Among the other local taxes and duties, such ineffective taxes making a small percentage from the budget receipts, as the hotel tax and resort duty, as well as dues for permission to arrange trading and service places have remained unchanged. It is necessary to shorten the list of taxes and duties and remove the mentioned anachronisms. Instead, it is possible to enhance efficiency of the whole system of direct and indirect taxes, provided that this system consists of the most important basic taxes, which make considerable percentage from budget receipts. This will allow to reduce total outlays for administration. At the same time, to provide for the proper level of budget receipts, the tax base should be expanded and the existing privileges should be cancelled. This will offset shortening of the list of taxes and duties.

The fact, that the draft code does not provide the full coverage of taxation-related items is also seen its drawback. Thus, it does not include duties of social character, which, as lawmakers claim, could considerably reduce tax burden. Though, having in mind that the Tax Code, inter alia, aims at covering all aspects of taxation within one document, which would be used both by subjects of taxation and inspection bodies, it should also include provisions for social payments. Although these payments are not included to this year budget, still they are compulsory payments and administered by state authorities. Therefore, they should be included to the Tax Code of Ukraine in form of a uniform duty to the State Social Fund, which would comprise all payments to state extra-budgetary funds (Pension Fund, Social Insurance Fund, Mandatory Unemployment State Social Insurance Fund).

The draft also provides changes related to the income tax, namely, the order of determination of the date of increasing of gross income and gross expenditure: income is deemed to be gained from the moment of transfer of ownership for some products. Expenditure is deemed to occur at the same time with the income, for

gaining of which expenses have been born. Such an amendment is absolutely unsound. The code has a provision permitting to include current expenses in gross expenditures only upon the fact of receiving of income. There could be a situation, when an enterprise would be unable to normally cover its expenses. As often, when an enterprise bears expenses (for instance, purchasing stationary) it does not know for sure, for what activities it will use the purchased goods (it is possible, that it will use them for different activities), or if these activities bring return at all. Implementation of this provisions will result in curtailing of innovation processes, impossibility for enterprises to introduce new technologies and renew their material and technical base. Instead, it would be reasonable to provide a uniform "upon the event" approach to determination of occurrence of income or expenses (when evaluating the income tax and the VAT) and rule out the mentioned provisions.

Besides, in draft the code retains some provisions on taxation of income, which have been the reason for disputes and need changing. Thus, the rules of amortization of assets has remained unchanged (on the basis of the balance cost of fixed capital); it is prohibited to include current expenses to production gross expenditures, not to mention covering of expenses for lubricants, technical service, repair, garaging, parking of cars and car renting from income (section 2 p.2031). Here introduction of a linear method of amortization estimation is seen reasonable, which would itemize the objects of amortization and at the same time increase amortization rates and reduce its terms: from 6% to 48% depending on types of fixed assets.

The draft code has certain irregularities in the list of incomes and expenses, for which an enterprise will be able to reduce the object of taxation when estimating the income tax. Specifically, it provides for a mechanism, allowing to include amounts paid for purchasing of fixed assets on leasing basis in gross expenditures. This could result in different misapplications: the major part of fixed assets would be acquired on leasing-basis, thus, payments for such fixed assets would be immediately included in expenses. The draft code should set provisions, disabling a taxpayer-lessor to include the purchased by him fixed assets, being an object of financial leasing, to his fixed assets, and at the same time to ban immediate including expenses for purchasing of such fixed assets to expenditures. Fixed assets acquired on leasing basis, should be included to fixed assets of a leaseholder.

The adopted draft code does not provide for simplified taxation system through purchasing a tax patent. This means total cancellation of this comfortable way of taxation of small businesses, which has proved to be of high efficiency. There is an opinion, that the right for purchasing of a tax patent should be reserved by individuals occupied in casino business, law, audit or notary practice only. The value of such tax patents will be defined by the code depending on a kind of activities. Thus, taxpayers – legal entities, having purchased a tax patent, will not pay the income tax and the value added tax, and individuals – the value added tax and the individual income tax (on earnings gained from such activities).

In the context of individuals' income taxation the draft regulates evaluation procedure for the cost base of immovable that is for sale by mere referring to the legislation of Ukraine, or by the some method of analogies, which is not explained at all. Therefore, the Law should set a mechanism of single declaration of property, which would not require documentary attest of the property value, to provide individuals with certain starting facilities for their further legal transactions with their funds (investing, purchase of real estate etc.).

The provision that regulates submission of income declarations by individuals and provides opportunity not to submit declarations by some categories of taxpayers (individuals having no additional source of income, or whose income from several sources has not surpassed the total of 12 minimal salaries for the year) should be adjusted to the requirements of article 67 of the Constitution of Ukraine ("… all citizens annually submit property and income declarations to tax inspections in their residency"). Thus, the draft should set the rules for submission of full or brief (tax report) declarations. The draft code should also provide the right to submit a brief declaration for those individuals, who within one fiscal year have received income in form of salary, state pension, scholarship, addressed aid, housing subsidies and compensations, and whose total income for a calendar (fiscal) year has not exceeded the total of 12 tax-exempt minimal salaries.

The draft code provides rather complicated rules of refunding the difference in the VAT payment and VAT liabilities to a taxpayer (VAT surpass). The project proposes a multi-level and complicated system of refunding. Thus, tax institutions have a right to demand from taxpayers documents related to inspections and audit of financial and economical activities. This provision should be amended, as, for instance, economic entities-exporters need prompt refunding of such VAT surpass. For the rest, the terms of VAT surpass refunding could be longer, for instance, 4 calendar months. Besides, the mechanism for accounting of the VAT surpasses occurring during import operations should be worked out in order to meet interests of the taxpayers,

who has been occupied with such business for a long term, carries out large-scale taxable transactions and has no tax debts.

As far as excises are concerned, there was a proposition to change the mechanisms for estimation of differentiated rates. There are three kind of them described in the draft: ad valor (in percentage), fixed and mixed. Instead, it would be reasonable to set brackets of the excise tax (in EURO). Abiding by these brackets, the Cabinet of Ministers of Ukraine would propose specified rates of this tax which would be further approved by the Verkhovna Rada of Ukraine.

Regulation of taxation of property proposed by the draft, uniting tax on of real estate (buildings and edifices) and land tax into one, also has certain drawbacks. The value of land plots, buildings and edifices, which are in ownership or exploitation, was set as the object of taxation. The draft does not changes the complicated mechanism of evaluation of the tax base for land plots, it still bases on either a plot value, or its dimensions plus a number of indexes. Introduction of additional indexes for land plots, located in recreation areas, could hamper tourism in Ukraine. To create initial conditions for efficient taxation of property, problems of evaluation of owned by individuals and enterprises property should be solved. Therefor, it is proposed to enter a provision, which will set current value of immovable as of January 1 of an accounting year as the tax base. For land plots, such a value will be determined using special methods, worked out by the Cabinet of Ministers of Ukraine. The cost of reconstruction of buildings and edifices will be taken as their current value, and if it is impossible to estimate – their balance cost. Besides, the value of property, pointed by individuals in their single declaration of property, as was specified earlier, could be taken as the tax base of individuals.

The present draft grants almost unlimited powers to tax institutions. This could create opportunities for malpractice, which would not allow economic entities to normally develop their businesses. Therefore, the power to distress tax debtors' assets and include them in a tax pledge; to arrest property; to evaluate debtors' property collected as a tax pledge that is subject for sail, should be delegated to court officers only, i.e. the draft should provide for the court-based settlement of disputes related to tax payments.

Under the draft, the Cabinet of Ministers of Ukraine regulates the order of scheduled and non-scheduled inspections, at that, non-scheduled inspections can be carried out on the basis of the resolution of a tax institution leader at any time and without preliminary notification, which is seen unreasonable in terms of the current economic situation and contradicts to the principles of law-dominated statehood. Regarding this circumstances, the order of conducting scheduled and non-scheduled inspections set forth by this draft should be changed, i.e. the draft should qualify rights and obligations both of taxpayers and tax levying institutions, as well as powers of senior officials, including those to be exercised by them when conducting inspections in offices of economic entities. There must be no more than 1 inspection a year.

In such a way, revising the Tax Code adopted by the Verkhovna Rada of Ukraine in the first variant will allow to improve this legal act and adjust it to the requirements, which the basic document on taxation of a country should meet. Adoption of the revised code will be a step for our taxation legislation toward worldwide used norms and standards.

"WHEREVER I AM AND WHATEVER I DO, I OWE MY MOTHERLAND EVER..."

By Vitaly Margulis, director general of the Ukrconsulting association, academician of the international Higher Academy of Cooperation

"Severity of laws hampers compliance"
Montesque

Before analyzing the law in force "On Procedure for Enforcement of Taxpayer Liabilities to the Budget and Public Purpose Intended Funds", I would like to cite a couple of wise men, who are well-known and highly respected all over the world. Francis Beckon mentioned three sources of injustice: violence, laws not protecting against willful actions and severity of laws. According to Friedrich von Hayek, the less capable the state is, the more laws government adopts. The very fact of enactment of the above law, its major provisions and expected implications serve as another confirmation of the cited words.

According to its preamble, the above law is "a special taxation law that regulates procedures for enforcement of liabilities of legal entities and natural persons for taxes and other mandatory payments to the budget and public purpose intended funds, calculation and payment of fines and penalties imposed on

taxpayers by controlling bodies". It is also indicated that the law "establishes the procedure for appeals against decisions of controlling agencies". Quite obviously, all the above procedures should have been set either by laws on certain taxes or duties or by the Civil Code of Ukraine, whereas adoption of the special law dealing with those issues once again demonstrates deficiency of the national legislation.

Almost all major provisions of the law serve as a confirmation of inadequacy of Ukraine's legislation and prove that the authors of the above quotations were right. Noteworthy, authors and advocates of the law accentuate positive changes introduced by subparagraph 19.3.2 reading, "Banking institutions shall accept payment documents presented by customers only in the event that there are sufficient funds on their accounts..." This provision does mean that the so-called tax file ceases to exist. Moreover, subparagraph 19.3.1 directly indicates that the tax file is abolished. From the viewpoint of advanced economies, taxation system based on the tax file is archaic and represents a post-communist paradox. However, I would like to adduce another quotation illustrating traditions of taxation system in this part of Europe. Outstanding historian Kluchevsky wrote, "What should have resulted in growing efficiency of people's work due to application of European cultural standards, turned into brutal fiscal exploitation of the people and oppression on the part of the police." Analyzing the above novation, it is necessary to remember that the underlying principle of taxation of entrepreneurial intentions instead of results of business activity makes Ukraine's taxation system different from most of those in developed economies. Following this principle, taxpayers assume liabilities to the budget and different funds long before they receive any payments from their customers. Prior to abolition of the tax file, taxpayers could submit payment documents to the bank and thereby avoid fines and penalties regardless of the amount of money on their bank accounts. From now on, there will be no such an opportunity and controlling government agencies will be capable of initiating bankruptcy proceedings against any business participant, leaving people jobless and reducing solvent consumer demand. Taking the above into account, it is possible to conclude that before abolition of archaic rules, lawmakers should have developed modern and civilized taxation principles.

Really positive change is introduced by subparagraph 1.1 of Article 3 reading, "Taxpayers' assets can be confiscated to enforce their tax liabilities only by court (arbitration court) decision." Though, subparagraph 7.2.1 is not in line with this provision, as it governs that "controlling bodies may decide, which taxpayers' assets will be used to enforce tax liabilities." It is quite obvious that controlling officials will prefer to be guided by the latter provision. This is not the only contradiction of Article 7. In conformity with subparagraph 7.3.1 determining what assets cannot be used to enforce tax liabilities, "it is prohibited to confiscate any assets being integral parts of property of state-owned enterprises not subject to privatization..." This rule of law runs counter to the Constitution and the law of Ukraine "On Property", since it directly discriminates private and collective forms of ownership. The above provisions apply to natural persons as well. To protect themselves, lawmakers included in Article 9 the following regulation: "Additional restrictions may be imposed by legal documents with regard to types of property of natural persons that can be confiscated to enforce their tax liabilities." Such restriction will hardly be geared toward protection of average citizens.

Article 8 "Tax Pledge" is another "masterpiece" of lawmakers. Its preamble provides that assets of taxpayers having budget arrears are subject to tax pledge "for the purpose of protecting interests of recipients of budget funds." Categories of recipients, whose interests shall be protected, are not specified. Nevertheless, it is possible to assume that lawmakers meant not school teachers, doctors and pensioners but those using state-owned villas and limousines, visiting sanatoriums and resorts at public expense etc. Furthermore, "tax pledge must not be documented." Hence, property owners will not even be aware of the fact that their property rights have been limited. Subparagraph 8.4, being the height of absurdity, establishes that despite the fact that existence of tax pledge may be unknown to property owner, it shall have priority over any other type of pledge.

Article 5 "Procedure for Calculation of Amount of Tax Liabilities, Appeals against Decisions of Controlling Bodies" demonstrates legal inequality of citizens, entrepreneurs and economic entities on the one hand and government agencies on the other. According to subparagraph 5.2.6 of this Article, "if a taxpayer appeals against decisions of taxation agencies in court (arbitration court), decisions of controlling bodies shall not be sufficient to consider a taxpayer guilty of tax evasion until the final verdict of the court is announced. Accusations, based not only on decisions of controlling bodies but also supported by additional evidence presented in compliance with criminal procedural law of Ukraine, shall be sufficient to consider a taxpayer guilty." Does it really mean that an authority other than the court can find anyone guilty of criminal offence? Is it really superior to any court?

