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Agricultural taxation in Ukraine: challenges and perspectives

Introduction

In a market economy, the tax system affects resource allocation, income and wealth but also has an important role in stabilizing the economy. Changes in tax law can lead to a reduction, or vice versa, increasing number of companies to influence their size and organizational structure. Tax system can affect how the management companies choose combined resources which is used – land, labor and capital, and on the situation in other sectors of the economy and the macro-economic situation as a whole [Babickiy 2004, p. 2].

The farm tax system since the development of the tax system of independent Ukraine had a special relationship with the state, which is weakly correlated with national economic system of taxation. In the agriculture there are always special tax regimes, and from 1999 – special indirect taxation regime.

The aim of the paper is to analyze agricultural taxation of Ukraine during 2000–2009, identify results of implementation of special tax regimes for agriculture and define the perspectives of farm tax system future development.

Review the agricultural taxation in Ukraine

Since the end of 90's farms in Ukraine use the special indirect taxation regime, this would be caused by the necessity of agriculture withdrawal of crisis.

The tax mechanism in agriculture should now be considered as a specific instrument of financial support for farmers. The consequence of this mechanism is that now taxes are turned from the fiscal tool into an element of financial support, through which increases the level of financial support of agricultural enterprises and formed a specific source of resources at the level of entities [Tulush 2006, p. 68–69].

The special tax regime of agriculture is carried out due to the fixed agricultural tax and special tax regime of value added tax.

According to the data Table 1, tax revenues from agriculture have increased during 2000–2009 in 3 times, while tax revenues to the consolidated budget and from agroindustrial complex is almost 2 times higher, respectively, 5.8 and 5.4 times. Due to this trend the share of tax revenue from agriculture has fallen almost by half: in the consolidated budget – from 3.1% in 2000 to 1.6% in 2009, in tax revenues from the agroindustrial complex – from 24.3% in 2000 to 13.5% in 2009. At the same time, agriculture plays a significant role in GDP. Thus, the share of agriculture in GDP, although reduced over the past decade, but at the end of 2009 was 11.2%.

Low share of tax revenue from agriculture was caused the special tax regimes that are not as tools of fiscal, but as elements of additional financial support of agricultural enterprises. Besides financial resources generated by the action of special tax regimes during 2000–2009 exceed the tax revenue from agriculture to the consolidated state budget by 2–3 times (Fig. 1).

Table 1
Agricultural taxation in Ukraine

Specification	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Tax revenue to consolidated budget, UAH bln	35.8	39.5	45.4	54.3	63.2	98.1	125.7	161.3	227.2	208.1
Tax revenue from agroindustrial complex, UAH bln	4.6	5.2	5.4	5.4	6.6	8.7	10.4	12.4	17.3	25.1
Tax revenue from agriculture, UAH bln	1.1	1.4	1.7	1.3	1.3	1.3	1.5	1.7	3.1	3.4
Share of tax revenue from agriculture in Consolidated budget, %	3.1	3.6	3.7	2.4	2.1	1.3	1.2	1.1	1.4	1.6
Share of tax revenue from agriculture in tax revenue from agroindustrial complex, %	24.3	27.5	30.9	23.9	20.1	14.5	14.0	14.1	17.8	13.5
Share of tax revenue from agriculture in agriculture GDP, %	1.4	1.7	1.9	1.7	1.4	1.4	1.5	2.0	3.0	3.3
Share of agriculture in total GDP, %	45.8	42.1	38.4	29.0	26.8	21.0	17.4	12.3	11.0	11.2

Source: Own estimates based on data from Statistical Yearbook of Ukraine and Ministry of Agricultural Policy of Ukraine.

