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Corporate income taxation – selected problems and decisions
The case of Ukraine

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Abstract

This paper is devoted to the issues of corporate income taxation in Ukraine and finding ways to resolve them in the context of European integration. The aim of this paper is demonstrate ways to improve corporate income taxation on the basis of balancing the interests of taxpayers against those of the government. The paper will highlight the key issues of corporate income taxation in Ukraine with its large share of unprofitable enterprises, unequal regulations for different corporate taxpayers and the requirement to pay tax advances even where there is an absence of taxable income. Based on our analysis, the causes of the origin and deepening problems of corporate income taxation in Ukraine will be demonstrated. A comparative analysis of income taxation in Poland and Ukraine was performed. It is believed that some elements of the Polish experience in the taxation of income can be applied to Ukraine.

Keywords: income, corporate income tax, tax base, tax rate.

Streszczenie
Podatek dochodowy od osób prawnych – wybrane problemy i decyzje
Przypadek Ukrainy

Artykuł dotyczy problemów opodatkowania dochodów przedsiębiorstw na Ukrainie i poszukiwania sposobów ich rozwiązania w kontekście integracji europejskiej. Celem artykułu jest prezentacja sposobu poprawy opodatkowania podatkiem dochodowym na podstawie równoważenia interesów podatników i państwa. W artykule zwrócono uwagę na najważniejsze problemy opodatkowania zysków przedsiębiorstw na Ukrainie, takich jak: duża część nierentownych przedsiębiorstw, nierówne przepisy dla różnych podatników podatku dochodowego, obowiązek płacenia zaliczek na podatek dochodowy nawet w przypadku braku dochodów podlegających opodatkowaniu. Na podstawie dokonanej analizy przedstawiono przyczyny problemów z opodatkowaniem dochodów na Ukrainie. Analiza porównawcza opodatkowania dochodów przedsiębiorstw w Polsce i na Ukrainie stanowi podstawę do wnioskowania, że niektóre polskie doświadczenia w zakresie opodatkowania dochodów mogą być wykorzystane na Ukrainie.

Słowa kluczowe: dochód, podatek dochodowy, podstawa opodatkowania, stawka podatku dochodowego.

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Introduction

Corporate income tax is one of the most important forms of taxation. It can have a sizeable amount of fiscal and regulatory capacity, which makes it the most powerful tool of fiscal policy in every country. At the same time, using corporate income tax as an economic regulator holds many risks. A high burden of corporate income tax can motivate taxpayers to migrate into a shadow economy or stop business activity. A large number of tax exemptions can have a negative impact on market competitiveness. Differing rates of corporate income tax can actually foment tax evasion. In recent years, Ukraine has faced a noticeable drop in corporate income tax as a percentage of total tax revenue due to real events, such as economic and political crises, and military operations in the east. Furthermore, other causes, such as imperfect tax legislation, tax accrual mechanisms, and tendencies toward tax evasion have further eroded revenue. The Ukrainian economy does not have enough resources to replace the lost revenue of corporate income tax. This situation demonstrates the necessity of searching for ways to increase corporate income tax efficiency. So, one of the objectives of the article is the assessment of fiscal efficiency of income tax and the determination of the causes of its failure.

The methods of corporate taxation in Ukraine are constantly changing. The changes are aimed at improving and simplifying calculation methods, procedures of reporting, and payment of taxes, all designed to reduce the work load on accountants. However, these changes have adversely affected the quality of tax liability calculations, and have led to mistakes because current tax legislation is open to ambiguous interpretation, which has increased the number of lawsuits brought by taxpayers against the tax authorities over tax audits. Additionally, illegal tax penalties imposed by the tax authorities have led to the development of negative attitudes of taxpayers towards regulators. This overall instability in income taxation to some extent also suppresses business activity in Ukraine by investors, both domestic and foreign, thereby preventing effective planning of financial flows, profitability, return on investment projects, and business decision-making. Finally, the constant changes in methods of income taxation negatively affect income tax revenue, and the presence of the unequal imposition of taxation creates conditions for an increase in tax evasion. In this context it is important to study foreign experiences with income taxation and to assess the capability of their implementation in Ukraine. Therefore, the article shows the analysis of legislative taxation and its impact on the fiscal effectiveness of corporate tax. Taking into account the large number of deficiencies in the corporate taxation methodology, it is necessary to examine the international experience, including the experience of Poland, and evaluate the possibility of its implementation in Ukraine.

1. Theoretical and methodological background

Various aspects of income taxation are well represented in the publications of domestic and foreign economists. Features of the formation and development of income tax

in Ukraine are represented in the work of Sokolovska (2004). An effect of income tax on the decisions of investors and entrepreneurs are reflected in the works of Sokolovska and Maiburov (2011) or Krysovatyi (2005). Domestic economists primarily pay attention to the problem of increasing the fiscal efficiency of corporate income tax. Their attention was focused on optimizing tax rates and expanding the tax base in order to increase revenue, and they did not pay much attention to the reactions of taxpayers, who saw their tax burden increase.

