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UKRAINE

TECHNICAL ASSISTANCE REPORT—REFORMING THE STATE FISCAL SERVICE

February 2016

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Fiscal Affairs Department

UKRAINE

REFORMING THE STATE FISCAL SERVICE

Thomas Story, Enriko Aav, William Crandall, John Crotty, and David Hartnett

September 2015

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GLOSSARY

AEO	Authorized economic operator
CIT	Corporate income tax
DFADT	Department for Foreign Affairs, Development and Trade
EC	European Commission
EUBAM	European Union Border Assistance Mission
FAD	Fiscal Affairs Department
GIZ	German Agency for International Cooperation
HNWI	High net wealth individuals
HQ	Headquarters
HR	Human resources
IT	Information technology
LTI	Large Taxpayer Inspectorate
MRD	Ministry of Revenue and Duties
MS	Member State
PIT	Personal income tax
SFS	State Fiscal Service
SSC	Social Security Contributions
STX	Short-term expert
TA	Technical assistance
TCC	Tax Clearance Certificate
UAH	Ukrainian Hryvnia
USC	Unified Social Contributions
VAT	Value-added tax
ZBB	Zero-base budgeting

PREFACE

In response to the request of the Minister of Finance, Ms. Natalie Jaresko, a technical assistance mission from the Fiscal Affairs Department (FAD) of the IMF visited Kyiv from July 19 to August 3, 2015. The mission comprised Messrs. Thomas Story (mission head), Enriko Aav (both FAD), William Crandall, John Crotty, and David Hartnett (FAD external experts).

The purpose of the mission was to review the preparations for the implementation of the reforms to the State Fiscal Service (SFS) and to update the reform plans; provide advice on the most appropriate project delivery and management approaches; and examine key operational areas in tax administration such as large taxpayer administration, value-added tax (VAT) administration and Social Security Contribution (SSC) compliance.

The mission was financed with the support of the Canada Department for Foreign Affairs, Trade and Development (DFATD).

The mission met with the Prime Minister of Ukraine, Mr. Arseniy Yatsenyuk; Minister of Finance, Ms. Natalie Jaresko; Head of the Presidential Administration of Ukraine, Mr. Borys Lozhkin; Head of the Committee on Tax and Customs Policy of the Parliament of Ukraine, Ms. Nina Yuzhanina; Deputy Minister of Finance, Ms. Olena Makeieva; Chairman of the State Fiscal Service, Mr. Roman Nasirov; and senior officials of the SFS. The mission also held consultations with members of the European Business Association and the American Chamber of Commerce in Ukraine.

Ms. Alexandra Janovskaia from the European Commission (EC) was an observer to the mission and provided inputs to details of technical assistance (TA) provision in Section IV.

A draft aide-memoire was provided to the authorities for comment at the end of the mission's visit. This draft was reviewed in the IMF headquarters and the report has been finalized. It consists of an Executive Summary and four sections: (I) Status of the State Fiscal Service Reform and a Plan of Action; (II) Achieving Sustainable Reform; (III) Operational Issues; and (IV) Fiscal Affairs Department Technical Assistance.

EXECUTIVE SUMMARY

The SFS was established in 2014 as the successor to the Ministry of Revenue and Duties (MRD), and with three components—tax, customs and tax police. Following the turbulence arising from mid-year leadership changes in the SFS, reform momentum was invigorated and a number of important initiatives are being pursued. Since May 2015, a comprehensive reform plan has been approved; execution of the plan has commenced; many regional and local leaders were replaced; a change director was appointed; integrity programs were expanded; and a set of indicators that provide for a substantial lift in organization performance are being pursued. There are preparations for ambitious changes to organization structure which will merge the field networks across tax and customs.

This is a very substantial change agenda. For it to succeed, it will need sustained political commitment, adequate resourcing, as well as stability and unity in the top team of the SFS. Further senior management changes in SFS are pending following the departure of the Deputy Chairman of the SFS, who was responsible for customs. It is critical that the pace of reform is maintained in this difficult period. FAD will mobilize a long-term expert to work with the SFS senior management on reform implementation from September, 2015. Steps have been taken to ensure formal project management in the implementation. On-going attention to reform management (through the proposed full time reform project team) will be key.

The SFS remains an over-manned organization. A considerable down-sizing is feasible but the final result depends on work process reforms and legislative changes. The 20 percent cut that is envisaged in the short term (by December 31, 2015) is challenging but seems achievable although a detailed plan of actions for realizing this target is needed. Reforms to tax police are also tracking in the right direction but have to be publicly monitored. Integrity reforms have commenced but are not convincing and nor of sufficient scale.

The reform plan needs to produce quick results and the SFS does not yet have the government's confidence. To win this trust, the mission's view is that a new "bargain" between the SFS, the government, business, and the community is needed. We suggest that this be delivered through five key measures that are intended to balance demands for urgent revenues, provide more fairness in the administrative system of tax collection, and eliminate corruption. The measures are as follows:

- **Improvements in revenue collection.** Initially these will flow from achieving higher tax audit yields and more efficient tax debt collection from the largest taxpayers.
- **A progressive vacating of roles, followed by a vetting before re-appointment of staff in the SFS**. The purpose is to be satisfied that staff are competent and honest. We conclude that this staff assessment must be done in stages so that essential revenue functions are not jeopardized and because of the logistics in vetting is complex. Stage

one would be through to December 31, 2016. It would cover not less than 25 percent of SFS staff, commencing with high priority/high vulnerability areas—large taxpayer administration and dispute resolution and proceed to include all tax auditors, all SFS headquarters and some Oblast staff.

- **A new system for fast tax dispute resolution.** A new department will be established within the SFS and must report directly to the Chairman.

- **More effective tax powers.** Better tax enforcement will not be achieved without streamlined access to bank account information, indirect audit powers and powers for administrative actions on tax debts. The moratorium on tax auditing affecting medium and small taxpayers should be removed from January 1, 2016.

- **Targeted compensation reform.** This would be available to staff after being vetted and re-appointed.

The major recommendations are the following:

Reform

- Adopt these priority actions through to December 31, 2016:

Action	Implementation
A new bargain with government—In return for significant improvement in revenue collections, increasing efforts to eliminate corruption, fast dispute resolution, and the vetting and re-appointment of staff (where appropriate), SFS receives targeted compensation reform and more effective powers.	
Improvement in revenue collections	On-going
Progressive Vetting and re-appointment of staff: 1) large taxpayer administration; 2) dispute resolution unit; 3) Pilot Audit Office; and 4) Regional Manager merger and appointment process;	March 31, 2016
Progressive Vetting and re-appointment of staff: 5) Audit and audit managers—all offices 6) Headquarters staff	December 31, 2016
Targeted compensation reform	From March 31, 2016 and after vetting and re-appointment
Legislative changes: 1) Access to Bank Accounts 2) Indirect audit 3) Administrative collection 4) Cancellation of the audit moratorium	December 31, 2015
Internal independent appeals unit reporting to Chairman	March 31, 2016

Other medium-term measures:

Integrity

- Develop a comprehensive integrity action plan for implementation from January 1, 2017 with two dimensions:
  - Measures to assess and screen all employees along with necessary training and information; and
  - Measures to reduce opportunities for corruption, to detect corrupt actions and apply adequate sanctions.

Large taxpayers

- Revise the large taxpayer definition so that around 60 percent of tax revenues are within the catchment from January 1, 2017.

Unified Social Contributions and personal income tax

- Harmonize the bases for Unified Social Contributions (USC) and personal income tax (PIT) and provide a single filing and payment for business from January 1, 2017.

Organization

- Continue plans to consolidate 50 regional structures into 25 tax and customs regions and to dramatically reduce the number of separate legal entities in tax administration.
- Continue to develop the five business streams of SFS with the intention to consolidate to three—service/operations, compliance and corporate services over the next two–three years.
- Review the headquarters structure to eliminate overlap in the “tax type” structures by June 30, 2016.

I. STATUS OF STATE FISCAL SERVICE REFORM AND A PLAN OF ACTION

A. Introduction and Fiscal Performance

1. **This mission is a follow-up to the FAD mission of July 2014 and has focused upon the recently adopted reform plan for revenue administration in the SFS.**[1] The SFS consists of customs and tax administrations as well as the tax police. Some strategic customs issues are canvassed, as well as the new financial investigation function within the tax police. Most focus is on issues affecting the tax administration. FAD intends to provide separate advice on customs administration as soon as practicable.

2. **In 2015, the revenue performance has met expectations for the major taxes.** Appendix 1 summarizes revenues against projections for the first six months of 2015 and general revenue performance for 2013 and 2014 is at Table 1. Overall revenue performance in 2014 was weaker as a percent of GDP, reflecting the difficult economic and political conditions. In 2015, VAT and corporate income tax (CIT) are holding up well against budget estimates (Appendix 1) while PIT, property tax and excise are broadly in line with the projections. SSC and other taxes (which are dominated by royalties on petroleum) are lagging behind.

Table 1. Government Revenues for 2013 and 2014

	2013		2014	
	Ukrainian Hryvnia, UAH (In billions)	% GDP	UAH (In billions)	% GDP
Revenue	634.9	43.3	639.7	40.8
Tax revenue	551.2	37.6	561.2	35.8
Tax on income, profits, and capital gains	127.2	8.7	115.4	7.4
Personal income tax	72.2	4.9	75.2	4.8
Corporate profit tax	55.0	3.8	40.2	2.6
Payroll tax	193.7	13.2	184.2	11.8
Property tax	12.8	0.9	12.1	0.8
Tax on goods and services	175.8	12.0	201.3	12.8
VAT	128.3	8.8	139.0	8.9
Excise	36.7	2.5	45.1	2.9
Other	10.8	0.7	17.2	1.1
Tax on international trade	13.3	0.9	12.6	0.8
Other tax	28.4	1.9	35.6	2.3
Nontax revenue	83.7	5.7	78.5	5.0

Source: Ministry of Finance.

[1] Thomas Story, Enriko Aav, and Debra Adams: *Tax Administration Reforms and Governance Options,* August 2014.

3. **There are concerns that amounts for CIT advance payments and VAT refunds will erode future performance.** The trends on these are discussed in Section III. After a large reduction in arrears for amounts owed for VAT in 2014, refund claims are growing in 2015 and there seemed to be a number of factors at play. The business community highlights the currency depreciation as a major driver of rising costs of raw materials. Internally, the SFS adopted from July 1, 2015, a new system for managing VAT payments electronically. With an expectation by business that future refund claims would be delayed, there was a desire to make refund applications in advance of the electronic matching system being implemented.

4. **Advance payments of CIT have not been credited against tax assessments.** Following major concerns expressed by business at overpayments of CIT, the authorities announced that a common budget classification code would streamline accounting for advance payments and CIT assessments.[2] As discussed in Section (III), there are plans to clear some of the accumulation in CIT credit balances over 2015.

B. Status of Reforms

5. **The 2014 FAD mission made a number of recommendations aimed at short-term revenue improvement before long-term institutional changes were adopted.** Immediate actions were intended to buttress collection of tax debts, better manage the largest taxpayers, and give some attention to concerns for fairness in the tax system through streamlined resolution of tax disputes. Longer term a more fundamental reform was needed to down-size the SFS, remove large numbers of suspect officials, and change institutional arrangements. It was thought that long term actions were feasible by 2017.The recommendations and progress in implementing them are summarized in Appendix 2.

6. **The current leadership of the SFS which has been in place for just three months is making rapid progress.** It has adopted a significant plan of action with very ambitious timescales. There are some early successes emerging with good progress made, for example, with organizational structure and planning, a new Charter for the SFS and a new reporting relationship with the Ministry of Finance. These reform gains are at Box 1.

7. **Nonetheless, the overall picture is patchy**. Less progress is evident on issues that are important to the government, business and society at large—putting an end to corruption, delivering effective tax dispute arrangements, reducing the cost of tax administration and increasing compliance with the tax laws.

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[2] See Minister of Finance, Order 651 On Approval of Amendments to the Budget Classification, July 20, 2015.

Box 1. State Fiscal Service Reform Progress

- **Replacement of the heads of Customs and the tax police** has provided the opportunity for radical thinking about how these parts of the SFS are organized and can operate. Reforms in the tax police are proceeding quickly. There has been less progress in customs.

- **A new Charter for the SFS** transfers the reporting line for the tax administration from the Cabinet of Ministers to the Minister of Finance. The charter also provides more operational freedom, and accountability, to the SFS Chairman.

- **A substantial reform plan** has been adopted by the SFS with short timeframes, the expectation of very fast, transformative results, and the participation of many people within the organization. The plan is organized by reference to governance and the appointment of senior officials; efforts to grow public trust by combating corruption; upgrading tax and customs controls to improve performance, effectiveness and efficiency; and modernizing powers , addressing the informal economy and improving the tax code to promote taxpayer understanding of it.

- **Replacement of many regional leaders** to promote reform and reduce the opportunities for corruption. Around 400 managers are being replaced. The roles of tax and customs leaders in regions are to be merged into a single leadership role.

- **The appointment of a change director** with significant experience of running and reforming private sector businesses to lead the SFS reform program. He will be supported by a small team of senior officials together with 50 staff drawn from across the SFS. In addition, the department has tendered for consultant support for the change function.

- **Territorial consolidation** within the audit function is proposed and pilots have started.

- **Short term performance indicators** were adopted to deliver improvements within three months.

- **An Executive Committee** of SFS is established from the beginning of August.

8. **The SFS is beginning to achieve some stability after a year of turbulence in which its leadership was removed, a temporary chairman was put in place, and a new Chairman and two deputies were appointed in May 2015.** Radical reform of the SFS to reduce its size and improve the efficiency and effectiveness of its functions is essential if its performance is to be brought up to modern international standards. Change on the required scale needs strong, visionary, and stable leadership with committed political support.

9. **Despite successes with some reform initiatives, the SFS does not have the confidence of government, business, civil society and citizens generally who continue to regard the tax administration as deeply corrupt.** There are concerns for taxpayer harassment and inappropriate use of powers. Unless trust in the SFS is restored, there is little hope of increasing the tax morale that underpins voluntary compliance in more advanced countries. Although internal investigators are having some success in uncovering significant examples of corruption within the SFS and these successes are made public, a more systematic approach is needed to reduce dramatically the incidence of corruption. It has been suggested that paying staff a living wage could end corruption but the mission believes the dynamic of reducing corruption will be much more complex. A central theme of this report is the nature of the "bargain" between the SFS and central government which is proposed in this report.

10. **In a number of areas the SFS faces significant challenges:**

- The leadership of the customs function remains vocal in its opposition to a unified tax and customs organization. This will have a destabilizing effect on the SFS. It will make it hard for government to have complete confidence in the top leadership of the SFS, and will damage the aspirations of business for a fully integrated tax and Customs administration. Internally, it undermines the functioning of the executive committee of SFS and the challenge and support that its members should provide to each other.

- Action against corruption has been insufficiently bold with few prosecutions and initiatives to reduce corruption are not comprehensive.

- Although there have been some signal successes in detecting tax pits and cash conversion centers (with substantial sums of money, company seals and arms recovered) these have yet to be eradicated.

- By not yet succeeding in raising the level of public confidence in tax administration, the SFS does not appear to have delivered any material increase in the level of voluntary compliance.

- The SFS remains discredited in the eyes of senior ministers that is demonstrated by the introduction of some constraints on its powers: for example, in 2015 and 2016 the SFS is prevented from auditing business with annual revenues of less than Ukrainian Hryvnia (UAH) 20 million.

- The new electronic VAT system formally introduced on July 1, 2015 is an improvement on the proposals for VAT bank accounts previously put forward. The prospects for success are uncertain. The SFS will have to work to ensure it is fully embraced by business and by its advisers who remain (at best) ambivalent while some are strongly opposed to the new system.

- More support from ministers and the head of the Parliamentary Tax and Customs Committee will be needed if legislative change necessary to support reform is to be delivered quickly. The mission was shown examples of proposals for legislative change that have been held up by Ministers or held up in parliamentary processes for many months.

- The SFS remains over manned by comparison with many other tax administrations. There are plans to address this but they need to be implemented quickly and intentions beyond a 20 percent reduction are not known.

- Many parts of the SFS are in separate legal entities. This poses a challenge for the SFS leadership in managing the revenue administration as a single entity.

