

# How should business interpret announcement of the 10-10-10(+3) tax reform

Let us start with stating that it is not yet absolutely clear what this reform will look like. In August, together with announcement of the intention to carry out the reform, only some key issues were announced: company profit tax rate reduction by 10 % (possibly, with transition to the model of withdrawn capital tax), introduction of unified VAT rate of 10 % (that is its reduction for the majority of goods now taxable at the rate of 20 %, with simultaneous increase of the discounted rate to the general level, for example, now for pharmaceuticals – 7 %), establishment of the rate of individual income tax at the level of 10 %, with simultaneous canceling of single social fee and increase in the military fee rate from 1.5 % to 3 % + intensification of control and liability. This is the content of the intended reform, according to its concept developers – the team headed by the Deputy Head of the Office of the President Rostyslav Shurma. And in his interview for Forbes in mid-August Mr. Shurma acknowledged that there is no final concept as yet, the process will be finalized within half a year.

Therefore, there are still no respective draft laws or at least detailed draft amendments in the related regulatory provisions, that would enable to conduct legal-technical-economic analysis already now as to what could be expected from the changes at the micro-level (specific companies, tax-payers). So far the discussion focuses on the reform concept in general, its possible outcomes at the macro-level, directions and principal approaches to the reform.

It is envisaged that the attitude to the reform formulated in that way is rather negative in the public domain, for different reasons and with references to different general arguments. Such external communication, though, mainly comes from the expert environment represented in the media. But the fact that no “admiration” and real mass voices of support coming from business can be heard either is

highly illustrative. Why?

In order to understand the situation in general, it is probably worth going back to late spring – early summer of this year when a number of businesses and public representatives wrote an open letter asking for the “resigning” of the Chairman of the Parliamentary Committee on Tax Matters, Mr. Hetmantsev, as the embodiment of the fiscal policy of the recent years. A meeting of the representatives of this movement with the Office of the President regarding the application was held. That was an open demonstration of lack of perception of what is being done in the field by such business and society. Mr. Hetmantsev is a member of the President’s party, and is perceived as the main ideologist and leader of the current fiscal policy. That is why appearance of the messages about the 10-10-10 may testify to the fact that the Office of the President has perceived this as major dissatisfaction with the current tax vector and has arranged this “demonstration” to see further response of the society/business to an “alternative”.

Largely non-available (compare, for example, to the “degree” of long-term discussion of the need to switch to the withdrawn capital tax) social response to the current initiative shows that this, most probably, is not what business and society in general need and hope for. Why?

To begin with, that is probably due to the fact that the proclaimed reform is not perceived as something “live”, capable of influencing business and society in the nearest tough war times. Since the concept requires up to half a year for further elaboration (thus, we reach the first quarter of 2023), and then comes development of specific draft laws, adoption (let us remind you that, under the Tax Code, amendments must be introduced at least half a year prior to the beginning of the year in which they will be applicable). Thus, will the amendments become applicable no sooner than in 2024? Business

needs to survive till that time. Thus, this reform is not a good response to the current urgent business needs from the timeframe point of view.

For example, as regards company profit tax. Is 10 % of tax better for business than 18 %? In abstract terms, yes. And what about practice? I once heard an interesting phrase, coming from one businessman: “I am ready to pay profit taxes if I really have the profit”. And if business does not have profit, will it be not the same what the rate is: 10 % or 18 %? Any rate can be multiplied by zero – and you will get zero. Concerns are there that in the second half-year the economy will become even less profitable. And while payers have profit for the first quarter or half-year due to different circumstances (for example, grain traders bought grain for the equivalent of 100 dollars last year at the exchange rate of 26, and have sold them for the same 100 dollars but at the exchange rate of 36; according to accounting data, they have earned almost 40 % of profit in UAH, but what about real profits? Will the tax under such circumstances constitute concealed seizure of capital?) or “reserves” from previous operations, and over the second half-year this reserve will be going away, and the same payers may address for the return of the tax paid earlier this year as overpayment following the cumulative total since the beginning of the year. Will it not be the case that on the basis of the results of the second half-year the balance in company profit tax, in case of fair reimbursement of the payments developed over the first half-year, may turn out to be negative? Unfortunately, taxation of profits, as it stems from communication with business, for many is not a real issue within the nearest future, due to anticipated absence of profits. And if there is any profit, then even the current 18 % is probably not an excessive amount, if the profit is calculated in a “fair” way”, and it is not the case that the state sees profit even where it is not there from the economic point of view. And the issue of experience

is mainly about “calculation by the law-maker and tax inspection”, and not the “price tag” in percentage to such calculation. Finally, introduction of profit tax in the form of withdrawn capital tax will help settle relevant issues in a better way. Since according to the general definition, profit is something that may be seized from business for consumption, with no harm inflicted on the business. And who can know it better than business when and how much can be seized.