An effect of income tax on macroeconomic indicators is presented in the works of Dennis et al. (2004), Diamond and Viard (2008), Favero and Giavazzi (2009), Gravelle (2014) and Huang and Frentz (2014). This research focused on the fiscal and regulatory problems created by corporate tax optimization. Alvarez et al. (1999), Auerbach and Poterba (1986), Boadway and Bruce (1994) and Laffer (2004) worked with the problems of integrating corporate and personal income taxes, and studied how tax changes affect taxpayer reaction.

Most studies have a unilateral nature; they reflect the impact of income tax on the payer or on the macroeconomic situation. In modern conditions there is a need for a thorough study on how tax revenue optimization impacts, and influences, the behavior of taxpayers. The aim of this paper is to identify existing problems and propose ways to improve the taxation of corporate income in the context of balancing the interests of both taxpayers and the government.

In this regard, the tax reform experience of other countries can also be useful for Ukraine. Many countries have had similar issues in the field of taxation as has Ukraine, and found solutions. It is not particularly easy to choose a country to use as an example because of the different initial conditions of development, finance and tax system differences, government regulations, etc. From our point of view, the best example for Ukraine in this situation is an examination of the experience of Poland. After the collapse of the Soviet system, Poland and Ukraine had similar conditions for development. However, today Poland is far outpacing Ukraine in terms of economic development.

The research methodology includes:

1. A historical analysis of changes in the legislation concerning the taxation of corporate profits.
2. An analysis of the fiscal efficiency of corporate income tax. A calculation of the corporate tax productivity coefficient has been done using formula (1):

$$R_{pr} = \frac{Ratio_{effective}}{Ratio_{standard}} \tag{1}$$

R_{pr} – tax productivity coefficient (corporate tax performance coefficient),
$Ratio_{standard}$ – current ratio of corporate income tax.

The effective ratio was calculated by formula (2):

$$Ratio_{effective} = \frac{Corporate\ tax}{Total\ profit} \quad (2)$$

3. A comparative analysis of corporative income taxation in Poland in Ukraine.

2. Results of empirical research

2.1. Introduction of corporate income tax in Ukraine

Choosing the best mechanism for the taxation of corporate income can be seen as a process of balancing the interests of both the taxpayer and the state. Nations behave like rational economic agents, and try to maximize income through taxation. Taxpayers in the same way, also wishing to maximize their income, seek to reduce costs, including taxes. This situation can be seen as being very close to a leviathan concept of the state. If a state were to move in this direction, it would be doomed to die, because tax increases have a limit, and this limit is different for every economy. The basic interests of the taxpayer and the state here are diametrically opposed, and in order to balance them it is necessary to find a compromise. The state, when defining an income taxation mechanism, should take into account that it must be acceptable to the taxpayers in terms of the possibility and feasibility of the further development of their businesses. For the state, business development is beneficial, because in the long run it will mean an increase in tax revenues by expanding the tax base. For taxpayers, income taxes especially should not be burdensome. An income tax is not onerous if the taxpayer does not believe it is a threat to his livelihood. This can be achieved both by the moderate taxation of income and by the compensatory mechanisms of the state. These concepts were developed in welfare economic theory. The taxpayer must be sure that the state uses tax revenue in order to increase the social welfare of all, not just the wellbeing of government employees. This aspect is key for Ukraine in its search for ways to improve its income taxation mechanisms. Given the peculiarities of Ukrainian development, sometimes even the implementation of reforms using the best of international experience may not work as in cases where the recipient's macroeconomic environment differs significantly from the donor's macro environment.

The process of the evolution of income taxation in Ukraine can be divided into the following stages (Table 1).

Table 1. The corporate income tax evolution in Ukraine

Period	Characteristic
1992–1994	Income taxation changed several times per year: gross revenue in the first quarter, then profit, and then again gross revenue. These changes were conditioned by the need to fill the treasury at all costs. Hyperinflation,

Period	Characteristic
	barter and breaks in the economic ties between Soviet republics virtually destroyed the industrial sector of Ukraine at that time, and the small business sector had not been yet formed. When the enterprises that tried to survive in these difficult conditions were not profitable, the government decided to tax their income. This is a typical example of the irrational behavior by states when the need to maximize income does not take into account long term consequences. The result was the growth of a shadow economy.
1994–1998	A large number of tax exemptions and exceptions were applied. Most of the exemptions and exceptions were misused, and were not designed to stimulate investment. There was a widespread practice of granting privileges to certain industries or even individual taxpayers. Such measures from the government were aimed at saving individual companies or industries (mainly mining, metallurgical, and the machine building industry). Some specific privileges should not be characterized as solely negative. If these benefits are short-term, they may be an alternative to direct budget subsidies. However, as this practice showed, these benefits were granted for an unjustifiably long term, and the excess profits derived from this preferential taxation were not directed at upgrading industries, but were distributed among the new owners. As a result, there was a preservation of outdated technological structures in these areas. That is why in modern conditions they are not competitive, not only internationally, but also in the domestic market. High energy needs in production make their products uncompetitive.
1998–2010	During this period there was a radical change in the methodology of income taxation. The tax base was calculated as the difference between gross revenue and gross expense. Gross expenses were restricted. They were redefined each year. The size of income before taxes done for tax accounting was never equal to the true value of the financial results. In fact, taxpayers conducted two types of accounting: financial and tax. The amount of difference between the two forms was so great that accounting to determine real income actually lost meaning. Moreover, legislation at that time required proper accounting, but did not define the mechanism of applying penalties when there was improper accounting. During this period, various types of short term tax incentives were regularly introduced. In particular, preferential mechanisms of income taxation for special economic zones and priority development areas and technoparks were designed. As a whole, the idea of preferential taxation of these entities was aimed at stimulating economic development in depressed regions and boosting technological innovation. Despite the fact that this idea had had success in many developed countries, it did not work in Ukraine, mainly due to the fact that it was used for the construction of tax evasion schemes.
2011–2014	The base of taxation began to represent the true financial results according to the accounting data, as revenues and expenses began to be recognized

