



# UKRAINE

## TECHNICAL ASSISTANCE REPORT—REFORMING THE STATE FISCAL SERVICE

February 2016

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**UKRAINE**

**REFORMING THE STATE FISCAL SERVICE**

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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
<b>A new bargain with government</b> —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.