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Key Principles of Reforming the Tax System in Ukraine

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The purpose of the research is to identify the key principles of reforming the tax system in Ukraine. The study is based on general theoretical and scientific research methods. The analysis revealed that a radical tax reform is needed in order to restore the economy of the country. To reflate the economy, it is proposed to replace the value-added tax with a five per cent sales tax. It has been concluded that the basic corporate tax rate (or corporate income tax) should be 12.5 per cent. The mechanism for determining taxable profit is based on the financial statements with enhanced opportunities to use the accelerated method of depreciation, exemption from taxation and taxable profit paid according to the results of the previous reporting period, in order to reinvest profit in the taxpayer's business activities. It is also necessary to abolish the simplified tax system and to shift to corporate taxation, as well as to the taxation of private entrepreneurs at the rate of five per cent.

Keywords: *Tax legislation, Value added tax, Sales tax, Corporate income tax, Fixed tax, Simplified taxation system, Shadow economy.*

Introduction

A high level of economic development and the quality of life are the indicators of prosperous countries. Therefore, the government pays a lot of attention to them. Nowadays, the priority directions of economic development are the share of innovatively active companies in the structure of entrepreneurship, the number of developed leading production technologies, and the share of high-tech sectors in the economy (Bogoviz, 2019). However, the development of these areas is impossible without a consistently high economic level, which many countries strive to achieve. For example, Ukraine, which is the poorest country in Europe in terms of GDP per capita and ranks 134th in the global economy ranking. Ukraine has ranked seventh in the poorest countries ranking since 2018 (Bloomberg Billionaires Index, 2018).

The studies confirm the influence of taxes on economic growth (McNabb, 2018). Thus, Ukraine should significantly increase its GDP and reduce the shadow economy in order to overcome poverty. Given the current trend of the GDP growth, Ukraine will not be able to overcome the high level of poverty in the coming decades. Therefore, there is a need for fundamental reforms in the country. First of all, a conceptual reform of the tax system is required.

The problem of reforming the tax system and considering the key tax reform elements in the conditions of the shadow economy, traditionally refers to one of the main issues of different countries. However, in scientific publications there is some uncertainty and debatability related to the approaches to understanding the essence of this problem. Due to the lack of a single scientific approach to the problem, there are numerous disputes when tax reforms are introduced in different countries under the conditions of the shadow economy. This emphasizes the relevance of the study. The research task is to analyse and improve the key elements of the tax reform in Ukraine under the conditions of the shadow economy.

It is believed that Ukraine is free to build its own national tax system, provided that it complies with the principles of fair competition in the international exchange of goods (services), labour, money, and capital. For example, Ukrainians can replace VAT with another consumer tax unless this contradicts the requirements of No. 6 and 1 of the European Union (EU) Directive on the tax neutrality in foreign trade with the European Union (Tymoshenko & Lomakovich, 2018).

The disadvantages and contradictions of the introduction of VAT are considered by a number of foreign authors. Thus, in the process of researching this issue, M. Shahe Emran and Joseph Stiglitz (2005) concluded that the benefits of switching to VAT are quite doubtful if the share of the informal economy sector is high. Many authors point to the low efficiency of VAT for the foreign economic activity liberalisation in developing countries (Baunsgaard & Keen, 2010; López-Laborda & Peña, 2018; Santoro & D'Agosto, 2019).

VAT is an important source of revenue for both national governments and the EU budget, but the existing system has not been adapted to the modern economy problems. They include vulnerability to fraud, high compliance costs for enterprises, and a heavy administrative burden.

As a result, all these shortcomings almost neutralise the potential positive effect of VAT on the budget. This conclusion is true not only for Ukraine, but also for all EU countries (European Commission, 2014; Smith, 2014). There will be a great financial compensator if VAT is cancelled, and the funds are stolen from it by Ukrainian Government officials, and their "business partners" are saved. Therefore, it is necessary to seriously consider the options for reforming the use of VAT or replacing it with other taxes that will meet the optimal tax system criteria (Tymoshenko & Lomakovich, 2018).

A good example is the experience of the United States, where the sales tax rate depends on the state and ranges from four to 11.5 per cent. For example, when taxable goods or services are sold in Texas, it is necessary to pay 6.25 per cent of the state sales tax in addition to the local sales tax. The local tax rate cannot exceed two per cent, so the highest rate is 8.25 per cent (Tax Topics, 2016).