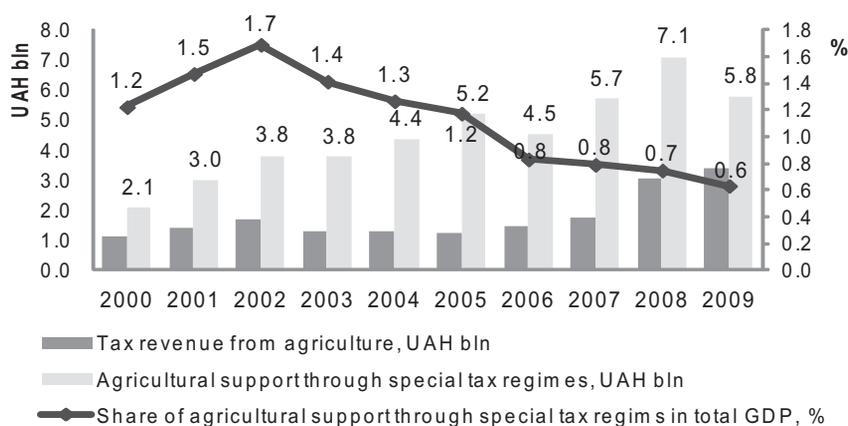


Figure 1

Ratio between tax revenue from agriculture and tax agricultural support (in 2009 the agricultural support through special tax regimes for 9 months, from 2007 – without FAT due to lack of data)

Source: Own estimates based on data from Statistical Yearbook of Ukraine and Ministry of Agricultural Policy of Ukraine.

So in general the main goal of the introduction of special tax regimes – reducing the tax burden on agricultural producers has been achieved.

Introduction of special tax regimes for the agriculture began with the adoption of the Law of Ukraine “On the Fixed agricultural tax” of 17.12.1998 No 320, which replaced 12 taxes and fees (since 2005 FAT united only 5 taxes: income tax, land tax, tax on environmental pollution, payment for exploration of natural resources; since 2011 due to Tax Code FAT united only 4 taxes: income tax, the fee for special use of water, fee of certain types of business in part of trading activity, land tax).

Among the positive features of the FAT should note the following:

- stable base and tax rates;
- promotion efficient use of agricultural land;
- encouraging capital accumulation and investment;
- lack of motivation to hide the results of activity, and therefore reduce the number of debtors;
- simplifying tax accounting, reporting and transparency of payment of taxes;
- motivation more effective management because of lack of linkage between economic activity and the amounts of paid tax liability.

Disadvantages of FAT consider that: 1) the tax does not include production costs and the level of profitability of agricultural producers, 2) calculate rates

Table 2
The main features of Fixed Agricultural Tax

Indicator	Characterization
The taxpayer	agricultural producers, in which the share of agricultural commodity production for the previous tax (reporting) year equals or exceeds 75 percent
Object of taxation	the area of agricultural lands transferred to the agricultural producer in ownership or use, including on the basis of lease, as well as transfer of lands of water reserves (lakes, ponds and water reservoirs) estimated as at July 1, 1995
Tax Rates	for arable land, hayfields and pastures – 0.15 for arable land, hayfields and pastures, located in mountainous areas and the Polissia area – 0.09 for orchards (except for orchards, located in mountainous areas and the Polissia area) – 0.09 for orchards, located in mountainous areas and the Polissia area – 0.03 for the water fund lands – 0.45 for arable land, hayfields and pastures, owned by agricultural producers, which manufacture (growing) crop production and processing at the closed grounds, or provided them for use, including lease terms – 1.0
Terms of payment	FAT is paid monthly but the amount of payment varies each quarter: 1 – 10%, 2 – 10%, 3 – 50%, 4 – 30%

are based on imperfect monetary valuation land through the undeveloped land market, 3) it puts the tax payers in an unfavorable conditions, who have different ratios of crop and livestock in gross production, 4) not all taxes are included in its structure depend on the size of agricultural land, therefore, as a result of the principle of justice is broken [Mogylniy 2005, p. 125–126].

In general, comparing positive and negative aspects of introducing FAT “... most economists noted the expediency of its introduction to the period of transformation of the economic system, which was accompanied by macroeconomic instability, imperfect financial and credit policy, monopolizing markets, lower real incomes, off-balance sheet transactions in economic activity, non-payment crisis and almost continuous loss-making enterprises in the industry” [Mogylniy 2005, p. 126].

In addition to the FAT, the most essential element of the special tax regime of agriculture is VAT. Support agricultural production by indirect funding mechanism through the VAT was introduced in 1999.