Table 1. The corporate income tax evolution in Ukraine (*continued*)

Period	Characteristic
	on an accrual principle. After 2011, a tax code was implemented in Ukraine which defined new approaches to corporate income tax from gross revenue and gross expenses that were formed on the basis of first events, eliminating the need for a business to report pre-paid revenue as income. It should be noted that such changes of the methods did not substantially influence the amount of tax revenue, which in this period of time fell constantly due to the deepening economic crisis and corruption processes taking place within the country. The list of dual-use costs (which were included in the object of taxation under certain conditions) was revised. For example, voluntary contributions to insurance (including private pension provision) of employees could not exceed 25% of the wage fund, while warranty costs, clothing and footwear, insurance and so on, were taxed in a limited way. Restrictions on the different types of costs significantly increased the fiscal effectiveness of income tax, but limited the implementation of its regulatory capacity.
01.01.2015–31.12.2015	The mechanism of accrual and payment of income tax again radically changed. The base of income tax is now determined according to data of financial accounting in accordance with national Provisions (Standards) of Accounting – P(S)A or International Financial Reporting Standards (IFRS). However, a number of tax differences have been identified, to which the object of income taxation has to be adjusted (tax adjustment that may increase or decrease the object of corporate income taxation). These tax differences are divided into 3 groups: differences arising from the depreciation of fixed assets, differences arising during the formation of reserves (provisions), and differences arising from the implementation of financial transactions. As in previous years, most of the differences are related to financial transactions.
01.01.2016 – project	The tax rate will be decreased to 15%. The taxable base will be only distributed profit.

Source: authors' elaboration based on *About income taxation*… (1992, 1995, 1997); *About changes in the law*… (1997).

All those changes had a significant impact on business activity development. For example, despite the desire to create the illusion of support for business development by reducing the tax burden in 1998–2010, the state resorted to outright fiscal measures that are not conducive to such development (in particular, the mechanism of depreciation accrual). It should be noted that in the mid 1990's, the depreciation of fixed assets in industry in Ukraine reached 50%, and 68% at the end of 2013, and even 80% in some sectors of the economy. In such a situation, the mechanism of depreciation accrual was aimed at a renewal of fixed assets. However, this mechanism of depreciation accrual, which was in force at that time, did not contribute to it. In

particular, P(S)A no. 7, Fixed Assets, envisaged the possibility of using five methods of depreciation accrual, the practice of which allowed the determination of the true cost of production. However, in practice, most taxpayers calculated depreciation by the tax method, which only made it possible to legally reduce the value of taxable income and did not ensure the proper use of depreciation. Although in theory the possibility of using accelerated depreciation was provided, financial resources from its use were directed primarily to working capital replenishment. Furthermore, although the law prohibited the government from seizing depreciation charges of companies, in 1999 a so-called depreciation tax was used in Ukraine, by which 10% of depreciation charges of enterprises had to be transferred to the government. This measure did not stimulate improvement in the state of fixed assets, since it was necessary to transfer to the state this form of depreciation tax. At a later date, the depreciation tax rate was lowered to 6%, and then the tax was abolished, but the negative impact it had produced was complete. There was a decrease in the residual value of fixed assets and the rate of depreciation became critical.

All those changes in corporate income tax methods were followed by a catastrophic growth of losses among domestic enterprises. In 1995, 20% of Ukrainian enterprises were unprofitable, then 33% in 1996, 50% in 1997, and more than 50% in 1998; the administration of income tax could not claim high fiscal efficiency. In practice, illegal methods of dealing with the unprofitability of enterprises were used. For example, officers of the tax service simply did not accept timely declarations in which losses were declared. The acceptance of declarations was carried out after the balance sheet date, with the tacit consent of the taxpayer. As a result, taxpayers declared losses (but hypothetically late) and the tax administration reported the reduction of unprofitability (because the report did not reveal declarations accepted after the reporting date) and reported fines (since a late filing led to payment of a fine). However, such measures could not serve as the basis for solving the problem, so in 1999 a decree by the president of Ukraine introduced a simplified system of taxation, accounting and reporting. This measure provided the state with two positive effects. First, conditions for self-employment were created, since for individual entrepreneurs the simplified tax system was indeed simplified, entrepreneurs had to pay a single fixed tax and maintain a minimal form of accounting that was possible without a professional accountant. At first, this helped to reduce unemployment and had a positive impact on the main macroeconomic indicators in terms of employment and the development of small enterprises. The second positive result was a reduction in the number of unprofitable enterprises. During the introduction of this simplified tax system, tax officers strongly recommended that unprofitable enterprises which fell under the criteria of a small business go from the general to the simplified taxation system. A single tax for legal entities that were on the simplified system of taxation represented a version of the turnover tax, for it was set as a percentage of revenue. During the years 1999–2011, there were small changes in the mechanism of levying a single tax;

they mainly concerned groups and rates for legal entities, and also features of the payment of fees for compulsory pension and social insurance (later, the unified social tax).