The level of taxation significantly affects investment. Their complementary relationship is confirmed in studies (Brown et al., 2018; Ohrn, 2018). DeMooij and Ederveen found that a one per cent decrease in the effective corporate income tax rate contributes to a three per cent increase in foreign direct investment (DeMooij, 2001). For example, in Ireland, the corporate income tax rate has decreased to 12.5 per cent since 2003 (Bräutigam et al., 2017).

Today, in Ukraine, income tax accounts for about two per cent of GDP or up to nine per cent of all tax revenues. At the same time, it is mainly paid by one thousand taxpayers, who have to give 30–40 per cent more than they actually earn due to tax adjustments. Income tax is collected based on the administrative pressure on taxpayers (Butenko & Butenko, 2017).

To "unshadow" the economy, a simplified taxation system should be abolished and fixed taxpayers should switch to the general taxation system. A simplified taxation system serves to perform a social function in an unstable financial and economic situation in the country (Buryak & Lukash, 2011).

A simplified taxation system is implemented through tax minimisation schemes: selling goods through “STS payers” with the underestimation of the declared annual income; the use of the system by legal entities for cash withdrawal; the registration of relations with individual entrepreneurs through civil law contracts instead of registering them as hired employees (Matviychuk & Khlyvnyuk, 2017).

There are no analogues of the Ukrainian simplified system of taxation, accounting and reporting in the European Union. Although, there are preferences for small and medium-sized businesses, they have to work within the framework of the general taxation system (Ambryk, 2015).

As it can be seen, Ukraine has to reform its tax system.

Research Methods

The study is based on general theoretical and scientific research methods. The evolution of tax legislation and certain problems of building the tax system are considered as part of the objective process caused by the development and change of tax relations. The research is based on the historical method, the formal dogmatic approach, the method of specific legal research, the method of logical analysis, as well as other methods and techniques. The sociological method was used to study the problems of the key elements of the tax reform in Ukraine, in the conditions of the shadow economy as it allowed us to assess the adequacy and ability of the legislation to regulate tax relations in modern realities. We used a comparative method in order to assess the problems of reforming the tax system in Ukraine.

The statistics of the State Fiscal Service of Ukraine, and the data of sociological surveys related to determining the key elements of the tax reform in Ukraine, and the conditions of the shadow economy were also used. We analysed the following documents: the Tax Code of Ukraine, the Tax Code of Ireland, as well as the legislative documents of the United States, Switzerland, Israel, and Sweden.

Results and Discussion

The analysis showed that the recent reforms in Ukraine did not contribute to poverty reduction and GDP growth. They resulted in the growth of the shadow economy and corruption, as well as the value of the company's own working capital and business expenses. As a result, such pseudo-reforms have decreased the investment attractiveness of Ukraine and the level of official employment, as well as promoted the growth of labour emigration of Ukrainian citizens.

The only way for Ukraine to overcome the shadow economy and get closer to the twenty most developed countries, is to completely change the tax system. Given the experience of other more developed countries, in particular, Korea and Singapore, it is a radical tax reform that can help to find a compromise between state needs and business opportunities and benefits. The attempts to introduce tax reforms are used to impose a heavy burden on taxpayers, complicating tax accounting. In light of this, the extension of the tax base in order to maximise tax revenues should be avoided.

A large number of the thefts of budget funds (up to 20 per cent) are based on value added tax. VAT is a mechanism for stealing money from the state budget. As proof, in 2017, 108 tax avoidance schemes were revealed by the tax authorities (Report of the State Fiscal Service of Ukraine, 2017). This happens due to the shortcomings of the current system and the way the tax authorities administer VAT. A recent study suggests that an average of 36 per cent of

VAT is the cause of fraud. Since VAT is the main source of state revenue, its abolition will significantly affect the state budget (VAT Gap, 2017). Thus, this is a debatable issue.

