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ACTUAL PROBLEMS OF TAXATION POLICY: THE INFRASTRUCTURE OF INDIVIDUAL INCOME TAX IN UKRAINE

Abstract

The paper presents the advantages and disadvantages of Ukrainian taxation on the basis of individual income tax analysis. The authors substantiate the defects of legislative base for collecting this tax.

Key words:

Financial policy, financial infrastructure, tax, tax burden, social market economy.

1. General Theoretical Fundamentals

The outset of the 21st century was marked with a crash of stereotypes regarding the development of economic systems. Indeed, the functioning and dialectic development of an economic system demands coherence and balance of interests at all levels of social relations. The pragmatism of researching the

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structure of economic interests, which determine the behavioural model of economic agents, assumes that the diversification of national economy is determined by the factor of raw materials, the absorptive capacity of the consumer market, and the ability to employ relatively free capital which flows under the influence of objective economic laws. Thus, we can not deny the standpoint of national financiers V.Fedosov, V.Oparin, and S. Lyovochkin which contend that ignoring one's interests will sooner or later cause negative consequences for everyone [14: 11]. However, the realization of pragmatic interests calls for an efficient economy, which can function successfully within a rational financial infrastructure. Moreover, the formation of the Ukraine's sovereignty has radically changed the environment in which this infrastructure is functioning. The decisive factors of this process were not only the formation of the market, but also the active processes of state development and consolidation of democratic principles for development. Due to democratization and establishment of a socio-oriented economy, the individual, group, and regional interests of various kinds were provided an opportunity to actively influence the financial policy, which presently is forced to serve as an intermediary, coordinating the centre and the regions. At that, the financial role of the state is growing not only quantitatively, but qualitatively in the first place. The millennial practice of social development shows that a society's strategy will only be successful when based on determinative economic factors. An economy can grow primarily owing to the information sector, the key role in which currently belongs to computer and communication technology. It creates preconditions for diversification of commodity assortment and computerization of other production sectors in the new economy. Moreover, along with the technological break-through, hardly will the society avoid revolutionary technology: biotechnology (including new medical technology and genetic engineering), robotics, and nanotechnology.

In the developed countries, these factors have less restrictions and more potential for self-development. However, economic relations in the market economies are indirectly regulated by the state. It legislates and controls the execution of the laws and juridical acts, which regulate economic activities, plays a key role in providing public goods, as well as fulfils some functions characteristic of the present level of social development: antitrust regulation, consumer protection, providing of pensions, social insurance, and stimulation of relevant markets. In addition, the state regulates external economic affairs – which increasingly influences the establishment of the socio-oriented economy – and, in most cases, participates in economic activities as an agent. Thus, the society is purposefully restricting certain spheres of economic relations so that to steer their development.

In analyzing the establishment of the market economy, a feasible conclusion would be that it is an accomplished social-democratic concept of social relations with the entrepreneurship rigidly controlled by the state and with a strong system of social and legal assistance. A socially oriented economy comprises of the following major elements: equal rights for all legal entities irrespective of their proprietary forms; free, yet governmentally controlled, pricing (except for direct

pricing regulations applied to basic consumption and industrial goods and services); state support for fundamental strategic industries provided within the national system for state interest economic guaranteeing by means of placing governmental orders, forming and maintaining official reserves, and governmental stimulation of industrial exports to developing countries; regulated inflow of foreign goods, services, and manpower to the domestic market and the formal right for all business entities to conduct entrepreneurial and external economic activity; priority allocation of budgetary funds to social security, development of general and professional education, scientific research, and health protection; existence of independent trade-unions, which ensure the conclusion of tariff agreement between employers and trade-unions; strict, equal law and order established according to the democratically issued laws for everyone.

More than twelve years of the Ukraine's independence demonstrated that democratization, along with essential advantages, gave way to numerous drawbacks. Reality testifies that the centralized money funds can flow in isolation from the processes of material production; the interests of certain structures, divisions, and regions do not converge within the chain of reproduction processes; whereas real ideological values can be replaced with populist slogans. In addition, the financial decisions do not always meet the objective realities and economic abilities.

In studying the attributes of a socially oriented economy, one can observe regularities when the interests of every individual, business entity, and the state in general are concorded through the financial infrastructure. Moreover, exactly this system channels economic stimuli.