In general, the implementation of the simplified system of taxation, accounting and reporting cannot be assessed as being solely negative. It had some positive effects. However, the long term existence of this alternative tax regime made it not only a tool to minimize income tax but also other taxes that offset its positive impact. This reduction in fiscal tax efficiency and its low regulatory effects caused further stages of reform in income taxation.

Despite significant progress in changing the order of determining income taxation in 2011, the system of income taxation which was in force at that time retained significant differences in the taxation of income from securities transactions, and the taxation of banking institutions, insurance companies and mutual funds. The procedure of taxing insurance companies provided the opportunity for them not pay tax on income, but on revenue at the rate of 0% on transactions with long-term life insurance, and at the rate of 3% at the implementation of other types of insurance. Thus, a difference in taxation of insurance companies from other taxpayers was formed, which led to the emergence of a large number of bogus insurance companies that were used in schemes of tax evasion. A similar situation exists in the development of joint investment institutions. Income accumulated in mutual funds was not taxed, and it was possible to withdraw the funds by paying dividends to individuals, which incurred a tax rate of only 5%, without paying advance contributions on income taxes. In fact, mutual funds were a type of tax-free haven in the country, which allowed a majority of construction companies and banks to legally declare losses for years, prompting an increase in the number of mutual funds.

As mentioned in Table 1, from 01.01.2015, the mechanism of accrual and payment of income tax again radically changed, and tax payers faced the necessity to calculate tax differences (Table 2).

Table 2. Classification of tax differences, provided by the tax code of Ukraine

Title of the group of differences	Total	Positive	Negative
Depreciation differences	6	3	3
Reserves / provisions	13	5	8
Financial differences	13	8	5
Other differences	27	16	11
Total	59	32	27

Source: authors' elaboration.

There was also a final annual tax period for the calculation of income tax and, the term of reporting on income tax increased, which is definitely a positive change. However, with the monthly payment of advance contributions, and with the new rules, the presence of losses in one of the quarters of the year are not exempt from the obligation to pay advance contributions. The mechanism of income tax payment by

advance contributions is very difficult for domestic enterprises. So, enterprises whose annual income exceeds UAH 20 million (about 800,000 euros) are required to pay income tax monthly, by advance payments, in the amount of 1/12 of the income tax paid over the previous year, and then by the enterprise's annual results. Alternatively, it pays the difference on which advance payments are lower than the amount of income tax in the reporting year, or the amount of overpayment (which is more characteristic for Ukrainian enterprises against the backdrop of the decline in economic activity) may be accounted as payment of advance contributions for the next year. This mechanism of income tax payment leads to a leaching of the working capital of Ukrainian enterprises and the deepening crisis of financing their activities.

At the end of 2015, the Ukrainian government introduced a draft tax code. This tax code is quite liberal and provides a substantial tax cut. For example, the corporate income tax rate will decrease to 15%, personal income tax to 10% and VAT to 15%. The taxable base of corporate income tax will consist only of distributed profit or its equivalents. According to Laffer's concept (2004) a large tax cut could encourage economic growth in the long run. For Ukraine, the question of how to replace losses to revenue in the case of a tax cut is still open. The idea about tax code liberalization is very positive, but the risk is how long this concept will exist. If the tax code changes the following year again, we hardly believe it will have a positive impact on economic growth.

2.2. Efficiency estimation procedure

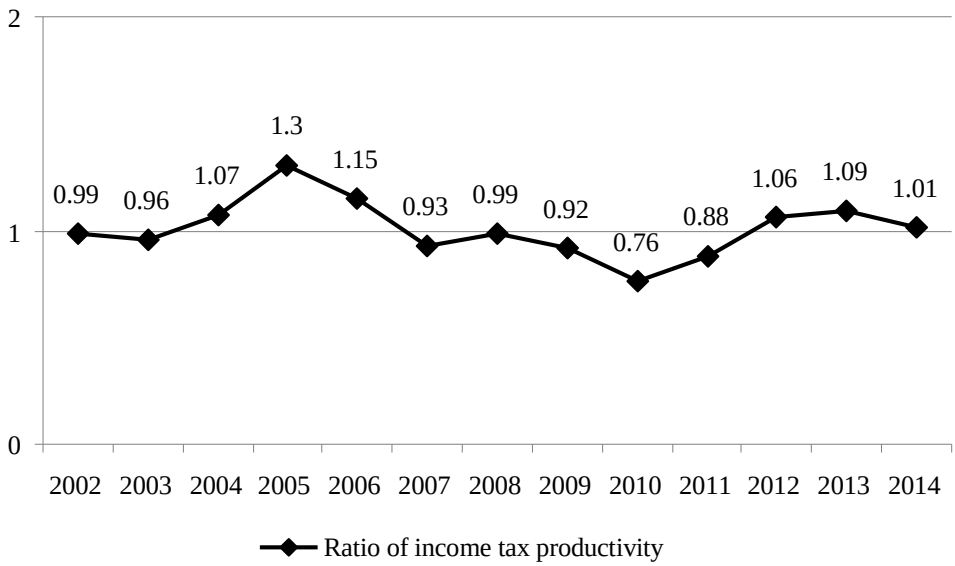
How the new system of income taxation in Ukraine will work and what risks may lower its fiscal efficiency can be predicted based on a systematization of the main drawbacks and an analysis of the causes of their emergence. In general, the practice of enterprises regarding payment of income taxes indicates the presence of these major problems:

- a large share of unprofitable enterprises (including those with artificial losses);
- the existence of unequal conditions of taxation for different income tax payers, resulting in lower fiscal efficiency of income tax (Figure 1);
- the need to pay advance payments of income tax even without income.

The share of unprofitable enterprises is consistently in the region of 40%. This unprofitability is often artificial, since enterprises cannot work at a loss year after year ad infinitum. Artificial losses were made possible by the regulations between 1998 and 2010, when income and expenses included advances. Another reason is the parallel existence of the simplified system of taxation. Businesses actively use single taxpayers to minimize their own taxes. The third reason, as stated above, is other modes of income taxation for insurance companies and mutual funds. This allowed them to minimize their tax liability. After the reform of 2010 (the introduction of the tax code, which changed the approaches to income taxation by abolishing the methodology of „gross income – gross expenses" and the earlier regulations) the share of unprofitable enterprises began to decline. The situation worsened in 2014, but this is not due to the technical features of calculation and payment of income tax, but due to the worsening of the economic and political situation in Ukraine.

As noted above, the parallel existence of the simplified and general tax systems and the presence of unequal conditions for different payers of income tax negatively affect the fiscal efficiency and productivity of income tax (Figure 1).

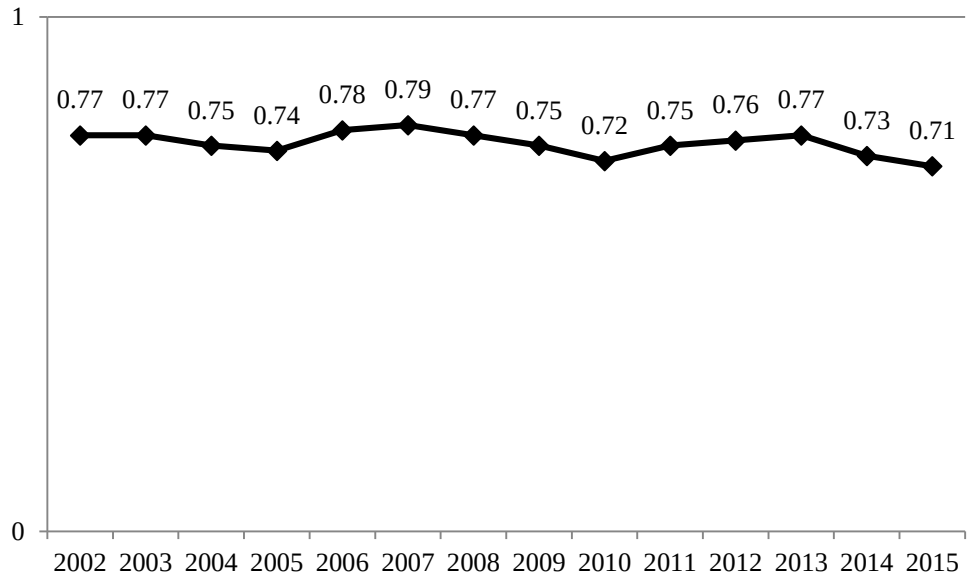
Figure 1. Ratio of income tax productivity in Ukraine in the years 2002–2014 (amounts of overpayments on income tax are not excluded)



Source: authors' elaboration according to data from the State Fiscal Service of Ukraine.

As seen from the graph, the coefficient of performance of income tax has a mixed trend. The general trend also shows that tax changes in 2010 positively affected the fiscal effectiveness of income tax, which began to decline in 2014 because of military operations in the east of the country. However, the studied schedule has other features, including a sharp increase in the coefficient of performance of income tax in 2005–2006, and the trend where the coefficient of performance was greater than one in a number of years, although with the presence of tax exemptions and exceptions it should always be less than one. This situation was caused by the practice of advance payment of income tax. And such payments were required from companies for a long time informally (the law did not envisage the obligation to pay advance payments), but with the necessity to fulfill indicators of budget revenues, tax officers persistently asked taxpayers to pay income tax in advance. The practice of advance payments for income tax has been in place since 2012, but its informal component continues to operate today, which leads to an increase in overpayments of income tax and a distortion of the true indicators of budget performance. After excluding overpayments, the dynamic of the ratio of income tax productivity will look as follows (Figure 2).