Analysing the experience of the EU, where VAT is found in almost every country, it should be noted that it took the most underdeveloped EU members more than 20 years to introduce VAT. During this period, they managed to restart the economy and create a reliable system to prevent corruption. However, Europeans are also trying to hide their income and transfer the surplus balance to the countries where there is no VAT or its rate is much lower. For example, in Switzerland, the VAT rate ranges from 2.6 to 8 per cent. In the island of Jersey, from three to six per cent. In Japan, Singapore, Taiwan, and Malaysia, the VAT rate is between three and six per cent. Moreover, the tax was introduced after a rapid economic growth. For example, Israel introduced VAT in 1976, when it was one of the global economy leaders.

The United States of America does not use a value added tax in the domestic tax system. Instead, there is a sales and use tax which is paid not to the federal budget, but to the state budget (Kalinesku et al., 2013). The reasons for this are purely economic: the introduction of VAT would increase the export orientation of enterprises and create additional barriers to imports, in particular, strategic raw materials such as oil, non-ferrous metals, wood, etc. (Steblyanko & Reznik, 2015).

As of January 1, 2018, there were 1.4 million legal entities and 1.94 million self-employed persons registered as taxpayers (Report of the State Fiscal Service of Ukraine, 2017). In 2017, there was a corporate income tax of UAH 69.3 billion, and the single tax of UAH 3.7 billion, in the total amount of UAH 67.6 billion (0.85 per cent of revenue), which were paid by legal entities; self-employed persons paid a single tax of UAH 15.4 billion (2.54 per cent of revenue) (The State Fiscal Service of Ukraine, 2017).

With the revenue of UAH 604 billion only from self-employed persons, a five per cent sales tax could provide a budget revenue of up to UAH 30 billion.

Therefore, taking into account all the problems associated with VAT, as well as unsuccessful attempts to "fix them" and combat corruption, the Ukrainian economy should abolish this tax. The problem may be solved by replacing VAT with a sales tax, which will fundamentally change the approach to tax administration and make corrupt decisions impossible. Positive tax shifts in Ukraine will attract the attention of foreign investors. This will contribute to export activities, in particular, domestic production, which will pave the way to economic development. The country will be able to introduce a stock market for security trading.

Retail sales tax (single-stage sales tax) is the second form of universal excises, which is a one-stage tax unlike VAT. According to the classification of the Organization for Economic Cooperation and Development (OECD), sales taxes occur at one of the following stages: production, assembly, wholesale trade, and retail sale. Depending on the stage, the payer can be either the manufacturer (in the case of a sales tax at the production stage) or the enterprise that collects the finished products (in the case of a sales tax at the assembly stage), or the wholesaler (in the case of a wholesale tax) or retailer (in the case of a retail tax). The object of taxation is the total cost of selling the product (Bedyk, 2016).

As it has already been noted, the US experience is a bright example - this is the only OECD member state in which a sales tax is the main tax levied on consumption. It is incorporated at the state level (and is levied on 46 out of the 50 states), as well as at the local level (Kilinkarova, 2015).

From the institutional perspective, the disadvantage of such a tax is the need to control all the points of the final sale of goods. The problems are primarily due to the fact that if such a tax is successfully evaded, the end seller receives the full amount or can split the savings with the buyer by giving a substantial discount (Drogovoz & Dubrovsky, 2015).

In order to control the retail sale, it is necessary to use cash registers, which is quite problematic in many countries, including Ukraine. Unfortunately, there is no guarantee that the sale of goods in a store takes place through cash registers. Therefore, the task is to legally regulate the obligation to use these devices.

The conditions motivating sellers to use cash registers should also be created. For example, a total tax rate of six per cent of sales of goods (services) can be introduced. Moreover, if the buyer registers the check number that they received from the seller in the tax authority database through their personal account, they will automatically get back one per cent (or two per cent) of the sales tax. This will encourage buyers to ask sellers for a check and resolve the issue of controlling the sales tax. In addition, there is an idea to introduce a lottery among 10 checks registered by the buyer and return the full amount of the tax paid, on a random basis. The ability to register a check should be limited to six months from the date of purchase.

Let us do the calculation. For example, if a person makes an average purchase of $25 per day, they will pay the tax of 25x6% = $1.50 and get back 25x1% = $0.25. It will be 0.25x30 = $7.50 a month. For 10 checks, the person will get $1.50, which makes 7.5 + 1.5x3 = $ 12 a month. Thus, the person will pay 30x1.5 = $45 of sales tax per month and get back $12.