Reflecting a complicated social event, the attributes of the financial infrastructure take on multi-dimensional social features and forms of manifestation.

One of the most essential and meaningful peculiarities an efficient economy is its social orientation. In particular, the social orientation of the economy is an inseparable element and the crucial feature of a civilized society. The socio-oriented economy assumes proper governmental programs with regard to employment, health protection, and introduction of educational and scientific developments. It determines the allocation of state expenditures and ensures the formation of the social safety net, the orderliness of privileges, the clarity of compensation regulations, and maximal benefit restrictions. It affects general situation and the quality of life in Ukraine in the first place, as well as encompasses all challenges at the macro- and micro- levels.

The research of financial infrastructure in the context of ensuring social and economic development proves the level of taxation to be the most urgent issue. It is one of the fundamental financial and economic indicators which essentially impacts budgetary revenues at all levels, all economic processes of state formation, as well as development of administrative and territorial units. The optimality in determining the threshold of this indicator determines the amount of financial resources available to state and local authorities for realization of relevant social and economic functions and ensuring economic growth.

2. The Paradigm of Financial Resources Redistribution Between State and Local Budgets

The new taxation paradigm which is now being developed in Ukraine calls for applicable recommendations for determining the level of financial resources to be redistributed between the state and local budgets. The socio-oriented market economy provides grounds for consolidating democratic principles of local government. At the same time, such an economy forms the social democratic political doctrine, as well as the social and legal consensus within the frames of political system, which is the basis for political, economic, and social stability in all fields of activity in any society, including the Ukrainian. The European experience testifies that at certain times the country decisions that are not the best, but those based on social and political consensus, which is the basis for social stability.

The theoretical foundation of the social market economy concepts is a thesis about the influence of institutions and regulations upon the behaviour of business agents, and the organic combination of economic competition and market freedom with social guarantees and compensations. In fact, the case in point is the protection of economic competition and freedom, as well as subsequent combination of the free initiative and guaranteed social advance based on economic growth. The major problem for both theoreticians and practicians is to determine a priori the scope of the problems to be solved by central authorities and those to be delegated to local governments. As A. Buryachenko and M. Paliy justly acknowledge, the key issue in this context is to determine the principle of revenue distribution among the branches of power; to define alternative ways of conducting state expenditures and to reform the system of revenues for their financing; as well as to form a system of financial resources providing to local authorities [5:14]. Here, the core determinant is the predominance of limits: whom and what to pay, and how to spend. Thus, the priority essence is to create the rules of the game and to follow these rules.

George Soros, the distinguished investor of the present, admits that elaborating the rules of play implies collective decisions, in other words, politics. A fair game includes individual decisions, i.e. the market behaviour [13: 23]. Further, G. Soros emphasises – and it is completely urgent for Ukraine – that people tend to vote with their purses and lobby the legislation which serves their own interests. But even worse, the voters and legislators often place their private interests above the public ones. Instead of acting on the basis of certain common-to-all-mankind values, the political leaders strive for being elected at any price; and thanks to the prevailing ideology of market fundamentalism, their intentions are considered natural, rational, and even desired for hitting the target. Such an «obedient» policy develops the postulates which are the foundation for the system of representative democracy.

Surely, the contradictions between private political interests and public interests existed at all times. However, they deepened as the views spread that success expressed in monetary terms should be rated higher than common human values, such as honesty. Thus, the growth of useful motivations' influence and the drop-off in the efficiency of collective decision-making are hunting each other reflectively. Bringing mercenary interests to moral principles corrupts politics, while the latter's insufficiency becomes the strongest argument for providing markets with absolute freedom.

Special attention should be paid to the fact that in the market economy, the financing of regional economic development is not a mandatory function of local authorities. For the most part, the local authorities ensure social stability in the region. Still, the situation in Ukraine is worsening also because it is not possible to shift a part of social expenditures onto business structures and population's income. The reason for it is low wages and unprofitability of some economic agents. Therefore, the impossibility of curtailing state budget expenditures excludes sharp changes in the tax system. Foreign experience shows that the state's functions are limited to providing public goods and services. Other market goods are produced, supplied, and financed by independent business entities. A striking example of this is Soyuz-Viktan Company's change of its place of registration. Hence, the financial independence of local government depends not on the region's financial resources, but on the funds at the disposal of local authorities, i.e. revenues of the relevant budget.

