

ICPS newsletter[®]

Ukrainian entrepreneurs ask Government not to wreck simplified tax system

Representatives of Ukrainian SMEs are proposing that the Government improve the prevention of tax evasion and raise single tax rates, but not change the rules of the simplified tax system the way that has been written into the amendments to the 2005 State Budget Law. The conclusions of a roundtable called "PORA Povazhaty Pidpryemtsiv" [Time to Respect Business] were used by the Government to adopt decisions aimed at improving the situation. However, these changes are likely to have only a temporary impact if the Government does not develop a full-fledged policy towards business soon

A roundtable called "Time to Respect Business" took place on 12 May 2005, the purpose of which was to arrange a dialog among Government, business and the general public on the impact of amendments to the current tax system and to regulations governing SMEs. The event was organized by:

- the International Centre for Policy Studies;
- PORA, a civic group;
- the Center for Institutional Development;
- the Institute for a Competitive Society;
- the Center for Political and Legal Reform; and
- the Civil Society Institute.

At the roundtable, all stakeholders were represented:

- regional and sectoral business associations;
- businesses operating under the simplified tax system;
- Government—Finance Minister Viktor Pynzenyk and First Deputy STA Chair Mykola Katerynchuk;
- VR deputies Volodymyr Bondarenko, Ksenia Liapina and Mykola Onishchuk;
- experts from top community organizations and think-tanks.

Participants focused their attention on analyzing amendments to the simplified

tax system contained in the 25 March 2005 Law #2505-IV "On amending the 2005 State Budget Law and certain other legislation." This law changes the conditions for taxing SMEs in three major ways:

- legal entities subject to the 10% tax must register as payers of the VAT;
- sole proprietors undertaking certain types of business activity are no longer eligible to use the simplified tax system;
- certain types of business activity are effectively subject to double taxation on the personal incomes of sole proprietors.

No common ground among opposing sides

The debate was built around five questions:

1. What is the purpose of changing the system for taxing and regulating SMEs?
2. How effectively do these decisions help achieve the declared purpose?
3. What problems have emerged as a result of these decisions?
4. What are other alternatives to achieving the same purpose?
5. How can the negative impact of these decisions be mitigated?

During the roundtable, two different views of these issues were presented: the position of businesses, which was

ICPS Supervisory Board holds a working session

On Tuesday, 17 May 2005, the ICPS Supervisory Board held its regular working session. The Centre's specialists presented the ICPS activity report for 2004, their view of the current political and economic situation, and a forecast for developments over 2005–2007 to members of the Supervisory Board. This presentation for members of the ICPS Supervisory Board can be downloaded from the ICPS internet library at <http://www.icps.kiev.ua/eng/library.html?4>.

As the higher governing body of ICPS, the Supervisory Board is in charge of making decisions regarding the ICPS strategy and of evaluating the Centre's performance. Meetings are held twice a year, during which the Board approves the ICPS activity report.

Today, the Board includes 21 members—high-level officials, MPs, foreign experts, ambassadors, and representatives of business and academia in Ukraine and throughout the world.

supported by experts and analysts, and the position of the Government. It turned out that these two positions have little common ground.

The position of government bodies

Mssrs. Pynzenyk and Katerynchuk clearly and thoroughly explained the immutable logic of the need to immediately increase tax revenues. The Government decided to do this by amending certain tax regimes, including the simplified one. The actual tax forms and rates remain intact. Had these decisions not been made, they argued, Ukraine faced the threat of an unbalanced Budget, leading to hyperinflation and hryvnia depreciation.

Amendments to the simplified tax system were primarily intended to limit the abuse that the Minister said was very widespread. Moreover, Q1'05 results showed a significant increase in Budget revenues compared to 2004, which convinced the Finance Minister that the decision was the right one.

The position of business

Business representatives showed complete understanding of reasons and purposes behind the Government's decision. However, they said these decisions were not strategically appropriate, as they were based entirely on the concerns of fiscal and tax policy, while the issue of economic development was not taken into account. Their conclusion was that the impact of these decisions was deadly for both business and the country as a whole. SMEs are one of the most law-abiding groups of taxpayers under the simplified tax system, yet they are finding themselves forced either to cease their activities, to move into the shadows, or to find ways around the increased tax burden. Alternatives include registering relatives as the owners of their businesses, formally changing the type of business activity, changing the contents of agreements, and so on. As a consequence, Budget revenues will fall and results for Q2'05 will be much worse than results for Q1'05.

Businesses agree that the simplified tax system gradually needs to be perfected. Indeed, they even offered an unheard-of suggestion: to raise single tax rates to make them fairer. Their key demand was that fiscal and tax policy serve the development of the country's economy and business, and not the reverse.

The simplified tax system really does need reform because it is not synchronized with the country's social security system and is often used to launder money through payments for fictitious services and to reduce the tax liabilities of individuals who are not actually engaged in business.

In order not to destroy legal business through the proposed amendments to the 2005 State Budget Law, it was proposed that the Government launch a series of public hearings on the problems of the simplified tax system and to use the conclusions to rework the Bill "On the simplified tax system" and submit it to the Verkhovna Rada for

adoption by 1 July 2005. Other recommendations from business included raising the ceiling on the single tax rate for sole proprietors and differentiating single tax rates according to earnings. As to legal entities, the business participants thought it made sense to raise the income limit that determines eligibility to use the simplified tax system and to exempt payers of the 10% single flat tax from mandatory registration as VAT payers.

Ukraine has no real economic policy

The business participants offered a strategic vision of Ukraine's economic development, something that was not evident on the part of the Government. The lack of a Government position on the development of the country's economy—which participants had expected to hear from Economy Minister Serhiy Teriokhin—was very sharply felt at the roundtable. Decisions to change the 2005 State Budget should have been based on a balance of two naturally competing interests: economic development and Budget revenues. Instead, one-sided, purely fiscal decisions were made. This seems to indicate that the function of the development strategies, policies and even just a specific position on the development of the commercial sector, business and investment is missing in the current Government. The lack of this kind of activity makes it impossible for business and Government to reach an understanding on tax policy issues.

The powers-that-be respond

On 16 May, just four days after this roundtable, the presidential press service announced that President Yushchenko had instructed the Cabinet of Ministers to take steps to liberalize business activity and to support business. The Cabinet was specifically instructed to:

- take measures to adopt laws on the simplified tax system for small business;
- consolidate the social insurance funds and simplify procedures, and amend the Law "On the VAT" to improve the administration of this tax;
- allocate more funds in the 2006 State Budget to finance measures to

implement the National Program for Contributing to the Development of Small Business;

- introduce a mechanism for public oversight of the institution of the Presidential Decree "On liberalizing business activity and supporting business."

According to UNIAN, a news agency, on 17 May 2005, Premier Tymoshenko announced that she intended to dismiss Andriy Dashkevych, the chair of the State Business Regulation Policy Committee. Premier Tymoshenko said that the working group of Government and SME representatives that was to review the simplified tax system was not functioning. The premier also criticized the work of First Vice-Premier Anatoliy Kinakh in this area and relieved him of his duties in this work. Responsibility was turned over National Deputy Ksenia Liapina instead.

The issue of business policy remains unresolved

Although the efforts of the organizers of this roundtable were successful, it is only a short-term victory. Ukraine still has no clearly formulated business development strategy. Without such a strategy, the Government risks finding itself in a situation where it will have to listen on a daily basis to the recommendations of ever-new interest groups who are dissatisfied and to cancel its decisions. ■

Organizing public dialog on critical policy issues is one of the tools ICPS uses to implement its strategy of introducing public policy in Ukraine.

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