I suppose that no analogues for the term "tax compromise" introduced by the law can be found in any other national legislation. Subparagraph 5.2.7 indicates that any businessman and any controlling official can "legally violate" any law, having reached preliminary agreement with his/her counterpart. This subparagraph is worth citing in full:

"Controlling official authorized to consider the taxpayer's appeal in the frameworks of administrative appellate procedure shall have the permission to propose the taxpayer a compromise settlement, which implies reduction of claims by the controlling body and taxpayer's agreement to pay the remaining share of tax liabilities.

Compromise settlement shall be proposed on the basis of facts and body of evidence provided by the appellant and giving good reasons to consider that compromise to be proposed can lead to speedier and/or fuller payment of tax liabilities, as compared to the option of settling the argument in court (arbitration court).

The procedure for application of this subparagraph shall be established by the national taxation authority."

I believe, no other rule of law can stronger stimulate criminal offences and corruption.

Another rule conflicting with the Constitution is incorporated in subparagraph 4.4.2 "Interpretations of Taxation Legislation", whose subsection "d" reads, "interpretation of taxation legislation is a published official explanation of some provisions of taxation laws." On the one hand, this rule provides for different interpretations of legal documents. On the other hand, all interpretations other than those made by controlling bodies are deemed to be informal. Moreover, controlling bodies are given the permission to interpret laws running counter to the rule of law that the Constitutional Court of Ukraine is the only authority empowered to interpret laws. Under the above subparagraph, "although interpretations of taxation legislation are not legal acts, they shall be reckoned with during the appellate procedure." Only the national taxation body is authorized to publish interpretations of taxation legislation thereby giving instructions to its regional departments.

As a matter of fact, the law established absolute irresponsibility. At the same time, subparagraph 6.2.1 of the law actually made the Pension Fund and the Social Security Fund of Ukraine subordinate to taxation authorities. Under the law, if a controlling body that carried out the procedure for agreement of tax liabilities with a taxpayer is not a taxation authority, that controlling body shall present respective taxation authority with a request to institute measures for enforcement of tax liabilities and calculation of their amount. On the basis of those documents, taxation authority shall demand payment. Firstly, it means that all payments to the Pension and Social Security Funds are viewed as taxes. Secondly, in the event of conflicts, the Funds will be able to state that they were not involved in the enforcement process. And finally, since the Funds are not able to ensure their receipts without assistance of taxation authorities, they are made subordinate to the latter. Wouldn't it be more expedient to transform the Funds into departments of taxation bodies?

Article 9 "Administrative Arrest of Assets" also runs counter to the Constitution and the law "On Property" establishing that property may be arrested only by court judgment and not decisions of administrative bodies. In compliance with subparagraph 9.1.3 of this Article, "arrest of assets means that owner of assets is prohibited to dispose of any of assets under arrest and must ensure their safe keeping and maintenance in proper condition. Any assets may be subject to arrest." Totally neglecting the right of ownership, this regulation can be viewed as a step towards the Soviet type of economy, similar to that under military communism.

The gist of subparagraph 19.4.5 remains absolutely unclear. According to this subparagraph, Article 8 of the Law of Ukraine "On Criminal Investigation Activity" should be amended as follows: "As for investigations of criminal offences in the sphere of taxation, all rights granted by this Article can be exercised exclusively by the tax police bodies within their competence." It is really difficult to understand, why it is proposed to no longer consider violations of taxation legislation as economic criminal offences, as the latter have always been within the competence of the Economic Crime Department of the Ministry of Interior.

Critical analysis of the law "On the Procedure for Enforcement of Taxpayer Liabilities to the Budget and Public Purpose Intended Funds" was initiated by several MPs, who proposed changes and amendments to the law. During public discussions of the legal document, entrepreneurs and representatives of the State Taxation Administration and Supreme Arbitration Court of Ukraine made a lot of critical remarks and well-grounded proposals. Hence, there is an urgent need for introduction of radical changes and amendments to this law.

EQUITY IN TAXATION OF CITIZENS' INCOMES IN UKRAINE.

By Valentyn Tregobchuk, doctor of economics, professor, head of the department for resource potential at the Institute for Economics of the National Academy of Ukraine; Oleg Moroz, doctor of economics, professor, dean at the chair of economics at the Vinnytsya National Technical University; Serhiy Matviychuk, junior research officer at the chair of economics at the Vinnytsya National Technical University; Ludmyla Shveijkina, lecturer at the chair of economics at the Vinnytsya National Technical University

The notion of taxation equity is the underlying idea of any system of legal regulation. Despite heated debates about the essence of this category, it has been the key attribute of any civilized taxation system for many years. The law of Ukraine "On Taxation System" establishes the principle of social equity alongside with other basic principles of formation of taxation system.

In the economic aspect, the principle of taxation equity means that revenues and expenditures of the national budget should influence redistribution of incomes placing heavier tax pressure on some citizens and providing others with tax privileges. Academic literature distinguishes two major types of social equity – horizontal and vertical[1]. The principle of horizontal taxation equity is based on the idea that the amount of taxes to be collected must depend on the amount of taxpayer incomes. Under the principle of vertical taxation equity (the principle of benefits), the one, who is granted more tax privileges shall pay more taxes. However, segregation of horizontal and vertical equity cannot completely solve one of the major problems of taxation, i.e. identification of the extent, to which taxation is equitable.

Paying closer attention to the above problem, it would be expedient to differentiate its two integral parts: assessment of taxation equity or direct collection of tax payments and estimation of equity of redistribution of collected tax payments. Such segregation seems quite logical, since equity of state expenditures or a method for distribution of funds formed of tax receipts does not directly depend upon a tax collection scheme.

This article mostly discusses methods for measuring tax equity during formation of income tax receipts. It is a matter of common knowledge that the income tax belonging to direct taxes does not represent the most efficient method for increasing budget revenues. Though, the reason for its application in taxation systems of many countries is that it performs an important social function, for the income tax stimulates leveling of citizens' incomes. In general, it is commonly supposed that direct taxes play not only a fiscal but also a leveling role.

However, quantitative analyses cited in the academic literature proves that even in the United States of America maintaining the old and stable tradition of the use of direct taxes, the purely fiscal aspect of the income tax does not have a strong impact on leveling of citizens' incomes[2]. On the contrary, it is the effect of national budget expenditures that is believed to be more progressive and efficient from the viewpoint of ensuring tax equity. In other words, distribution policy has priority over fiscal one. So, the question arises, whether it would be expedient to increase budget receipts by means of the income tax, which is less effective from the fiscal viewpoint than the value added tax on the one hand and whose collection won't result in tangible leveling of citizens' incomes.

Proceeding from the aforementioned, the article is targeted toward analysis of taxation equity in Ukraine from the fiscal viewpoint notwithstanding the public distribution policy or the effect of national budget expenditures. Authors deem such a provision to be rather essential, as Ukraine's national budget is formed not only of the income tax and effectiveness and justice of the public distribution policy is not based only on a method for collecting tax payments.

To answer the above question, a number of indicators characterizing various aspects of tax equity in Ukraine and calculated on the basis of statistical data were closely analyzed.

The first stage of the above analysis is represented by formation of statistical database to be used for calculation of indicators characterizing conformity of the income tax with the principle of tax equity or its ability to influence distribution of incomes so that to bridge the gap between various strata of population.

In our analysis, we use such indicators as division of Ukraine's economically active population by the level of income and structure of the gross income of different groups of population[3]. On the basis of the structure of the gross income, it is possible to calculate average amount of tax payment per representative of each group. In this respect, we assume that incomes received as wages and salaries are taxable, incomes from secondary activities are non-taxable according to the Cabinet resolution "On the Income Tax of Citizens" and

incomes from other sources are not included in the formally declared amount of the gross income. Incomes from subsidies, grants and pensions should also be viewed as non-taxable by definition.

On the basis of those assumption we divided personal income into two parts: taxable, including incomes from salaries, wages and business activity, and non-taxable, inclusive of incomes derived from secondary activities and other sources. As a matter of fact, correlation between those two parts will be different for each group of taxpayers, for it will depend on the structure of the gross income within the limits of each definite group.

For each group of the economically active population, calculation of the amount of the income tax represents a function of the amount of income to be taxed in two cases: taxation of wages/salaries (realistic) and taxation of the whole income (potential).

As a result of all calculations, we finally received a database required for further stages of analysis and incorporating division of Ukraine's economically active population by the level of their total incomes, separation of taxable and non-taxable incomes as well as paid and potential amount of the income tax. Table 1 gives input and output data as well as formulas used for some calculations.

Table 1. Calculation of division of the income tax payers (1999).

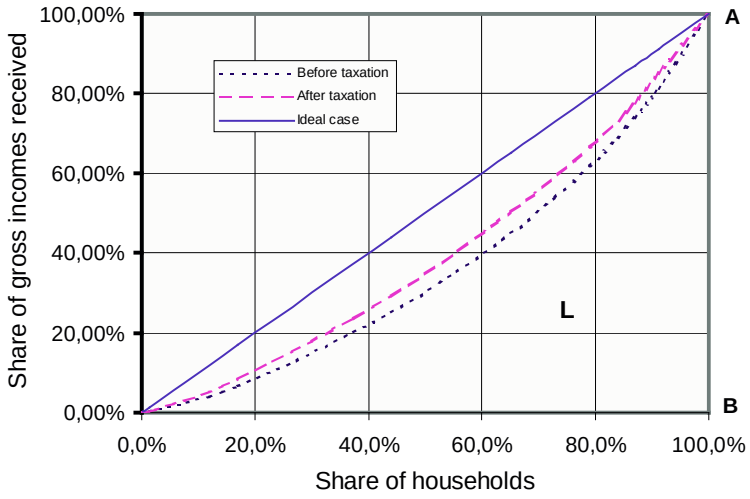
Statistical indicators											
Share of economically active population, %	0.3%	4.8%	15.5 %	21.1 %	17.7 %	13.1 %	9.6 %	5.8%	3.7%	2.6%	5.8%
Average monthly personal income, UAH	33.04 5	99.1 35	165. 23	231.3 15	297. 41	363. 5	429. 59	495.6 75	561.7 65	627.8 55	726.9 9
Including:											
Wages and salaries, %	31.7	42.7	50.9	53.1	54.4	55.5	61.6	62.6	57.9	57.7	58.4
Income from business activities, %	1.2	2.9	2.6	4.0	3.2	3.9	4.3	5.9	5.9	8.2	9.1
Income from sale of agrarian produce, %	18.2	13	7.5	6.3	4.8	3.3	3.3	2.7	2.6	2.8	2.3
Pensions, subsidies, grants, %	33.4	30	27.2	27.1	27.6	27.8	22.1	19.8	21.9	21.3	14.2
Other sources of income, %	15.5	11.4	11.8	9.5	10	9.5	8.7	9	12.4	10	16
Estimated indicators											
Potentially non-taxable gross income ([P6+P7]*P2)	16.15 901	41.0 42	64.4 38	84.66 13	111. 82	135. 58	132. 31	142.7 54	192.6 854	196.5 186	219.5 51
Total amount of income prior to taxation of all incomes (P3+P4+P6+P7)	22.00 797	69.3 95	120. 28	168.6 29	215. 32	262. 44	334. 65	397.5 31	442.6 708	494.1 219	623.7 574
Potential amount of income tax (f(P9))	0.500 797	5.23 95	12.0 93	19.34 43	28.6 14	38.0 39	52.4 79	65.05 63	74.08 416	84.37 438	110.3 015
Paid amount of income tax (f(P9-P8))	0	1.13 53	3.88 46	6.696 73	9.57 45	13.0 79	26.0 17	36.50 54	35.54 709	45.07 065	66.39 129
Calculated share of tax in personal income (P11/P2)	0.0%	1.1%	2.4 %	2.9%	3.2 %	3.6 %	6.1 %	7.4%	6.3%	7.2%	9.1%

It should be mentioned that the assumed need to divide income into taxable and non-taxable is a very important factor that can essentially influence the analysis results. Meanwhile, there is no other opportunity to form database required for the analysis due to the absence of realistic data on household incomes in this aspect. Though, accuracy of our calculations and adequacy of the received results can be verified. For instance, multiplication of the calculated average amount of the income tax paid by one taxpayer by the number of the economically active people gives the amount of potential budget receipts from the income tax

equaling UAH 4,372 million in 1999. Since in reality this figure constituted UAH 4,434.4 million or miscalculation amounted to around 1.5%, database received on the basis of the above calculations can be viewed as quite exact result that can serve as a basis for calculation of indicators directly characterizing the subject of our analysis.

In our viewpoint, it would be expedient to start the taxation equity analysis with the Lorenz curve construction. The Lorenz curve is a striking example illustrating the principle of taxation equity "in practice". The curve demonstrates how progressive taxes can bridge the gap between incomes of taxpayers making distribution of incomes after taxation more equal than before (see figure 1).

Figure 1. Lorenz curve



Using the example of the Lorenz curve, the academic literature states that progressive taxation is the most fare, as it enhances taxation equity. Taking into account the fact that the Lorenz curve serves as the most illustrative and famous attribute of taxation equity, it would be rather interesting to construct such curve and calculate the Jinni coefficient with regard to the income tax in Ukraine.

According to the given criterion, Ukraine's system of taxation of citizens' incomes is characterized by inability to perform redistribution of citizens' incomes following the principle of social equity, i.e. for the purpose of closing the gap between distribution of incomes among different social groups. Therefore, opportunities of the national taxation system to level citizens' incomes seem quite minor.