According to the laws of Ukraine such special regimes for VAT were introduced:

1. For agricultural producers (agricultural producer is an enterprise whose main business is the supply made (given) agricultural commodities (services) on

their own or leased production facilities, as well as goods made on commission in which the share price of agricultural commodities (services) is not less than 75 percent of all commodities (services), set during the previous twelve consecutive reporting tax period total):

a) regime of VAT accumulation:

- VAT which should be paid to the budget for sale operations of agricultural commodities and services of own production, except the sales of milk and meat to the processors (this rule to “except the sales of milk and meat to the processors” was excluded on the basis of Law of 31.10.2008 No 639-VI). These funds remain available to agricultural producers and used to purchase inputs for production purposes (the mechanism was introduced by the Decree of the President of Ukraine of 02.12.1998 No 1328) (hereinafter – *VAT for purchase production inputs*). Since 2004, the use of VAT has been changed – at first the funds use on compensation of VAT paid in the price of production factors, and the rest is directed to the purchase inputs (the Law of 24.06.2004 No 1878-IV).
- VAT which should be paid to the budget by agricultural enterprises for sale own milk, cattle, poultry, wool production, and also dairy products and meat products produced in their own processing plants, remains fully available to these agricultural enterprises and focused on supporting their own livestock production (this was introduced by Law of 18.02.1999 No 442 -XIV) (hereinafter – *VAT for the livestock support*). Since 2009, this rule applies only to agricultural enterprises who have not chosen the special tax regime (the Law of 12.22.2009 No 1782-VI).

b) VAT at zero rate due to the milk and meat sold by agricultural producers to processors (hereinafter – *the support the zero VAT rate for milk and meat*). It was cancelled on the basis of Law of 31.10.2008 No 639-VI.

2. For processing enterprises:

- VAT which should be paid by processing enterprises to budget for milk and meat products, is aimed exclusively for payment of subsidies for agricultural producers sold their milk and meat in live weight (this was introduced by Law of 18.02.1999 No 442-XIV) (hereinafter – *VAT for subsidies payment*). Initially these subsidies back to producers of milk and meat, and in 2009 are directed to a special fund budget and then using the payments on one cow (The Law of 12.22.2009 No 1782-VI). The deadline for the regime set January 1, 2015 under the Tax Code art. 209.

Due to the introduction of special regimes have been increased substantially the financial support of agricultural production, which is virtually impossible to provide direction in the budget. In general financial support of agricultural

producers through special regimes of VAT in 2008 amounted to 7.1 billion UAH, more in 9.8 times than in 2000. During 2000–2008 the average financial support through the special regimes of VAT was almost 31 billion UAH, on per year average – 3.4 billion UAH (figure 2). The agricultural enterprises received most financial resources through the regime of subsidies payment and the purchase inputs, respectively their share was in 2008 – 39 and 37%.

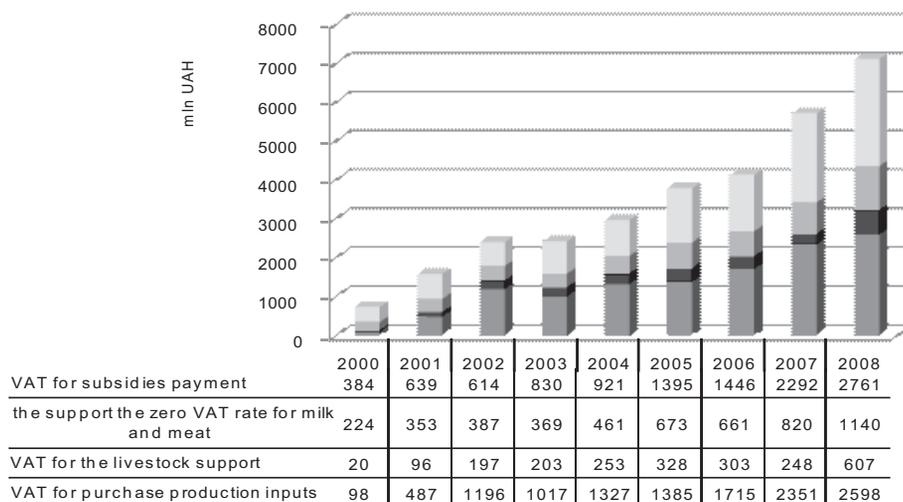


Figure 2

The structure of financial support of agricultural producers through special regimes of VAT
Source: Own estimates based on data from State Tax Administration of Ukraine.