Financial practice elaborated mainly two approaches to local budgeting. The first one is the principle of budgetary equivalence or fiscal equality. The second is the principle of national solidarity called «equalization of financial capacities». The first principle is based on the idea of fair taxation or fiscal equality applied not only to individuals or business units, but also to the region's population as a whole. According to this principle, the financing of local budgets should directly correlate with the tax burden imposed upon the residents of the region. This means that each region can provide more public goods and increase the population's welfare as long as it can ensure sufficient tax funds. Adhering to the first principle implies that the amount of public goods and services supplied by local budgets should be determined by the amount of taxes collected in the region. Such an approach is not only socially fair, but also, as I. Lunina notes, stimulates effective regional development [10: 187–188].

Analyzing the applicability of this principle, it is necessary to highlight some arguments, which must be considered should the state strive for levelling out the financial capacities of the regions. To ensure efficient financial mechanism of regionalization, it is necessary to form the financial providing of relevant governmental bodies based on their assigned authorities.

The second principle is founded on the joint willingness of industrial and agricultural regions to function as a single economic complex of the country. It implies such a redistribution of financial resources as to maintain more or less equal level of regional supply of public goods. Consequently, taxes should be

determined in economic, as well as social, terms and accounted for in the regional policy. Moreover, the social value of taxes is determined as a share of foregone personal welfare of certain tax-payers with the consequent transfer of this share to the rest of the Ukrainian population through the budgetary system. Thus, the notion of the tax as an objectively preconditioned payment of natural and juridical persons to the budgets of administrative bodies at different levels was accepted for practical purposes. From the theoretical standpoint, it is worth noting that any tax, apart from fiscal and regulative influence, entails indirect, external to the fisc, social consequences.

The evolution of financial knowledge about the public nature of taxes is inseparably related to the theoretical notion of state goods. State goods are public goods the providing of which is financed by state authorities. These public goods are neither produced nor provided by the private economy, but brought forth by the state's functioning. Incidentally, if the state is an institution which produces irreplaceable public goods, then these goods are sold to consumers at prices set by social agreement. The value of public goods is the amount of taxes, and the remuneration for state goods is an authentic spending of tax revenues. Owing to this, the state – being the producer of public goods – and the society reach an equivalent barter agreement: «goods – taxes».

In this context, an important component of the public choice mechanism is laws and procedures as a basis of financial decision-making. The final result of collective interplay largely depends upon the rules applied to it. The peculiar feature of the rules of collective contracting is that they can further the realization of the interests of individual participants to social choice in different ways: they can ensure either common utility or re-distributive nature of the decisions made. In this way, these laws either promote or hinder the representativeness of state finances.

Condition to full consideration for the interests of all collective decision-makers is the unanimous approval of financial decisions. The unanimity rule is unique because it accounts for the interests of individuals and relevant structures. However, under present conditions, financial decision-making at the state level is impossible to realize through direct participation of each citizen. This rule demands a lot of time and resources to find a compromise that would meet everyone's interests.

In all other cases of decision-making, those whose interests contradict the approved decision will be negatively affected. Such effects are obviously of re-distributive nature since only the members of certain group will benefit from financing the providing of public goods.

Proceeding from the structure of the Ukrainian budget [14: 254], worth mentioning is the «unique» phenomenon introduced by national politicians: the division of the budget into two parts – the general and the special funds. The general fund represents the revenues and expenditures of the budget itself, while the special fund – primarily the off-budget funds of budgetary institutions. The uniqueness of this phenomenon lies in the fact that because the state has

no means to support its own structures, it takes away their earnings derived from executing their assigned functions.

Consequently, the role of the financial infrastructure in ensuring social and economic development does not primarily entail consideration for regional peculiarities, which is also important, but is intended to dynamize the process of social and economic development, which has recently started, and to contribute to social consolidation. However, such a consolidation demands that the objectively needed fiscal, economic, social, and political concernment about taxation at the macro-level be brought in line with the subjective perception of the tax as the infringement upon private property of an individual tax-payer.

It is natural that under current economic conditions, social requirements, and resource constraints, the effectiveness of public administration is brought to the forefront of scientific and social concern. Individual income tax appeared in the epicentre of taxation interests [14: 27–28].