It is almost impossible to enhance taxation equity measured using the Jinni coefficient. The Jinni coefficient analysis indicates that the existent system of taxation of citizens' incomes cannot ensure their leveling even provided that taxpayers will declare all incomes they receive.

In 1999, incomes of 10% of the most impoverished citizens amounted to 19.2% of those of 10% of the richest. Subsequent to taxation, the above figure increased up to 20.54%, while its maximum value constituted 20.98%. The above can be explained by extremely low income of the 10% group formed of representatives of the most impoverished citizens on the one hand and inefficient system of taxation of citizens' incomes on the other.

Hence, the aforementioned indicators prove ineffectiveness of the income tax in Ukraine from the viewpoint of implementation of its major objective. However, neither the established inefficiency of taxation of citizens' incomes in Ukraine nor quantitative measurement of that ineffectiveness point out to the factors that evoked such a situation. Apparently, there are numerous factors (one of the most important preconditions is growing inequality of citizens' incomes), though we would like to pay our attention to those that directly relate to the taxation system. For that purpose, we would analyze indicators characterizing the taxation system in details, such as real tax rates applied to different social groups and their mean-square error.

By real tax rate, we mean rate used for ultimate calculation of the amount of taxes to be transferred to the budget or the relation between the amount of paid taxes and that of the gross money income:

$$R = \frac{T_{paid}}{I_{gross}} * 100\%$$

To put it differently, in our example, real tax rate is represented by the part of the amount of the income tax in the gross income of a citizen.

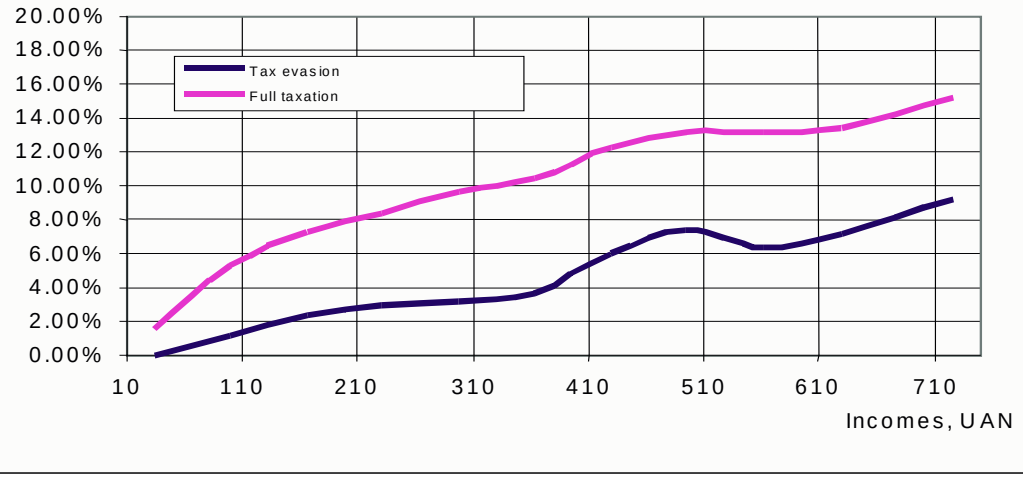
Since taxable amounts of citizens' incomes in Ukraine are calculated on the basis of progressive scale providing for non-taxable minimum amount of income, real tax rates for citizens with different incomes will vary. Analyzing those rates, we will be able to estimate tax burden on different income groups and its impact on leveling of citizens' incomes.

Moreover, quadratic deviation of real tax rates applied to different social groups from weighted average real tax rate is another important indicator (see figure 3). Economic essence of this indicator lies in the fact that it characterizes deviation of real tax rate from the average value. It is quite understood that the higher is the dispersion, the more differentiated is tax burden on different social groups. Growth of this indicator proves increasing difference between the lowest and the highest real tax rates applied to incomes of the most impoverished and the richest citizens. Hence, value and dynamics of the above indicator allow calculating the extent, to which taxation is equitable.

Analyzing the obtained results, first of all, it is necessary to pay attention to discrepancy between real tax rates calculated on the assumption of complete tax payments and real tax rates paid only partially as a result of tax evasion. Diagrams given in figure 3 indicate that progressive taxation of citizens' incomes in Ukraine is only of declarative nature. In fact, provided that the rich citizens conceal a substantial part of incomes, growth of real tax rate is very slow and unstable.

The diagrams demonstrate that incomes of the overwhelming majority of Ukrainian population, except for the most impoverished citizens, whose incomes do not exceed the amount of UAH 100, were taxed at the 2-9% real rate. Taking the above into consideration, it is necessary to mention once again that according to official data, incomes of 10% of the richest citizens five times exceed those of 10% of the most impoverished strata of population and in reality this gap appears to be much higher.

Figure 2. Real tax rates, 1999.

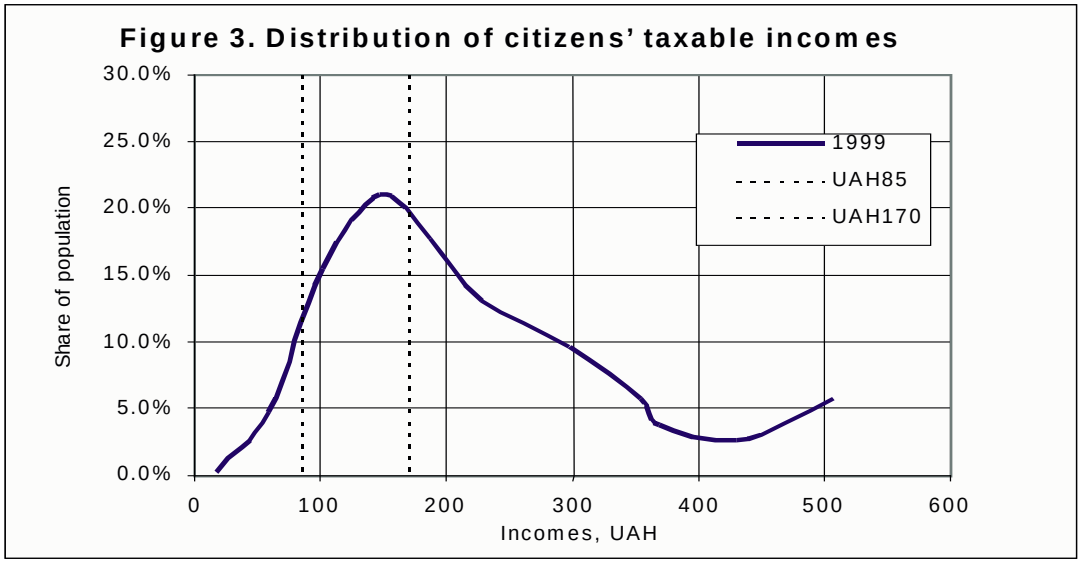


Proceeding with the analysis of figures, we would like to emphasize that in conformity with calculations, weighted mean real tax rate amounted to 4.03% in 1999. The same year, mean square deviation of tax rates constituted 4.29%, whereas minimum calculated tax rate equaled 0% and maximum one constituted about 10%. On the one hand, the above proves existence of a gap between tax rates applied to different income groups determining a certain tax differentiation. On the other hand, calculated figures characterize the current situation as rather unstable, especially, if to compare those data with indicators calculated by Musgrave, Kaize and Leonard for the US[4]. According to those indicators, in 1968, the share of the income and property taxes in American citizens' incomes fluctuated from 2% (for citizens with annual income below US$ 4,000) to 21.2% (for citizens with annual income over US$ 92,0000). As for those data, it is necessary to state that taking into account a twenty fold difference in incomes between the marginal groups, the US taxation agencies applied tax rates differing more than ten times.

It is necessary to mention that such a situation emerged because of considerable share of concealed personal incomes. Should we study real tax rates calculated on the assumption of declaration and taxation of all incomes, the situation will be very optimistic. According to statistical data, in 1999, real tax rate would have amounted to 9.8%, while standard deviation would have equaled 6.276%, which, to a certain extent, is in

line with the idea of more or less fare redistribution of incomes but does not provide prerequisites for its formation.

Therefore, results of analysis of distribution of real tax rates in Ukraine are unsatisfactory, which can be explained by inefficient taxation system and wide-spread tax evasion. The above results actually mean that the majority of population pay taxes at the rate close to average one. In other words, declared differentiation of tax rates does not actually exist and progressive nature of tax rates remains obscure. As a matter of fact, taxation rate close to proportional one is applied in Ukraine, as it provides for just minor deviations from average value.



We believe structure of taxation system, namely the income tax, to be one of the reasons for such a discrepancy between declared principles of that system and its actual implications. Indeed, should we study the scheme of distribution of citizens' taxable incomes given in figure 3, it will be possible to conclude that over 50% of Ukrainian citizens' incomes lie in the limits of UAH 17-85 or UAH 85-170. To put it differently, over 50% of Ukrainian population pay taxes at close rates. Given this situation, it is hardly possible to expect considerable differentiation of amounts of tax payments that could influence the Lorenz curve and Jinni coefficient.

Economic literature gives different definition for the notions of progressive tax and taxation system. In general, it is safe to suggest that the idea of progressive tax implies growth of its rate with increase of taxpayers' incomes and thereby heavier tax burden. It is common knowledge that progressive nature of taxation system is a vitally important precondition for taxation equity.

As we have already mentioned, to realize the declared principle of progressive income taxation, Ukraine's taxation system envisages taxation of natural persons at the compound progressive rate, according to which total income shall be divided into several shares, each of them taxed individually. In this case, each following share of the total income is taxed at a higher rate. So, formal attributes prove Ukraine's income tax system to be progressive. However, previous calculations give grounds to doubt the possibility of reaching the required standards of social equity and equality. The following chapter describes an effort to determine the extent, to which the income tax is progressive in Ukraine by means of quantitative indicators and establish, whether the progressive income tax really fosters more optimal distribution of incomes among citizens.

As a rule, rates of growth of the amount of income tax exceed those of income itself. A calculated value of weighted progressive income tax effectiveness indicator demonstrates that for all groups of taxpayers, average rates of increase of its amount exceed those of income tax growth by nearly 35%, which proves sufficiently progressive nature of income tax system .

At the same time, it would be expedient to stress that value of progressive income tax effectiveness indicator P1 is too unstable with regard to certain social groups. For example, the diagram demonstrates that progressive income indicator reaches its maximum value in the point that approximately corresponds to monthly income of UAH 150. For social groups with such income, increase of income tax amounts with growth of incomes occurs 1.5-2 times quicker than increase of income itself. Meanwhile, as for the social group with monthly income exceeding UAH 450 (upper middle income), the break-neck fall of progressive

income tax effectiveness indicator P1 is observed. In case of citizens with high incomes exceeding UAH 550, this indicator tends to grow again. As far as the middle income group is concerned, values of the indicator lie between 30% and 5%. Although, no upward or downward trend is observed, which could be expected.

We would like to determine factors influencing dynamics of progressive income tax effectiveness indicator P1. For this purpose, it is necessary to establish the role of such factor as tax evasion. If we completely disregard the above phenomenon, calculated value of the weighted mean progressive income tax effectiveness indicator P1 will go down to 16%. At the same time, values of the indicator will become more stable with regard to different income groups. The diagram (see figure 3) illustrates absence of considerable fluctuations of respective curve.

It should be accentuated that income curve based on values of the progressive income tax effectiveness indicator P1 calculated disregarding tax evasion factor is downward, which serves as evidence that the income tax in Ukraine becomes less progressive with growth of incomes regardless of taxpayers' financial discipline. The above means that even under theoretical assumption that absolutely no incomes are concealed, rates income tax growth will tend to decrease with increase of personal income. So, it is doubtful that current system of taxation of personal incomes could even hypothetically serve as a basis for effective leveling of citizens' incomes.

In general, the obtained results are in line with distressing conclusions made on the basis of the real tax rate analysis. Dynamics of P1 and P2 indicators demonstrate that notwithstanding progressive nature of Ukraine's taxation system, it becomes less progressive with growth of incomes. It means that as personal incomes grow, the amounts of income tax reduce in both relative and absolute terms, which entails almost intangible differentiation of tax burden on the majority of taxpayers. It should also be emphasized that this distinction is not evoked by tax evasion but inherent in Ukraine's taxation system.

Conclusions

I. This article addresses the issue of equity in taxation of citizens' incomes on the basis of a large number of various indicators, including the Lorenz curve, the Jinni coefficient, the quadratic deviation of real tax rates, progressive income tax effectiveness indicators etc.

II. According to the constructed Lorenz curve and calculated Jinni coefficient, Ukraine's income tax system is characterized by its inability to redistribute citizens' incomes following the principle of social equity and in such a manner that would bridge the gap between different income groups. Real tax rates and indicators of progressive income tax were analyzed so that to determine the reasons for the above situation.

III. Analysis of real tax rates distributions proves that incomes of most citizens are taxed at the rate close to average one. In other words, the declared differentiation of tax rates is actually absent and taxation system remains insufficiently progressive. As a matter of fact, Ukraine's taxation system is rather proportional than progressive, since it provides for just minor deviations from average rate.

IV. Statistical data allow a conclusion that the share of income tax increases with growth of income, which serves as evidence of progressive nature of the income tax in Ukraine. Though, the analysis made in this article indicates that correlation between the paid income tax measured in relative and absolute terms and growth of personal income varies in different income groups and tends to decrease. Therefore, the income tax in Ukraine becomes less progressive with growth of incomes, which, alongside with tax evasion, considerably complicates efforts to bridge the gap between different income groups and more fairly distribute citizens' incomes.

