

Ukrainian VAT compliance in a global context

IT solutions can help reduce time spent on VAT returns but regulatory stability is crucial

The world we live in is increasingly dominated by information technology and IT solutions. The move towards IT optimization is particularly noticeable in the business world, where the implementation of IT solutions into operational processes allows companies to save time and resources. However, there are limits to the benefits these technological breakthroughs can provide. This is particularly true when it comes to electronic systems designed to ease the process of tax compliance. While these systems can lead to significant efficiency gains, they cannot succeed in isolation if other factors continue to create barriers to simpler tax compliance. Global trends related to VAT compliance reflect this reality and offer insights for Ukraine as the country seeks to improve its business climate.

VAT as Economic Indicator

One of the most widespread taxes in the world today is Value Added Tax (VAT). In 2015, 162 countries applied VAT (including alternative forms of consumption taxes), and the number of countries continues to grow. In Ukraine, VAT generates 39% of budget revenues. Both businesses and end consumers pay VAT. However, while VAT payment is a quick and trivial process for consumers, the procedure of VAT payment and compliance for Ukrainian businesses is in need of improvement.

Based on the results of the "Paying Taxes 2017" rating, the PwC tax team has prepared a special review: "VAT compliance: the value for business and how technology can help". This review offers analysis on why it is easier to pay VAT in some countries than in the others, and what role technologies can play in improving the situation.

Why are tax payment processes so important for the economy of every country? Primarily, this is because the relative ease or complexity of paying taxes serves as one of the indicators of a business environment's efficiency. The less time and money spent on reporting, the more resources a business can invest in growth and development. Secondly, in today's global economy, capital flows freely to wherever it receives the best treatment. Thirdly, strong and attractive economies gain greater influence over government regulatory policy, with the authorities increasingly obliged to take the tax compliance suggestions of businesses into account. This is why large investments gravitate towards places where the complexity of the taxation system does not outweigh the expected benefits. This becomes a self-perpetuating process, as businesses then push for an even more straightforward tax system.

Ukraine's Poor Performance

There is currently a worldwide trend to reduce the amount of time required for VAT compliance. During the period from 2008 to 2015, this annual figure declined by 22 hours on average. In Ukraine, the figure fell by 33 hours. This is a positive result but it remains relatively insufficient, given the overall number of hours spent on VAT compliance in Ukraine. In absolute terms, the figure for Ukraine still stands at 199 hours per year. The figures are much lower among Ukraine's nearest neighbours (Belarus - 39, Romania - 54, Moldova - 55, Slovakia - 84, Hungary - 96, Poland - 98). Ukraine's figure is also almost

four times higher than EU standards. The average amount of time required for VAT compliance in EU countries dropped from 74 to 56 hours between 2008 and 2015. At the same time, among the most developed countries of the EU, this figure is less than 50 hours per year. Georgia, a country that recently began serving for Ukraine as a beacon for economic liberalization, has cut the time spent on VAT compliance almost in half over the same period, with the total falling from 180 to 94 hours.

In our opinion, constant changes serve as disruptive and constraining factors preventing the improvement of this indicator in Ukraine. These include significant annual changes to the country's Tax Code, the introduction of the electronic VAT administration system, and other changes to VAT accounting rules. In particular, it is worth noting that the forms of VAT return and VAT invoice change almost every year. This is much too frequent. Even the implementation of simpler reporting forms requires businesses to spend additional time adapting to the new rules.

Cost-Cutting Technologies

Data from around the world demonstrates that VAT compliance time decreases more rapidly in those countries that introduce IT solutions for this purpose. The logic behind this trend is simple. Let the technology perform this function, while humans focus on thinking and other creative processes.

In 2015, electronic VAT reporting and compliance systems were in use in 76 of the 162 countries applying VAT. The introduction of electronic reporting systems has led to drops in VAT administration time of more than 100 hours per year in countries including Armenia, Morocco, Senegal, Algeria, and Brazil. In this respect, Kenya leads the pack: following introduction of an e-reporting system, it has achieved the largest reduction in this indicator, with the figure falling to 81 hours instead of the previous 300 hours. This reduction took place 3-4 years after the introduction of IT systems because the business community required some transitional time to adapt to the new system. Special service centers provided training to taxpayers to assist with this adaptation process.

These successes are impressive, but it is worth stressing that introduction of an IT system for VAT compliance may have a very limited effect if other factors within the business environment remain unchanged. This is evident in the example of Brazil. Despite having an electronic VAT system in place for 7 years, the number of hours required for VAT compliance in Brazil has declined from 1374 to 1189 hours, which is still the highest in the world. Despite a certain level of automation, VAT accounting in Brazil remains complicated by the fact that the country has a rather intricate VAT system in place. There are four types of VAT with different rates and accounting rules. They are payable at the local and national levels and include monthly reporting. In addition, the tax rules in Brazil change every year, which results in companies constantly having to analyze new changes. The most striking contrast to the confusion in Brazil is Switzerland, where taxpayers need only eight hours for VAT compliance, which is the lowest total of all analyzed countries. This achievement is down to the highly automated Swiss VAT payment. VAT



reporting is quarterly, and a single basic VAT rate is in place. In addition, Switzerland's tax legislation is stable.

With this in mind, the introduction of an electronic VAT administration system in Ukraine in the middle of 2015 is unlikely to have a significant impact on the country's standing in the Paying Taxes rating. On the one hand, the introduction of this system should reduce the time spent on VAT compliance by limiting paperwork (since VAT invoices are now exclusively electronic). At the same time, at the initial stages, the transition to registering VAT invoices in the system requires additional time to adapt. The technical deficiencies of the system have also increased time expenditure, as taxpayers must perform the regular procedure while dealing with technical issues. Stringent requirements also serve to increase the time VAT payers must spend on this process. It would be too optimistic to expect a significant reduction in Ukraine's VAT compliance time due to the introduction of the electronic VAT administration system. Provided the country's current tax legislation remains unchanged, we should be able to witness a gradual improvement of the Ukraine's indicators in upcoming years as taxpayers become more accustomed to the system and the system itself is improved. However, the current version still requires taxpayers to perform a significant number of potentially automatable actions.

Simplifying VAT Compliance

Improving the VAT compliance process in Ukraine requires modernization of the existing software so that taxpayers can quickly and easily work with large volumes of tax data and automate the preparation and filing of reporting without the need for manual checks. At the same time, significant progress in this unachievable without the development of the market for accounting and tax software. Therefore, the respective software should be developed professionally based on the results of public tenders and ideally under conditions of real competition.

In addition to this process, the state can also quickly facilitate the simplification of VAT compliance by easing the requirements for mandatory requisites of the VAT invoice. A strong positive signal for taxpayers could be sent by introduction of a moratorium on tax audits of input VAT confirmed by registered VAT invoices.

In conclusion, it is worth emphasizing that the above measures will only have a significant effect under conditions of relative tax legislation stability. Ukraine's tax system has considerable potential for development and simplification but this will require legislative changes. The traditional practice of adopting crucial changes with immediate implementation in most transactions and without ample time for analysis and subsequent adaptation of accounting systems is unlikely to lead to effective reform of the tax system.

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