11. **The SFS reform plan needs to produce substantive results quickly. The political leadership of most developed countries keep their distance from tax administration although they hold the operational leaders to account through regular parliamentary questions and enquiries.** The position is different in Ukraine with concerns about tax administration exercising the most senior levels of the government. The SFS leadership have to win the government's confidence that they can successfully deliver reform, and quickly. That should enable the political leadership to refrain from criticism of the SFS and enable more positive supporting comments.

C. Plan of Actions

12. **The mission proposes a set of actions to be implemented by the end of December 2016 that would enhance tax and duties collections and increase ministers' and public confidence in the SFS.** Conventional wisdom has suggested that increasing compensation for SFS employees, addressing corruption more vigorously, and addressing other operational inefficiencies could transform the SFS. The mission sees it differently and believes that a more comprehensive, interdependent set of actions amounting to a new "bargain" between the SFS, the community and government is the key to a transformation of the SFS in order to build trust and greater operational success. Table 2 summarizes the proposed measures. An overview follows and there is further discussion in Sections II and III.

13. **An immediate priority is to replace the present approach of simply asking the government for additional funding and policy change with a new bargain that offers something in return for extra funding and policy change.** The constituent elements of a new bargain would be that the SFS would commit to:

Table 2. Priority Actions for 2015 and 2016

Action	Implementation
A new bargain with government—In return for significant improvement in revenue collections, increasing efforts to eliminate corruption, fast dispute resolution, and the vetting and re-appointment of staff (where appropriate), SFS receives targeted compensation reform and more effective powers.	
Improvement in revenue collections	On-going
Progressive Vetting and re-appointment of staff: 1) large taxpayer administration; 2) dispute resolution unit; 3) Pilot Audit Office; and 4) Regional Manager merger and appointment process;	March 31, 2016
Progressive Vetting and re-appointment of staff: 5) Audit and audit managers – all offices 6) Headquarters staff	December 31, 2016
Targeted compensation reform	From March 31, 2016 and after vetting and re-appointment
Legislative changes: 1) Access to Bank Accounts 2) Indirect audit 3) Administrative collection 4) Cancellation of the audit moratorium	December 31, 2015
Internal independent appeals unit reporting to Chairman	March 31, 2016

- An increase in revenue collection.

- Increased effort to eliminate corruption (discussed in Section II).

- Removal, vetting, and re-appointment of all officials in positions where they could be bribed or otherwise corrupted—starting with the Large Taxpayer Inspectorate (LTI)—by March 31, 2016—because it handles the largest part of revenues collected. The proposed organization changes discussed in Section II suggest further areas that can be addressed: dispute resolution unit; the pilot Audit Office; and the Regional Manager merger process (also by March 31, 2016); followed by all of Audit and headquarters staff (by December 31, 2016). The processes of vetting and re-appointment will need to be determined by the SFS based on HR and other policies. These processes have various timing constraints built-in, and to some extent this will determine how fast the organization can proceed. [3]

[3] It is expected will result in the full review of 25 percent or more of the total SFS.

Vetting needs to be sufficiently thorough to expose hidden bank accounts and other assets in Ukraine and off-shore.

14. **In return the government would seek to deliver the following:**

- Expanded powers and legislative reforms, for example, to remove unproductive work, allow administrative collection of tax debts not in dispute, the use of imputed income to calculate the tax liability of those in the informal economy who have no business records, and early removal of the prohibition on audit of those with annual revenue of less than UHA 20 million.

- Targeted compensation reform for those coming successfully through the vetting process (depending on results of reform Action Plan initiatives in this area).

Independent administrative appeals unit

15. **If the SFS is to re-establish trust with business, a priority has to be the development of a fair and effective internal appeals system.** Business appellants rarely win administrative appeals against tax assessments but they win around 50 percent of all judicial appeals. They want and deserve a cost efficient and fair administrative appeals system. The SFS should set up a centralized internal and independent administrative appeals unit reporting directly to the Chairman—details are discussed in Section III.

Recommendation

- Adopt the priority actions set out in Table 2.

II. ACHIEVING SUSTAINABLE REFORM

A. Rationale for Integrated Revenue Administration

16. **Faced with resistance and public statements of dissent at the directions for customs reform, the mission was asked to clearly state the rationale for an integrated institutional model containing tax, customs and tax police functions.** In the discussion that follows, the case for a "three in one" institutional model is confirmed.

17. **The SFS was established in 2014 on a foundation of three pillars—taxes, customs, and tax police—to be a single tax and duties administration department but there were significant difficulties from its inception.** Although led by a single chairman, from the outset the SFS had the appearance of three distinct departments in one. Customs and tax police were led by powerful individuals appointed by government as deputy commissioners without any involvement of the commissioner. Both customs and tax police were almost immediately seeking independence from the SFS which put considerable strains on what was supposed to be a single leadership team. There were early examples of clear dysfunction and public statements and

behaviors that undermine a coherent top team. The hybrid structure of two subject based groups—customs and taxes—and a functional enforcement group seemed to have limited life expectancy.

18. **The question of whether customs should become part of a border protection agency was considered carefully.** Becoming part of a border protection agency was not seen as the most appropriate option. There was no known precedent for a customs operation that collected as much in taxes and duties as the Ukrainian customs—more than 40 percent of all taxes and duties—becoming part of a border protection agency. This option was seen as deeply unattractive because it was highly likely that the primary focus would be on border protection and security and that collection of revenues would be put at risk.

19. **Splitting the SFS into separate tax and customs departments was seen to offer some advantages.** The principal advantages were perceived to be an exclusive focus for customs top management on trade facilitation, border protection and operational performance outcomes. In addition, the customs leadership could focus on eradicating corruption in what has been seen by many as the most corrupt area of government. Splitting the SFS would also have had the advantage of removing the tensions at the top of the organization.

20. **A number of advantages in keeping the SFS together were also identified and were felt to significantly outweigh the disadvantages.** The main advantages were identified as:

- the most conducive approach to maximizing revenue collections because of synergies in information, audit and enforcement actions;
- credit for taxes collected at the border is checked and given in a single organization;
- opportunities to better configure information technology (IT) systems for exchange of information and for officials to share knowledge of tax/customs aspects of the same taxpayer;
- planning coordinated enforcement actions around shared data;
- whole of taxpayer view easier to achieve; and
- greater opportunity for a "one stop shop" for taxpayers.

21. **The recent creation of a single audit function for all taxes and duties dealt with by the SFS has already proved its value.** This has enabled the bringing together of customs and taxes data bases which has led to the identification of a number of VAT frauds and increased taxes and duty collections. One such fraud involved more than UAH 200 million where imported fruit was supported by VAT inclusive invoices for computer parts with the VAT to be reclaimed in due course.

22. **The tax police also wanted independence from the SFS or to be incorporated in a new national financial investigation unit.** These possibilities were also considered carefully but the function was felt to be an intrinsic part of the SFS with its focus on delinquent officials and fraudulent taxpayers. A reformed and modernized tax police was considered to be an essential element of the merged compliance and enforcement business stream to be developed over the next two–three years.

23. **A new organizational structure based on functional business streams has become the SFS preferred approach because it produces an integrated department and requires an executive committee to pull together to deliver the SFS' objectives and targets.** The mission supports the SFS decision to develop five business streams—tax operations, compliance, enforcement, finance and performance, and customs—with some discrete functions reporting to the Chairman. Whilst customs audit has moved into an integrated audit business and customs violations are dealt with in the enforcement business, all other customs operations are in a single stream to allow for modernization and reform before they too are integrated into other business streams. (The development of the executive committee is addressed below).

24. **The SFS is to move to a new five-stream organizational structure**. This structure has been approved in principle via the Reform Action Plan and the revised Charter for the SFS. The high-level structure is depicted in Figure 1.

B. Other Organizational Issues

25. **A number of observations from the 2010 FAD report remain pertinent when considering SFS organization plans.**[4] This report made the following comments about the tax administration. All of these observations remain relevant for the SFS today, and some are being addressed in current proposals:

a) Business process re-engineering in the core tax administration functions is needed to achieve efficiencies; the tax block development was relying largely on yet-to-be-re-engineered processes.

b) Structures are not fully function-based;[5] for example, there are separate departments administering legal entities and natural persons—these are tax-type structures and combining them in function-based ones could lead to substantial economies.

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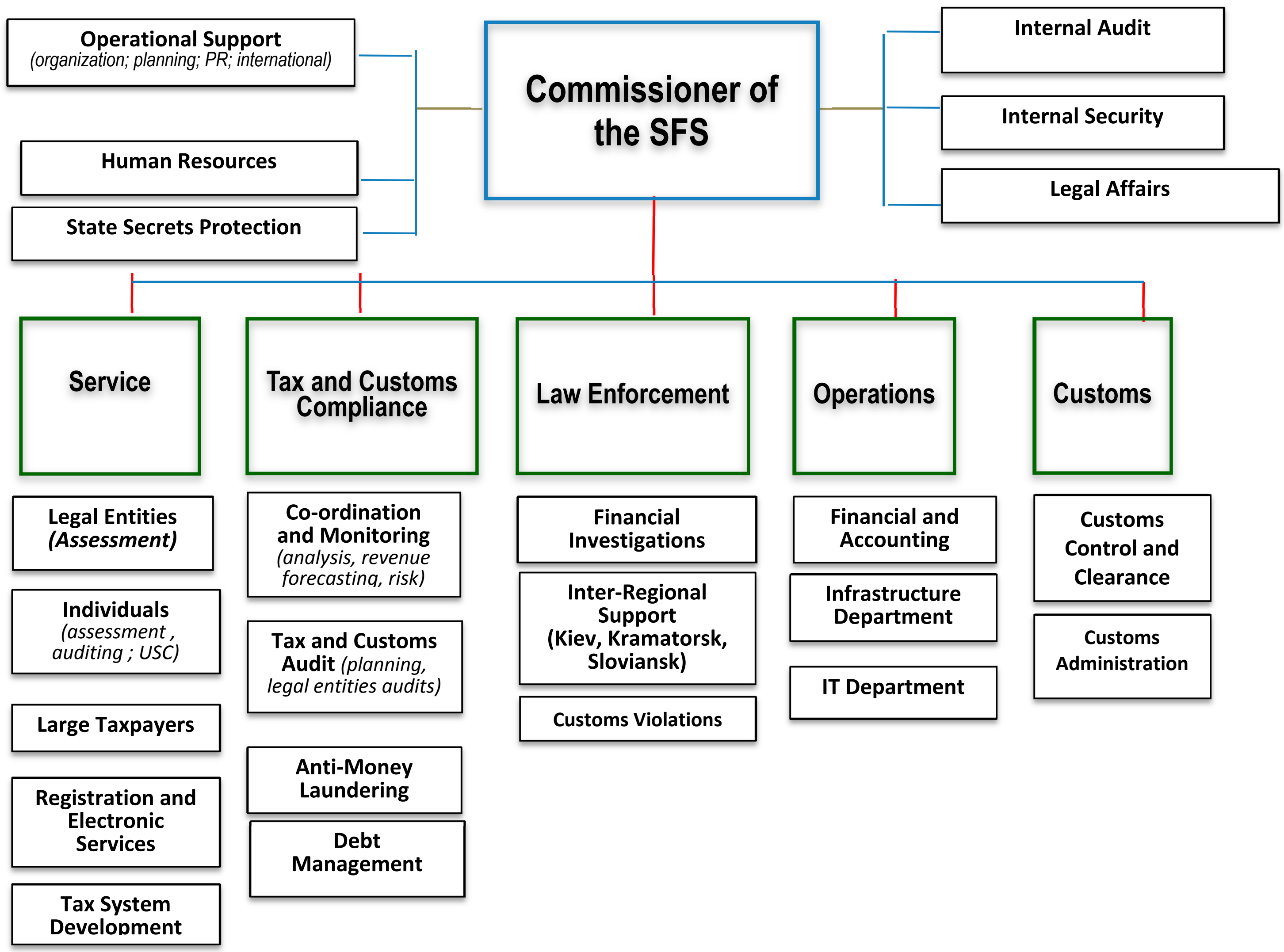
[4] Peter Barrand, Thomas Story and Mark Konza: *Addressing Tax Administration Reform Challenges,* December 2010.

[5] Function-based organizations are structured on the basis of the type of work performed, rather than the type of tax or taxpayer. The expectation that in grouping together similar activities that require similar skills or specialties is that real gains and major efficiencies can be achieved through an increased depth of knowledge in core areas of business expertise across taxes. The most common functional groupings cover registration, accounting, return and payment processing, taxpayer services, audit, filing and collection enforcement, legal and disputes.

Figure 1. State Fiscal Service Proposed High-level Organization



Source: State Fiscal Service.

c) Office network consolidation proposals at the time reduced management layers, but did not sufficiently reduce the number of tax administration locations to levels more in line with modern administrations; one option would see a long-term goal of having no more than 20 or so sites concentrating on VAT-registered taxpayers, with another 100 or so offices concentrating on small taxpayers and providing general services only to all taxpayers in their area.

26. **Currently, the actual staffing level for the SFS is 47,543.**[6] **This number is excessive, and plans are underway for significant downsizing.** Officials suggested cuts could be in the order of 10–20 percent in 2015. Details on current actual staffing levels are provided in Table 3.

Table 3. Actual Staffing Levels for the State Fiscal Service

	Number of Employees	Headquarters (HQ)	Operating Offices Including LTI
Taxation	33,335	976	32,359
Tax police	5,347	327	5,020
Customs	8,861	216	8,645
Totals	**47,543**	**1,519**	**46,024**

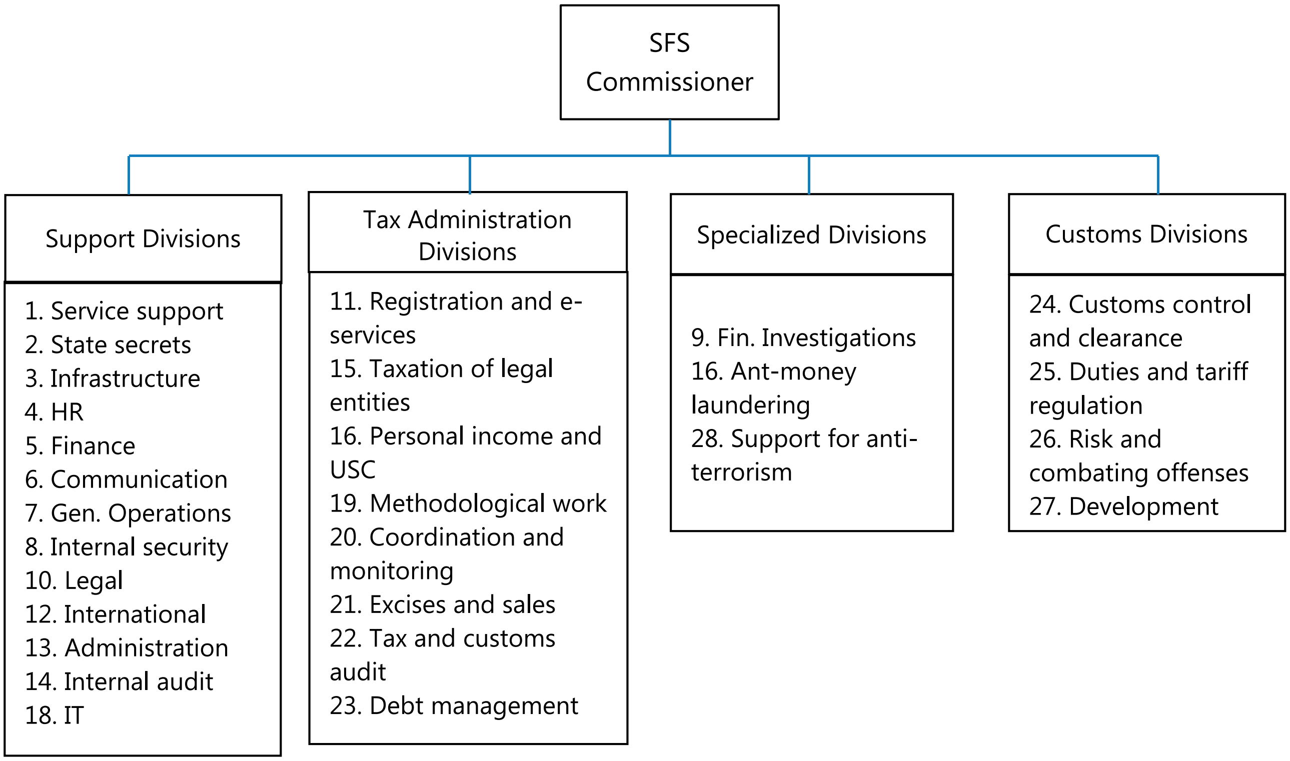
Source: State Fiscal Service.