There are about 60% on milk and dairy products and 40% – for livestock and poultry in the structure of subsidies payment by processing enterprises to agricultural producers. The level of transfer payments for the analyzed period rather high and is about 97–98%. All this shows that agricultural producers through this special regime receive significant financial support for livestock production. But despite this livestock industry could not overcome the crisis which is evident from figure 3. If milk production was mostly positive during 2000–2009, but the meat production has not reached the profitability.

Perspectives of agricultural taxation development in Ukraine

Thus, Ukraine's agriculture remains the largest recipient of benefits in the economy through special tax regimes and mechanisms. This leads to the conclusion that the contribution of agriculture in general financial fund of the country

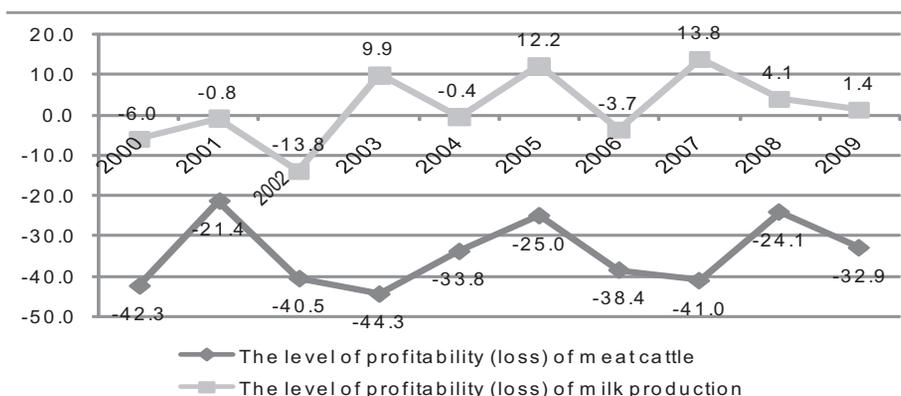


Figure 3

The level of profitability (loss) of livestock production in agricultural enterprises, %
Source: Statistical Yearbook of Ukraine.

is unreasonably low. Therefore seems necessary to review tax benefits for agricultural producers.

Fixed Agricultural Tax. Tax rates determined as a percentage of monetary valuation of agricultural land, which is fixed at 1 July 1995. Indexing the tax base is not provided so the amount of FAT is less than 6 UAH per hectare. As a result, since 2005 the FAT rate is significantly lower than the rate of land tax payable on account of FAT. Therefore, local budget lacks funds for land protection [Tulush 2010, p. 4].

In addition, charging the tax in its present form is disconnected from economic activities of individual agricultural enterprises, for which no need agricultural land is subject of FAT. This is a company that specialized in growing vegetables in greenhouses and livestock complexes (primarily poultry).

Application of this regime for these agricultural enterprises are unacceptable because they are able, first, independently regulate the level of taxation of their income by changing size of agricultural land, and, secondly, the level of their income allows to involve part of them to develop local infrastructure.

FAT was developed for crop production and its application for industrial-type agricultural enterprises (greenhouses and poultry plants) is unacceptable because it leads to unproductive budget losses.

Thus, an important aspect of improving the instruments of direct taxation is to establish objective criteria for limiting the possibility of applying a special tax regime on the basis of monetary valuation of agricultural land of entities in which such lands are not the main means of production [Tulush 2010, p. 6].

VAT for the purchase production inputs. This VAT is a kind of combination of the accumulation regime with a fixed fee regime. An application rate «output»

of 20% creates a positive balance of the VAT, while the directions of its using are not determined, the control over expenditure is not provided. The main task of special regime is not the simplify procedures of VAT administration in agriculture, but formation of additional financial resources in the agricultural enterprises.