In the 20th century, individual income tax took a principle place in different tax systems of the world. It became the fiscal instrument characteristic of the advanced culture of state organization and having a refined mechanism which demands that tax-payers and tax-collectors treat their rights and duties reasonably, which is promoted through making tax-payers and tax-collectors clearly understand its essence and mechanism. These issues and their evolution are analyzed in the financial literature [3].

However, as Andrushchenko V. L. admits, the major intricacy about the knowledge of the XXth century income taxation lay not in the taxes themselves as the product of human intelligence, but in the social conditions under which tax systems functioned and the impact of the social and economic environment upon them. With regard to taxes, the science of finance consists in the administrative and organizational ability to ensure maximal state revenues while neutralizing negative effects of taxation on the economic processes and condition of the economy [2:165]. Therefore, taking into account that during 1998–2003 the share of individual income tax revenues in overall tax revenues of the Ukrainian master budget has been continuously increasing – from 16 to 24% respectively [12], the urgency of researching this issue is not diminishing.

3. Individual Taxation

The effectiveness of the finance specialists' cooperation and the analysis of the respective governmental bodies' experience were embodied in the approval of the Law «About Income Tax on Individuals» on May 22, 2003. The speed of elaborating and approving the Draft of this Law by the Supreme Council of Ukraine persuades us in the achievability of the objectives declared by the government of Ukraine with regard to reformation of the system of financial and economic, including fiscal, relations. In this regard, worth pointing out are the

numerous benefits in the new mechanism for taxing the population's income. They entail more astringent accounting rules and, thus, control over the possibility of tax-evasion; simplification of tax rates; elimination of double–taxation of the individuals' income drawn from imposing the income tax and the obligatory contributions to state social and retirement insurance funds; encouragement of mortgage lending; the graduality of implementing the law; approximation of individual and corporate income taxation ideologies, etc.

On the other hand, the limitation of time devoted to thorough examination of the wording of such a fundamental law, the focus on the advantages of the suggested amendments in discussions, scientific publications, and periodicals [9], as well as the accentuation on the reduction of local revenues and the necessity for their compensation, made it impossible to assess the legislative innovation in full measure. The shortcomings of the new law can cause difficulties in forming local budget revenues, as well as in the interactions among tax-payers, their employers, and state tax authorities.

First of all, worth underlining is the tradition of defining the terms used in this legislative act. The treatment of individual income tax is appealing in the first place. The essence of the tax, as defined in Article 1.1.3 «Charges to Individuals for Services», implies designation of its purpose, specifically – services rendered to the tax-payer and related persons by respective territorial communities, i.e. at the expense of corresponding local budget. Thus, individual income tax should be included in the budget of local authorities in full (100%). This runs counter to the Budget Code of Ukraine (to be precise, Articles 64–66) which reads that individual income tax should be apportioned among local, district, and regional budgets.

The specific definition of services rendered to an individual by the territorial community would make it possible to mitigate this inconsistency. As long as the matter concerns the services which are the result of the powers delegated to local authorities by the state, the inclusion of individual income tax receipts in the district and regional budget revenues, which is accounted for in the calculations of inter-budget transfers, is rational and valid. In case individuals pay for the services rendered by the territorial community and its authorities within their own powers, it would be reasonable to include individual income taxes in the local budget revenues, which are not counted in the inter-budget transfers.

As a result, it is necessary to define the range of services which the territorial community should charge as a tax on personal income to an individual. Obviously, the authors do not insist on the need to bind every tax, including individual income tax, to a certain public benefit received by the tax-payer. Contrary to this, the authors believe this approach to be a step back in the development of fiscal theory and practice since the longstanding experience demonstrated the frailty of perceiving the tax as a fee for certain services rendered by the state, as well as services financed by common public fund – the budget. Moreover, the growing complexity of social life prevents from unambiguous and fixed differentiation among national and local benefits. Therefore, it would be reasonable to

define the notion of individual income tax more precisely as a fee paid by the individual for the services provided by the territorial community within its natural and delegated legal competence.