27. **The current organization structure of the SFS for tax administration remains complex, and a hybrid of tax-type and function-based approaches.** The structure, which is generally followed at HQ and in operating offices (regions, large taxpayer offices, and districts) is depicted in Figure 2.

28. **The organizational structure of the SFS is overly bureaucratic, top-heavy and generally inconsistent with modern, leaner organizations.** Furthermore, the organization structure is more or less replicated in each region, district, and large taxpayer office. At a minimum, this kind of structure provides far too many layers of management and other diseconomies of scale. At a more basic level, it suggests that some of the tax administration processes are in need of more fundamental review. Only registration and e-services and debt management appear to be truly structured on a functional basis. Most of the remaining functions are still a hybrid of tax-type and functional structures, with the result that some inefficiency remains.

[6] Current establishment levels (positions or 'regular staffing') are much higher at 58,124. The comparable number in 2008 was about 80,000, suggesting a fairly aggressive reduction in SFS establishment.

Figure 2. Organizational Structure of the State Fiscal Service[1]



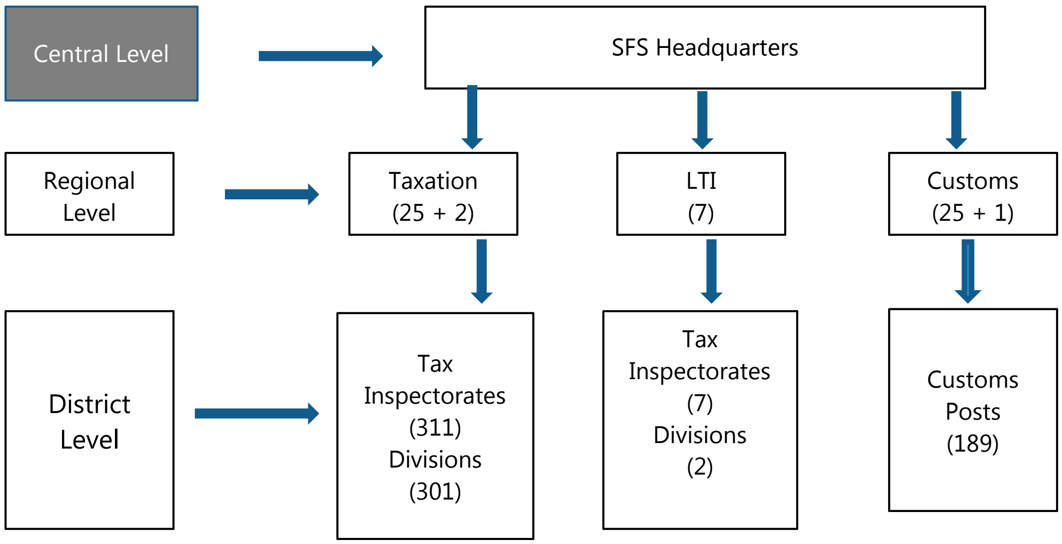
Source: State Fiscal Service.

[1] Divisions are numbered as provided by SFS. Groupings have been created by the mission.

29. **The office network of the SFS remains largely un-modernized.** The 2014 FAD report had suggested a significant streamlining, but this has not materialized. The current network of offices is depicted in Figure 3.

30. **An immediate compression of the SFS Field office network is planned to be implemented in the coming months.** This essentially involves the merger of the Regional (Oblast) level offices for both tax and customs. As depicted in Figure 3, there are currently 25 Tax regions and 25 Customs Regions. Furthermore, at the present time all these regions as well as the 7 LTI regions, 3 specialized departments, and the 311 Tax Inspectorates they supervise are separate legal entities (totaling 371). In the new configuration, there will be just 25 separate legal entities (the combined customs and tax regions). The effect of this change is said to be more direct control by SFS headquarters. While the mission supports this change, and it is expected to yield economies of scale, there are two issues to note: 1) there is no proposed merger of tax and customs operations at this point; and 2) the long term goal of the SFS should be to exist as a single legal entity.

Figure 3. Current Office Network of the State Fiscal Service



Source: State Fiscal Service.

31. **In conjunction with the reform plan, a pilot project called "The Audit Office" is being developed in Kyiv City office.** This project involves a major restructuring of the audit operations. Audit staff from four departments (dealing with tax and customs audits, VAT refunds, tax frauds, and the taxation of individuals) will be merged into a new Audit Office structure. Corresponding rayon level units will also be merged into the new structure and removed from local rayon office supervision. This reform initiative is intended to deliver significant staff savings, bring all audit staff under tighter management supervision, and break corrupt links between auditors and business taxpayers.

32. **The re-structure will have a major impact**. As outlined in Table 4, it envisages an appreciable reduction in the numbers of auditor staff (from 628 to 560), and will have its greatest impact on current managerial and supervisory positions with a dramatic de-layering (from 166 to 30). All affected occupants of positions in the current structure will be required to resign from their current posts and apply for positions in the new Audit Office structure. Rigorous technical and psychological testing will be used to screen all applicants.

33. **The timelines for the establishment and staffing of the Audit Office are highly compressed with staff testing, selections, and appointments to the new structure to be completed by end-October.** The plan is to accommodate most of the staff of the Audit Office in a single location in Kyiv City. This is a high-risk project with an ambitious reform agenda. Some project risks are readily identifiable. The absence of a full-time team in the Kyiv City office to drive the implementation of the project is a critical risk that should be addressed immediately. It is also important to note that the project will not address current audit procedures and work practices which, given current project deadlines, would not be feasible.

Table 4. Potential Staff Impact of Audit Office Project—Kyiv City

	Audit	Vat Refund	Totals
	Existing Situation		
Audit managers	121	45	166
Analytical staff	119	...	119
Auditors	473	155	628
Total	**713**	**200**	**913**
	New Proposal		
Audit managers	30	...	30
Analytical staff	60	...	60
Methodology staff	50	...	50
Auditors	560	...	560
Total	**700**	**...**	**700**

Source: State Fiscal Service.

34. **Other re-structuring measures are under active consideration.** For example, the headquarters tax and customs audit group is looking at options where all scheduled audits might be done from the regional offices, and only unscheduled audits performed in the districts. Another proposal under consideration involves the movement of audit and debt management (back office functions) to the regional level leaving only front office functions (registration, services, returns) for the districts. This proposal is a variation of the 2010 FAD suggestion to create a minimum number of medium taxpayer offices leaving districts to manage small taxpayers. These measures, and others like them, are all supported by the mission given the impending downsizing imperative for the SFS.

35. **Headquarters structure is fundamentally important to the overall set up of the SFS**. It will determine the shape and structure of all the regional and district offices. One of the first things the SFS should do is to review their headquarters structure with a view to eliminating the remaining tax-type functions. This should be done concomitant with Reform Action #28 (the reorganization of SFS structure by functional area) and should make use of technical assistance if possible. More fundamental business process reviews could ensue, with assistance from private sector experts, at a later date.

C. Zero-Based Budgeting

36. **The Reform Plan calls for the application and testing of zero-base budgeting (ZBB).** Action Plan # 23 requires the implementation of ZBB in a region and an appropriate central level unit. These projects will be assessed and if successful implemented across the SFS. Launch of the pilots is planned for 1 October, with results assessed by 31 December.

37. **ZBB is quite different from business process re-engineering.** ZBB is a method of budgeting in which all expenses must be justified for each new period. Zero-based budgeting

starts from a "zero base" and every function within an organization is analyzed for its needs and costs. Budgets are then built around what is needed for the upcoming period, regardless of whether the budget is higher or lower than the previous one. Business Process Re-engineering, or *Business Process Management,* on the other hand, is the practice of rethinking and redesigning the way work is done to better support an organization's mission and reduce costs. It focuses on the organization's business processes—the steps and procedures that govern how resources are used to create products and services that meet the needs of particular customers or markets. Re-engineering identifies, analyzes, and re-designs an organization's core business processes with the aim of achieving dramatic improvements in critical performance measures, such as cost, quality, service, and speed.

38. **Few organizations can successfully apply ZBB without the assistance of professionals who are expert in appropriate techniques**. The SFS would be well-advised to engage such experts. The purpose of the ZBB initiative could be stated as an effort to complete an in-depth review of expenditures in order to identify cost savings opportunities for integration into the budget process. The reform project team should develop a ZBB process for the SFS based on the methodology suggested. Typical actions would include the following:

- Engage the organization and its managers, explain the concept of zero-based budgeting, its purpose, the process, and the end result.
- Perform an in-depth analysis of the targeted expenditure areas, review trends, and compare to benchmarks (if available).
- Apply various techniques such as expenditure value assessment and best practice comparison, evaluate individual expenditure items and identify cost savings opportunities.
- Review consumption practices and expenditure-related policies and recommend changes where necessary.
- Establish budget guidelines and targets for each expenditure.
- Present to management for review and discussion.
- Review budget submissions and determine impact on overall budget.
- Ensure that execution plans identify a timeline for completion, resources required, and assign accountability.
- Monitor progress to ensure obstacles are cleared and targets are met.

D. Reform of the Tax Police

39. **The leadership of the SFS recognize that significant reform of the tax police is an essential element of delivering a modern tax administration but rightly say that this has to be done sensitively against the backdrop of the conflict in eastern Ukraine.** The tax police are presently organized in three divisions—investigators, operatives (who provide background information and intelligence), and teams working in the east of Ukraine.

40. **Tax police are feared inside and outside of the SFS.** Staff are cognizant of the reputation of tax police for detecting and investigating corruption. It is reported that tax police see corruption where none exists—for example, lawyers and others in the SFS are reluctant to drop a case that is lost in a court of first instance lest the tax police think they have been bribed. They are feared outside the SFS because they are seen as an aggressive, armed force that is seriously corrupt and that seeks payment of duties and taxes when none are properly due. Business and their advisers have pressed for the tax police to be reformed into a civilian investigative force, without guns and uniforms, although they recognize that there are times when they have to deal with violent organized criminals.

41. **The new leadership of the tax police has begun a series of reforms that the mission supports.** These reforms are beginning to take effect and no adverse impact on performance is evident. The mission was advised that in the three months since the leadership change, VAT of more than UAH 2.9 billion had been recovered and more than UAH 320 million from cash conversion centers had been returned to the budget. This performance was said to be better than in any recent three-month period.

42. **The key elements of the tax police reforms are the following**:

- Introducing a new top management team to promote behavioral change and lead by example.
- Bringing in a new generation of investigators who will be untainted by corruption and scandals of the past.
- Merging the investigative and operative teams to form a new Financial Investigation Unit which will focus more on blocking tax and customs fraud and recovering money for the budget (Ministry of Finance) than on long running criminal trials. One of the reform objectives is for the Financial Investigation Unit to be invisible to honest people.
- Having zero tolerance for bad behavior and poor performance by investigators.
- Promoting through the media the new strategy of recovering money and the improved standards and behavior expected of investigators.

- Improving investigators’ understanding of all relevant laws.

43. **Demilitarization is an essential part of reforming the tax police but it requires detailed explanation of form and context.** Although the Financial Investigation Unit has given up over 10,800 weapons in recent weeks and many investigators have come out of uniform, both weapons and uniforms are essential for Special Weapons and Tactics Teams and other groups dealing with organized criminals but they are not needed for the investigation of less violent tax and duty fraudsters.

44. **The mission does not see the removal of ranks as an essential element of reform.** The military ranks presently enjoyed by the tax police raise particular issues because with rank comes special financial benefits. Ideally, investigators would not have a military rank but removing those ranks would reduce their compensation packages. That in turn would undoubtedly lead SFS investigators to seek positions in other arms of government where benefits for rank are still available. Some investigators are already enquiring about transfers. A significant number of transfers would diminish the capacity of the SFS to recover money for the Budget. Moves to recruit civilian investigators without ranks are also welcome but will take time.

45. **Although the incidence of serious tax and duty fraud is significant in Ukraine, the size of the Financial Investigation Unit, at around 10 percent of SFS staff, is much larger than is commonly found in other countries.** The increasing use of risk management supported by sophisticated IT is enabling a growing number of countries to identify cases for serious investigation with less human intervention than in the past. The use of complex algorithms in Ukraine to detect types of VAT fraud is a good example of this approach.

46. **With less people needed to find cases for investigation, tax administrations have the choice of whether to downsize their enforcement functions or deploy more people into active investigation.** Many countries make compromises in reaching this decision and few have as many as 10 percent of their staff involved in major investigations. As the SFS considers the right size for the department, it should look carefully at the number of people needed for the Financial Investigation Unit.

47. **Careful tracking of the reforms to tax police is needed.** To meet existing concerns about the tax police on the part of business and civil society, and to evaluate the reform process, the deputy commissioner should arrange for regular independent surveys of public perceptions of the new Financial Investigations Unit. This will enable him to adjust the reform program where necessary.

48. **The SFS should start planning how best to integrate within two years its separate business streams for compliance and enforcement.** Just as the tax police function has to be changed significantly, very considerable changes are needed in the audit function as customs and tax audits are integrated, improved and better targeted. Similarly, the informal economy needs to be tackled more vigorously not least because ministerial expectations of additional

taxes are very high, and debt collection needs to be made more effective and efficient. All this involves a huge program of change which at present justifies having distinct business streams for compliance and enforcement to ensure that there is sufficient leadership capacity to deal with everything, including business as usual. But the SFS will soon need a single tax and duties compliance risk management program to provide an overarching strategy for all aspects of protecting the tax and duties take. That approach will require a single deputy chairman with responsibility for compliance and enforcement leading a single business stream.

E. Integrity Reforms

49. **Corruption remains a significant problem for the SFS.** The SFS has been making some progress in its anti-corruption program. The mission was advised that:

- the Anti-corruption or Integrity Division has been staffed up with more than 450 employees nation-wide, and steps are being taken to ensure its independence within the SFS;
- the focus of this unit's work is shifting to more serious punishment for offences, and a policy of zero-tolerance, no excuses;
- there is a code of ethics for public servants (three years old), and a specific code for the SFS is under development—it will be presented to all employees, who will be required to accept and sign;
- technological solutions, such as video cameras at customs ports, are being considered; and
- asset statements for all staff (except support staff) have been completed.

50. **In addition, there are specific integrity measures in the reform plan, all of which are supported by the mission.** These measures are generally considered doable within the timeframes given, with the exception of action item #18 (review IT systems to identify and eliminate opportunities for corruption). Similar initiatives in other revenue administrations have taken much longer than two months. The actions in the reform plan are itemized in Table 5.

51. **However, despite the efforts to date, results have not been particularly encouraging.** For example, in the first six months of 2015, criminal proceedings have been launched against only 41 employees, and outcomes of this process are not yet known. Also in the first six months, a total of 142 employees have been dismissed (most for disciplinary reasons). Out of tens of thousands of asset statements (all employees except support staff), only 17 infractions have been identified, most of which resulted in a small fine. The SFS has no information on any prosecutions of taxpayers for offering bribes to government employees (this is not an SFS responsibility).

Table 5. Integrity-Related Actions in the State Fiscal Service Reform Plan

#	Description	Deadline
10	Increasing control over high-risk processes.	31/12/2015
11,12	New employees in division to focus on asset statements of top 500 SFS employees. Independent expert group for oversight to publicize results.	30/11/2015
13	First semi-annual report on fighting corruption in SFS.	30/9/2015
14	Independent experts to assess degree of corruption, publicize outcomes, SFS to identify remedies.	31/03/2015
18	Review IT systems to identify and eliminate opportunities for corruption.	31/8/2015

52. **The SFS, and the country in general, still have a long way to go to ensure integrity.** In 2014, the Transparency International Corruption Perceptions Index rated Ukraine 142nd of 175 countries (in 2007, it had been 118th out of 179). In separate surveys, revenue administration is identified as a major place for corruption. In addition, the Business Ombudsman Council, an independent permanent advisory body under the Cabinet of Ministers with a mandate to establish a transparent business environment and prevent corruption, has received more complaints about the SFS than about any other body. To date these complaints have dealt with such issues as VAT refund delays, refusal of VAT taxpayer registration, and abuse of power during inspections by the SFS.