V. Analysis of the maximum possible amount of tax revenues proves that regardless of tax evasion compound progressive taxation of the concealed amount will not result in substantial enhancement of tax equity and will not entail any tangible leveling of citizens' incomes.

VI. Hence, income taxation is not an important factor of enhancement of taxation equity. A well-designed system of redistribution of tax receipts can produce much better results. Taking the above into account, sources of formation of funds to be distributed will not matter. It is necessary to stress once again that income tax mostly performs the leveling and not fiscal function. We have established that for the time being, Ukraine's income tax system performs its fiscal function only partially and completely fails to accomplish the objective of leveling citizens' incomes. Therefore, it would be expedient to increase budget receipts by means of more effective and predictable taxes, such as the VAT, and enhance taxation equity through well-designed and transparent system of funds' distribution.

VII. Understanding the fact that the above proposal is radical and may be unacceptable, it is imperative to outline necessary changes in Ukraine's taxation system. One of the key measures for smoothing

(not removing) the aforementioned negative factors is revision of the existent income tax scale aimed at bringing it in line with the structure of citizens' incomes. The analysis demonstrates that the issue of taxation equity is the most topical for persons with incomes up to UAH 120 and over UAH 450. Therefore, to enhance taxation equity, it is necessary to level the amount of non-taxable minimum income and that of living minimum and differentiate the scale's sector corresponding to the gross monthly income of 10-60 non-taxable minimums.

References:

[1] Pushkareva V. M. History of Financial Discipline and Taxation Policy. Textbook. Moscow. The Infra-Moscow. 1996; Yutkyna T. F. Taxes and Taxation. Textbook. Moscow. The Infra-Moscow. 1998.

[2] Atkinson A. B., Stigliz J. E. Lectures on Public Economics. The McGraw Hill Book Company. International Edition. 1995. P. 386-388.

[3] 1999 Statistical Year-Book of Ukraine. The State Committee for Statistics of Ukraine. Kyiv: The Ukrainian Encyclopedia. 2000.

[4] Pushkareva V. M. The same source

Democracy, Governance and the Market

John D. Sullivan
Center for International Private Enterprise

Since the early 1980s, the world has witnessed an unprecedented trend toward democracy and market-based economies. Nonetheless, much work remains to be done to reinforce this progress and to prepare nations for the political and economic realities of the 21st century including globalization. Even long established democracies such as Colombia, Peru and Venezuela have seen their political and economic stability threatened. Other countries including Turkey, Indonesia, and Ukraine are under severe pressure as they attempt to establish a democratic rule- of-law society, now seen as the minimum requirement for business and economic growth.

Contemporary history has shown that countries with democratic, market-based systems are best equipped to respond to the challenges of globalization. Specifically, there are three essential aspects of democracy that have proved to be crucial to long term economic and social development.

· A stable democratic system is the best guarantor of political stability, which is essential for long term economic growth.

· Democratic practices such as transparency and accountability are essential for effective and responsive government and for efficient and prosperous economic activity. (The financial crises Asia and Russia experienced in the late 1990s are cases in point.)

· Sound legal and regulatory codes backed by the rule of law must exist if business is to thrive in a market economy.

Strengthening democratic governance

The experiences of the 1980s and 1990s demonstrate that failure to incorporate democratic governance as part and parcel of economic reforms seriously jeopardizes the entire reform agenda. For much of the last twenty years it was fashionable to speak of the Washington Consensus, a reform program based on macroeconomic stabilization, fiscal reform and other adjustments to economic policy. Recent developments–especially in Eastern and Central Europe (as well as in Indonesia and Argentina)–demonstrate the limits of this approach. Equal attention must be paid to the key institutions in society and to the process through which government decisions are made. In short, building democracy and a market economy has to begin by making sure that the rules of the system are open and fair for all.

The intellectual foundations for efforts to build a broader and more comprehensive democratic reform agenda stem from the field of New Institutional Economics developed by Ronald Coase and Douglass North who won the Nobel Prize for their work. In its simplest formulation, the institutional approach simply says that rules are important in conditioning outcomes. Put more elegantly, the success or failure of any effort to achieve a long-lasting transition to democratic market-oriented systems depends on the design and functioning of the underlying institutional framework.

In order to highlight the importance of institutions, let me point out three common myths about the relationship between the state and the market:

The first myth is the belief that once private enterprise constitutes a substantial portion of an economy, it has become a market economy. History abounds with examples of where this has not been the case. The Philippines under Ferdinand Marcos and Indonesia under Soeharto are classic examples of economies that were capitalist based on private enterprise. But they definitely were not open-market systems. Economists call this type of behavior rent seeking. The rest of us call it corruption and cronyism. Simply stated, the greater the degree of systemic corruption in a society, the less its economy functions on market principles.

It should be emphasized that many different types of market economies are possible, and there are real distinctions between the institutional structures in different countries. But all market economies share a common feature: a competitive system where the rules are the same for all participants. Furthermore, only a fully functioning democracy can sustain such as system over time.

The second myth is grounded in the common misconception that the business community or the private sector in general is a homogeneous monolith that either supports or opposes certain policies or leaders. This is not the case. In fact, most countries have several business communities, each with its own interests and objectives. In the economy of a single country there can be the state sector, the private sector and the informal sector. Even within the private sector, there might be firms and entrepreneurs who work mostly in international trade while others are engaged in producing solely for the domestic market. Clearly, these two groups will not always support the same policies. Nor will they always favor market-oriented reform.

Firms created behind protectionist trade barriers–and with strong links to and benefits from government–tend to support the status quo. Often they also are quite anti-democratic. Conversely, firms that have been locked out of government favors, small entrepreneurs and those engaged in international trade are quite often the leaders behind the demand for change. Because the business community is so diverse, it would be wiser to form partnerships with business associations, think tanks, foundations, and other business organizations that have a vested interest in an open economy and a democratic political system.

The third myth is the most dangerous and is often called the market fundamentalists' view. It is the belief that markets will spontaneously emerge if government stops intervening in the economy. This is far from true. The government must establish consistent, fair rules and laws so that a strong market economy may emerge. Further, government institutions and self-regulating organizations have key roles to play in ensuring that the rules are enforced. Credible, fair bank supervision is but one of the most obvious of these functions.

Without binding rules and structures that govern all players, anarchy follows. Business then becomes nothing but "casino capitalism" where investments are only bets: bets that people will keep their word and that companies tell the truth; bets that workers will be paid; and bets that debts will be honored.

Foreign assistance and development

Getting the relationship right between government departments, business organizations, civil society, and market institutions is really vital. Any foreign assistance programs run by the donor countries or the international financial institutions must seek to achieve some very concrete objectives:

· Promote development of the laws and institutions necessary for open, market-oriented economies including property rights, antitrust or competition laws, banking regulation, and sound accounting rules.

· Increase citizen participation in the democratic process by allowing business groups and other parts of civil society to participate in the day-to-day process of making decisions.

· Create open systems of feedback to government including legislative hearings, regulatory review panels, citizen advisory panels, and other channels of communication between society and the state.

· Foster private voluntary organizations and freedom of association.

· Build support for–and understanding of–the rights, freedoms and obligations essential to a democratic private enterprise system.

· Enhance the entrepreneurial culture of the society by providing incentives to innovate, save, invest, and launch new firms.

· Simplify compliance systems for micro and small businesses to enable them to join the legal (formal) economy and the mainstream of society.

· Expand access to business and economic information necessary for informed decision-making by all parts of civil society.

Reports from the field

How can these objectives be accomplished through actual projects? Below are some examples of how business associations, think tanks and other civil society groups have implemented these goals. Many other examples and links to other groups can be found at CIPE Web site http://www.cipe.org/ and at http://www.ned.org/, the site of the National Endowment for Democracy in the US.

Strengthening the role of business associations and creating a national business agenda. As advocates for the private sector, business associations play a vital role in encouraging good governance and sound policymaking in industrialized nations. In most emerging market economies, however, such associations are only beginning to realize the importance of "strength in numbers" and why it is in the business community's interest to promote a democratic process. Mobilizing small and medium-sized enterprises is especially important to create the critical mass that drives reform. Associations are one of the most effective groups to carry out this effort.

National business agendas. A common tool to affect public policy is a national business agenda. This agenda identifies policy reforms of the highest priority for the business community in the near term. The agenda specifies the reform in terms of laws and regulations and offers concrete suggestions for vital changes. The key to the national business agenda is the notion of participation. Programs in countries as diverse as Egypt, Paraguay, Haiti, and Nigeria have followed a similar set of steps:

- Meeting with members in open forums to identify barriers to business growth and job formation
- Analyzing policies and forming recommendations
- Publishing in the media to gain input from concerned parties
- Formulating policy reform programs
- Publicizing the agenda
- Presenting the agenda to the President and key ministers in a national meeting
- Ongoing advocacy directed at the government, including the executive and parliament branches

The Nigerian Association of Chambers of Commerce, Industry, Mines, and Agriculture (NACCIMA) has used its agenda for several years to coordinate economic reform. In 1999, this task assumed critical importance due to the country's struggle to create a true democratic system after a number of years of military rule. Given the degree of pressure on NACCIMA from both Nigeria's political transition and its continuing economic crisis, developing and publicizing the national business agenda demonstrates NACCIMA's remarkable ability in the face of considerable hardship.

Another good example is the National Association of Businesswomen (NABW) in Malawi. Over the last several years, NABW created a national call to action to redress the grievances experienced by women entrepreneurs. It held regional forums across the country featuring focus group meetings that identified the major issues facing women including lack of information and access to credit. Based on these meetings, the NABW developed a national business agenda and advocated before government in support of legislative changes that would boost the growth of women-owned enterprises in Malawi.

Reforming institutional structures that create barriers to participation in the formal economy and democratic decision-making. Members of the informal sector are entrepreneurs who produce legitimate products without proper permits or legal status because they lack the resources to comply with burdensome, excessive rules and regulations necessary to participate in the formal economy. In many countries the informal sector can account for up to 50% of the official economy. These entrepreneurs are locked out of the formal economy and the political process as they work in low-income, low-growth business activities. A large and growing informal sector results from fundamental flaws in government processes and is proof that a market system hasn't been created.

Hernando de Soto of the Institute for Liberty and Democracy in Peru was one of the first persons to recognize the challenges the informal sector presents to political and economic reform. Lack of secure property rights is central to his thesis that millions of people are condemned to poverty in many countries of the world, as well as sidelined from their countries' political discourse. De Soto's path-breaking research has literally changed the nature of the debate about markets and democracy as illustrated in his latest book, The Mystery of Capital. Further, the efforts of de Soto and his ILD team are building market institutions in such diverse settings as Egypt, Mexico and the Philippines. He will shortly be turning his attention to Russia following a lengthy meeting in July with President Vladimir Putin who expressed considerable interest in his work.

Combating corruption to support democratic values. Business communities in developing countries are realizing that corruption is costing them money, and they must do something to eliminate it. Corruption not only hurts economically the business community and the citizens of developing countries, it also has a destabilizing effect on democracy and the general well being of a nation. Combating corruption can serve as a lever or a tool for bringing about broader reforms and improving the functioning of governance.

The National Association of Entrepreneurs (ANDE) in Ecuador created a research and advocacy program targeted at eliminating some of the main opportunities for corruption. ANDE's focus has been not to

blame past corruption on any one particular group. Instead it championed the need to initiate reforms that will change the direction of business and institute clean governance practices.

Its studies showed that since the Republic of Ecuador was founded 167 years ago some 92,250 legal norms have been created–and 52,774 still were in force in 1997. The sheer number of overlapping, unclear and contradictory laws and regulations has created an environment of legal chaos, leaving the application and enforcement of laws to the discretion of bureaucrats. Since Ecuador is a civil code country (as opposed to a common law country), its courts could not reconcile law or create precedents. To address this critical issue, ANDE recommended creating a seven-member judicial committee empowered to codify and reconcile existing law. ANDE's advocacy campaign succeeded so well that the judicial committee it recommended has been included in Ecuador's new constitution.

Another approach to combating corruption is to help build the watchdog role of the media in society. CIPE has launched a new network called Journalists against Corruption or PFC (its Spanish initials) made up of 500 journalists throughout Latin America. PFC supports journalists dedicated to investigating and exposing waste and unethical conduct in government and corruption in all sectors of society. PFC is a network, clearinghouse and service provider for these journalists and the organizations that support them. It not only encourages enhanced investigations and reports about corruption, it also offers investigative assistance and advocates on behalf of journalists when they suffer reprisals. Last year, for example, protests from PFC journalists resulted in the prompt release from jail of two Mexican reporters who had been reporting on corrupt practices and drug trafficking by the police. PFC is accessible from CIPE's Web site at http://www.cipe.org/

Promoting sound corporate governance measures. Another focal point in a comprehensive strategy is the promotion of sound corporate governance principles. This issue is obviously related to anti-corruption issues because it attacks the supply side of the corruption relationship. Further, since the high-profile scandals during the Russian and Asian financial crises, corporate governance issues have surfaced as key reform issues in the developing countries and transition economies. One of the lessons from these crises is that weak or ineffective corporate governance procedures can create huge potential liabilities for individual firms and, collectively, for society. In this sense, corporate governance failures can be potentially as devastating as any other large economic shock. As M.R. Chatu Mongol Sonakul, the former Governor of the Bank of Thailand, has remarked:

There is no doubt in my mind that for the Asian economic crisis to be solved in a sustainable and long-lasting fashion, the government and the corporate sector have to work together better. By this, I don't mean that not working together was the cause of the recent economic crisis. Probably it was the other way around, working far too well together and in collusion with each other…The Asian financial crisis showed that even strong economies lacking transparent control, responsible corporate boards, and shareholder rights can collapse quite quickly as investor's confidence erodes.