In this connection, we must state that in regard to individual income taxation, the recently adopted legal regulations, unfortunately, have neither clarified nor eliminated the problems of equitable allocation of the correspondent tax among the budgets of territorial communities (equi-level local budgets) in case the tax-payer's place of residence is different from that of income acquisition. The treatment of individual income tax in Article 1.13 and the definition of tax domicile in Article 1.14 provide a possibility for ambiguous interpretation of the target address for allocating this tax:

- to the budget of the territorial community of an individual's permanent residence;
- to the budget of the territorial community of an individual's preferred residence;
- to the budget of the territorial community where the individual or entity withholding the tax resides.

Indisputable is the case when all three positions concerning the tax-payer match. However, which budget has the right to revenues from the individual's income taxes in case when the places of registration, permanent residence, and employment are absolutely different? Neither the Budget Code of Ukraine nor the Law of Ukraine «About Income Tax on Individuals» elucidates this issue. Only the longstanding tax practice in Ukraine provides an answer to this question. That is, in case the tax-payer is not self-employed, the income tax goes to the local budget of the employer's (individual or entity) place of registration. Hence, taking into consideration the specific character of national registration system, as well as to avoid possible inconsistency in the rights to budget revenues from individual income taxes, the current state of affairs with the budget – the tax-recipient – should be enforced legislatively. It should be noted that with regard to employers – individuals, this problem is partially solved in Article 16.3.3 of the Law under consideration.

As a result, Article 16.3.4 should be expanded so that to include the need for tax administration's control over the accuracy and timeliness of tax payments not only at the registration place of legal entity or its department, but also at the individual's tax domicile or his/her place of registration as a tax agent.

In order to protect local authorities from essential losses of the projected individual income tax receipts due to an unforeseen change in the corporate employer's place of registration during the fiscal year, one of the following measures should be settled:

- including a special purpose transfer payment for moderating the negative effects arising from the tax-payer's change of registration place

onto the list of subventions recognized by the Budget Code of Ukraine;

- ensuring the immutability of the tax-receiving budget until the end of the fiscal year if the employer's place of registration changes.

Furthermore, the description of the first taxable period suggested in the second paragraph of Article 1.7 is not accurate enough. Thus, if the employee receives his/her monthly income on the 31st day of the month, the tax reporting period will last only one day. That is, the end of the preceding taxable period will contemporize with the beginning of the next one. Therefore, it would be more correct to define taxable period as the period of labour activity for (not – in) which the income was received.

The application of such terms as «accrued income» and «paid income» also evokes criticism. A closer examination of the text of Law makes an impression that these notions are identical in the taxation of individuals. It might be acceptable when the matter concerns the prevention of tax evasion and the inadmissibility of disparity in the accrued and the paid income. However, in certain cases the equivalence in using these terms is meaningless. For instance, Article 3.4 goes about the accrual of «income in any non-monetary form». But income can only be accrued using the cost parameter, which is money. In Article 3.4, therefore, the word «accrual» should be logically replaced with the word «payment».

Doubtful also is the efficacy of including into the monthly taxable income the «income received by the tax-payer from his employer as free additional benefits in the value of lodging or using other tangible or intangible corporate property, except when the benefits are required for the tax-payer to perform his labour function or stipulated by the norms of labour contract» (Article 4.2.9.a). As a matter of fact, in trying to minimize tax payments, employers may supplement their labour contracts with a standard clause about passing tangible or intangible corporate property to employees for free use. In this case, the afore-mentioned regulations will work only for the employers which do not pay income tax on the motor transport handed over for use. Therefore, in view of economic efficiency and social justice, it would be feasible to dispose of all the exemptions specified in this Article.

Inasmuch as the Law provides for inclusion of the sum of financial assistance into the average monthly taxable income of individuals, the equivalence in approaches to defining the taxation object for both individuals and entities, is virtually sustained. The above-mentioned regulation would gain even more significance if specified the notion of «financial assistance» used in the text. It might be identical to the definition of financial assistance quoted in Article 1.22 of the Law of Ukraine «About Corporate Income Tax». Even so, it follows that, along with other incongruities, the inclusion of non-refundable financial assistance defined as «a sum of money transferred to the tax-payer in grant» into the average monthly taxable individual income does not comply with the conditions of taxing the income received by the tax-payer as a gift, as stated in Article 14. The term

«refundable financial assistance» would reflect more accurately the essence of financial assistance transferred to an individual from his/her employer as a fringe benefit. That is why it would be practical to take traditional approach to the Law of Ukraine «About Income Tax on Individuals» and refer to Article 1.22.2 of the Law of Ukraine «About Corporate Income Tax» when interpreting the term «financial assistance».