Figure 2. Ratio of income tax productivity in Ukraine 2002–2014 (amounts of overpayments on income tax are excluded)

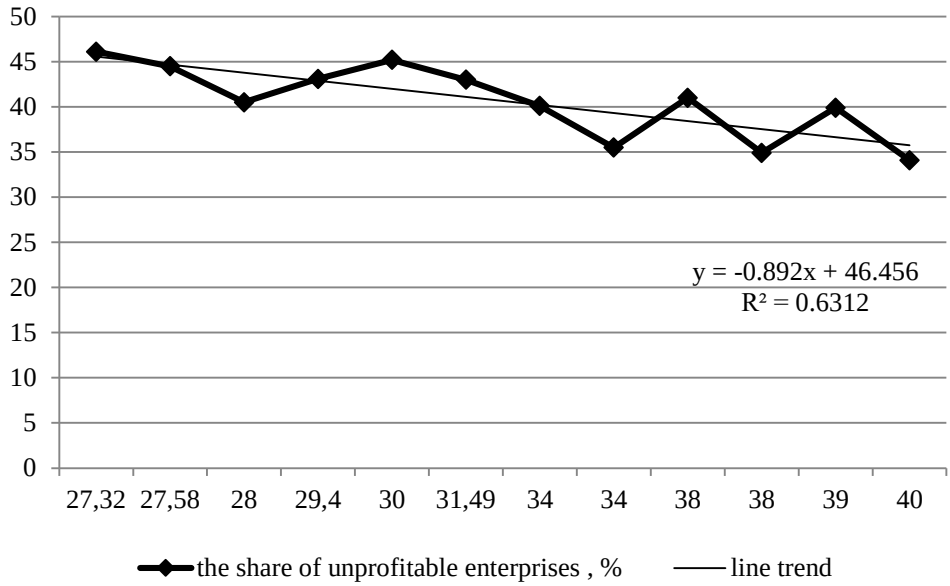


Source: authors' elaboration according to data from the State Fiscal Service of Ukraine.

As can be seen in the graph shown in Figure 2, the coefficient of tax productivity of income tax did not reach the value equal to 1 during any of the studied years. This means that the fiscal effectiveness of income tax was raised only by administrative methods without taking into account the interests of taxpayers. In fact, over the years, the state actually stimulated taxpayers to evade income tax, forming a vicious circle: the state made taxpayers pay advance contributions, since it lacked regular revenues from income tax, taxpayers had to pay income tax in advance in an amount which was determined by officers of the fiscal services based on the performance of the enterprise, so taxpayers looked for ways to hide parts of their business, adding to the shadow economy. Generally, a hybrid phenomenon of shadow economy and gray economy was formed in Ukraine, when one and the same entity carried out a part of its activity officially, and another part in the shadows. Sometimes these two processes are so deeply intertwined that it is almost impossible to separate them, and owing to this, ramified schemes of tax evasion, including income taxes, were formed. The reason a large share of Ukrainian enterprises appears unprofitable is not so much a result of inefficient management but the result of income tax evasion.

In order to assess the impact of the shadow economy on the loss ratio of domestic enterprises, we have built a regressive dependence between the integral index of the shadow economy (calculated by the Ministry of Economic Development and Trade) and the share of unprofitable enterprises (Figure 3). Calculations from 2014 were excluded because there is no information from three regions of Ukraine.

Figure 3. The dependence of the share of unprofitable enterprises from the integral index of shadow economy in Ukraine in years 2002–2013



Source: authors' elaboration according to data from the Ministry of Economic Development and Trade of Ukraine and the State Statistics Service of Ukraine.

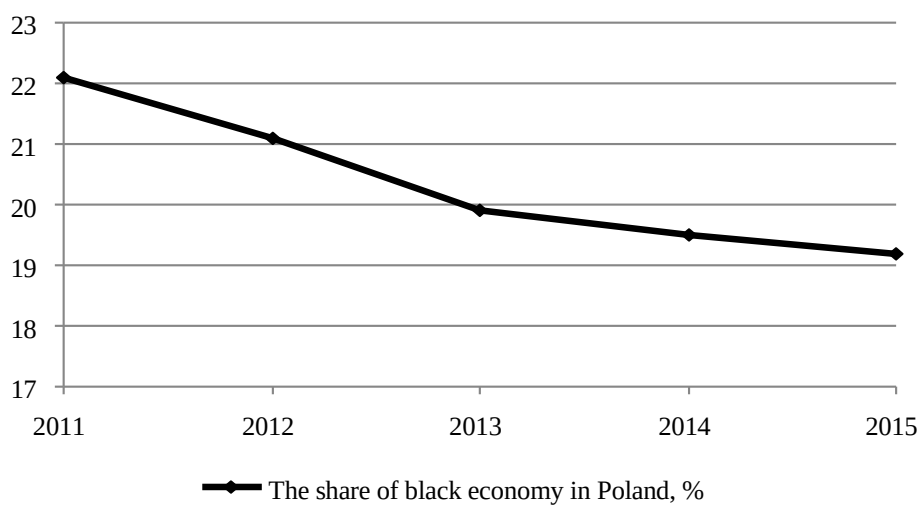
As shown in Figure 3, between the studied parameters there is a close relationship; the coefficient of determination shows that the variation of loss of domestic enterprises is 63.12%, as determined by the variation of the integral index of the shadow economy. The model is credible and significant, as the calculated values of the Fisher and Student criteria exceed the tabulated ones. The ratio is reversed, i.e. the reduction of the shadow economy integral coefficient contributes to profitability growth in domestic enterprises. Therefore, future reforms of the income tax code should be aimed at reducing the administrative burden on taxpayers, and to stimulate its activity in the official sector. It should be noted that a set of measures aimed at removing business from the shadows will not work without the elimination of administrative pressure. In addition, measures to facilitate the removal of profits from the shadows are long-term, and one should not expect a significant impact from their implementation in the first year. In this case, the notion of possible corporate tax changes in 2016 by the government can have a significantly positive effect on economic growth, but this belief is based on the condition of „no changes" in the long run.