Even countries which have few large firms may want to begin looking at the question of corporate governance since it is now being adapted to meet the needs of family owned companies. Even more important are the privatized firms and those still in the public sector. Ensuring good standards of corporate governance in these areas greatly enhances the faith of the public in the integrity of the privatization process and helps ensure that the country realizes the best return on the national investment

Conclusions

Issues such as combating corruption, fostering corporate governance, strengthening women's business associations, and reducing barriers to formality have created new opportunities. Each serves as a focal point to push forward with market reforms and adoption of democratic practices. For example, sound corporate governance requires a framework of market institutions as well as sound business practices based on democratic principles. Similarly, ensuring that women and entrepreneurs of modest means have access to the business system as participants and leaders helps to ensure that an open market economy exists for all firms, not just for a favored few.

As Roque Fernandez, a brilliant former Argentine Finance Minister, once said, "The Cold War is over and the University of Chicago won." He was referring to the market-oriented economic reform agendas being pushed throughout Latin America and much of the rest of the world. At the time he was right. Now, I'm hopeful we can add critical new dimensions to this view by bringing about a broader and profoundly democratic agenda. It must be based on transparency, accountability, property rights, and other fundamental rules societies and economies can use to govern themselves.

John D. Sullivan is Executive Director of CIPE, which was established in 1983 as part of the effort of the National Endowment for Democracy (NED) to promote worldwide democratization and market reforms. An affiliate of the US Chamber of Commerce, CIPE has been involved in more than 700 projects in 75 countries and has conducted management training programs for business associations and think tanks in Asia, Africa, Central and Eastern Europe, Eurasia, Latin America, and the Middle East. CIPE also maintains an active electronic and print communications program. Currently, it has overseas offices in Egypt, Kosovo, Montenegro, Romania, and Russia.

LEGAL REGULATION OF INSPECTIONS CARRIED OUT BY GOVERNMENT AGENCIES.

By Oleg Ivchenko, head of the Private Employer Congress, academician of the Higher Academy of Cooperation

It is rather difficult to answer a question of whether legal regulation of revisions is possible in Ukraine, for each controlling body shall comply with certain regulations indicated in special laws. For instance, the State Taxation Administration shall follow the laws of Ukraine "On State Taxation Service in Ukraine", "On Police", some taxation laws and its own numerous regulations; the Police shall keep within the laws "On Police", "On Criminal and Investigatory Activity of Police", a number of codes and specials rules of the law; the Board of Audit and Inspection of the Ministry of Finance shall observe the law "On the Audit and Control Service in Ukraine" and rules of special laws; the Sanitation and Epidemiological Service of the Ministry of Health Protection shall comply with the laws of Ukraine "On Hygiene and Disease Prevention Services" and "On Protection of Consumers"; the State Committee for Metrology and Standardization shall keep within the law "On Protection of Consumers" and other legal acts…

According to data of the State Committee for Regulatory Policy and Entrepreneurship (SCRPE), as of November 15, 1998, there were 100 bodies authorized to examine and inspect economic entities or institute other measures ensuring control of entrepreneurial activity. It should be mentioned that most of the above authorities are quite specific and cannot exercise control over all business participants. For instance, the Ukrainian State Committees for Physical Culture and Sports or for Geology and Utilization of Mineral Resources can hardly inspect bakeries, groceries or enterprises manufacturing household chemical goods etc.

For the time being, entrepreneurship in Ukraine is regulated by excessive number of legal acts, including:

I. 88 national laws
II. 218 presidential decrees
III. 98 resolutions of the Cabinet of Ministers of Ukraine
IV. 1,862 instructions of ministries and administrations
V. Moreover, 32 ministries and administrations deal with licensing of numerous types of economic activity.

In our opinion, there are certain controlling bodies that frequently control not only business participants but also other economic entities. What is the difference between those two notions? Business participants carry on their activity for the purpose of deriving profit, whereas economic entities, such as government agencies, municipal bodies, charitable foundations and non-governmental organizations, can also pursue some other goals. The following Ukrainian controlling bodies most frequently perform inspections of economic entities:

1. Ministry of Agrarian Policy	21. State Stock Market and Securities Commission
2. Ministry of Finance	22. Bodies of the State Committee for Statistics
3. Ministry of Natural Resources and Environment Protection	23. State Export Control Service
4. Ministry of Health Protection	24. State Committee for Standardization, Metrology and Certification
5. Ministry of Industrial Policy	25. Ukrainian Consumer's Association
6. State Committee for Construction, Architecture and Housing Policy	26. Bodies responsible for sanitation and epidemiological control
7. State Committee for Land Resources	27. Bodies responsible for veterinary control
8. State Committee for Protection of National	28. Bodies responsible for ecological control

Borders 9. State Taxation Administration 10. Central Board of Audit and Inspection of the Ministry of Finance 11. Pension Fund 12. State Customs Service 13. State Antimonopoly Committee 14. Bodies of the Ministry of Interior 15. Office of Attorney General 16. National Security Service 17. National Bank of Ukraine 18. Treasury 19. State Assay Chamber 20. National Inspection for Price Control	29. Labor protection agencies 30. Fire protection agencies 31. Bodies of the State Plant Quarantine Service 32. State Inspection for Herb Quality Control 33. National Council for Television and Radio Broadcasting 34. State Energy Saving Inspection 35. State Geological Supervision 36. State Geodesic Supervision 37. Social Insurance Fund 38. Fund for Compulsory Social Insurance against Unemployment 39. Fund for Social Insurance against Casualty and Occupational Disease

The July 23, 1998 presidential decree No. 817 "On Some Deregulatory Measures in the Sphere of Entrepreneurship" was published several years ago. The legal act represents the first effort to exercise control over activity of business participants. Unfortunately, the document cannot completely govern supervisory activity of control bodies, since those functions are regulated by the national law. However, it is necessary to emphasize that according to statistical data published in the press, after enactment of the above decree, the number of inspections decreased four times, while that of controlling bodies reduced from 55 in 1997 to 32 in 1999. Though, later on, the number of those bodies started gradually increasing again and amounts to 39 today.

What is the reason for such a strong desire of controlling agencies to check up activity of business participants? On the one hand, most controlling bodies are vested with legal powers to allocate definite share of confiscated funds for their own development. The above entails excessive endeavor on the part of controlling agencies, whose well-being depends on their competence and enterprising abilities. On the other hand, the national budget incorporates such article as proceeds from financial penalties and sanctions. Specifically, the 2002 budget revenues are planned in the amount of UAH 210 million (!), which is unlikely to encourage decrease in the number of planned inspections and alleviation of tax burden on economic entities.

As a matter of fact, such a situation is intolerable for both entrepreneurs and the State Committee for Regulatory Policy and Entrepreneurship.

The Committee initiated elaboration of the draft "On Basic Measures for Carrying out Inspections of Activity of Business Participants on the Part of Controlling Agencies". The SCRPE draft is targeted toward establishment of uniform rules and principles of inspections of economic entities.

On the basis of the SCRPE draft, public organizations of entrepreneur-employers cannot disregard the aforementioned problem and therefore the Private Employer Congress and the Ukrconsalting, the association of Ukraine's consulting companies, worked out the draft "On the Uniform Methodology of Inspections of Economic Entities by Ukraine's Controlling Government Agencies".

Distinctions between the two drafts are conceptual. Developing their draft, public organizations pursued the goal of establishing a uniform methodology of inspections for all controlling bodies, which is reflected in the name of the draft. We believe that formulation of basic principles of inspections by controlling bodies will necessarily result in adoption of a large number of ministerial regulations that will be justified by the need of ministries and administrations to keep within the national law. Hence, approval of the uniform methodology seems to be the only logical way out.

Substitution of the term "business participants" with the term "economic entities" offers an opportunity to set the uniform methodology of inspections and apply it to all enterprises and organizations.

Notwithstanding conceptual distinctions, the drafts have similar structure and analogous articles. For instance, terms incorporated in Article "Definitions" of the draft worked out by NGOs are different due to another conceptual approach, which entailed abolition of Article "Supervisory Bodies" and rejection of the term "supervision" depriving state controlling bodies of an opportunity to suspend activity of economic entities and institute preventive or compulsory measures.

The drafts provide for different lists of controlling bodies. In conformity with the SCRPE draft, only the following eight government agencies are empowered to perform controlling functions:

1) Antimonopoly Committee
2) State bodies responsible for protection of consumers
3) State Export Control Service
4) National Inspection for Price Control
5) State Taxation Service
6) State Customs Service
7) Board of Audit and Inspection
8) State Stock Market and Securities Commission

Under the SCRPE draft, all other controlling agencies belong to the category of "supervisory bodies", which, in our viewpoint, gives grounds for unprecedented abuse of powers on the part of any controlling body, including regulation of certain types of activity. Moreover, taking into account such budget article as proceeds from financial penalties and sanctions, some agencies can even legalize those powers.

The draft proposed by NGOs indicates three types of controlling authorities:

1. Fiscal bodies ensuring budget receipts:
- State Taxation Administration
- Board of Audit and Inspection of the Ministry of Finance
- Treasury
- State Price Control Service
- State Stock Market and Securities Commission

2. Controlling bodies ensuring security of citizens:
- Sanitation and Epidemiological Service
- State Fire Protection Service
- Bodies responsible for protection of consumers
- Bodies responsible for ecological control

3. Law enforcement bodies ensuring protection of national and social interests:
- Ministry of Interior
- National Security Service
- State Customs Service

Twelve controlling bodies are obviously more than eight. Though it should be mentioned that, for the time being, there are 100 controlling agencies authorized to check up economic entities, of which 39 carry out regular inspections. So, the proposed number of controlling bodies is hardly overstated.

The drafts give different definitions of the goals and objectives of controlling bodies. The SCRPE document reads that controlling agencies shall:

I. Render assistance to business participants by means of holding consultations, giving written recommendations for elimination of existent violations, elaborating and controlling enforcement of a plan of measures for liquidation of those infringements

II. Supervise, according to their competence, compliance of business participants with legal requirements

III. Timely detect and prevent potential violations of legal rules

IV. Eliminate reasons and preconditions for violations of the law

V. Estimate activity of business participants from the viewpoint of compliance with legal requirements

VI. Bear responsibility for losses inflicted on business participants as a result of violations of the rules of this law

The key goal of the draft worked out by public organizations is to help economic entities avoid making any harm to interests of citizens, society and the state by establishing parity relations between controlling agencies and economic entities. The goal is similar to the underlying principles of the SCRPE draft.

The drafts provide for identical types of inspections – according and beyond schedule – though the NGOs' draft regulates such an acute problem as procedure for confiscation of documents.

The following procedure for confiscation of documents is proposed:

During any inspections, controlling agencies have the permission to confiscate only documents confirming violation of the law. It is prohibited to confiscate the originals of statutory documents, licenses and permissions to carry on economic activity and other documents, whose absence can entail suspension of business activity of economic entities. If it is necessary to confiscate some originals of documents, controlling agencies that carry out inspection shall copy those documents at their own expense and hand over required copies to an economic entity. The period of inspection of confiscated documents by controlling bodies may not exceed two weeks following the date of confiscation.

We guess that the above provision will protect economic entities against abuses of controlling agencies in the process of confiscation of documents.

One of major advantages of the draft elaborated by public organizations is responsibility of both employees of economic entities and controlling state officials for violation of the law.

It means that both legal entities and natural persons evading taxes and officials imposing fines and penalties without good reasons will bear responsibility. If officials of a controlling body impose any financial sanctions by mistake, they shall compensate the amount of those fines and penalties at their own expense. In the event of repeated mistakes, such officials of government agencies shall be deprived of the right to hold certain offices for the term not less than five years.

Application of this provision should reduce the number of illegal decisions of Ukraine's controlling government agencies and encourage fight against corruption.

The drafts propose very similar procedures for carrying out field inspections according and beyond schedule. The only novation is mandatory presence of witnesses during inspections.

New Article "Conflict of Interests in the Process of Supervision" has been introduced. The draft elaborated by NGOs reads, "In the event controlling officials directly or indirectly financially depend on or are family members of any of the employees of an economic entity, they have no permission to perform their duties in regard to that economic entity." Of special note is the provision governing, "Should any laws or legal regulations incorporate non-transparent provisions, which can result in different interpretations of respective rights and obligations of either economic entities or controlling bodies and their representatives, the interpretation that favors an economic entity shall prevail." Incidentally, recently adopted Criminal Code of Ukraine contains analogous provision. Both drafts regulate the procedures for selection and expertise of goods samples, requirements to field inspection documents, access to information of controlling bodies about economic entities and compliance of the latter with written recommendations of government agencies. It should be mentioned that those procedures are beneficial for entrepreneurs.