Worthy of note is the fact that the definitions of some other terms were also omitted in the Law (for example: «single mother (father)», «regressive payments»), which may cause discordance in interpretation when applied and, accordingly, bring the tax-payers and tax authorities into conflict.

An element of the resident's object of taxation defined as «the income of Ukrainian origin subject to final taxation upon payment», which is cited in Article 3.1.3, is actually a part of gross taxable income suggested in Article 1.6: «Gross taxable income includes all items of income subject to final taxation upon accrual (payment)». Therefore, Article 3.1.3 can be considered as duplicating Articles 3.1.1 and 3.1.2, and thus, pointless. The same is true for Article 3.2.3 on the taxation object of non-residents.

The condition regarding the size of taxation object stated in Article 3.4, in fact, introduces higher tax-rates for income paid out in non-monetary form. The mechanism of tax-rate calculation is progressive, similar to that applied to excise taxes before the year 2000 [10]: the higher is the tax rate coefficient (R_t), the heavier is the taxation of non-monetary income.

The implementation of this mechanism requires theoretical substantiation of the criteria of optimal fiscal policy, for example, in terms of economic effectiveness and social justice. Obviously, non-monetary payments, especially to employees, should be restricted in the national economy by applying a correspondent coefficient. In this case, however, the employer acts as a tax agent; in other words, the volume of individual income taxes and additional charges against payroll calculated using this coefficient simply increases the employer's gross expenses. As a result, the employer's income decreases, and so does his tax on income. Consequently, the economic interest of an employer in reducing non-monetary payments to employees, as assumed in Article 3.4, only fades away. On the other hand, the principle of social justice with regard to citizens, which receive income in a less liquid form, is violated as well.

Hence, in order to eliminate these disproportions, it would be feasible to limit the level of the employer's gross expenses related to the in-kind remuneration of labour (i. e. its monetary equivalent) calculated at ordinary prices without applying the coefficient. This measure will also allow to reduce the unjustified budget losses caused by a drop-off in corporate income tax proceeds.

Praiseworthy is the legislator's attempt to take proper account of the realty maintenance expenses of individuals by means of reducing the recognized gain on the sale of real estate property by 10% per each holding year. However, justification for such a discount is questionable. According to the formula indicated in

Article 11.2.1, the recognized gain on the sale of real estate held by the tax-payer for the period of eleven years amounts to 0 hryvnyas, irrespective of the amount of income realized from disposition of real estate and the acquisition costs incurred by the tax-payer. From the economic perspective, this approach actually assumes recovery of the individual's invested fixed capital in 11 years. This period stands no comparison with the period of depreciating the respective (first) class of capital assets of the taxable enterprise in terms of benefit for the latter. In reference to Article 8.6 of the Law of Ukraine «About Corporate Income Tax», the annual depreciation rate for the first class of fixed capital equalled 5% before and 8% after January 1, 2004, which is respectively 2 and 1.25 times lower than 10% «depreciation» rate applied to the real estate of individuals. Consequently, in this case, we can certify ambiguity in approaches to individual and corporate taxation.

Furthermore, local authorities lack clear stand concerning the formation of their revenues from individual income taxes on real property sales or exchanges. The problem is that the «amount of tax on such a gain [gain from the above-mentioned operations] can not be less than the amount of the minimum wage set on the January 1 of the year of disposition of such an object». When the value of income calculated according to the formula is positive (which is possible when revenues exceed the cost of real property or within the 10-year period of holding the property), this would be acceptable. But can we apply the words «tax on such a gain» to the loss which occurred due to objective reasons? It would be logical to say: «No». However, considering the importance of fiscal motives in building relations between tax-payers and state tax authorities, the authors doubt the efficacy of this response. Thus, to our mind, it would be feasible to add clearness to this clause.

The clause on almost preferential terms of taxing income from transactions with real property in total area up to 100 m^2 (Article 1.1.1) requires more accurate definition as well. These 100 m^2 can be occupied by one person or, similarly, ten persons; consequently, the economic and social benefits from attaining or losing the right to this property will differ.