53. **The SFS needs to develop a more comprehensive and pro-active approach to integrity.** The proactive focus should be based on a systematic approach to the diagnosis of problems and the development of appropriate solutions.[7] A comprehensive action plan, which would include current reform plan actions and existing initiatives, would result, and this action plan could be directly managed by the SFS' new Executive Committee. Appendix 3 provides information, based on international experience, concerning the development of a systematic approach to integrity. The overall plan for integrity in the SFS must have both of the following components:

- measures to reduce the opportunity for corruption, to identify and detect corrupt actions, and to apply adequate sanctions; and

[7] Internationally developed tools, such as the World Customs Organization's Revised Integrity Development Guide (2014) could be used.

- measures to assess and screen all employees, along with necessary training and information.

54. **Only when the integrity strategy is well launched with the above essential components can the administration turn its attention to the issue of working conditions, including remuneration.** Adequate compensation is considered an important underpinning for the integrity strategy. The SFS Reform Plan includes the following measure:

> *With the Ministry of Finance, establish an independent expert commission on the labor remuneration system in SFS, publicize its recommendations, and implement the first recommendations (by 30 September).*

55. **Officials advise that SFS salaries have been flat over 10 years and have sharply deteriorated in real terms.** Over the same period, there has been a three-fold rise in the cost of living. Achieving some salary restoration is necessary for sustainable progress on anti-corruption measures.

F. Addressing Legislative Gaps

56. **The legal framework of the Tax Code does not provide the critical tools that SFS staff need to undertake effective audit and compliance enforcement work.** In the view of many Parliamentary members and the business community, the existing powers of the SFS should be further curtailed because SFS officials are seen to use those powers to harass taxpayers and to facilitate rent-seeking.

57. **The starting point for any review must be the requirement for SFS to rely on documentary evidence to identify noncompliant tax behavior.** Under the current law, all tax liabilities must be supported by a business's documentary trail. For example, where cash has been diverted from a business, the auditor must be able to trace the movement or sale of the goods to which that cash transaction might relate. If the SFS auditor cannot do this, then the SFS is unable to calculate the tax evaded and cannot proceed to recover unpaid tax. Similarly, an assessment for unpaid tax cannot be issued where a business has provided services, been paid in cash but the delivery of those services were not documented in an explicit services contract.

58. **Cases of unexplained wealth accumulations go largely unexamined by SFS.** Where a business entrepreneur has accumulated a large amount of unexplained wealth, the SFS has no authority to examine the affairs of that individual to determine the source of funds for that wealth. Moreover, the auditor cannot determine whether a company in which the individual has an ownership interest has fully and properly accounted for tax and USC liabilities on income received by that individual. These examples highlight the urgent need for the SFS to be authorized by law to use indirect measurement methods to ascertain the correct tax and USC liabilities of any taxpayer. Draft legislation to address these matters with respect to individuals, was submitted to the parliament in early 2015 but was rejected.

59. **The SFS's inability to access bank account information is also a fundamental impediment to improving tax compliance.** For any effective audit of a business's tax affairs, an SFS auditor should have access to bank account data to trace flows of payments and funds. This is not possible in Ukraine with the result that much of its audit effort is ineffective.

60. **Excessive bureaucratic prescriptions in law and the involvement of the courts also inhibit SFS collection enforcement.** For example, the requirement for the SFS to provide 60-days' notice before collection enforcement action can be taken against a company may provide sufficient time for a recalcitrant taxpayer to dispose of the assets of a business. Similarly, the requirement that the court system be involved in any collection enforcement action against an individual taxpayer imposes unnecessary constraints on timely, effective SFS actions.

61. **Because its powers to conduct audits are seriously constrained by law, SFS has been unable to address Ukraine's shadow economy.** With audit resources focused on formal business operations, little attention is paid to the collection of taxes from people operating in the informal sector. Many successful entrepreneurs and high net worth individuals are never subject to serious SFS scrutiny.

62. **SFS auditors need better audit and collection enforcement powers to influence taxpayer compliance.** Ukraine will only be able to build a culture of tax compliance if its taxpayers believe that the revenue administration is both capable of detecting and addressing noncompliance, and fair in its treatment of taxpayers in accordance with the law.

G. Improving Governance

63. **The SFS reform plan calls for improvements in governance of the organization.** Proposed measures and their status are as follows:

- Subordinate the SFS to the Minister of Finance (action completed).
- Delegate powers from the Minister to the SFS Chairman (under examination).
- Establish executive committee (completed).
- Appoint reform coordinator from private sector (completed).
- Create a unit in charge of reforms (mission was advised that a reform unit of up to 50 full-time persons would be established).

64. **Effective project management is key to achieving success with the reform program.** Revenue administrations in other countries that have had modernization success have applied sound program and project management approaches to the required tasks. The attached Appendix 4 provides a description of best practice in the area of project management and governance for revenue administrations.

Executive committee establishment

65. **The SFS has accepted a recommendation from FAD and by executive order of the Chairman has established an executive committee that is to operate from August 3, 2015.** The executive committee, made up of the chairman, the leaders of the SFS business streams, chief counsel as an adviser, the head of human resources (HR) and the change director, will meet regularly to consider operational performance and progress with change. The mission recommends separate meetings for performance and reform, and that other senior leaders, such as the head of the organizational and administrative department, are invited to participate when they can add value.

66. **Members of the executive committee and other senior leaders should have a clear understanding of what topics and issues are proper to the committee.** Typically these will include:

- ensuring effective and efficient delivery of the SFS's business (perhaps using visual management to consider performance while growing trust and co-operation between the organization's leaders);
- shaping organizational behaviors, policies, processes and structures to achieve SFS' objectives;
- oversight of the development of the business streams and functional strategies;
- reviewing overall business planning;
- leading and promoting change to secure improved performance;
- oversight and management of key strategic risks; and
- managing external relations with key stakeholders.

67. **Normally meeting agenda items will be supported by papers commissioned by a secretariat.** These papers, addressing key points without going into great detail, should be presented by a member of the committee or by another senior official who joins the meeting for that topic. Committee members are encouraged to both challenge and support each other.

68. **There is a latent conflict in the way the SFS executive committee has had to be established which should be kept under constant review.** Ukrainian law requires the Chairman, as head of the SFS, to make all significant operational and strategic decisions and it does not recognize that an executive committee has a role in a government department. It follows that the SFS executive committee will operate "under license" from the chairman who will need to be very careful not to overrule reasonable dissent from his views and to offer every opportunity for consensus to be reached. Where a member does not make a positive

contribution on a regular basis, consideration should be given to removing them from the committee and from their role in the business.

Recommendations

Integrity

- Develop a comprehensive integrity action plan for implementation from January 1, 2017, with two dimensions:

  - measures to reduce the opportunity for corruption, to identify and detect corrupt actions, and to apply adequate sanctions; and

  - measures to assess and screen all employees, along with necessary training and information.

Organization

- Continue to develop five business streams—tax operations, compliance, enforcement, finance and performance, and customs—with the intention to consolidate to three streams—service/operations, compliance and corporate services—over the next two–three years.

- Continue plans to consolidate 50 regions into 25 tax and customs regions, and to dramatically reduce the number of separate legal entities; in the long term, seek to have a single legal entity for the SFS.

- Implement the Audit Office pilot in Kyiv City to achieve management delayering.

- Review the headquarters structure with a view to eliminating the remaining tax-type functions by June 30, 2016.

- In the longer term, undertake more fundamental business process reviews with assistance from private sector experts.

Zero-based budgeting

- Engage private sector experts to assist in ZBB initiatives, and follow the processes suggested in the report in order to complete an in-depth review of expenditures and identify cost savings opportunities.

Reforms to tax police

- Initiate independent and regular surveys of public perceptions of the new Financial Investigations Unit.

- Commence preparations for the integration of the compliance and enforcement business streams to be completed by end of 2017.

Addressing legislative gaps

- Undertake a fundamental review of all tax audit and collection enforcement powers to strengthen the capacity of the SFS to address Ukraine's major tax compliance problems, including the informal/shadow economy.

- Ensure that the review, inter alia, addresses current documentary requirements that inhibit the identification of unreported tax liabilities, authorizes the use of indirect means to identify tax liabilities, provides for access to bank account information in appropriate cases, and empowers timely SFS collection enforcement actions.

Improving governance

- Establish a full-time team of 50 people for reform project management.

- Establish an executive committee for the SFS.

- Consider international best practice in making project management governance arrangements for the SFS.

III. OPERATIONAL ISSUES

A. The Large Taxpayer Inspectorate

Large taxpayer selection criteria and filing rules

69. **From November 15, 2015 all taxpayers meeting LTI selection criteria will be required to register with the Central Office of the LTI.** This new registration requirement will bring to an end previous arrangements under which over half of large taxpayers were able to remain under the supervision of their local office. At present, there are 1,978 large taxpayers with less than half (804) registered in the central office. The changes mean LTI has the authority to compel any large taxpayer that fails to register to change their place of registration and can transfer their files to the LTI Central Office, effective from January 2016.

70. **Large taxpayer selection criteria need to be modified to reflect Ukraine's changing economic situation and facilitate the management of existing and new large taxpayers.** A large taxpayer is currently defined as a legal entity whose turnover exceeds UAH 500 million over four consecutive quarterly reporting periods or whose total taxes paid (or payable) exceed UAH 12 million over the same time period. The LTI currently supervises approximately 1,340 large taxpayers. The changes to registration rules will double the LTI case base; it is estimated that up to 3,000 taxpayers could come under supervision. The mission shares the view that changes to

the criteria will be needed to ensure the largest taxpayers remain a manageable group that will receive adequate LTI surveillance and compliance management attention.

71. **Proposals to update the large taxpayer definition are under active consideration by SFS management.** The current proposal is for a large taxpayer to be defined as a legal entity whose turnover exceeds UAH one billion over a period of 12 consecutive months or whose total taxes paid (or payable) exceed UAH 15 million over the same time period. LTI management's analyses of previous year's data show that 1207 taxpayers would either satisfy the turnover criteria or a UAH 15 million tax liability criteria. Importantly, revenues to be secured from large taxpayers under the proposed new large taxpayer selection criteria are expected to be in the range of 50 to 55 percent of total government revenues.[8]

72. **Once a taxpayer satisfies the large taxpayer selection criteria, a failure to meet turnover/tax paid criteria in the short term should not result in the taxpayer's immediate removal from LTI supervision.** From the LTI's perspective it should have the right to maintain close supervision of any large company that is facing serious financial challenges in order to secure ongoing tax and social security payments from that taxpayer, even if it no longer technically meets the selection criteria. As a company's arrangements with creditors to settle its debts (including debts managed by the LTI) could extend over a period of years, consideration might be given to extending the LTI the right to maintain supervision of such a company for a two-three year period.

Large Taxpayer Inspectorate staffing

73. **LTI management is moving forward with organizational changes that will significantly increase centralized control over LTI operations.** The new organizational structure is built around eight industry specializations under the Central Office providing coordination and enhanced support to branch office specialists located in seven regions. The reorganization is also intended to strengthen the delivery of services to taxpayers under LTI supervision.

74. **The staffing of the LTI warrants careful review as its operations are being re-organized.** Staffing numbers in the LTI are 2,108 as at July 2015. While it is recognized that the LTI has a range of noncore functions associated with the management of large taxpayers, international comparisons suggest that the LTI is substantially overmanned.

75. **A review of LTI staffing should start with its audit operations**. Such a review and calculation of audit staffing requirements might proceed on the basis of assumptions drawn from conventional work load and staffing ratios. Using the assumptions outlined at Box 2, it appears that Ukraine should be able to complete a reasonable level of audit coverage of large taxpayers

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[8] The mission did not have access to the data that LTI management used to make these calculations.

with 200 or so skilled auditors. Of course, any changes to these assumptions regarding level of audit coverage and number and type of cases to be completed each year will affect staffing requirements. Nonetheless, assumptions of this kind should provide a basis for a detailed review of LTI audit staffing needs.

Box 2. Approximate Calculation of Audit Staffing Requirements

Assumptions

1. LTI would place all large taxpayers on a four-year cycle of comprehensive audits.
2. Two LTI auditors would be required for each comprehensive audit and they could complete five audits each year.
3. A program of issue-based audits for those large taxpayers not subject to comprehensive audits would also be undertaken with say one-third of that group of large taxpayers subject to an issue-based audit each year.
4. An auditor could complete eight issue-based audits each year.

Comprehensive audits (assuming 1200 taxpayers)

$$\text{No of auditors required} = \frac{1200}{4 \times 5} \times 2 = 120 \text{ auditors}$$

Issue-based audits

$$\text{No of auditors required} = \frac{1200}{3 \times 8} = 50 \text{ auditors}$$

Large Taxpayer Inspectorate audit activity

76. **LTI audit activities have been conducted against a background of recent compromise arrangements**. The compromise arrangements which were available in the first semester of 2015 permitted certain taxpayers with outstanding tax liabilities or understated liabilities to pay five percent of those liabilities in full satisfaction of past obligations. Taxpayers were given until mid-April to take advantage of the compromise scheme.

77. In the first semester of 2015, the LTI reduced its comprehensive audit activities and shifted its focus to unscheduled audits (Table 6).

78. **LTI is considering the introduction of a new program of risk-based desk audits.** Currently, cameral audits essentially involve mathematical and documentary verifications of return data. Under the proposed desk audit program large taxpayers would be asked to provide specific documents in electronic form and that documentation would be reviewed at the desk by

an auditor using systems-based risk criteria. A formal audit (and further contact with the taxpayer) would only be initiated when a significant tax compliance risk was identified on the basis of those criteria.

Table 6. Large Taxpayer Inspectorate Audit Results

	Scheduled Audits		Unscheduled Audits	
	2014	2015	2014	2015
Number of audits performed:				
- Comprehensive	237	74		
- Specialized			496	241
Total assessment				
(including fines and charges) UAH'000	497,916	151,465	425,634	179,463

Source: State Fiscal Service.

79. **The use of risk-based systems to identify audit risks in taxpayer reporting and documentation can only ever be an adjunct to a "top-down" risk-based compliance strategy.** That compliance strategy should drive the program that identifies the large taxpayers across all major industry sectors that will be subject to comprehensive and issue-based audits over the cycle of the LTI's audit program.

80. **An important objective of the desk audit proposal is to significantly reduce time spent on documentary checks and reduce physical contacts with taxpayers by auditors.** That objective is worthwhile and is supported.

81. **The utility and benefits of the new desk audit program are not clear and should be reviewed after a year of operation.** A key purpose of such a review would be to determine whether any significant, additional compliance risks have been identified on the basis of those documentary reviews and what of audit results were achieved.

82. **Legislative changes may be required to permit the gathering of documents in electronic form by the STI.** The law allows the STI to seek documents from a taxpayer after an audit has been commenced but some clarification may be required when documents are transmitted in electronic form and required to be certified by the taxpayer.

83. **The LTI is obliged to deal with a large number of requests for tax clearance certificates (TCC) and other documents required both by other administrative agencies of government and by the SFS itself.** For example, in the first six months of 2015, the LTI has received 13,000 TCC requests while only 12,600 requests were received in the whole of the 2014 year. Another example relates to an SFS requirement. Taxpayers have sent to the LTI 24,700 "requests for registration of accounting books" in the first half of 2015 compared with a total of

39,000 requests processed last year. Clearly, processing of administrative documents represents a significant workload for the LTI.

84. **While the LTI has started to address some of these essentially "low value" workloads and administrative services provided to other agencies, its strategy is to focus on streamlining and building e-services to ensure that these workloads are handled efficiently.** In particular, LTI is exploring the possibility to provide access to the SFS server for the government's Tender Committee so that it can check that entities seeking to bid on government contracts are up-to-date with their tax payments. Taxpayer confidentiality and data security issues arise with this proposal and would need careful consideration before proceeding. LTI is also examining the possibility of a common electronic format and procedures for other information requests.

85. **LTI should also be asking the fundamental question whether many of these tasks are critical to the delivery of its mission objectives to ensure improved tax compliance by large taxpayers.** If those services are not, then steps should be taken to eliminate those workloads wherever possible.

86. **Legislative changes may be necessary to give effect to proposals to streamline SFS administrative processes.** For example, to provide access to the SFS database for the Tender Committee and to facilitate new electronic formats for processing of information requests will likely require legislative changes.

High net wealth individuals

87. **The proposed new organization structure of the LTI Central Office includes a department for high net wealth individuals (HNWI).** This is an appropriate new organization arrangement to give focus to a HNWI program in the SFS.