Under final sections of the drafts, controlling authorities are ordered to introduce changes and amendments to regulatory documents running counter to those drafts and elaborate the Uniform Minute of Inspections of Economic Entities by Controlling Bodies, whose requirements should be observed by all government agencies. The draft of NGOs also prohibits controlling bodies to pass any regulations conflicting with the draft. At present, experts of the SCRPE, and O. Ivchenko and V. Margulis, authors of the draft proposed by NGOs, are trying to reconcile the two drafts so that to elaborate a document vitally important for all economic entities in Ukraine. Hopefully, on the eve of parliamentary elections, all candidates will demonstrate their understanding of entrepreneurial problems and solve them in a civilized manner.

From Official Sources

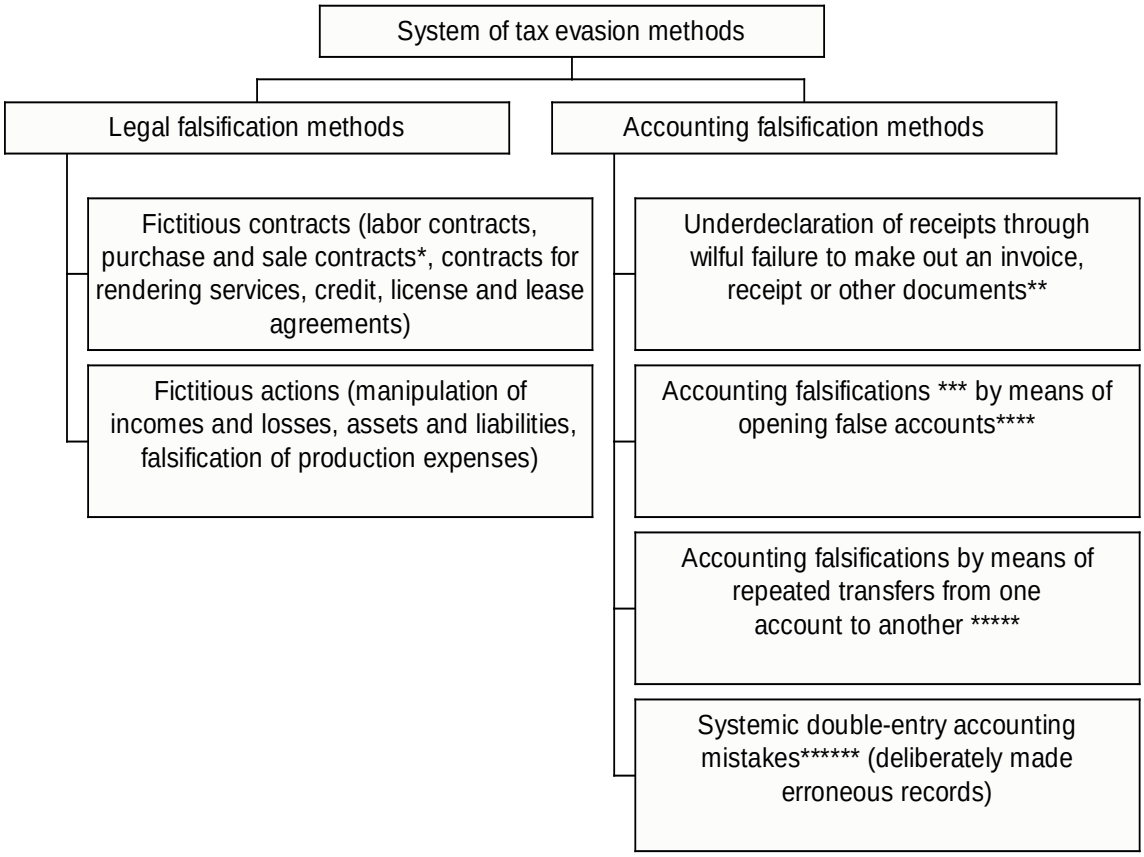
TAX EVASION AS A SOURCE OF DIRTY MONEY

By Oleksander Baranovsky, head of the analytical and methodical department of the Accounting Chamber, doctor of economics.

Tax evasion is one of major sources of shadow incomes derived by legal entities and natural persons. Being a very dangerous social phenomenon, tax crimes represent criminal offences against legal rules regulating enforcement of taxes and other mandatory payments and ensuring control over timely and full compliance.

Foreign experts distinguish a large number of tax evasion tricks[1] (see figure 1).

Figure 1. System of tax evasion methods



* As far as purchase and sale transactions are concerned, tax evaders often use the following manipulations:

- Undercharged price billed on invoices enabling offenders to pay or receive a part of actual price in dirty money, which is called “incomplete invoicing”
- The so-called re-invoicing allowing tax evaders to transfer the difference between the amount indicated in invoice and the actual price to an anonymous account and fictitiously increase production costs
- A price lower than the actual one usually indicated in land sale contracts, which enables the buyer to evade taxes on the one hand, and pay most of the price with dirty money on the other. Furthermore, the seller is given an opportunity to reduce taxable income by means of receiving cash payments for land.

** Often, no invoice is made out by legal entities and natural persons, who let apartments and cars, render different services etc. Real estate is frequently sold at ridiculously low invoice prices and major part of payments is made in dirty money. Price can also be undercharged due to various types of discounts, including wholesale and quantity, early payment and cash payment discounts etc.

*** Results are falsified by means of premature accounting

**** Those accounts can be called “account pro diverse”, “transit account”, “debit account”, “interim account”, “consortial account”, “secretarial account”, “operational account” etc. Tax evaders also resort to anonymous and internal bank accounts and the notorious “Conto pro Diverse”. According to Paufer, these accounts perform the function similar to that of shadow deposits or storage vaults and ensure circulation of dirty money.

***** A profit-making transaction’s entry is repeatedly transferred from one account to another until the deal becomes unrecognizable and unprofitable.

****** Understatement of balance figures is also widely proliferated. This trick is based on fictitious liabilities existing in the following forms:

- Invoices are fabricated
- Overcharged price billed on invoices is used to transfer the difference between the indicated and actual price to the shadow account of the customer
- Long-term borrowed capital is fictitious

In Germany, up to 25% of profits are concealed[2]. According to estimates of the Union of German Tax Officers, the shadow economic sector equals 12% of the GDP. In construction industry, evasion of taxes and social security contributions amounts to billions of D-Marks despite the fact that German legal system is highly developed, taxation authorities are competent and experienced, while the country is socially, economically and politically stable[3]. In Ukraine, the situation is not that good and realistic scales of tax evasion can hardly be determined.

Werner Eberhardt, head of German Customs Service, believes that in Germany, tax evasion turned into popular sport. Last year, nearly EUR 1.6 billion were confiscated on the highways as car travelers attempted to smuggle money out of the country. Nevertheless, in the opinion of experts, taxation authorities detected only a small share of smuggled cash and 300 times more money was illegally taken out of the country.

Police confiscates cash if its amount exceeds the equivalent of EUR 17 thousand. Smugglers hide money in very different places ranging from glove drawers to bread loafs and specially equipped places.

The reason for such large-scale offences is an extensively high savings tax. Cash smuggling can hardly be stopped before 2010, when all banking institutions of the European Union will have to inform respective national taxation authorities about any deposits of citizens.

Ukrainian experts indicate two groups of methods used to conceal taxable profit[4]:

1. Illegal methods based on falsification and overstatement of expenses, forged documents, bribery etc.

2. Legal methods based on deficiencies in national taxation law. As a matter of fact, entrepreneurs using such methods cannot be prosecuted, as those tricks represent no criminal offence.

According to researchers, tax evaders apply numerous legal methods, including:

- overstatement of production expenses
- accelerated depreciation
- preferential taxation of capital increase
- depletion deductions
- investment of assets in municipal bonds, trusts and charity funds
- split of incomes and family partnerships
- remittance of bad debts
- option systems, bonuses etc.

In conformity with data of the State Taxation Administration of Ukraine and proceeding from analysis of violations in Ukraine's banking sector, it is possible to conclude that the following tax evasion mechanisms are used most frequently:

- Bearer deposit certificates
- Cash receipt in banks in the name of a fictitious economic entity
- Numerous types of manipulations involving bills
- Loro-accounts used to purchase foreign currency for non-existent resident
- Illegal attribution of personal expenses to production costs

Opinion poll involving representatives of the Ukrainian small and middle business demonstrated that business participants are legally paying their employees not more than a seventh part of actual salaries and wages[5]. According to experts of the Russian Institute for Applied Politics, actual income of average Russian citizen equals formally declared income multiplied by 1.43, whereas personal incomes of rich people are 10 or more times higher compared to amounts they declare. 20-40% of entrepreneurs carrying on business in the production sector and 40-60% of those engaged in trade evade taxes[6].

In Ukraine, mostly low-income citizens present tax declarations. According to data of the State Taxation Administration, in 2000, the number of Ukrainians, who had to declare incomes received from secondary activities, amounted to 3.5 million, of which one third were war veterans, disabled persons and other low-income citizens. Moreover, in 2000, 84 thousand persons additionally paid to the budget around UAH 20 million, whereas the budget returned the amount of UAH 35.8 million to 616 thousand citizens. Experts do not believe the above phenomenon to be incidental. One of the politicians, who had been actively engaged in formation of the modern income tax system and wanted to remain anonymous, stated that authors of the Cabinet decree "On Citizens' Income Tax" and the law of Ukraine "On State Officials" pursued the only goal: to legally conceal large private and shadow bureaucrats' incomes. For the above reason, Ukrainian society does not demand modification of rules of the game, i.e. elaboration of measures for control over huge expenses of state officials. So, those rules still represent a powerful tool used by corrupted officials. Since all efforts of power to form an efficient system of control over personal incomes fail all the time, those

bureaucrats “of modest means” can easily buy villas and limousines and simultaneously receive unemployment benefits and subsidies for housing and communal services.

The Tax Administration of the State Revenue Service of Latvia is interested to legalize incomes of three categories of taxpayers: persons, who have to explain sources of their legal incomes (for instance, incomes from sale of apartments); persons, who receive wages and salaries in dirty cash and persons, who enter into criminal transactions and draw illegal incomes. Inspections of incomes of those categories of taxpayers can be carried out in the event that natural persons grant loans to legal entities, purchase companies, privatize apartments or other property, buy real estate, corporate shares or vehicles for cash, make large contributions to the Pension Fund etc.[7]

At the same time, it is necessary to point out that under the existent taxation system, Ukrainian workers and employees, who receive wages and salaries, are deprived of an opportunity to conceal their incomes. Hence, it is the employer, who evades taxes.

High income tax rates serve as another reason for tax evasion.

Experts of the State Taxation Administration assert that reduction of tax rates attended with growth of the number of taxes will do no harm to the budget. According to the STA data, income tax revenues can reach the level of nearly UAH 7.8 billion in 2002, whereas this year, those receipts will amount just to UAH 6.9 billion (the existent maximum rate of income tax equals 40%).

The STA press department informs that around 90% of the able-bodied population of Ukraine will pay the income tax at the minimum rate of 10%.

According to the Russian Ministry of Taxes and Duties, within three months of 2001, income tax proceeds rose by nearly 70% due to alleviation of tax burden and introduction of the uniform 13% rate[8].

In the majority of European states, banking institutions shall furnish data on bank accounts to the computer center of state departments of taxation and finance at the end of each fiscal year. The latter shall check up balances of those accounts and calculate the amounts of taxable income. Banking institutions are also empowered to require presentation of identity documents and personal identification numbers by residents willing to open accounts, which rules out any possibility of concealment of incomes and tax evasion. However, in every country, there is a definite category of persons, such as foreigners and immigrants, who may not follow the above procedure. By virtue of the law, those persons are not viewed as taxpayers and therefore can open bank accounts without producing any of the above-mentioned documents.

For instance, in Spain, a Swedish resident willing to obtain residence permit must be registered by the Spanish Taxation Department and receive personal identification number. This document does not oblige a Swedish resident to pay any taxes and serves exclusively as identification of a person in the event he/she effects any payments. To obtain the personal identification number, it is necessary to indicate an address in Spain, such as the address of a mail or a post office box, hotel or a lawyer the person is acquainted with. After that, the Swedish resident will be granted a card filled out in Spanish and bearing the seal of responsible state body, name and personal identification number of that person. In Sweden, this person visits a bank and opens an account indicating his/her real name, as the bank will necessarily check identity documents. Bank clerks will find out that an account holder is a Swedish emigrant, who lives in Spain but carries on business in Sweden. For this reason, a bank account of this person will not be viewed as a resident one and no data on it will be presented to fiscal authorities. A person can produce the personal identification number card granted in Spain. As a Swedish bank clerk has no idea of how the residence permit should look, nothing shall prevent him from opening the account. Except for Spain, personal identification number cards can be obtained within a week and for free in Portugal, Greece, Cyprus, Malta and Central and Latin American countries[9].

It should be mentioned that tax evasion schemes are getting more sophisticated and more difficult to reveal. In practice, there are numerous tax evasion tricks. Conventionally, they can be divided into three following groups:

I. Transactions that are not documented in accounting records

II. Transactions that are partially documented in accounting records, which entails concealment of income

III. The so-called pseudo-transactions, involving fictitious contracts

Manipulation of income by means of failure to report on business activity represents a trick used for receiving dirty money. To evade taxes, a company avoids registration by state authorities, files for liquidation and continues to operate or presents documents confirming that business activities are exempt from taxation.

Falsification of production expenses is documenting of fictitious or fabricated manpower, service, material and other costs in the event that either any reason for deduction of those expenditures is absent or respective legal restrictions are ignored.

For instance, a hotel documented expenses for wedding of a daughter of a company's president as conference expenditures. Airplane tickets were overpriced due to falsification of currency exchange rate.