So that not to equate local securities with other types of securities, as well as to encourage the initiative and development of self-government, would it be viable to include the income derived by the tax-payer from such an investment in the income excluded from the overall monthly or yearly taxable income (Article 4.3.3).

The compliance with the condition to value an acquired investment asset at historical cost, which, nevertheless, should not be lower than the sales price of the investment asset (Article 9.6.4), may cause artificial overstating of the tax-payer's expenses and a correspondent decrease in investment income, which does not meet the interests of local budgets with regard to revenue formation. Consequently, this clause should be excluded from the Law.

Moreover, the withdrawal of budgetary funds from local authorities due to poor employee performance of the Treasury – which is not accountable to local

authorities (Article 20.4.3) – lacks substantiation. Since both the State Tax Administration of Ukraine and the Treasury of Ukraine are the institutions of equal competence and power, it would be more logical to levy financial penalties for the Treasury's inaction with regard to full or prompt repayment of the overpaid individual income tax similarly to those of the tax authorities, in other words, directly from the budget account of the relevant Treasury body of Ukraine.

In addition, the Law does not solve the issue of applying the general procedure of refunding the essential amounts of individual income taxes when the real sources of income are unknown or thoroughly concealed. This may result in legal ways of evading taxes on such income as, for example, the employer's payments to educational institutions as a compensation for the taxpaying employee's vocational training or retraining in the field of employer's business activities or general production needs (Article 4.3.20).

Conforming to one of the taxation system's formation and targeting principles – the comprehensibility principle – requires that certain subparagraphs of the Law be simplified. For instance, additional explanation is needed for the essence of Article 4.2.4: exactly which indicator should not exceed the amount of an able-bodied individual's monthly subsistence wage fixed on January 1st of the reporting taxable year, multiplied by 1.4, and approximated to the nearest 10 hryvnyas, – either the amount of insurance payments made by the resident employer at his/her own expense under the long-term contract of life insurance or private retirement insurance of the tax-payer, or the amount of wages paid out to the tax-payer.

Likewise, uncertain is the ability to include in the tax credit of the tax-payer's first-degree familial relative the amount of insurance payments made by the tax-payer, in case he/she insures against the risks identical to those independently insured by the relative (Article 5.3.5). The Law does not specify whether the 50-% limit is applied to accounting for this amount under the insurance contracts drawn up for the benefit of such a familial relative. The logic of taxation mechanism and tax credit suggests that it is not. However, the imprecision of formulations causes multiple interpretations of legal regulations, which is intolerable in a jural state.

As a result of settling accounts with a tax-payer terminating labour relations with an employer, the amount of taxes paid may exceed the employee's tax liabilities accrued during the accounting period. Yet, who in this case will be entitled to a budgetary refund – directly the tax-payer (upon the results of the fiscal year) or the employer (who will recompense the overpayment at his own expense) – is still hard to understand from the Law.

Certain regulations on taxing income from long-term contracts of life insurance and private retirement insurance arouse negation as well.

First of all, ill-founded is the size of the taxation object – 60% off the lump sum or regular and gradual insurance outpayments.

Second, the restrictions imposed on the deductibility of the tax-payer's expenses for insurance carried at his/her own cost under the long-term contracts of life insurance or private retirement insurance (stipulated by Article 5.3.5) and, at the same time, the taxation of insurance outpayments contradicts the principle of one-time tax collection from the one and the same object (in this case – the tax-payer's funds accumulated at the non-governmental pension fund or the long-term life insurance fund). If to consider the life expectancy of Ukrainian citizens in 1999-2000, which for Kyiv inhabitants alone exceeded 70 years [6: 71], the analyzed conditions of individual taxation hinder the reformation of the pension providing system and the development of insurance market in Ukraine.

The regulations set forth in Articles 4.3.32b and 15 create the same impression. In fact, they equate the insurance money under the contracts of property insurance with the sale of such property, unless the tax-payer replaces the lost value. These conditions might be acceptable in a democratic state, such as Ukraine. However, the requirements of time limits and objects for replacement are unrealistic. In certain cases, the tax-payers may lack the possibility or necessity to repair old or acquire new property, similar to the one lost, such as works of art or a house.