88. **The LTI has undertaken significant research and started to develop criteria to identify those HNWI who might be brought under a new audit program.** Some HNWI have been identified but it is recognized that, without access to a range of external sources of information, SFS's data on HNWI will be incomplete.

89. **Significant "push-back" has already been encountered in particular with respect to proposals to access information on HNWIs' bank accounts.** SFS has sought to reach a compromise on this issue by proposing that the permission of other agencies including the Prosecution Service, Security Services, and Internal Affairs Ministry would need to be obtained to access information on a HNWI's bank accounts but this proposal has been rejected.

90. **At the same time, it is also recognized that other law changes are needed to provide the underpinnings of a HNWI program.** For example, to increase dramatically

penalties for failure to file returns and to extend the statute of limitations period for tax recovery and prosecutions.

B. Tax Audit

Audit coverage

91. **Audit coverage in Ukraine continues to decline.** Of approximately 600,000 legal entities, less than one percent (4,867) received a planned audit in 2014 (Table 7). In 2015, the declining trend line continues with only 1,635 planned audits completed in the first semester. The bulk of the SFS audit coverage is achieved through unplanned audits, which are triggered by criteria within the law (see below). The numbers of those types of audits (28,013 in 2014) have further declined when compared with the 2013 year when 32,496 cases were completed.[9]

Table 7. Audit Results for 2014 and First Semester 2015—Nonlarge Taxpayers

	Planned Audits		Unplanned Audits	
	2014	First Semester 2015	2014	First Semester 2015
Legal entity taxpayers				
Number of audits performed	4,867	1,635	28,013	9,882
Total assessment (including fines and charges) UAH'000	3,024,054	895,659	4,016,218	1,567,501
Collected revenues	…	…	…	…
Individuals				
Number of audits performed	3,455	1,462	34,948	8,144
Total assessment (including fines and charges) UAH'000	99,824	50,008	130,132	40,508
Collected revenues UAH'000	86,185	30,721	47,160	19,280

Source: State Fiscal Service.

92. **The SFS now faces additional constraints on its audit activities because of the audit moratorium implemented for the 2015 and 2016 years.** That moratorium principally affects the authority of the SFS to undertake audits of small–medium taxpayers (turnovers less than UAH 20 million) where compliance risks are likely to be very high. Importantly, however, the moratorium does not prevent audits of the critical revenue sources of VAT, PIT, and USC withholding, and excises, that such taxpayers may be required to pay.

[9] See Story and others, August 2014.

Risk assessment

93. **The SFS audit program remains unbalanced. Only a limited number of planned audit cases are undertaken.** The 17 percent of audits that are planned audits are all initiated from the SFS risk assessment model. The remaining 83 percent of audits which are unscheduled audits include many high risk cases. Audit management asserts that a significant proportion of these cases are also identified by the risk model. Of the 28,000 unplanned audits undertaken in 2014, the largest number involved VAT refund claims (which is a key risk factor in the SFS model). Thirty percent of unplanned audits involve business liquidations, and about seven percent are requested by the police.

94. **An option is to set a target for increasing planned audits over the next few years.** SFS should try to set some ambitious targets despite the current moratorium on some categories of audits (of taxpayers below the 20 million UAH turnover level). For example, the target for planned audits in 2016 might be set at 25 percent, with incremental increases planned for later years.

Audit adjustments and disputes

95. **While the number of completed audits continues to decline, the average amount assessed (including fines and charges) on each audit is substantial.** For legal entities, the average amount payable on a scheduled audit in 2014 was approximately UAH 621,000, and in the first semester of 2015, approximately UAH 547,000. For unscheduled audits, the amounts were approximately UAH 143,000 in 2014 and UAH 158,000 in the first semester of 2015. These results highlight the greater potential effectiveness of scheduled audits.

96. **The majority of audit adjustments are contested in the court system by taxpayers.** According to the SFS audit head, 65 percent of audit adjustments are disputed in the court system. This level of disputation would suggest that there is a significant problem with the quality of SFS audits, especially if taxpayers are successful in their court appeals. However, there may also be serious issues with the impartiality of the judiciary and the level of their expertise in tax law matters (also see further discussion on quality of assessments at Section E).

97. **Article 56 of the Tax Code provides a significant incentive to disputation of audit assessments by taxpayers.** This article prevents the SFS from taking collection action on a disputed tax debt and, so long as this provision remains in force, the effectiveness of all of SFS audit operations will be seriously compromised. Audit staff highlighted the common practice followed by small-medium taxpayers who liquidate a company while a tax dispute is before the court, thereby making it impossible to collect disputed revenue if the case is successfully concluded in favor of the SFS.

Management of audit operations

98. **The SFS audit management team is seriously concerned about its ability to manage audit operations across its extensive network of rayon offices.** Auditors working in rayon offices are generally connected into their communities and under the supervision of rayon heads who also have close links to the local communities.

99. **Rent-seeking and other corrupt practices are likely to be facilitated (and go undetected) because of the community ties of rayon heads and auditors.** Under the current SFS organizational arrangements, it is not possible to provide close supervision of audit staff located in rayons and detect corrupt behavior where that occurs.

100. **SFS faces its greatest reputational risk while significant numbers of audit staff remain largely unsupervised.** Government ministers, members of the Parliament, and the business community all consider the SFS to be a highly corrupted agency and its audit operations to be the vanguard of corrupt practices and taxpayer harassment.

101. **To address these supervision and corruption problems, SFS audit management is planning to move audit staff to the regional level.** The objective of this plan is to consolidate the management of audit operations at the regional level, to ensure that all audit activities are undertaken on the basis of identified risks (wherever practicable), and to strengthen the supervision of audit staff and provide greater industry and technical specialization.

102. **While many audit staff will remain in the rayons, their reporting arrangements and responsibilities will be changed.** Audit staff in the rayons will report to, and be under the supervision of, audit managers at the regional level and will only undertake audit cases that have been assigned at the regional level.

Audit powers

103. **Auditors' powers to perform their work effectively continue to be seriously constrained.** Some examples follow. Auditors must rely on documentary evidence located in the taxpayer's records to support their audit findings. Such documents are often fraudulently "re-constructed" when a taxpayer is given notice of an impending audit. Auditors cannot have access to a taxpayer's bank information to identify unreported income and sales. They are also not permitted to use "indirect" methods to determine a taxpayer's income.

104. **All of these constraints severely limit the ability of SFS management to deliver an effective audit program.** They also significantly distort the type of audit operations conducted by the SFS and the excessive burdens placed on taxpayers to provide wide ranging documentary evidence.

C. Value-Added Tax Administration

Current situation

105. **FAD (2014) mission recommendations are partially implemented.** The VAT registration threshold was increased to UAH 1 million on January 1, 2015.[10] However, with the rapid deterioration in the currency exchange rate and inflation, the effect of the increase is regarded as limited. While VAT fraud remains a major problem, a fast track deregistration procedure when fraud is detected was not adopted. A change in registration procedures from November 14, 2014[11] does speed up deregistration initiated by the taxpayer but this is not relevant for missing trader and related frauds.

106. **A risk-based off-site visitation program to control the VAT register and deter VAT fraud was also not introduced.** A mission recommendation to include a sunset clause on the June 2014 VAT account proposal was not accepted but a modified e-system for VAT accounts was developed and launched in July 1, 2015. The modifications addressed FAD concerns about the ability of the business to access working capital (see below).

New e-system for value-added tax administration

107. **The SFS believes that the new e-system will deter VAT fraud.** The e -system was launched July 1, 2015, after six months of testing, during which it was optional for taxpayers to apply. The model differs in one significant respect from that which was discussed in the 2014 FAD mission report.[12] This is regarding the treatment of domestic VAT transactions, where only amounts equal to net VAT payable, on the value added component, are to be deposited to the seller's individual VAT accounts. This is in contrast to the former proposal where the full VAT amount calculated on each transaction, was payable to the VAT account.

108. **Despite the modifications, the system adds burden to compliant taxpayers and it remains to be seen if it will bring the desired impact on VAT fraud.** Much emphasis is placed upon the requirement that all claims for VAT credit will be denied in the absence of the commensurate deposits in the VAT account. Notably there is a requirement for payment within 14 days of the sale—a partial limitation on access to working capital compared to the standard VAT system with a monthly or quarterly filing and payment obligation. As a concession for voluntary compliance, an amount equal to the 12-month average per month obligation may be under-remitted compared to the amounts of VAT payable on the invoice value. Notably the system relies upon accurate identification of the parties to the transaction (through use of an

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[10] The Law No 71, amendments to the Tax Code.

[11] Order of the Minister of Finance No 1130.

[12] A description of the first bank account system proposal is at Story and others: (2014), pp.52–53.

identifier on the invoice). Where there is a default in depositing to the VAT account by a supplier, there is no alternative to a reliance on court-based dispute resolution before the purchaser can claim the amounts of input VAT. A full description of the system is provided in Appendix 4.

109. **In parallel with monitoring of the impact of the new e-VAT system, distortionary anti-fraud requirements within the tax code need to be re-visited.** As an example, Article 188.1 of the Tax Code restricts a determination of the tax base of transactions to the contract price and therefore discriminates against businesses selling goods at a discount. The law requires the calculation of VAT on sales, based upon the purchase price, if the latter was higher than an actual sales price. The practice of selling goods at a loss on the purchase price can arise in multiple but not improper commercial situations (e.g., obsolete goods, promotions, a change in accounting policy, and changes in exchange rate). Removing the actual sale price from the VAT base is a denial of commercial realities and imposes unnecessary pressures on legitimate business. If authorities are certain that the new e-system of VAT accounts will effectively deter VAT fraud, other preceding and disproportionate measures that were introduced with the same reasoning, should be removed.

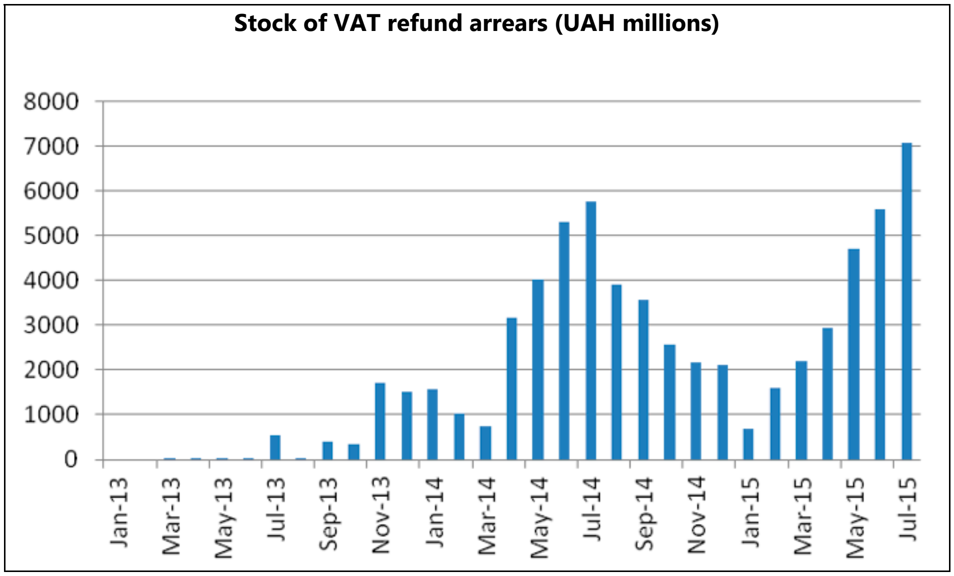
Refund arrears

110. **VAT refund arrears are growing.** VAT refund arrears are defined as those being more than 74 days old. They have grown rapidly in 2015 after almost being eliminated in 2014. As of July 1, 2015 the amount of VAT refund arrears reached UAH 7.075 billion (Figure 4). According to the SFS, the growth trajectory is expected to continue until the end of August 2015.

111. **The amount of VAT refund claims is growing faster than refunds paid.** New VAT refund claims submitted during the first half of 2015 total UAH 35.867 billion. Compared to the same period last year, this is a substantial increase—43 percent—or growth of UAH 10.724 billion, in the nominal value of refund claims (the amount of claims for period of January to July 2014 was UAH 25.143 billion). The total amount of VAT refunds paid during the current year to July 1, 2015 was UAH 26.701 billion. Compared to the same period last year, this is an increase of 31 percent representing UAH 6.346 billion in additional refunds paid (the amount of refunds paid during January to July 1, 2014 was UAH 20.355 billion). Detailed VAT refunds data is provided in Appendix 5.

112. **As a result, the stock of nonrefunded VAT claims is accumulating quickly.** By July 1, 2015 the stock of nonrefunded VAT claims was UAH 21.913 billion. This is growth of UAH 8,413 billion from an opening stock of UAH 13.499 billion in the beginning of the year. Out of the total outstanding stock of nonrefunded VAT claims, VAT refund arrears (those being more than 74 days old) is UAH 7.075 billion. This is the highest amount for 2015 and exceeds by UAH 1.305 billion, the peak value for 2014. Last year’s peak was also reached at July 1.

Figure 4. Value-Added Tax Refund Arrears 2013–15



Source: State Fiscal Service.

113. **The following factors are contributing to the rapid growth of the VAT refund arrears in 2015:**

- Legislative change in the beginning of 2015, which allowed VAT refunds claims to be submitted one month earlier compared to the rules applicable in 2014. This change had a one-time, bring forward, effect at the beginning of 2015 by increasing total VAT claims by an additional one month amount.

- The rapid depreciation in the exchange rate in 2015 flowing through to immediate increases in costs of (imported) raw materials.

- Budget constraints: while average amounts of monthly refund claims are around UAH 6 billion per month, the budget allocated funds for payment of refunds are, according to the SFS, limited to UAH 5 billion (the mission has not verified these figures).

- As expressed by the SFS, and in anticipation of likely restrictions to refund claims under the e-VAT system, taxpayers brought forward claims for unused VAT credit to be cleared up before the start of the VAT electronic administration system on July 1, 2015.

114. **The authorities are implementing measures to reduce VAT refund arrears.** In March 2015, the rules for automatic VAT refund were changed so that the ratio of the automatic refunds has increased from around half to two thirds of total amount of refunds and the criterion for minimal wage was abolished. In addition, a new criterion was adopted requiring the taxpayer to have fixed assets exceeding three times the value of VAT requested for refund. The authorities

also plan to use the forthcoming budget revenue to overcome the VAT refund arrears and lower them down to the level of the beginning of 2015.

D. Advance Payments of Corporate Income Tax

115. **Ukraine faces a major problem to manage the offset of accumulated CIT advance payments against CIT liabilities on an ongoing basis.** At end-June 2015, the amount of advance CIT payments was UAH 21.8 billion, which was equal to 54.2 percent of CIT revenue in 2014.

116. **Commencing in 2013, a new system of monthly CIT advance payments was introduced for businesses with annual turnover higher than UAH 10 Million.** The amount of each monthly payment was based upon tax payable on the previous year's income. With the economic downturn in 2013 and an increase in corporate losses claimed for that year, amounts of prepaid CIT rapidly accumulated on a separate account in the Treasury. Moreover, according to SFS staff, any excess of CIT quarterly payments (over relevant CIT liabilities) made under the system in operation prior to 2013 could not be used to offset advanced payments in 2013 (and later years). Nor were such excess CIT amounts refunded due to a lack of funds available in the budget. Those excess CIT payments made prior to 2013 are included in the accumulated CIT advance payments balance of UAH 21.8 billion described above.

117. **Some steps are being taken to reduce the stock of advance CIT payments, but there is a need for a more comprehensive medium-term solution.** On July 20, 2015, an order, combining advanced payments accounts with accounts of CIT liabilities, was issued by the Minister of Finance as a first step in reducing the stock of advance payments. This should allow automatic offsetting of those two obligations on a single account.

118. The SFS estimates that by the end of 2015 offsetting arrangements will slow the growth of the stock of CIT advance payments The arrangement for the period to December 2015 envisages that UAH 4.4 billion will be offset against monthly CIT installment payments due (Table 8).