As stated above, to develop reforms of the income tax, it is advisable to learn from the experience of Poland, which has some of the best indicators of economic development and some of the lowest indicators of a shadow economy among post-socialist countries. This could provide alternative paths to effective corporate income tax reform.

2.3. Corporate income tax in Poland. What could be useful for Ukraine?

In general, the existing mechanisms of income taxation in Ukraine and Poland are similar, despite the fact that new mechanisms of income taxation have been active in Ukraine for less than a year, and there are a number of uncertainties that must be eliminated. In particular, Ukrainian legislation has no provision which regulates the procedure for recognition of income and expenses for tax purposes if the order of their recognition in accounting under IFRS and Provisions (Standards) of Accounting is different and separate tax adjustments on these occasions are not provided. Under Polish law, such income is recognized on the date of receipt of funds. Polish law regulating income taxation clearly emphasizes the need to link the costs incurred with income received, indicating that such costs are not recognized. This helped Poland to decrease the share of its black economy (Figure 4).

Figure 4. The share of shadow economy in Poland in years 2011–2015 (in %)



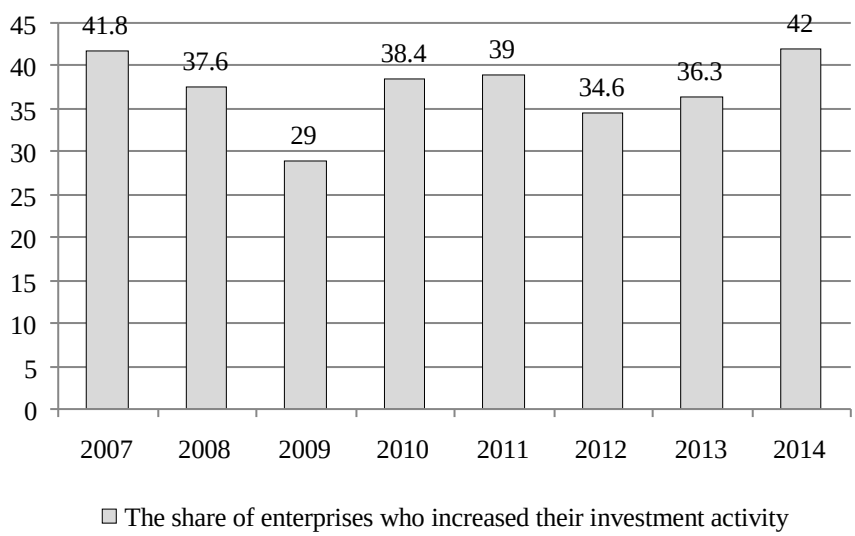
Source: authors' elaboration according to data from the Ministry of Treasury Republic of Poland.

The tax code of Ukraine does not contain such provisions, which could be the source of potential conflict between the fiscal authorities and taxpayers. As noted above, taxpayers may determine taxable income based on accounting data that is conducted according to IFRS or Provisions (Standards) of Accounting – P(S)A. However, domestic P(S)A contains standard „Costs", which limits the possibilities of taxpayers to reduce taxable income in certain categories of expenditure. The IFRS doesn't contain the standard „Cost", and it considers a priori that a business is being created for profit, so all costs of doing business are appropriate. Unfortunately, this

rule does not work in Ukraine, since most business taxpayers are trying to hide real profits by manipulating costs.

Also, in the Ukrainian order of income taxation, taxpayers are allowed to reduce the object of income taxation by the amount of losses in prior periods. However, in the presence of a high level shadow economy, it will allow taxpayers to manipulate financial results and reduce payments to a minimum or without paying tax at all. However, in Poland there is a limitation on the transfer of negative results, being possible only for 5 years, and the amount of the negative value of the financial result that may be included in the reduction of taxable income may not exceed 50% of taxable income. In this way, the state insures itself against excessive revenue loss. Regarding the feasibility of applying such experience in Ukraine, in our opinion, it is advisable to introduce a similar 50% limit on transfer of losses for Ukraine; it will encourage taxpayers to declare true income gains and losses. However, given the disastrous state of the Ukrainian economy, we consider a limit of 5 years for the period of loss transfer inappropriate. Ukrainian taxpayers have to be forced to declare real gains and losses; this would help increase the level of trust in the Ukrainian economy and attract future investment. This was the result in Poland (Figure 5).