The authors believe the clause on prohibition of sponsored and charitable contributions to state and local authorities, charitable foundations and other not-profit organizations established by them, or third persons upon their instruction (Article 9.7.7) has no direct action and, therefore, is superfluous.

Positive of the Law is that it sets into order tax privileges and ensures proportional changes in their size when the basis for their computation – the minimal wage – changes. But the absence of the former privilege for children below the age of 18 irrespective of the status of their parents draws additional attention. It is clear that this measure is dictated by the need to curtail tax concessions. However, it should be taken into account that an ordinary (average) Ukrainian family receives no targeted state support for upbringing children above 3 years of age. Thus, the social justice and equity in taxing or, in other words, establishing equality of gross income of individuals with no children and those having children below 18 years of age appear to be dubious.

Similarly doubtful is the clause (Article 6.3.3) stating that self-employed individuals can not actually receive any social tax privileges. Of course, the impossibility of receiving a tax privilege will not become a deciding factor in entrepreneurial decision-making, but it will not become an incentive to business or other independent professional activity as well. On the other hand, people are granted tax privileges stipulated by Article 6.1.2 depending on their social status. Therefore, the impossibility of receiving tax privileges because of independent employment suggests that such citizens are discriminated.

Thus, an attempt to improve the system of tax privileges calls forth significant remarks at once. The criticism grows as certain situations, which might occur in practice, are modelled.

For example, let us consider the case of obtaining the right to no-purpose charitable (material) aid. According to Article 9.7.3, this aid is not included in the gross monthly taxable income if an individual received the monthly wage which did not exceed the subsistence wage fixed on January 1 of the accounting taxable year, multiplied by 1.4, and approximated to the nearest 10 hryvnyas. The following input data would meet this condition: wage – 510 hrv., material aid – 365 hrv. In this case, the sum of insurance payments to social funds would equal 12.75 hrv. (510 × 0.025), and the individual income tax would make 33.83 hrv. ([510 - 237 - 12.75] × 0.13).

In another case, an individual receives the wage which exceeds the subsistence wage only by 10 hrv.: wage – 520 hrv., material aid – 365 hrv. Now, the sum of insurance payments to social funds would be 13 hrv. (520 × 0.025), but the individual income tax would amount to 113.36 hrv. ([520 + 365 - 13] × 0.13).

The difference in the accrued income is 10 hrv., but the size of the tax burden on actual income in the second case is 3.4 times larger. An individual with no right to social tax privilege receives by 69.78 hrv. less income.

On the other hand, such could be the losses of local budgets if the employers somewhat decreased the accrued wage (in this case by 10 hrv.) in order to optimize tax payments. Owing to this, it would be expedient to preclude these and similar actions of tax-payers and their tax agents by optimizing the list of social tax privileges and conditions of their application.

The social privilege applies only to the wage and similar outpayments. Moreover, this privilege is applicable only to a certain size of the wage. The privilege is not applied to the amount received which exceeds the fixed size.

Unfortunately, the problems of legal nature disallowed fixing the subsistence wage for 2004, which will cause uncertainty in the basis for applying the coefficient of 1.4. It is important to note that the privilege is provided exclusively at the principal place of work.

In seeking to significantly curtail tax privileges, including those applied in individual income taxation, it would be reasonable to preserve only one social tax privilege – stipulated by Article 6.1.1 – irrespective of the type of employment the person is involved in. The other tax privileges mentioned in Articles 6.1.2 and 6.1.3 would function more effectively if transformed into the targeted subsidies to respective categories of population, based on the declared priorities of the state social policy.

Meeting the above-mentioned priorities gives grounds to the following proposal. The list of stipend recipients (stipend is not included in gross monthly taxable income) composed of pupils, students, post-graduate students, attending physicians, and graduates of military academies, should either be shortened by removing the last three positions or logically finalized by supplementing it with doctoral students (Article 4.3.26).

Hence, in our opinion, the complicated elements of individual income tax, as well as lacking approbation of the adopted law, underlie the many questions which arise from critical review of the text. However, we have every reason to believe that the objective of this scientific research – which is to reveal ambiguous, contradictory regulations of the Law of Ukraine «About Income Tax on Individuals» and to give recommendations for its improvement in order for administrative authorities to further explain or consider them when developing and improving the corresponding legislative and normative acts, which are to be approved on the basis of this Law, – will finally be achieved.

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