Except for the aforementioned, tax evasion tricks can include the following types of manipulations:

I. Manipulation of losses. Losses can be fabricated, entered into other balance sheet account and even purchased.

II. Manipulation of assets (failure to document, partial documentation, repeated documentation and re-documentation). Documentation implies compliance with double-entry accounting principles. Failure to document implies falsification of the inventory period, failure to carry out inventory of goods, failure to carry out inventory in the event of low-grade goods, discrepancies in commodity volumes, and squandering of money. Partial documentation implies undercharged prices. Repeated documentation may emerge as a result of price discount and can be a precondition for falsification of expenditures. And, finally, re-documentation serves the purpose of transferring dirty money to business structures.

III. Manipulation of liabilities. Failure to document liabilities is usually a result of shadow transactions. Due to this trick, clients pay for suppliers' services in dirty money. Re-documentation of liabilities is used for laundering money by means of fake investments or loans.

Dirty money can be generated in the process of deriving income from capital, first and foremost, as a result of concealment of bank interest payments.

National legislation does not provide for elimination of all potential opportunities to evade taxes. As a matter of fact, many economic entities legally evade taxes by effecting payments through accounts of their debtors and structures that do not exist in reality, using loan accounts and other settlement schemes or discrepancies in the bank or tax law.

Ukraine's inadequate system of cash circulation control also serves as one of the factors aiding tax evasion. Numerous issues of legal control over cash circulation still remain unsettled. In this situation, enterprises having budget arrears actively use cash payments, which enables them to escape taxes.

Circulation of the so-called dirty cash stimulates tax evasion as well. Payments in dirty cash allow withdrawing large amounts of live money from circulation, which results in decrease of budget proceeds. Each type of business applies its own scheme of dirty cash payments. However, all those schemes incorporated just several simple tricks. As a rule, wages and salaries are documented in accounting records as income from secondary business activities exempt from charges to extra-budget funds. Another popular way to escape taxes is to effect cash payments without keeping any records.

The pending issues of accounting documents and state registration of enterprises and companies inflict heavy losses on Ukraine's budget system. Inspections demonstrate that a large share of legally registered entrepreneurs and companies either present no financial reports and income statements at all or submit the so-called zero balances.

According to data of the Ukrainian Accounting Chamber, tax revenues are adversely affected by the existent system of payments to the budget established under the law of Ukraine "On Foreign Economic Transactions in Goods Made on Commission". That system enables companies to export goods made on commission for processing and import finished products or currency earnings from commodity sale without payment of taxes and duties, inclusive of the VAT, the export and import duties.

Specifically, company-intermediaries carried out large-scale export transactions in sun-flower seeds. Processed produce was not imported in Ukraine and the underdeclared amount of currency receipts equaled only the cost of sun-flower seeds. In 2000, the amount of currency earnings from exported sun-flower seeds totaled US$ 134.3 million, including US$ 103.8 or 77.3% of receipts from barter dealings, which entailed budget losses of UAH 240 million.

In 2000, volume of export transactions with goods made on commission constituted US$ 242 million, whereas that of processed products equaled just US$ 104.7 million. The above example serves as evidence of "hidden" export of raw materials and sales of finished products outside the customs territory of Ukraine without payment of taxes and duties.

Large amounts of funds are not transferred to the budget through the fault of banking institutions. Many banks violate payment procedures, delay execution of taxpayers' payment orders, frequently aid persons, who do not belong to bona fide taxpayers, to evade taxes and do not properly perform their functions related to control over the established procedure for cash transactions.

The so-called deposit tricks very convenient for tax evasion are also popular. According to those schemes, a company opens deposit bank accounts for its personnel. Only small amounts of money are entered in those accounts though the rate of interest on deposits is extremely high. As a rule, banking institutions withhold the income tax from deposited amounts, whereas workers and employees of a company receive interest exempt from income tax. Violations of the tax law in the financial sphere are often caused by illegal activities of currency exchange structures that used not to document the substantial amount of earnings or operate without necessary licenses. Another acute problem is posed by schemes that allow withdrawing money in the shadow sector and involving private individuals. Those customers open bank accounts, to which they transfer money received from payments of bills, sham contracts for marketing and other services as well as other fictitious contracts.

In conformity with data of the National Bank of Ukraine, only the amount of money transferred to loro accounts in Latvian banks constituted US$ 1.6 billion. The same is true about loro accounts of Russian banks. Within initial six months of 2000, funds transferred to loro accounts by enterprises that never paid the VAT increased four-five times, despite the fact that the number of fake companies shut down by taxation authorities was ten times higher as compared to the same period of 1999[10].

During audit inspection of the Kyiv-based joint-stock commercial Intercontinentbank, tax officers found out that in 2000, some of its clients illegally transferred large amounts of money to correspondent accounts of commercial companies in Russian, Latvian and Estonian banks. Only over that year, around UAH 2 billion were illegally transferred through the Intercontinentbank! At the same time, the amount of unpaid VAT totaled UAH 400 million. Some accounts in the Intercontinentbank were opened on presentation of lost passports and in the name of imprisoned persons.

Money can also be withdrawn from legal circulation with the help of insurance companies. Those companies offer quite legal schemes of evasion of some taxes. For this purpose, an enterprise can conclude a contract for insurance against financial risks or delayed payments of wages/salaries, provided that the term of insured accident is known in advance. It is necessary to mention that by virtue of the national law, insurance indemnity is non-taxable. So, notwithstanding the fact of violation of the law, it is hard to prove it and apply any sanctions to both insurance companies and enterprises, to which they provided services. It can be possible only if cash is received under fictitious contracts, provided that respective documents do not comply with legal requirements or any of taxes related to those contracts have not been paid.

Organized crime groups invented a lot of tricks to evade customs duties, such as use of false commodity description, underdeclaration of value of goods (double accounts) etc. Those tricks also include misdescription of purpose of import/export (transit, temporary import/export) to avoid existent restrictions. The Customs is often presented with false certificate of origin used for reduction of customs duties and unfair export of commodities.

Offshore zones abet growth of partial and total tax evasion. According to the Law Encyclopedia, the term “offshore” is applied to world financial centers and some types of bank transactions. Offshore zones are recognized as territories, where national and overseas banking, financial and other institutions effect payment transactions with non-residents, i.e. foreign legal entities and private individuals in foreign currency, provided that companies registered in those zones are granted preferential tax treatment, including complete exemption from any taxes. The above entails mass inflow of capital of major corporations to offshore zones. Hence, institutions localized in the offshore zone use territory of a host country to carry on transactions outside its borders and are not integral parts of a country’s economy. States fostering formation of offshore zones are interested to obtain registration duties from overseas companies, create new job etc. As a rule, offshore zones are established in small countries having limited resources and unable to develop their economies. For the time being, the list of most famous offshore zones includes the Bahamas, the Virgin Island, Cyprus, Vanuatu, Malta, Nauru, Liberia, Panama, Ireland and Liechtenstein. The term “offshore” is also applied to international law companies carrying on their business activities in tax havens.

There are nearly fifty countries that can be regarded as offshore zones, for their legislation provides for registration and functioning of international business companies. Even more states offer an opportunity to register quasi-offshore firms[11].

Elisabeth Guigou, French Minister of Justice, asserted that US$ 8 trillion are kept on offshore bank accounts, which equals the American GDP. According to data of the Organization for Economic Cooperation and Development, the number of investment funds in offshore zones had been rapidly increasing and amounted to about 6,000 in 1999 that was six times higher as compared to 1998[12].

Small island republic of Nauru covering the territory of 21 square kilometers and populated by 10,850 residents became member of the United Nations Organization only in 1999. However, many large companies from all around the world have focused their attention on this island. While law enforcement agencies, including the FBI and Interpol, were making strenuous efforts to close down different offshore zones, somewhere in the middle of the Pacific there was a tax haven beyond their reach. According to data of American and Russian law enforcement agencies, 250 banks located in Nauru laundered over USD 70 billion in 1998. At the same time, the country's bank secrecy laws are much more severe than those of Switzerland and the Cayman Islands. According to the NBU, Ukrainian residents opened 98 accounts in Nauru banks in 1999 and money on those accounts made up 35% of all funds kept by Ukrainian private individuals and legal entities in offshore zones[13].

Every year, twelve million people visit Andorra located 226 km from Barcelona and often called "European Hong Kong" or "Pyrenean Switzerland". The country shelters those, who evade taxes: approximately 60,000 of its residents or over 80% are foreigners[14].

"High net worth individual tax status" (HNWI) is the official Gibraltarian name for rich foreigners willing to conceal their incomes. Only those, whose annual income tax amounts to no less than GBP 45,000 are considered as HNWI.

Although, governments of many world economies legally prohibit to carry on business activities in some famous offshore zones thereby negating advantages of the above tax minimization method. The OECD named 35 "harmful tax havens", which must cooperate with a global crackdown on tax evasion or else they risk incurring economic sanctions by major industrialized nations. Companies operating in a country having preferential taxation system incur high initial expenses for employment of local auditors, preparation and presentation of reports, maintenance of local offices etc. For this reason, firms established in offshore zones not included in the black list enjoy 100% offshore jurisdiction.

The US Federal Bureau of Investigation stroke a powerful blow on the Cayman Islands offshore. FBI agents exposed a scheme of work of about 500 banks registered in that offshore zone and dug out lists of clients of a number of banks, which gave rise to numerous criminal proceedings on tax evasion.

Investigation of the Cayman banks case was launched as long ago as in 1996, when a video producer pleaded guilty to using a Cayman Island bank to evade taxes, the first of a potential flood of such cases since a massive breach of the British colony's vaunted bank secrecy was exposed. Michelle A. Pruyn admitted she concealed $240,000 at the now-defunct Guardian Bank & Trust Ltd. of Grand Cayman by working with its chairman, John M. Mathewson. As a result, Ms. Pruyn evaded about $40,000 in taxes from 1991 through 1993. Mathewson opened an account for her in the name of Cogan Corp. about 1991, and she deposited income from her video production companies. No evidence existed that Cogan conducted any business. Mathewson had pleaded guilty in March 1997 to charges including conspiracy, money laundering and aiding income tax evasions. Because of Mathewson's help, the U.S. government has recouped $50 million in back taxes and penalties, and can expect to get a total of $300 million[15].

There are other more or less simple methods for legal tax evasion.

The first and the simplest one is to save on taxable articles. In 1930, the U.S. companies sold cigarettes packs containing a set of five 11-inch cigarettes, as a tax was imposed on each cigarette. Within 1828-1855, French were using inconvenient three-wheeled carts, for each wheel was taxable. Medieval French houses had neither windows nor doors facing streets, since each door or window was liable to tax. In the 19th century, some English newspapers were published on a large single sheet, for a tax was levied on each page.

To protect its customers against accusations of tax evasion, administration of a Hong Kong casino gave each visitor a written receipt confirming that money was won. The casino instantly turned into the major Hong Kong center for laundering money of mafia.

Another opportunity to legally escape taxation is wider interpretation of production expenses. Cynthia Hess from Indiana declared the whole amount of US$ 2,100 paid for breast correction as "Business Investment". The State Department of Taxation and Finance believed perfection in appearance to be a private affair. "But I am a dancer!", resented the lady. She filed an appeal with court and won the case.

Here is one more illegal tax evasion trick. In the 13th century, the English village Gotam was famous for its lunatic asylum. In fact, all patients just simulated madness to escape taxation[16].

Established fact of tax evasion is not sufficient evidence. It is much more important to track the whole chain, detect sources and places of location of shadow capitals, methods for laundering money and major organizers and perpetrators.

There are grounds to state that tax crimes became organized. Tax evasion schemes are getting more and more intricate involving well-trained accountants, auditors and lawyers.

Incidentally, the so-called consultations on tax evasion and money laundering are viewed as a type of shadow business.

In advanced economies, consultations of citizens and private companies about tax evasion became an independent business activity yielding enormously high profits and involving hundreds of companies and thousands of private experts. In 1981, gross income of eight major U.S. accounting companies amounted to nearly US$ 7 billion. The role of law companies, special bank departments and brokerage firms in the above activity is constantly enhancing and the amount of their profit can hardly be estimated. Such services are rendered at the international scale. For instance, Baker & MacKenzie, the major U.S. law company has departments in 22 countries[17].

Nevertheless, tax evasion is neither a sport nor a hobby. According to international legal standards, tax evasion is recognized to be a criminal offence, since it always entails decrease of tax receipts and public expenses and limited opportunities to level citizens' incomes. All over the world, scales of tax evasion are growing in leaps and bounds, for each shadow transaction generates additional amount of dirty money. In Germany, tax evasion is reckoned among such criminal offences as robbery or murder, with the only difference that a person voluntarily paying the amounts of evaded taxes and respective fines shall be recognized not guilty[18].

Article 212 of the Ukrainian Criminal Code reads that an employee of an enterprise, company, organization or a person carrying on business activity as a private individual or any other person guilty of willful evasion of taxes, duties and other mandatory payments shall be sentenced to a penalty in the amount of 300-500 non-taxable minimum incomes or deprived of the right to hold certain offices or engage in certain activities for the period not exceeding three years in the event such actions inflicted substantial losses on the budget or purpose-intended public funds.

References

[1] K. Kotke. Dirty Money. Moscow. The Delo i Servis. 1998. P. 65-89.

[2] S. Yurgelevich, M. Downy. Taxation Problems in Ukraine. The Tendentsii Ukrainskoi Economiky (Trends of Ukraine's Economy). December, 2000. P. 42.