119. **This offsetting arrangement will not stop the continuing accumulation of advance CIT payments.** By end 2015, SFS officials acknowledge that the amount of CIT advance payments will have reached UAH 33.2 billion, with a net amount of UAH 11.4 billion in CIT installment payments added to the June 2015 stock of UAH 21.8 billion referred to above. One can assume that due to the economic downturn in 2015, a large proportion of businesses will report losses. It remains unknown what amount of CIT advanced payments will be credited against 2015 liabilities. Because clear budgetary issues arise that are beyond this mission's objectives and tasks, there is a need for the authorities to consult on development of a medium-term strategy for clearance of these substantial arrears.

Table 8. Monthly Offsetting of Credits against Corporate Income Tax Advanced Payments: July–December 2015 Period

(In millions of UAH)

Month	Accrued Advanced CIT Payments	Amount of Offset CIT Credit	Net Advanced CIT Payments
July	2,630.4	942.1	1,688.3
August	2,630.4	959.1	1,671.3
September	2,630.4	804.6	1,825.9
October	2,630.4	664.7	1,965.8
November	2,630.4	577.5	2,052.9
December	2,630.4	463.1	2,167.3
End of 2015		4,411.1	11,371.4

Source: State Fiscal Service.

E. Reforming Tax Dispute Resolution

120. **Recommendations in the 2014 FAD report have not yet been implemented although there are plans for dispute resolution reform and some legislative changes have been prepared.** A sound system for resolving tax disputes lies at the heart of a good tax administration and is valued by taxpayers (particularly business taxpayers) and tax officials alike.

121. **The number of unresolved disputes remains unacceptably high—**at more than 75,000 with a value of around UAH 180 billion (for internal and judicial appeals)—and there is a significant disparity of outcome between appeals resolved through the internal administrative procedure and those decided by the judicial system. Dispute data is at Table 9 for internal appeals The SFS wins an overwhelming majority of internal appeals while success in the Courts is split about evenly between business and the SFS, though business wins more in money terms.

Payments of disputed tax

122. **Automatic waivers of tax where assessments are disputed continue to drive the number of appeals.** Business representatives have again confirmed that it is common practice to dispute tax assessments in order to postpone payment of tax. Some businesses dispute assessments in order to gain time to divest themselves of assets so that there is nothing with which to pay taxes when an appeal is eventually lost. The 2014 FAD report provided several examples of countries which require disputed tax to be paid in full or in part before appeals are determined and recommended a similar approach be adopted by Ukraine.

Table 9. Stock of Internal Appeals

	2012		2013		2014		2015	
	Number	Amount UAH Billion	Number	Amount UAH Billion	Number	Amount UAH Billion	Number	Amount UAH Billion
On hand at start of year	3,162	20.874	3,234	32.861	3,768	42.263	3,334	47.900
Received during year	1,022	23.498	1,267	21.596	884	13.146	310	8.341
Finalized during year	950	11.511	1,013	11.005	730	9.448	285	3.611
On hand at end of year	3,234	32.861	3,488	43.451	3,922	45.961	3,359	52.630
On hand at start of year [1]	33,518	49.861	40,689	73.824	44,578	72.363	49,947	79.180
Received during year	15,740	38.921	19,853	26.423	16,801	19.322	7,148	13.635
Finalized during year	7,088	9.474	10,500	11.150	2,572	4.267	3,351	2.332
On hand at end of year	42,170	79.307	50,041	89.097	58,807	87.418	53,744	90.483

Source: Ministry of Revenue and Duties/State Fiscal Service.

[1] Discrepancies between closing and subsequent year opening stock data should be noted.

123. **No material progress has yet been made by the SFS with development of a requirement for an up-front payment.** Business representatives are concerned that they will not be repaid for years if they pay cash up front but then win their appeal. SFS lawyers therefore favor a requirement for some sort of lien or guarantee when an appeal is made in order to meet these concerns. However, they have made little progress with drafting legislation because they are concerned that such a provision would be subject to a lengthy delay in Parliament as has happened with legislative proposals to reform the internal appeals procedures. With the total taxes in dispute presently exceeding UAH 185 billion and SFS expecting to win cases involving at least 30 percent of that sum, the SFS and Ministers need to urgently address the legislative changes necessary for handling disputed taxes.

Internal appeals resolution

124. **The SFS recognizes the need for significant reform of the internal administrative appeals function.** Business representatives are concerned that the administrative appeals system operates in favor of the SFS with those involved in decision making favoring their audit colleagues rather than reaching objective collusions. There are also concerns on the part of business representatives and SFS leaders that there is corruption in the system. Business representatives are skeptical that an internal appeals unit can operate efficiently and in a more timely way than the courts, but if they are to have confidence in it they want it to report directly to the chairman.

125. **To reduce the elapsed time of administrative appeals and improve the handling of these appeals the SFS is planning to introduce a single level system managed in head office.** The SFS have a draft law before parliament, (where it has been for several months), to achieve this. The aim is for appeals to be made to a central unit which will be staffed by appeals

specialists some of whom will be skilled people transferred in from Oblasts. This approach is expected to reduce the timeframe for individual administrative appeals by 80 to 90 days which will be welcomed by business. The new unit will report directly to the Chairman.

126. **The timescale for starting the new internal process should be brought forward.** The SFS wants the new process to apply to both tax and USC appeals but legislation to reform the USC process is not yet before parliament. The SFS is therefore content for the tax legislation to be delayed while the USC changes catch up. The mission believes that there should not be any delay while the two processes are synchronized and that parliament should be asked to pass the relevant tax legislation as soon as possible. The new USC appeals process can catch up in due course. The SFS should plan for the new tax appeals approach to start around three months after the legislation is passed to allow for careful management of the transfer of appeals from Oblast offices to the new central unit.

127. **Going forward, most tax and USC appeals should be resolved by the new unit.** The processes by which the new unit will operate should be set down in writing and published for consultation as soon as possible. This will help business gain confidence in the unit as will the inclusion of a small number of private sector lawyers and, possibly, officials from tax administrations in other countries in order to build capacity in this sensitive function and build credibility. It would also help promote confidence in the unit if a joint SFS/business/tax adviser forum was established to focus on the operation of the unit in its first two years.

128. **The head of anti-corruption in the SFS should be fully consulted about the method of operation of the new unit.** Up until now SFS officials handling appeals have been reluctant to settle a case for less than the amount assessed, even where there is evidence to support such a conclusion, for fear of investigation for corruption. And officials responsible for a case lost in a court of first instance will persist with litigation at the next level for similar reasons. In most other countries, oversight mechanisms in appeals units provide for cases to be settled with the approval of a senior manager without investigative involvement. The SFS should be aiming for a similar approach.

Assuring quality of assessments

129. **The SFS have begun to take steps to improve the quality of assessments that may be subject to appeal.** Courts, SFS managers and business representatives have all observed that the quantum of assessments is not always fully justified and assessments are not always supported by good evidence. The mission supports a new approach to assessing which involves the certificate of audit completion being signed off by a lawyer. However, further senior management action is needed to ensure any qualification from a lawyer is properly acted upon.

130. **Although additional evidence can be added during proceedings it is not always easy to come by.** A better and more efficient approach is to ensure that necessary evidence is available when assessments are made. To help auditors and managers understand what they

have to do, the legal function has prepared a 500 page methodological guidance manual which addresses every possible situation that could be thought of. Although encyclopedic in scale it is said to be well indexed and relevant sections can be taken out for use when needed. The mission welcomes this development and notes that the guidance has been prepared in cooperation with Oblast level auditors although it was disappointing to learn that the HQ head of audit knew nothing about the guidance.

131. **The SFS has prepared draft legislation to allow for appeals to be settled by mediation.** The mission recognizes mediation as a useful dispute resolution tool and agrees that it should be trialed in Ukraine. However, the mission recommends that trials of mediation should take place within the new appeals unit.

F. Unified Social Contributions Compliance

Contributor register and return filing

132. **The SFS has made significant progress in cleaning up the register of USC contributors.** Since mid-2014, the SFS has introduced new procedures for registration and de-registration for USC obligations, completed a major stock-take of USC contributors, and removed a large number of defunct contributors from the register. The current number of registered USC contributors is approximately 3.12 million. In 2014, approximately 404,000 natural persons and 250 liquidated entities were removed from the register.

133. **While compliance with expected monthly and annual filing obligations is consistently high across all USC contributor categories, the reported USC liabilities in those returns are seriously understated.** Under-reporting of USC liabilities remains a major compliance challenge which the SFS is struggling to address.

134. **Reporting on USC and PIT withholding continues to require the completion of two separate returns and payments.** Consolidation of these reporting requirements into a single return form and payment would be an important taxpayer service initiative that business would support. This “integration” of filing and payment has been under consideration in SFS and there have been discussions with the social security funds. However, these discussions are stalled.

Harmonization with the personal income tax

135. **Harmonization of the bases for USC and PIT should facilitate compliance with reporting obligations, particularly by employers.** It is understood that the bases for calculation of USC and PIT are not significantly dissimilar so a proposal to harmonize them should be welcomed by contributors as a law simplification measure.

Obstacles to achieving improved compliance with USC reporting obligations

136. **The combined burden of USC and PIT provides a major incentive for employers and their employees to understate both of these liabilities.** The average burden of USC is 39 percent and 13.4 percent for PIT. It is widely recognized that the combined tax burden of USC and PIT is excessive.

137. **Under-reporting of salary payments is rife.** According to SFS officials, 57 percent of companies report salary payments to all employees at a level less than two times the minimum monthly salary level of UAH 1218.

138. **SFS managers report that auditors are constrained by law regarding what they are able to examine in auditing USC liabilities.** SFS auditors do conduct significant numbers of unscheduled audits to identify USC payment noncompliance but the scope of those audits is invariably focused on the identification of employees who are not registered on the books of an employer. Regarding an employee's salary entitlements, auditors do not have the legal authority to look beyond the formal documentation of each employee's labor contract.

139. **Importantly, SFS auditors have no legal authority to use "indirect methods" to determine the real level of remuneration of the employees of a business.** It is an open secret that the use of cash payments to employees to supplement salaries specified in their employment contracts is widespread. Various forms of fringe benefits to top up salaries also go unreported for USC purposes.

140. **SFS auditors work with labor inspectors in the Ministry of Social Policy on USC noncompliance issues but the labor inspectors' powers and sanctions are also limited.** Under the labor law, the main sanction that can be imposed on an employer is a penalty (equal to 30 minimum salaries) for failing to submit a notification to the SFS that a new worker has been engaged.

141. **SFS does not have a separate program of USC and PIT withholding audits**. Much of the audit work related to USC liabilities arises when the SFS receives information about unregistered workers. These audit cases are reported under the heading of unscheduled/unplanned audits.

142. **Significant numbers of audit staff who might be undertaking PIT/USC compliance work are currently assigned to other priority work.** SFS is potentially required to conduct special inspections of the tax affairs of public servants subject to the Government's "lustration" program. Approximately 3,100 of these inspections are either in progress or scheduled. There are 80,000 government employees potentially subject to the lustration program.

Recommendations

Large taxpayers

- Revise the large taxpayer definition so that around 60 percent of tax revenues are within the catchment from January 1, 2017.
- Review the proposed new program of desk audits after one year to assess its utility and effectiveness.
- Review the need to undertake "administrative functions" that have marginal (if any) value in supporting LTI compliance objectives.

Tax audit

- Rebalance the audit program to increase the number of planned audits to a 25 percent target in 2016 with incremental increases in the target in later years.
- Proceed with plans to move audit staff from rayons to the regional level and exercise closer supervision and control over auditors who remain in those rayon offices.
- Undertake a detailed review of the Tax Code to identify legislative changes to strengthen audit and enforcement powers and seek government and parliamentary approval of a package of legislative changes.

Value-added tax

- Introduce tax administration initiated fast track deregistration procedure to support deterrence of VAT fraud.
- Review the tax code to remove distortionary anti-fraud requirements such as those under Article 188.1.

Corporate income tax

- Develop a medium-term solution to the continuing accumulation of advance CIT payments

Tax disputes

- Require a minimum payment or guarantee equal to a share of tax in dispute before tax appeals at first instance or court-based appeals are accepted.
- Implement a new system of internal dispute resolution through a special unit reporting direct to the chairman of the SFS by March 31, 2016.

Unified social contributions

- Harmonize the bases for USC and personal income tax and provide a single filing and payment for business from January 1, 2017

- Remove legal obstacles that prevent SFS auditors from determining the correct level of remuneration (including cash payments, fringe benefits, etc.) paid to employees for purposes of USC/PIT withholding calculation and assessment.

- Establish a separate audit program for USC/PIT liabilities and assign appropriate staff resources.

IV. FISCAL AFFAIRS DEPARTMENT TECHNICAL ASSISTANCE

143. **FAD has been supporting the SFS during 2014/15 by providing TA in following areas:** (1) preparing for SFS reform—four short-term expert (STX) visits (Hartnett); (2) Improving management of large taxpayers—three STX visits (Teed); (3) Collection of tax arrears and improving disputes resolution—one STX visit (Collins). Also a headquarters revenue administration diagnostic mission was provided in 2014 and a mission on taxation of natural resources visited Kiev in June 2015. FAD revenue administration TA activities are financed by the Canadian DFADT.

144. **The SFS reform efforts will require coordinated TA assistance in a number of areas.** In addition to the FAD TA other TA providers can be involved in supporting SFS to implement reforms. The EC, the U.S. Treasury, and the World Bank are already active in supporting SFS. A number of other donors, including the German Agency for International Cooperation (GIZ), and government of Netherlands are also involved in building SFS capacity (see Appendix 7). Donor support should be well coordinated to avoid overlapping and fully utilize available resources.

145. **There is a number of areas that require TA support.** The most critical areas are as follows:

- managing SFS institutional reform;
- building sound anti-corruption processes and staff integrity mechanisms;
- strengthening LTI;
- revamping tax audit;
- reforming SFS headquarters;
- reviewing business processes;
- reforming SFS structure, streamlining network of local offices;
- managing HR during reforms;
- strengthening customs;
- establishing HNWI unit;

- strengthening compliance management;
- harmonizing USC base with PIT;
- strengthening compliance with payroll taxes;
- strategies for compliance management and the informal economy; and
- improving disputes resolution.

146. **The FAD will mobilize a resident advisor to support SFS in managing institutional reforms.** The advisor will be installed in September 2015, preliminarily for one year. This assignment may be extended if there is a need for further support though this would be subject to financing. In addition to that, SFS will be supported by STX visits. See Table 10 for proposed TA activities during 2015/16. A customs diagnostics mission is also planned during September 2015. The mission will focus on identifying urgent operational improvements in Ukraine customs.