Legislation should provide for the automatic transfer of the information about checks through gadgets, computers, or a phone call to the contact centres of the tax authorities.

In addition, a check is a guarantee for the purchased product, which will also stimulate the buyer to request it. In general, the use of cash registers is a worldwide practice and its introduction in Ukraine cannot be regarded as a single case (Panasyuk, 2015).

Particular attention should be paid to the corporate income tax, which is the main tax for business entities. Legal entities have to pay an 18 per cent tax rate, which is different from similar taxes abroad. Since 2015, the tax has been following a classic European model of administration; taxable income is determined based on financial statements and adjusted for differences defined by the Tax Code of Ukraine (TCU). Tax revenues have dramatically increased due to the adoption of the Tax Code of Ukraine. Thus, in 2011, the budget received UAH 55 billion compared to UAH 40 billion in 2010. At the same time, tax revenues to the budget increased by only 33 per cent (from UAH 55 to 73.4 billion) over seven years (2011-2017).

The current corporate income tax has a number of disadvantages. Thus, there is an important task of reviewing and reforming the tax fundamentally by focussing on overcoming tax minimisation and the illegal display of the negative value of the taxable item.

Some EU countries have dramatically reduced income tax rates in recent years, including Belgium (the nominal tax rate will be reduced from 34 per cent to 25 per cent by 2020), Denmark (from 21 per cent to 18 per cent), France (from 33.33 per cent to 25 per cent), Italy (from 27.5 per cent to 24 per cent), Croatia (from 20 per cent to 18 per cent), Slovakia (from 22 per cent to 21 per cent), and the United Kingdom (from 20 per cent to 17 per cent) (Dieter Bräuninger German corporate taxes, 2018).

The low corporate income tax rate in Ireland (12.5 per cent, 20 per cent under dividends) has attracted the attention of large international organisations. More than a thousand companies have placed their production facilities and/or headquarters in the country (Facebook, Google, Twitter, Intel, Dell, etc.). Compared to other countries where the tax rate is double Ireland's, the state does not agree to unify the tax system. The country is a popular platform for establishing and conducting diverse business activities due to its simple and effective tax system. It is not surprising that since 2008, a huge number of different companies (more than 14,000 enterprises) have been registered in Ireland, despite its relatively small population.

In Ireland, a corporate tax rate of 12.5 per cent is levied on trade income and certain dividends from a foreign country, and a tax rate of 25 per cent is imposed on non-trade income. Taxable trading income is based on the profit in accordance with the financial statements adjusted to comply with the Irish Tax Code (Review of Ireland's corporation tax code, 2017).

In Ukraine, we propose replacing a corporate income tax with a corporate tax based on a mechanism for determining taxable profit in accordance with the financial statements and the adjustments defined by tax legislation, as well as expanded opportunities for applying the accelerated depreciation method (following the example of Ireland).

When replacing the tax, the main task is to develop a mechanism for businesses to pay income tax and prevent them from declaring losses and withdrawing funds into offshore zones. The axiom is the fact that the measures of the tax authorities will not contribute to this, as there are many ideas of demonstrating losses. Therefore, the main objective is to encourage the enterprise to declare income rather than losses. For example, the following provision may be introduced: if a private company declares losses in three consecutive tax periods, it is declared bankrupt and is subject to liquidation. An exception to this may be significant inflation or devaluation of the national currency. For example, more than 22.5 per cent, per year.

New companies can be exempted from taxation and tax inspections for the first year of existence. It is also advisable to offer progressive-regression tax rates. For example, during the first year after the adoption of new corporate tax legislation, the general tax rate is set at 12.5 per cent of the income (see Tables 1 and 2). At the same time, if the enterprise declares profit based on the results of the first year, the tax rate for the second year is reduced to 16.5 per cent. If the results of the second year declare enterprise profit again, the tax rate is reduced to 14.5 per cent, etc. In the case of the declaration of losses, the tax rate is not reduced. When a loss is declared in a certain year, the tax rate for the next year is automatically increased by two per cent; if a profit is declared, the rate is reduced by per cent, but it cannot be lower than 12.5 per cent. If the company has reported losses for three years, it is declared bankrupt and liquidated (excluding the first year after the adoption of the new corporate tax legislation).