Let's go over to VAT. Ideally, this tax must be neutral for business, while business should be transparent for taxation. Since that is an indirect consumption tax. Respectively, business should just act as the agent of fiscal tax administration and collection from end consumers. How much to collect should not be the matter of principle for business in case VAT functions well, the same as it does not matter for the cashier, since both for business and for the cashier this is not their money. Therefore, VAT rate does not have any direct influence on business in case the system functions well. Distortions appear where the system is imperfect or functions inadequately. And this is what should be overcome with business in mind, instead of playing with the tax rate as the “lure” for business. Ukraine formally has one of the best and most complex systems of VAT administration in the world. At least, I have never heard about any other country in Europe with the centralized registration of tax invoices by the tax body, with prior inspection and the right to block, as well as mandatory provision of funding or acknowledged credit in the centralized electronic administration system. However, it is this system that creates real obstacles on the way to doing business, in particular, due to manipulations with tax invoice blocking as well as in the domain of budget reimbursement. But the reform does not include fighting these phenomena, abuse by state bodies, that really do harm to business.

But let us get back to the VAT rate. It still matters, but at a more general macro-economic level. It does not really matter for the buyer in the shop what components of the check he is paying; of importance is only the total amount. And here the tax component adjusts consumption since the amount

of money consumers may spend is still limited. And if it is not enough for everything, there will take place some redistribution between the essentials and something one may do without. Here the demand for “non-critical” products is, in fact, cut, and thus opportunities of that business are cut. Therefore, reduction of the general VAT rate releases additional money for consumption and increases the economic base for business. Thus, we can see the indirect effect of the rate at the micro-economic level.

And if we speak about the overall picture, do we have excessive consumption of many groups of commodities in Ukraine now that should be limited? For example, consumer goods. By the way, this is a good example for comparison since 10 % for this group will anyway be a higher amount than in the neighboring Poland and the rate Europe is heading for – zero VAT for food, in particular, as a tool of fighting currently high inflation. The rate below 10 % VAT is set (compare it even with Poland) for other critical groups of goods as well. Our people staying there now do see this. And the reform suggests: get back since our rates for what belongs to essentials will be higher? And business also sees it. So 10% VAT is not even perceived well as “hype”.

Probably, at the stage of the war and post-war recovery it would be expedient to drastically change the attitude to this tax. Finally, VAT is also called a universal excise duty. So, why not deviate from this universality for this special time and leave this tax over this special period only for specific (limited) groups of goods and services that may really be considered not that much demanded in this period. You have to pay for “luxury”. And transfer this to the category of excise duties for manufacturers or import or sales tax at the stage of final sales. Such alleviation of the tax system and deprivation of the overwhelming majority of tax-payers of the burden of participation in the VAT administration system (in particular, for goods and services mainly designed for export) will have a better effect than VAT rate reduction (and for some, for example, for medicines – increase) to 10 % for all, with further declared complication and introduction of a more substan-

tial burden and VAT administration responsibility as well as a higher tax burden (as compared to the European Union and, in particular, our neighbor – Poland) in terms of percentage for critical commodity groups. These considerations belong to the range “if you criticize – make suggestions” in order to show availability of more attractive and expedient alternatives.

The overall impression is that, with their declared radicalism, the authors, in fact, have not got rid of the old paradigm of “tightening the nuts” for tax-payers, with certain minor allowances. This is illustrated by the suggestion related to the military fee. Why shall it be left as a separate one (and intended to be increased twice) if it is almost fully identical to the individual income tax? We have heard a lot that this is caused by the fact that the individual income tax is distributed between the local budget where it is collected and the central one, while the military fee fully goes to the central budget. So what, only due to this, due to the incapacity of the state to ensure normal administration and distribution it has got two taxes instead of one? Or is it just for the individual income tax to also be 10 % (10-10-10), and not 13 % (if we add military fee)?

In brief, there are a lot of questions to the suggested reform as it has now been voiced, and there are already claims to it. It does not evoke any special enthusiasm. And certainly it is still not at the processing stage when it is possible to forecast the consequences for specific companies at the micro-economic level.



Oleksandr Minin  
Senior partner,  
KM Partners/WTS Consulting