Figure 5. The share of enterprises which increased their investment activity in Poland in years 2007–2014 (in %)



Source: authors' elaboration according to data from the National Bank of Poland.

The average level of investment activity in Poland is approximately 36%. As can be seen from the diagram, in the studied years (except 2009 and 2012) the share of enterprises that increased their investment activity was higher than the average level. This means that taxpayers prefer to invest their real profit and not evade taxation.

Depreciation accrual is among the positive features of taxation in Poland that should also be mentioned. The list of fixed assets in Ukraine for the purpose of depreciation accrual is much larger. This needs to be cut, considering the experience of Poland. It helps to make calculating taxable profit easier. It cuts the time which accountants spend calculating income tax and filing tax reports. This would also help improve the Ukrainian position in the Doing Business ranking (Poland has a rank of 96, Ukraine is at 108).

The Polish experience of preferential taxation in special economic zones is noteworthy, especially taking into account the fact that in Ukraine this has also been used, but because of corruption and its less than perfect design, it was not successful. In our view, one of the key success factors of Special Economic Zones in Poland is that exemptions on income tax were earmarked and depended on the volume of the capital investment and labor costs. Therefore, there was a stimulation of development in the infrastructure of the regions where SEZs were established, and new jobs were created. It should be noted that priority is given to those taxpayers who carry out productive activities. This helped Poland to cut unemployment and keep salaries at quite a high level. This experience is very important for Ukraine in the context of stimulating the development of depressed regions.

Conclusion

The results of this study found key issues of corporate income taxation in Ukraine and defined possible ways for improving income taxation based on Polish experience in this area.

1. The first of the main issues of corporate income taxation in Ukraine is low fiscal efficiency. It is caused by the problem of a large share of unprofitable enterprises in Ukraine, most of which are artificially unprofitable. Taxpayers hide true profits and evade taxes. This problem came from the 1990's, when the government tried to increase revenues but did not take into consideration the effects on taxpayer behavior. At present, the government must be more judicious with tax code implementation. Mechanisms used for corporate income taxation have to be clear for everybody and must not allow a double meaning. Here again, the Polish experience is very useful for Ukraine. It could help to decrease the share of the shadow economy, and encourage enterprises to declare actual profit and losses.
2. The second problem is in the field of tax allowances. The Ukrainian government has used different types of tax allowances in corporate income taxation. Unfortunately, none of them worked as desired. We can see two main problems in this sphere.

The first is that the government has approved tax allowances which do not help increase investment activity. Between 1995 and 1997, the Ukrainian government used a lot of different tax exceptions to support selected enterprises. This went counter to stimulating market competition. As a result, those tax allowances never resulted in reinvestment. The second problem is that a high risk of using tax allowances for tax evasion exists. This happened in Ukraine in 1995–2005, when Special Economic Zones were used for tax evasion schemes. To reassert, the Polish experience is very useful for Ukraine. The Ukrainian government should study that experience and apply it to Ukraine to increase employment and investment activity, especially in depressed regions.

3. The third problem is using a mechanism of advanced income tax payments, which leads to a drain on working capital within enterprises, especially acute with the background of the overall shortage of available financial sources for Ukrainian business. This problem came from the 1990's, when the government forced unprofitable enterprises to pay taxes. Unfortunately, the government keeps repeating the same mistake. This situation motivates tax payers to evade taxes.
4. A controversial achievement is the new mechanism introduced in Ukraine in 2015 being used to calculate income tax on the basis of financial results determined according to accounting data. In our opinion, financial and tax accounting cannot be considered equal, at the least because of the difference in the purposes of these two types of accounting. The aim of financial accounting is to provide the most complete and accurate information to the user, while the aim of tax accounting is to correctly determine the tax base and tax amount. Previously, as was the practice in many developed countries, Ukraine calculated income tax on the basis of the difference between income and expenditures as defined by tax laws. Now the object of taxation is defined on the basis of financial results before taxation, adjusted for tax differences as defined by tax law. In our opinion, this method unnecessarily complicates the formation process of income before taxation, makes it non-transparent for auditors, and generates precedents to use tax evasion schemes.
5. The draft tax code introduced a completely new method of calculating corporate income tax. It cuts the taxable base and tax rates. In the long run, this method can help increase business activity and stimulate economic growth. At the same time, the decision to follow this course is very risky, because the government does not have enough resources to replace revenue losses from tax cuts. Looking again at the Polish example can be useful for Ukraine, because it shows how to balance the interests of the government and taxpayers through a strong definition of rules for both sides, the government and taxpayers, and has followed this path for some time. The rules of taxation help the government to levy a sufficient amount of taxes and create the necessary conditions for economic growth. Taking into account the Polish experience will improve the level of fairness of income taxation, reduce the tax burden on promising and environmentally focused fields of activity, and create a favorable climate for investment in domestic enterprises.

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