3. K. Kotke. The same source. P. 136-137.

[4] V. Kutsenko, I. Rozputenko, V. Yurchyshyn. The Shadow of Economic Reforms in Ukraine. Bulletin of the Ukrainian Academy of Public Administration. No. 2. 1998. P. 41-42.

[5] L. Povolotskaya. Should the Parliament Consider New Proposals of the Taxation Administration, Most Ukrainian Citizens Will Be Paying a 10% Income Tax. The Fakty i Kommentarii (Facts and Comments). May 17, 2001. P.5.

[6] S. Romanov. Crimson Jackets or the Truth about Russian Nouveau Riches. Moscow. The Veche. 1996. P. 26.

[7] I. Klymenko. Declaring Poverty. The Companion. 2001. No. 8. P. 15.

[8] L. Povolotskaya. The same source.

[9] Legal and Illegal Tax Evasion Methods. The Offshore express. September 18, 1996.

[10] Taxation Aspect of Export of Ukrainian Capital. The Visnyk Podatkovoi Sluzhby Ukrainy (Bulletin of the Taxation Service of Ukraine). 2000. No. 34. P. 22.

[11] V. Harkusha. The Latest Offshore. The Companion. 2001. No. 20. P. 25. Also see: B. Ivanovsky. Private Offshore Banks: Stricter Financial Control. The Offshore Express. 1998. No. 43. P. 22.

[12] In this War, Only Separate Battles Can Be Won. The Novye Izvestiya. September 11, 1999.

[13] A. Yavetsky, V. Andriyenko. There Is an Island For Money Laundering. The Halytski Kontrakty. 1999. No. 47.

[14] K. Kotke. The same source. P. 308.

[15] FBI Closed down the Cayman Islands Offshore. The Chelovek i Zakon (Man and Law). 2000. No. 1, P. 79.

[16] Haven't You Ever Paid the "Dentist-of-Your-Boss-Tax"? The Zerkalo Nedeli (Mirror Weekly). 1998. No. 10.

[17] Tax Declaration: Living Under the Public Gaze. The Economica i Zhizn (Economy and Life). 1991. No. 20. P. 13

[18] K. Kotke. The same source. P. 5-6.

Advantages and Problems of Introduction of Budget Reform in Ukraine
Summary of Focus Group Research

On October 24, 2001, within the framework of the Information for Reforms Program the Ukrainian Center for Independent Political Research and the Center for International Private Enterprise carried out a focus group research on "Advantages and Problems of Introduction of Budget Reform in Ukraine".

The focus group research objectives were as follows: to evaluate the process of the budget reform in Ukraine, to point out major breakthroughs in reforming of the system of inter-budgetary relations, key problems and obstacles hampering the reform and to propose measures to enhance its efficiency.

The research was carried out using deep conjoint interviewing (a focus group method) and expert assessments. By the snow ball method a group of 7 participants including experts for inter-budgetary relations and budget reform was composed. Experts representing different social sectors were involved in this group: representatives of central and local authorities, researchers, and independent analysts, which made possible carrying out thorough and comprehensive study of the problems on the agenda.

The focus group participants

Pavlo Kachur, the Association of Agencies for Regional Development of Ukraine
Mariya Kryvolap, the territorial budget department at the Ministry of Finance of Ukraine
Nina Krasnostup, deputy head of the general financial department at Kyiv Municipal State Administration
Volodymyr Lozytsky, deputy head of national budget and budget policy department at the Ministry of Finance of Ukraine
Yevhen Fyshko, the Institute of Reforms
Ihor Shpak, expert for inter-budgetary relations
Vasyl Yurchyshyn, the Agency for Humanitarian Technologies

The research gave a great deal of information enabling to evaluate efficiency of carrying out of the budget reform in general and to formulate key problems of the system of inter-budgetary relations, as well as specify recommendations and measures to enhance its efficiency.

The obtained within the research materials are reliable can be used in practice for further quantitative researches and scientific analysis of the given problem.

The research findings could be of interest to lawmakers, representatives of respective authorities, businessmen, academicians, journalists and the public.

Research Summary

The research participants pointed out the following advantages of the budget reform in Ukraine:

- Adoption of the Budget Code of Ukraine is a breakthrough
- For the first time, the national budget and the program for social and economic development were harmonized and submitted to the Verhovna Rada simultaneously Thus, we are approaching introduction of a target-program method. Besides, the budget reflects the same priorities, as provided by the program for social and economical development
- Transparency of the National budget of Ukraine has grown
- The fact, that 400 deputies have voted "for" the Budget Code indicates their willing to create the optimal system of inter-budgetary relations in Ukraine
- Within the last years we have watched rather proper carrying out consolidated budget of Ukraine
- It first became possible to regulate and optimize payments related to the budget of development, to harmonize it with the program for social and economical development, i.e. the country's budget of development was estimated within the framework of this program. The budget for development includes investment outlays, as well as estimated outlays for a number of national programs, approved by the Verkhovna Rada and the government resolutions

- Procedures related to additional grants to local budgets were introduced. That is, from now it is of particular interest to local governments, if the national budget is balanced or there is budget surplus, as they will have an opportunity to receive additional grants only if there is national budget surplus
- Clear procedures for loans to local budgets were provided
- Gradation from the primitive principle of financing a budget institution to a new principle of responsibility for budget money could be observed. Now everyone should now, where and how to spend money and is to account for it
- This year, up to international standards, receipts from privatization were first included in financing sphere, as, regarding their inconstant character, they cannot not be deemed budget receipts
- From the political viewpoint, positive outcomes of refusing from specific "rules of the game" for each territorial unit consist in formulation of common "rules of the game" for the country as the whole, thus making a system
- Procedures, enabling to mark Ukraine as a rather open country in its budget-related matters were set
- Fundamental basis for struggle against corruption were set, as the budget and corruption are closely connected. So, the more transparent the budget is, the more standardized and transparent budget procedures are, the less chances are left for corruption
- The budget reform provides a number of stimuli for economical development aimed at expanding taxation base, growth of the total budget receipts from tax payment, ensuring development of regions and supporting depressive zones.
- Regional budgets have received a chance to decrease their outlays at expense of economic spending of their budget resources, but at the same time, the budget spending will remain stable. The regions have gained an opportunity to increase their local budget receipts. This is the resource, which for the first time is not included in the unified "common basket" and becomes a starting point allowing the territorial community to develop, strengthen its financial position, solve its problems, being not afraid of tomorrow, when its extra-efforts could be estimated for the next year taxation base, thus, making the community start from the very beginning
- One of the breakthroughs of the Budget Code is rather coherent and complete specification of all of budget process procedures
- The Budget Code differentiated between powers of central and local governments. List of powers and revenues of territorial communities was specified. The Code set provisions for a number of outlays and provided approaches to re-calculation of transfer payments, incentive mechanisms for achieving the budget surplus
- Local budgets have received a financial recourse, i.e. specific receipts they can count on. Budget receipts are to be estimated under solvency indexes for the last accounting period
- For the being it is possible to say that the budget code "works"
- The Parliament will pass over its initiative in budget-related matters to the Government, which is inherent to west democracies as well. It is executive power that should start the budget process, as it is armed with technologies of macroeconomical predicting and is to create the budget basis
- Elaboration of a budget resolution by the government is under way now. It is not included in the Budget Code, though it exists under another title, and the parliament has a right of advising in the resolution-related discussions. Thus, the government will estimate the budget on its own macroeconomical data stipulated in the budget resolution.
- The government has retained enough autonomy to be able to defend the principles it has set both in the budget resolution and budget draft
- The Budget Code provides executive power with sufficient flexibility in carrying out the budget in order that it could react to changes in internal economic situation or external challenges whatsoever. Thus, changes in all budget-related documents should be approved by the parliament, but there is still a certain span (one or two months) enabling the Ministry of Finance to adequately react to any endogenous or exogenous shocks
- The Ministry of Finance has received a shield to cover its unwillingness or technological disability to react to requests of lobbyists - there is a formula and a computer program – so, changing of at least one parameter of the formula will ruin budget appropriations (for instance, transfer payments for each of 700 local budgets could call in question)

- Implementation of the program-target method of financing (block grants) has started. Budget programs each provided with a comment by the chief program manager were created (in particular, criteria of evaluation of the budget programs were specified)
- In Kyiv the program-target method of spending has been used for the last 5 years. Upon approving of such a program, the money allocated for it will be spent through an appointed and approved program manager. Thus the money will directly to the chief program manager and won't diffuse in a local budget

The research participants specified key problems and obstacles hampering carrying out of the budget reform in Ukraine.

- The problems could be conventionally divided in four groups. The first of them comprises methodological questions only, which are in the scope of economists and budget experts. The second group of problems is connected with political aspects. The third group of problems deals with legal irregularities of some processes. The fourth one comprises the matters related to the modern Ukrainian mentality - almost habitual disrespect of the law by Ukrainian citizens.
- The society is not ready for introduction of the program-target method of financing of local budgets
- Authorities fail to comply with transparency principles. Thus, this year the draft budget for 2002 was not published in "Uriadoviy Kurrier", as provided by the Budget Code
- The Ministry of Economics and the Ministry of Finance should estimate total of receipts, for instance, of the VAT, excise or other receipts, and parliamentarians, accordingly to their institutional nature, should deal with budget outlays
- Failure to specify in legal acts, that receipts from privatization are to be the source of budget revenue along with borrowings is also seen a problem of methodological character, as selling of assets should pursue covering of the national debt, which is an axiom of economics
- There are also methodological problems as to mechanisms of carrying out of the budget and servicing of local budgets by the treasury
- Insufficient responsibility of executives is a shortcoming of the Budget Code. For example, there is nothing mentioned about responsibility of the government for improper carrying out of the budget, or responsibility of a budget money manager for embezzlement. The government's responsibility in the case, if the Verkhovna Rada does not approve its report on carrying out of the budget also remains unregulated
- The process of carrying out of the inter-budgetary reform has frozen on the level of cities and districts and wont go further. The Budget Code could not be that efficient anyway, as the question of an administrative and territorial reform is still pending
- There are no clear rules of estimation and balancing of the budget, which should regulate the actions by fiscal bodies in any situation whatsoever
- Immediate and full implementation of the program-target method will consume all budget outlays, which will mean impossibility to maintain all budget institutions, thus, a number of them will be subject for liquidation
- The key problem of the budget reform is that it is of partial character, as it still has not become an element of the reform of common social relations. Today, carrying out the budget reform, we urge administrative and territorial reforms, tax reform, as well as systemized changes to the law on local self-governments and local state administrations. Thus, we as if continue living in different time spaces at the same time, and this fragmentation of our life considerably devaluates the general positive effect
- The problem of irregularities in legal acts is acute. Such problems are often solved de facto in each separate case, thus decision-making is less objective. Nobody knows, what will be the effects upon regulation of "gaps" in budget legislation
- More attention should be paid to training and re-training of personnel, employed in the system of fiscal bodies, as the Budget Code demands changing a number of procedures. So, this army of officers, employed in fiscal bodies, will unavoidably face a lot of new information, new forms of accounting and statistics reports
- Public discussion on the budget-related matters yet has not become duly practice for Ukrainian authorities
- Tax burden is distributed extremely unevenly, including the regions. At the same time, no necessary researches are carried all over the country, so we do not know, what regions are depressive ones and actually need grants

The research participants outlined the following measures to be taken for enhancing efficiency of the budget reform in Ukraine:

- It is necessary to realize the intermediate provisions of the Budget Code, and thus, the Cabinet of Ministers of Ukraine should regulate within the next two years the problem of inter-budgetary relations at the level of a village, town, city, district
- There is urgent necessity to carry out full and profound re-training of personnel employed in financial institutions according to new procedures of the Budget Code. Systemized programs of the Finance Ministry should be broadcasted in working hours. A regulation, which would bind officers of fiscal bodies to watch TV and learn in certain hours, should be issued
- Aiming at avoiding mistakes when predicting budget receipts, it is advisable to more actively use databases of the National Bank and the State Property Fund, the State Committee for Statistics, the State Tax Administration, deputies, members of the VRU Budget Committee. This work is to be entrusted to a special working group, and such a group needs legal regulation for its activities
- Considering amendments to the Budget Code, it should be noted that resolutions by the Verkhovna Rada of Ukraine related to the national spending, indebtedness and changes in tax legislation, should be taken by a qualified majority of voters
- It is to fix in legislation, that any amendments to a draft budget, which provide exceeding the planned outlays or change budget receipt items, can be entered only if agreed with the Finance Ministry first, and then with the Cabinet of Ministers in its the session
- It is advisable to increase potential of independent analytical, expert centers and civil organizations and enhance their role they already play in Ukraine. This potential should be used for monitoring of carrying out of local budgets, elaboration of models of analysis and presentation of budgets at different levels; ensuring transparency of the budget process, running of public hearings and educational programs
- It is necessary to more effectively work over methodical grounds for the process of estimation and realization of the budget for development
- The law provides should provide for responsibility for violation of its provisions. A public servant should know, what he will face should he violate the law. This would enhance discipline among the budget executives on the whole and become a serious strike on corruption
- The procedure of estimation of the budget receipts should be improved
- A budget resolution, according to its nature, should be a political document with a medium-term validity, where the Verkovna Rada would determine the policy and the Cabinet of ministers specify short-term measures and instruments for its realization
- It is necessary to promote new principles and approaches set in the new Budget Code among representatives of financial world and the wide public. This can make the budget process a social phenomenon. State authorities should enhance public awareness of the “need” in efficient implementation of the budget reform.