However, now the mechanism of VAT is the most effective instrument to support the development of agriculture in Ukraine, which determines the suitability of its saving in the near future.

Under conditions of cancel of the special VAT regime would be appropriate to introduction an alternative special regime of VAT administration aimed at ensuring the tax administration simplicity. This regime became popular in European countries and under the conditions setting the optimal size of a fixed compensation rate will not lead to distraction of financial resources of enterprises and significant losses for the budget corresponds the requirements of WTO concerning financial support instruments of national producers [Tulush 2010, p. 94].

VAT for livestock support and subsidies payment. In the opinion of some experts this mechanism undermines long-term farm competitiveness. They stimulate greater production as a reaction to subsidies rather than market developments and the comparative advantages of farms producing these products. Subsidies could stimulate higher production but they do not improve competitiveness and do not necessarily support investments in the improved quality of milk and meat, which are urgently needed in order to increase the competitiveness of agricultural producers and to enable food processors to sustain their position in internal and foreign markets [Zorya 2006, p. 13].

VAT for livestock support and subsidies payment have increased income inequality within the agricultural sector, providing most benefits to a small group of larger farms. In 2004 only 7 percent of the farms received 75 percent of all subsidies. This is explained by the coupling of the VAT expenditures with production (the more you produce the more subsidies you receive) and a biased distribution of limited budget resources to the well-connected farm managers. While the share of subsidies in the gross income of livestock producers was 3.8 percent on average, the small privileged group of large farms received 10.4 percent of their gross income from the state. This is the statistics for large farms. Regarding individual producers, there is the information that many of them did not receive the VAT returns from the processing plants in spite of being eligible [Zorya 2006, p. 13–14].

But from another side the use of this mechanism – a powerful source of agriculture support, especially livestock. Although the livestock industry is unable to completely withdraw from losses, but without this help agricultural enterprises would have more losses.

Conclusion

The agricultural tax system in Ukraine has turned from a fiscal mechanism to the mechanism for providing additional financial resources through special tax regimes that are realized through the fixed agricultural tax and special taxation regime for value added tax.

During 2000–2009 the main purpose of introduction of specific tax regime for agriculture – reducing the tax burden was achieved. The share of tax revenue from agriculture in the consolidated budget was declined by half.

At the same time by introducing special tax regimes of agriculture has received significant amounts of additional financial resources, which is 2–3 times higher than the tax revenue from agriculture. In particular, financial support of agriculture through the regimes of VAT during 2000–2008 amounted to 31 billion UAH.

Despite criticism of special tax regime of agriculture is the most effective instrument to support the development of agriculture in Ukraine, which defines the suitability of its saving in the near future with some adjustment some provisions of the FAT and VAT.

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Opodatkowanie rolnictwa na Ukrainie: wyzwania i perspektywy

Streszczenie

System opodatkowania rolnictwa na Ukrainie przekształcił się z mechanizmu fiskalnego w mechanizm dostarczenia dodatkowych środków finansowych za pomocą specjalnych zasad opodatkowania, funkcjonujących jako stały podatek rolny oraz specjalny system opodatkowania podatkiem VAT.

W latach 2000–2009 podstawowy cel wprowadzenia specjalnych zasad opodatkowania w rolnictwie w postaci obniżenia ciężaru podatkowego został osiągnięty. Udział wpływów podatkowych z sektora rolnictwa w budżecie centralnym zmniejszył się o połowę. Jednocześnie na skutek wprowadzenia specjalnych zasad opodatkowania rolnictwo otrzymało znaczące środki finansowe, będące 2–3-krotnie wyższe niż wpływy podatkowe z sektora rolniczego. Mianowicie, wsparcie finansowe przez specjalne zasady opodatkowania podatkiem VAT w latach 2000–2008 wyniosło 31 mld UAH.

Mimo krytyki, specjalne zasady opodatkowania rolnictwa pozostają najbardziej efektywnym instrumentem wsparcia rozwoju rolnictwa na Ukrainie, co uzasadnia ich dalsze funkcjonowanie w przyszłości, pod warunkiem korekty niektórych regulacji dotyczących stałego podatku rolnego oraz VAT.