Table 1: Income tax rate calculation

Profit is declared	
Year	Rate, %
1	12.5
2	16.5
3	14.5
4	12.5
5	12.5

Source: Developed by the Authors

Table 2: Loss tax rate calculation

Loss is declared	
Year	Rate, %
1	12.5
2	18.5
3	20.5
4	22.5
5	Bankruptcy

Source: Developed by the Authors

The profit margin is another issue. A higher profit increases the enterprise efficiency. Therefore, there is a need to encourage the company to be effective and report a significant profit. In this regard, it is proposed to introduce the incentives depending on the company's revenue and the profit declared.

Tax inspections are an acute problem of the enterprises. A new tax system should be aimed at reducing the contact between business and tax authorities, as it contributes to corruption and does not help to eliminate the shadow economy and minimise taxation. This should be based on the following principle: if the company is stable, declares profits and pays taxes honestly, there is no need to check it. Thus, in order to stimulate the corporate tax payment, it is proposed to exempt the company from tax inspections for the next fiscal period if it has currently declared a profit of at least 10 per cent of the revenue received in the previous period.

It is also proposed to introduce a reinvestment mechanism, providing the company with tax exemption in the amount of the tax paid for the previous fiscal period if the tax-free funds are invested in innovative projects of the enterprise.

Thus, an enterprise that conducts honest business activities and stably declares a significant profit will get the following advantages: a low corporate tax rate of 12.5 per cent; exemption from tax inspections; possibility of making tax-free reinvestments in its activities in the amount of the corporate tax paid.

Today, a simplified tax system also requires attention. The overwhelming majority of small-scale industries support the system explaining that small businesses do not have a financial capacity to grow and develop; a high tax burden inhibits their economic activity and, in fact, these entities struggle to survive. The development of small businesses is limited by the legislation which sets marginal revenue. When the entity receives higher revenues, they want to "fit in" the permitted amount and hide the income that goes beyond it. This also proves the need for radical reforms related to the use of cash registers.

Two different tax regimes for the same business entities, in the same economy, guarantees the formation of a tax game platform. Therefore, we believe that although a simplified tax system aims to reduce the tax load on “weak” businesses, it is a successful mechanism of abuse and fraud. No effective tax reform will work until there is a simplified tax system.

There is no European country that has a simplified taxation system similar to the Ukrainian one. For example, Sweden does not have any special tax regimes for small and medium-sized enterprises. All enterprises are subject to the common tax base, tax rates and obligations for registration, the filing of documents, reporting, and payments (Elert et al., 2019).

Therefore, it is necessary to abolish the simplified tax system and to shift to corporate taxation, as well as to the taxation of private entrepreneurs at the rate of five per cent, in addition to the social security tax. It is also necessary to introduce a new taxation form for private entrepreneurs (for micro-businesses with the income of up to UAH 100 thousand per year) patenting, which will simplify registration, accounting, taxation, reporting and termination of entrepreneurial activity by individuals.

The use of patents should be limited to a few micro-business activities that are difficult to impose a tax on. The tax rates should be low. The main purpose of patenting is to familiarise micro-enterprises with the procedure for paying taxes, rather than to receive tax revenues (Lipych, 2012).

Conclusions

Having analysed the tax system of Ukraine and compared its legislation with other countries, we confirmed the need for radical changes. The following steps will improve the system:

- The replacement of VAT with a sales tax at the rate of five per cent for all taxpayers. The tax will be paid once, when selling goods (services).
- The introduction of the mandatory use of cash registers.
- The introduction of a corporate tax with a basic reduced rate of 12.5 per cent with a progressive-regression coefficient.
- The exemption of honestly operating profitable businesses from tax inspections.
- The possibility of making tax-free reinvestments in the amount of the corporate tax paid will encourage taxpayers to conduct honest business activities, as well as significantly increase the number of profitable enterprises and the GDP growth rate.
- The abolition of the simplified tax system and transition to corporate taxation, as well as to the taxation of private entrepreneurs at the rate of five per cent. In addition to the social security tax, the introduction of a new taxation form for private entrepreneurs

(for micro-businesses with the income of up to UAH 100 thousand per year) in respect to patenting.

The relevance of the study is the possibility of using its results to improve tax legislation when implementing tax reforms, in particular in law enforcement activities.

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