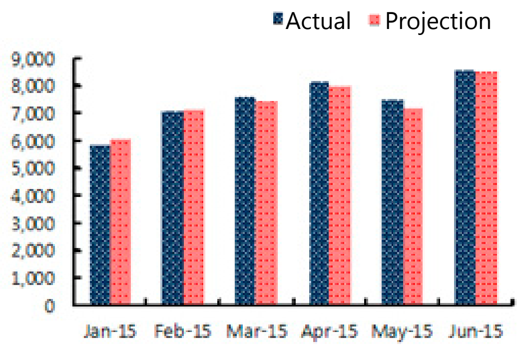
Table 10. IMF-Planned Technical Assistance Resources (FY2015/16)

Priority Area	Planned TA Activities	Type of TA	Proposed Timing
Managing institutional reform	Support to planning, steering, and governance capabilities of reform implementation. Coordination with other donor activities in reform program.	Resident long-term expert	September 2015–August 2016 (possible extension)
Large taxpayer management	Support to LTI reform	STX visit 1 X 14 days	October 2015
Large taxpayer management	Support to LTI reform	STX visit 1 X 14 days	December 2015
Payroll tax compliance	Advice on strengthening compliance management of the Unified Social Contributions and other payroll taxes	STX visit 1 X 14 days	October 2015
Payroll tax compliance	Follow up visit on strengthening compliance management of the Unified Social Contributions and other payroll taxes	STX visit 1 X 14 days	February 2016
HQ Structure	Support to delivering functional HQ structure (subject to availability of resources)	STX visit 1 X 14 days	November 2015
HQ Structure	Support to reforming HQ structure (subject to availability of resources)	STX visit 1 X 14 days	March 2016
Dispute resolution	Support to improve the internal dispute resolution system (subject to availability of resources)	STX visit 1 X 14 days	November/December 2015
Dispute resolution	Support to improve the internal dispute resolution system (subject to availability of resources)	STX visit 1 X 14 days	March/April 2016
General	Review of progress and ongoing advice	Staff visit 4 X 5 days	Quarterly, starting in September 2015
General	Review of progress, ongoing advice, planning further TA	Follow up Headquarters mission	May/June 2016

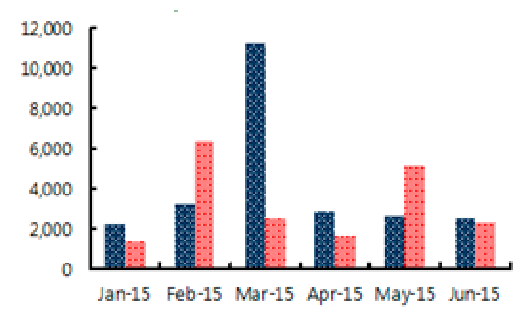
Appendix 1. Collections in 2015

Ukraine: Revenue Performance, January–June 2015
(UAH Millions)

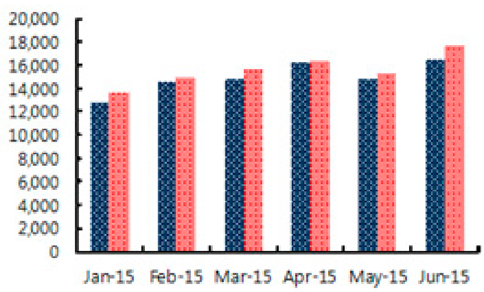
Personal Income Tax



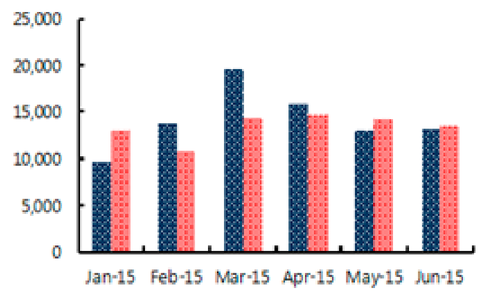
Corporate Income Tax



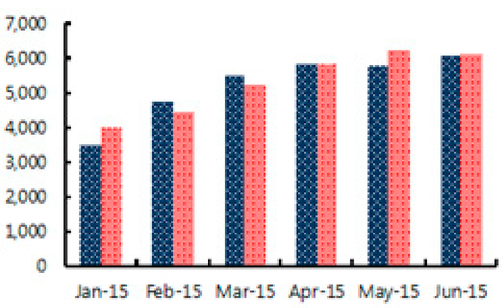
Payroll Tax



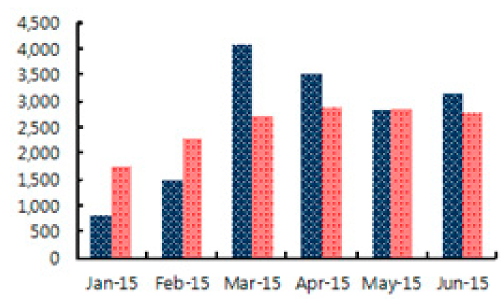
Value-Added Tax



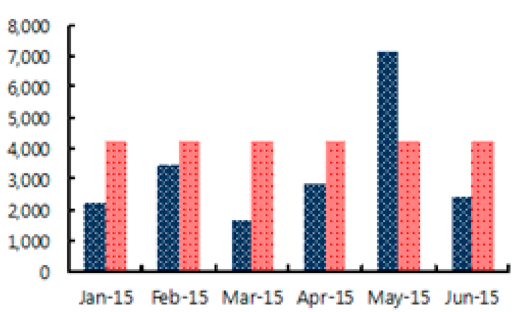
Excise



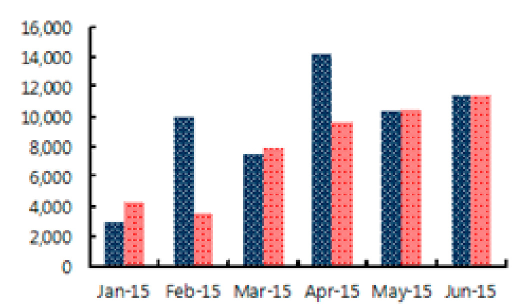
Customs Duties



Other Taxes



Nontax Revenues



Appendix 2. Status of Past Fiscal Affairs Department Recommendations

Recommendation		Status
Category	**Description**	**(Implemented in full, in part or not addressed and any comments)**
Organization and governance	Announce the future model for governance arrangements for revenue administration in MRD by August 31, 2014 and commence preparations to launch a new agency from July 1, 2017.	Implemented. MRD has become SFS that is an agency reporting to the Minister of Finance.
	Appoint a new deputy head within MRD responsible for the tax administration by end August 2014.	Accepted but still requires parliamentary approval. New organizational structure will have five deputies incorporating tax administration.
Managing late/stop filers	Improve management of late and stop filers through: Designating unit responsibility for filing compliance; and developing a proactive filing compliance enforcement program that includes outbound call capability and electronic reminders of filing dates by end August 2014.	Not implemented
Tax debts	Provide an offer for installments to be paid on outstanding debts under an extended two year term by September 30	Not implemented.
	Review management of largest debtors and assign the cases to a centralized and separate function by December 31	Not implemented but preparations commenced
USC enforcement	Cleanse the contributor register.	Implemented. Over 300,000 entities were removed.
	Remove legislative obstacles (for example auditor access rules and inadequate penalties) for detecting under-declared wages and rapidly expand the payroll audit program.	Not implemented.
	Initiate partnering with business associations to improve under-declared wages.	Not implemented
	Harmonize administration of USC with payroll PIT in the medium term.	Not implemented. Proposals have been examined.
	Expand on-site program of payroll auditing for USC compliance	Not implemented
Tax disputes	Remove an automatic waiver of payment of disputed debt.	Not implemented but plans being developed. Some tax dispute reform proposals have been in Parliament for 5 months.

Recommendation		Status
Category	**Description**	**(Implemented in full, in part or not addressed and any comments)**
	Require a share of tax in dispute to be paid before the dispute proceeds to the court system.	Not implemented
	Establish a centrally managed, and independent appeals unit in MRD for resolving tax disputes under administrative procedure.	Not implemented. Mediation proposals were developed but not legislated.
	Expand the timeframe for filing an appeal to at least 30 days.	Not implemented
Tax audit	Evaluate the cameral audit program performance to determine the results of the program and, based on this evaluation, revise the approach by June 30, 2015.	Implemented in part with new approach to audit being piloted in Kyiv City.
	Centralize all risk assessment under one function and reduce obligations to undertake (non-risk based) audits required by third parties by December 31, 2015.	Implemented in part with strategy and risk assessment for tax and customs audit under single leadership
	Rebalance the audit program through reducing unplanned audit activities while increasing planned risk-based audits.	Not implemented.
	Commence a high income self-employed program by January 1, 2015.	Not implemented but preparations are underway.
Large and high wealth taxpayers	Remove the discretion for large taxpayers to choose a tax office to manage their tax affairs.	Implemented—Legislation passed.
	Transfer all taxpayers meeting the large taxpayer criteria to the LTI.	For implementation from November 15, 2015
	Commence an HNWI program from mid-2016 after the LTI has reached its full operational capacity.	Implemented in part—commenced with a small number of HNWIs now managed centrally.
VAT administration	Increase the VAT registration threshold to UAH 1 million.	Implemented
	Introduce a fast track de-registration procedure to support control of VAT fraud.	Not implemented
	Expand the off-site visitation program, based upon risk analysis, for selected new VAT registrants.	Not implemented
	Include a “sunset” clause on any VAT bank account proposal for no later than December 31, 2015.	Not implemented because new approach taken to VAT compliance with introduction of electronic VAT system from July 1, 2015.

Appendix 3. Developing a Systematic Approach to Integrity[13]

Elements of an integrity strategy

There are a number of components that should be taken in to account in the development of a specific integrity strategy. These include:

*Leadership and commitment***.** There needs to be a firm commitment at the highest political level to the achievement of the highest level of integrity. This political commitment will drive the full engagement of senior management and staff. There should be clearly defined supervision, decision-making structures and obligations and staff at all levels should be made accountable for their own actions.

*Regulatory framework***.** Complex regulations, procedures and administrative guidelines allow corrupt practices to develop and flourish. The extent to which the law permits the exercise of discretion by officials should be brought to the absolute minimum needed for the proper administration of the law. Where discretion needs to be exercised, it should be fettered by appropriate rules and oversight.

*Transparency***.** Increased accountability and maintaining an open and honest relationship with all clients and stakeholders is crucial to maintaining public trust and confidence. There should be a capacity for judicial review of tax decisions made. Client service charters can demonstrate a revenue administration's commitment to providing quality service.

Automation. Electronic service delivery of all revenue administration functions limits the opportunities for corruption to occur, or if they do happen, to remain undetected. At the same time, the security of the automated system will need to be guaranteed to prevent attack from the inside or the outside.

*Reform and modernization***.** Integrity and anti-corruption efforts should be a key component of any reform and modernization program. At the same time, the broader reform program will be fundamental to the success of any integrity strategy as reform targets improved efficiency, effectiveness and responsiveness.

Audit and investigation. Any integrity strategy needs strong and specific tools to identify and to deal with corrupt behavior. Internal and external audits review systems and processes, focusing on those deemed to be more vulnerable to corruption. Random checks of specific operations can also be built in as a means to ensure ethical officer behavior. There should also be mechanisms in place to encourage or even require staff to report corrupt practices.

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[13] Many aspects of these references come from the World Customs Organization's Revised Integrity Development Guide (2014).

Code of conduct. A code of conduct specifically tailored to the challenges of maintaining an ethical revenue administration is an important component of an integrity strategy. Such a code sets out the standards of behavior and conduct demanded of employees to ensure that the integrity of the organization and its good reputation are maintained. The code should also provide a guide for resolving the thornier issues related to ethics that can emerge. Finally, the code should make absolutely clear what penalties are the consequence of corrupt behavior and these penalties should be a true disincentive.

Human resource management. Managing the personal integrity of staff can be the most challenging aspect of the integrity strategy. Expectations should be clear that a high level of work performance and personal integrity is expected but this can only flourish if the work environment is fair and recognizes the contribution of its employees. Reform of systems and procedures alone without the commitment of staff will not deliver the needed improvements in integrity. There are several areas of HR management that should be covered in an integrity strategy: (1) remuneration and conditions of work; (2) recruitment, selection, and promotion; (3) deployment, rotation, and relocation; (4) training and professional development; and (5) performance management and appraisal.

Morale and organizational culture. The integrity strategy needs to be predicated on the existing organizational culture, cognizant of any need for change to achieve real and sustained improvement. Staff and staff associations need to be actively involved if real change is to be effected. This is perhaps one of the most difficult parts of the integrity strategy as it involves influencing and sometimes changing individual attitudes and behaviors.

Relationship with the private sector. Client groups can play a central role in controlling or eliminating corruption and this should not be underestimated. Most forms of corruption in tax administration involve external partners and these partners need to be actively engaged and supportive of any integrity strategy, client surveys, liaison committees and a comprehensive communications strategy should all be elements of this component of the strategy.

Illustrative integrity actions

High level commitment

- establishment of a broad national program for anti-corruption, within which the integrity approach is developed
- cooperative agreements on integrity issues between national agencies (e.g., revenue administration and police organizations)
- multi country (regional or worldwide) declarations on integrity (e.g., Customs Arusha Declaration 1993)

- publication of high level integrity action plans

- establishing "integrity and ethical behavior" as a competency requirement for senior management

Regulatory framework

- review and simplification of revenue codes and statutes

- adoption of international agreements (e.g., Kyoto convention on customs procedures-based on principles and standards)

- introduction of e-commerce

- acceptance of risk-based principles and management

- development of plain language initiatives, especially in tax forms and guides

Transparency

- online access to legislation, regulations and interpretations
- publicly available fact sheets and other guidelines
- publication of performance standards and performance information
- establishment of complaints hotlines for public and employees
- establishment of customer help desks and service centers

Automation

- introducing processes to increase transparency
- establishing processes to minimize taxpayer contact, except in the service function
- implementing automated and electronic payment systems
- establishing computerized audit selection programs

Reform and modernization

- including integrity strategy as an element of reform initiatives

- establishing integrity governance within reform plans

- consideration of whistle–blowing programs, including legislation

- instituting a specific response to accountability for integrity (establishing internal affairs divisions. clarifying HR responsibilities, making integrity an overall management responsibility, undertaking perception surveys)

Internal audit

- establishing a specific focus for integrity issues in internal audit projects
- developing investigative capacity for integrity-related investigations (not necessarily to be done by internal audit)
- ensuring adequate internal control systems
- carrying out both random and planned audits and inspections

Human resources management

- developing linkages between performance and incentive pay and integrity
- inculcating integrity as a component of recruitment, selection, promotion and appraisal
- conducting internal staff satisfaction surveys
- establishing integrity counselors in the field
- developing integrity-related data collection including such items as alleged incidents or cases of corruption (status of investigation, if any, type of potential infraction, outcome of investigation, sanctions imposed (if any), appeal or redress, location, etc.)
- developing tools to analyze integrity data on a monthly or quarterly basis to evaluate the application of integrity policy and to determine changes in policy or emphasis if required
- developing appropriate training for integrity
- ensuring training in other areas includes an integrity component

Relationships with the private sector

- establishing national consultation committees on integrity-related issues
- developing specific protocols with high-risk sectors or corporations (e.g., those involved in excisable goods)

Appendix 4. Project Management and Governance

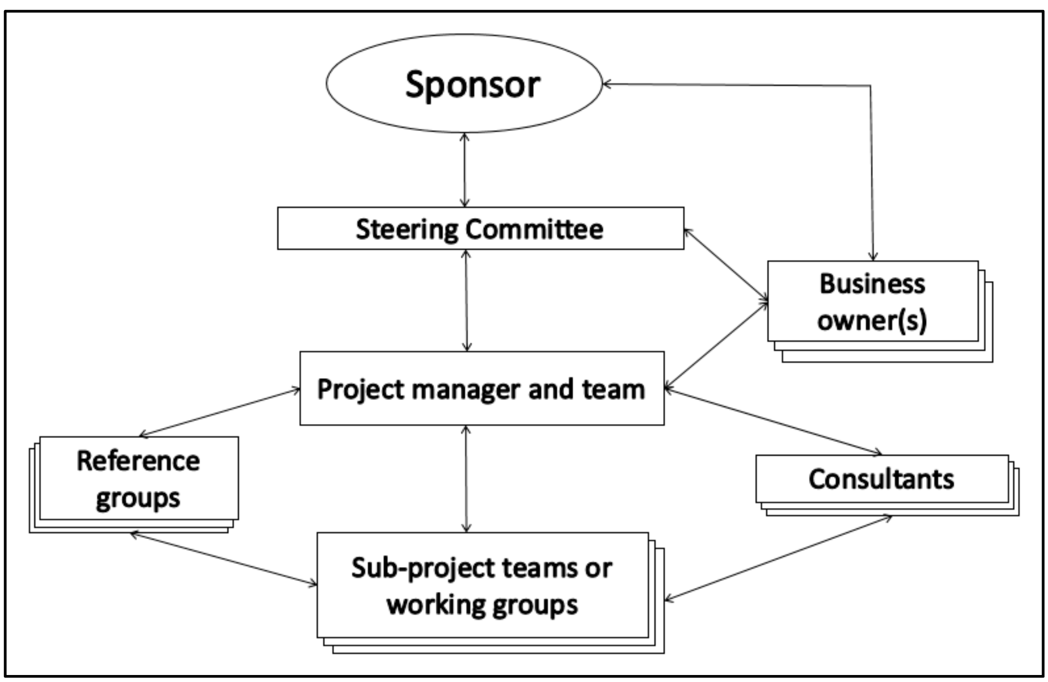
Introduction

Project management is a formalized and structured method of managing change in a rigorous manner. It focuses on developing specifically defined outputs that are to be delivered by a certain time, to a defined quality and with a given level of resources so that planned outcomes/benefits are achieved. Applying a formalized project management methodology helps clarify goals, identify resources needed, ensure accountability for results and performance, and foster a focus on final benefits to be achieved.

Setting up a project management structure

It is essential to establish a management structure for the project that identifies the specific players, their respective roles and accountabilities, and the interaction between them for the life of the project. This arrangement must be tailored specifically for the project and does not necessarily need to reflect existing operational line management structures. The diagram below illustrates a typical project management structure that comprises (1) a project sponsor (or owner); (2) a steering committee; (3) a project manager (and support team); and (4) a business owner. Roles and responsibilities under this arrangement are discussed below.

Figure 5. Standard Project Management Structure



Roles and responsibilities in a project management structure

Overlaying project management arrangements across the general management structure of the organization can cause conflict within an organization in regard to accountability and reporting. It must therefore be made very clear to all concerned how the project governance structure (accountabilities and reporting arrangements) will operate within the general management structure of the organization. The roles and responsibilities of the entities in the project management structure are described below.

Project sponsor (Chairman, SFS)	Has ultimate authority and provides executive approval and sponsorship for the project. Has budget ownership for the project and is the major stakeholder and recipient for the project deliverables. Advocates the benefits of the project to the government and community, takes responsibility for negotiating the support of other government ministries for the project, and assists in resolving cross-agency issues or disputes arising from the project. The sponsor is ultimately responsible for ensuring that the outcomes/benefits targeted by the project are secured before formally closing the project. Specifically, the sponsor's responsibilities include: • act as "champion" of the project; • advocate the project internally and externally; • secure broader government support for the project; • facilitate and support policy and funding recommendations; • provide high level direction; • resolve complex issues escalated from the steering committee when requested (and agreed); • ensure that the deliberations of the project are adequately recorded and available to appropriate parties; and • formally close the project.
Project manager	Responsible for overall management of the project. Accountable for establishing a project implementation plan, developing and managing the work plan, securing appropriate resources, delegating the work, and ensuring successful completion of the project. All project team members report to the project manager. The project manager handles all project administrative duties, interfaces with the project sponsor and business owners, and has overall accountability for the project. More specifically, the project manager is required to: • engage with stakeholders; • develop and maintain the project plan, including formal specification and agreement of goals, objectives, scope, outputs, resources required, budget, schedule, project structure, roles, and responsibilities; • manage the day-to -day aspects of the project;

	• manage project team members; • resolve planning and implementation issues as they arise; • monitor and manage the project budget; • monitor and manage the project risk; • report to the steering (or executive) committee, raising strategic issues; • communicate project status to the committee and other stakeholders; and • maintain project documentation. The project manager is a key person and appropriate selection and delegation of authority is therefore critical.
Steering committee (or executive committee) **(Chaired by SFS Head)**	Provide assistance in resolving issues that arise beyond the project manager's jurisdiction. Monitor project progress and provide necessary tools and support when milestones are in jeopardy. Collectively, the committee's role is to: • ensure the project's scope aligns with the requirements of the stakeholder groups; • approve project plans and budgets; • provide the project manager with strategic guidance and support; • regularly review project progress and issues; • make strategic decisions where required; • address any issues that have major implications for the project; • resolve disputes between the project manager and the business owner(s); • control the scope of the project as emergent issues force changes to be considered; • monitor the project budget and project risk; • take responsibility for any whole-of-government issues of the project; • assist the sponsor in championing the project; • ensure adherence of project activities to standards of best practice; and • report on progress to the sponsor.
Project team members	Support the project manager in ensuring that project deliverables are achieved. More specifically, the project team members: • work as directed by the project manager; • collaborate with operational staff across all work streams; • analyze business processes; • partner with the other project team members in challenging the current business rules and systems and identifying improvement opportunities; • identify organizational issues, risks and impacts; and

	• promote creative thinking.
Working groups (or sub-project teams)	Support the project manager in ensuring that elements of the project plan are completed. Their direct involvement in the project will depend on how the project is scoped. It is essential therefore that careful attention is paid to defining exactly what is in scope and what is out of scope to ensure that nothing "falls between the cracks," and to avoid the tensions that might develop between the project team and operational business areas. Specific tasks include: • analyzing the issues and risks involved in delivering specific outcomes; • developing treatment strategies; • translating the strategies into concrete goals and objectives; • developing work plans and determining resource requirements (human and financial); • developing supporting policies and procedures; • setting business and financial milestones and other measures of efficiency and effectiveness; and • monitoring and evaluating outputs and outcomes.
Business owner(s):	Operational managers accountable to the project sponsor for the realization of the project outcomes/benefits in the post-project environment. There may be one or more business owners, at a number of managerial levels, depending on the size of the project. They are continuously involved from the early conceptual stages of the project through to the testing and acceptance of the completed outputs. The business owner's responsibilities include: • providing assurance that the project will deliver all of the outputs necessary to realize the expected outcomes/benefits; • contributing resources to the project in order to ensure that the outputs are developed satisfactorily; • ensuring that the project outputs (i.e., products and services) are "fit-for-purpose"; and • ensuring that appropriate change management planning is in place to integrate the project outputs into the regular business operations when the project closes.
Reference groups	Small representative group of clients/users from areas that will be affected by the project's work. They may comprise staff from business units impacted by the project; or taxpayers, tax advisors or intermediaries in the tax system that will be required to use the outputs of the project; or a combination of these groups. Participants are selected on the basis of experience and/or special expertise in the activities/processes under review, and the reference groups are convened to focus their collective technical expertise and business experience to reach consensus solutions for operational issues that arise in the project.

	This level of engagement with internal and external users promotes “ownership” of the project outcomes more broadly across the organization and within the community. Reference group members also help disseminate information about the scope and outcomes/benefits of the project throughout their business areas and peer groups.
Consultants and contractors	Consultants and/or contractors from outside the organization may be engaged by the project manager or by the steering committee to provide specialist expertise or services not available from internal resources. Typical examples of external providers include: • business analysts • IT specialists • legal advisors • probity advisors • training experts • communication experts • quality assurers

Core competences for a project manager

Project management skills and experience are at least as important as knowledge of the business operations. However, the project manager should develop a reasonable understanding of the business operations in order to be able to communicate effectively with project team members, and with operational managers and staff to ensure that operational issues and concerns are addressed. Core project management competencies include the following:

- ***Project management:*** Possesses knowledge of project management methodologies, and has experience in managing significant projects.

- ***Strategic outlook:*** Demonstrates a broad-based view of issues events and activities and a perception of their longer-term impact or wider implications.

- ***Strong planning and implementation skills:*** Is goal oriented; develops and implements plans to achieve results; shows a clear sense of direction; meets deadlines and avoids crises; confronts issues; influences others and enlists the support of key players.

- ***Problem solving and analysis:*** Analyses issues and makes systematic and rational judgments based on relevant information. Trusts in own ability to accomplish the task and select an effective approach to solving the problem.

- ***Innovation:*** Creates new and imaginative approaches and shows a willingness to question traditional assumptions.

- ***Communication:*** Communicates effectively both orally and in writing; has good presentation skills; negotiates effectively; influences and convinces others in a way that results in acceptance or agreement.

- ***Flexibility and resilience:*** Successfully adapts to changing demands, conditions and people; maintains effective work behavior in the face of setbacks or pressure; remains calm, stable, and in control of emotions.

Appendix 5. E-System for Value-Added Tax Accounts

Following is a description of the basic principles for the new system of VAT accounts.

Each VAT taxpayer has an individual treasury account on which they have to deposit an amount of monies calculated as a result of their transactions reported on VAT invoices and by applying a legally determined formula (see below). Each VAT taxpayer is obliged to register its VAT taxable sales by entering into the e-system VAT invoices within 15 days after payment or shipment, whichever occurs first. Taxpayers have to deposit funds, in the amount equal to the VAT on sales that were offset by VAT credits reported to the system by suppliers or customs and corrected by the formula. The formula determines a limit for the tax amount on a VAT invoice (that a supplier enters to the system). If the VAT value on the invoice exceeds the formula-based limit, the supplier of goods and services should deposit additional funds on the VAT account to ensure acceptance of the invoice by the system. The deposit can be offset only by credits that were reported and paid to the system by suppliers. Taxpayers should also submit their monthly VAT returns. Treasury accounts will be swept at the VAT payment deadline to clear reported tax obligations.

The system is designed to disallow crediting VAT from false invoices on which VAT was not paid by the suppliers. The authorities hope that this will stop VAT leakages created by missing trader fraud.

The system will bring additional burden to taxpayers. In addition to enhanced reporting requirements for input of VAT invoices to the system, businesses have to bring forward their VAT payments, which will affect their working capital. To ease the burden on regular VAT payers, an "overdraft"[14] was designed as a part of the formula to determine final amount of required deposit. Also, VAT refund criteria were eased—a VAT refund request can now be submitted after expiration of one month from the filing deadline instead of two months.

[14] Overdraft—an element in the formula that allows taxpayers that had stable payments during the year reduce amount of their monthly deposit to VAT account by amount equal to 1/12 of their VAT payment during previous year.

VAT Invoice Control Formula:	
+	∑ VAT Invoice on Sales
+	∑ VAT Paid to Customs
+	∑ VAT Account
-	∑ VAT Invoice on Supply
-	∑ VAT Refund Claim
-	∑ (VAT Supply Amount—VAT Supply Invoice Amount)
+	∑ Negative VAT Values
+	∑ VAT Overpayments up to July 1, 2015
+	∑ Overdraft (average VAT paid during preceding 12 months)
=	**∑ lowest value for VAT invoice acceptance**

Appendix 6. Information on Value-Added Tax Refunds for 2013–15

(Amounts in UAH millions)

Period	Remaining refund amounts at the beginning of the year	Refunds paid in cash	Amounts offset to reduce tax liabilities	Amounts that were declined to refund	New refund requests	Outstanding stock of VAT refund claims	Refund arrears[1]
Jan-13	4597.7	45,959.0	3,782.6	2,337.8	43,340.9	3,427.5	0.0
Feb-13	3427.5	4,508.0	787.4	2,213.4	1,103.6	2,965.5	0.0
Mar-13	3427.5	8,834.0	694.1	1,800.5	5,746.2	3,447.4	0.1
Apr-13	3427.5	13,688.3	846.7	1,829.4	10,329.1	3,104.8	2.1
May-13	3427.5	18,467.7	945.1	1,904.8	14,558.2	3,287.8	2.1
Jun-13	3427.5	23,713.5	1,084.6	1,954.5	19,449.0	3,320.3	2.1
Jul-13	3427.5	27,499.4	1,180.2	1,981.1	24,150.4	4,415.2	528.7
Aug-13	3427.5	33,462.1	1,266.0	2,483.4	30,031.9	3,218.2	14.0
Sep-13	3427.5	36,928.3	1,507.2	2,403.3	34,875.0	4,907.1	404.6
Oct-13	3427.5	42,866.7	1,756.3	2,716.0	39,112.7	3,631.5	348.0
Nov-13	3427.5	45,609.9	1,880.4	2,682.1	43,210.4	6,442.8	1,720.7
Dec-13	3427.5	51,262.4	1,979.0	2,830.8	47,016.4	6,373.6	1,526.7
Jan-14	3427.5	53,447.6	2,091.0	3,410.8	49,978.1	6,944.6	1,570.3
Feb-14	6,944.6	5,180.0	206.6	87.0	4,745.4	7,056.1	1,038.0
Mar-14	6,944.6	6,648.3	260.5	184.9	8,646.2	9,580.0	737.4
Apr-14	6,944.6	8,935.0	333.7	210.7	12,332.6	12,772.1	3,170.8
May-14	6,944.6	13,129.0	480.2	280.3	16,139.6	13,215.4	4,029.5
Jun-14	6,944.6	18,029.2	754.1	532.7	20,623.2	13,166.5	5,320.4
Jul-14	6,944.6	20,355.3	913.8	402.8	25,143.2	15,383.5	5,770.7
Aug-14	6,944.6	25,073.6	1,012.6	499.0	29,275.0	14,707.0	3,900.8
Sep-14	6,944.6	29,567.8	1,160.3	534.9	33,138.6	11,646.9	3,575.9
Oct-14	6,944.6	34,054.4	1,251.0	555.8	37,445.5	9,752.2	2,565.5
Nov-14	6,944.6	38,847.7	1,379.2	511.1	41,166.7	8,731.7	2,156.4
Dec-14	6,944.6	42,094.4	1,619.8	546.9	46,016.8	10,290.5	2,099.7
Jan-15	6,944.6	43,332.8	1,700.6	577.5	51,714.8	13,499.7	697.5
Feb-15	13,499.7	4,816.4	409.1	103.3	5,506.5	14,859.7	1,598.9
Mar-15	13,499.7	9,072.7	549.9	241.4	12,228.7	17,364.4	2,187.2
Apr-15	13,499.7	12,037.4	823.8	381.9	19,719.8	20,517.2	2,941.7
May-15	13,499.7	16,465.8	1,024.0	448.7	25,485.2	21,929.7	4,702.6
Jun-15	13,499.7	21,425.4	1,200.1	706.5	30,657.7	21,938.3	5,598.6
Jul-15	13,499.7	26,701.3	1,439.9	529.6	35,867.0	21,912.7	7,075.5

Source: State Fiscal Service.

[1] Stock of VAT refund claims that have been outstanding for over 74 days.

Appendix 7. Technical Assistance Provided to the State Fiscal Service by Other Donors

Donor	**Areas of intervention**	**Time Frame and Forms of Assistance**
European Commission, EUBAM and EU member states (MS)	(i) Strengthening tax administration capacity and support longer-term tax administration reforms; integrity and good governance measures, tax compliance including high net-worth individuals, developing indirect tax audit methods; excise mark management, electronic invoicing, automation of VAT collection, transfer pricing, implementation of global standards, automatic exchange of information.	(i) Mobilization of EU Member State (MS) national experts for short-term visits, study tours, long-term embedded experts from the EU MS.
	(ii) Customs; common transit procedure	(ii) Ongoing short–term project until end-2015, with possibility to extent; but the aim is to launch a twinning project in 2016. Also study visits to EU MS.
	(iii) Authorized Economic Operator (AEO): Ukraine will participate in EU AEO Network meeting, 30/09, a bilateral meeting with EC, 1/10; plus three study visits to EU MS in September-November 20.15.	(iii) Advisory services, Ukraine participation in peer group activities, study visits
	(iv) Pan-EUR-Mediterranean Convention on rules of origin	(iv) Seminars already provided and bilateral meetings held with EC. More assistance can be provided on request by Ukraine, with the aim to facilitate Ukraine joining the Convention
	(v) Post clearance audit	(v) EUBAM provided assistance through seminar, study visit. Assistance on drafting legislation by EUBAM can be provided on request.
	(vi) Twinning on integrated border management, including anti-corruption	(vi) Project will be provided by a consortium of Germany, Lithuania and Poland will start end-2015 for 18 months.
	(vii) Harmonization of Ukraine Customs Code with EU acquis (within the scope of the Deep and Comprehensive Free Trade Area) and its implementing provisions and harmonization of Ukraine regulations with the EU Duty relief Regulation	(vii) EC is ready to support in a one-two year project the legal harmonization (with assistance of EU member states through short-term missions, study tours and advisory work).

Donor	Areas of intervention	Time Frame and Forms of Assistance
European Union advisory mission	Law enforcement component in customs	Continuous advice through EU member states experts based in Ukraine
GIZ	Strengthening tax administration capacity and supporting longer-term tax administration reforms; organizational development, anti-corruption measures, administration of VAT refunds, tax compliance of high income earners, transfer pricing, risk-based tax audits, local tax collection in view of the decentralization process.	Continuous: workshops, short visits of tax experts. For 2015-17: on Ukraine request: provision of long-term embedded expert; capacity development including possible contribution to covering IT needs.
Netherlands	(i) Fighting tax crime: Studying the work of the units within the Dutch Financial Police responsible for analyzing crime in the area of taxation as well as the units responsible for combating fiscal fraud with the help of ICT instruments; overview of the software and practical use of the different software tools. (ii) Tax compliance: – Modern approaches to tax compliance – Developing an effective taxpayer audit program – Tackling tax evasion and avoidance – Combating VAT fraud – Transfer pricing – Design and management of Large Taxpayers Office – Strengthening management skills	(i) Study visits, advisory services. (ii) Participation by the SFS staff in the relevant workshops in the Center of Excellence in Finance.
USA (US treasury)	(i) Large Tax Payer office: strengthening tax compliance, particularly among large taxpayers. (ii) Implementation of the SFS reform strategy.	(i) Ongoing: short-term missions by U.S. Treasury TA department to provide strategic advice. (ii) Assistance programs can be put in place on request from Ukraine.
World Bank	Development of legislative amendments for implementation of transfer pricing and improvement of VAT administration	Project implementation until October 2016: TA assistance is provided through different TA instruments including desk review, advisory missions, and workshops.