



# FISCAL CAPACITY OF LOCAL GOVERNMENTS IN UKRAINE: PIT AND PROPERTY TAXES IMPACT

October 11, 2023



Ministry  
of Digital Transformation  
of Ukraine



MINISTRY FOR  
RESTORATION

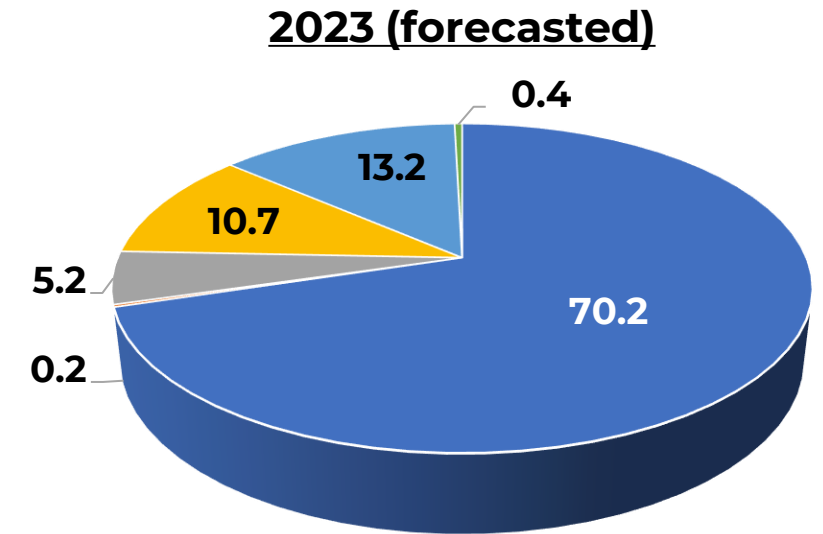
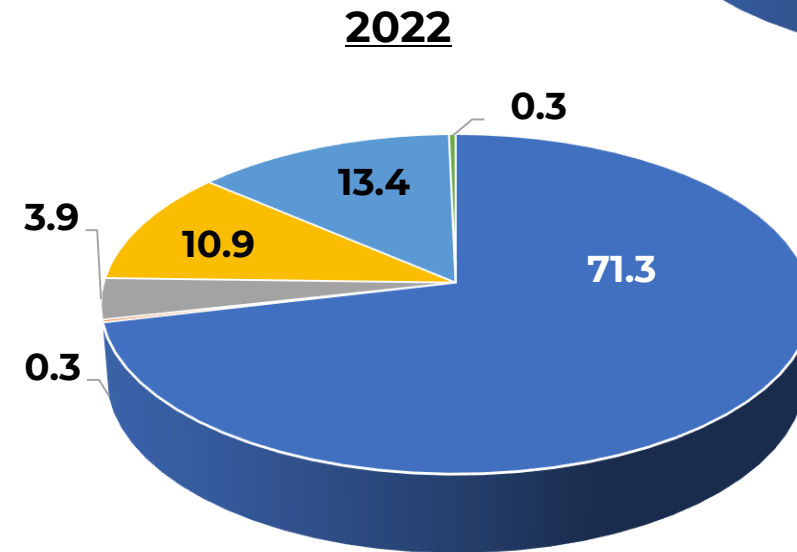
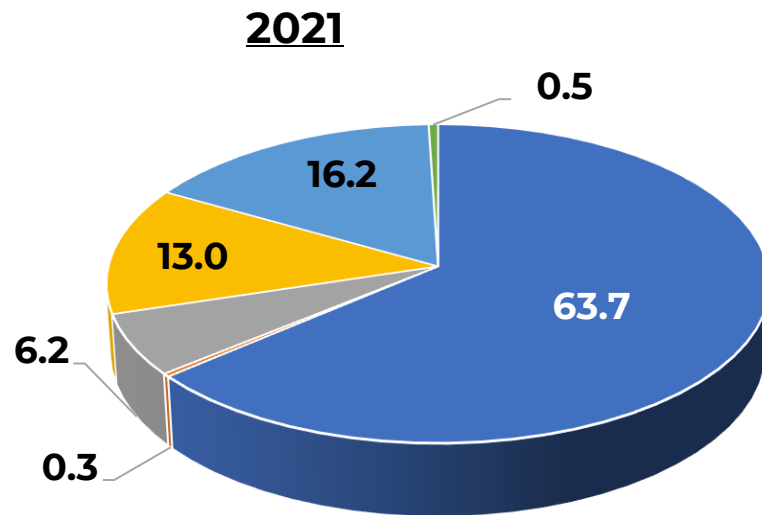
# Presentation is about:

Key tax revenue sources for local governments in Ukraine and related challenges:

- *Personal income tax*
- *Property taxes*

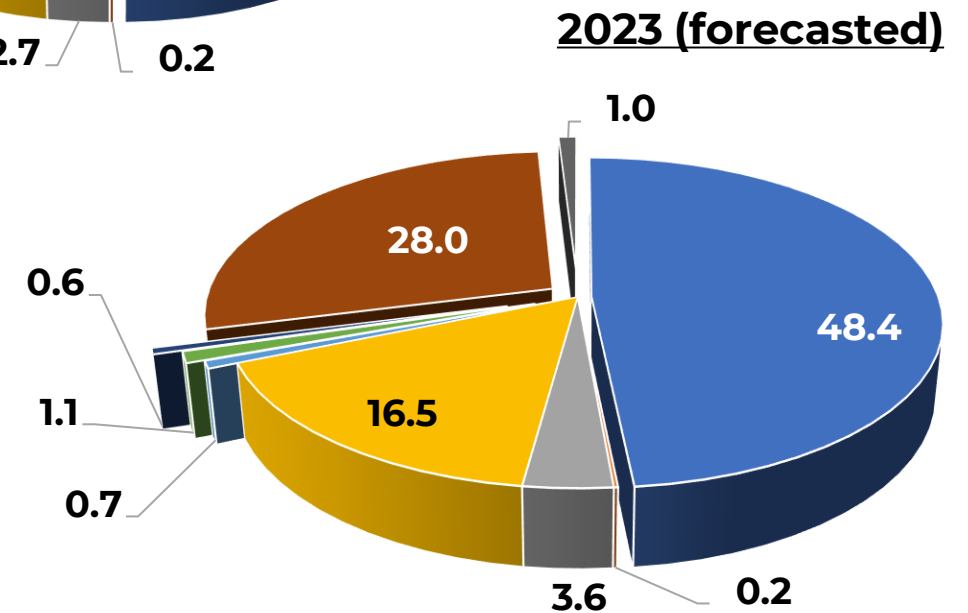
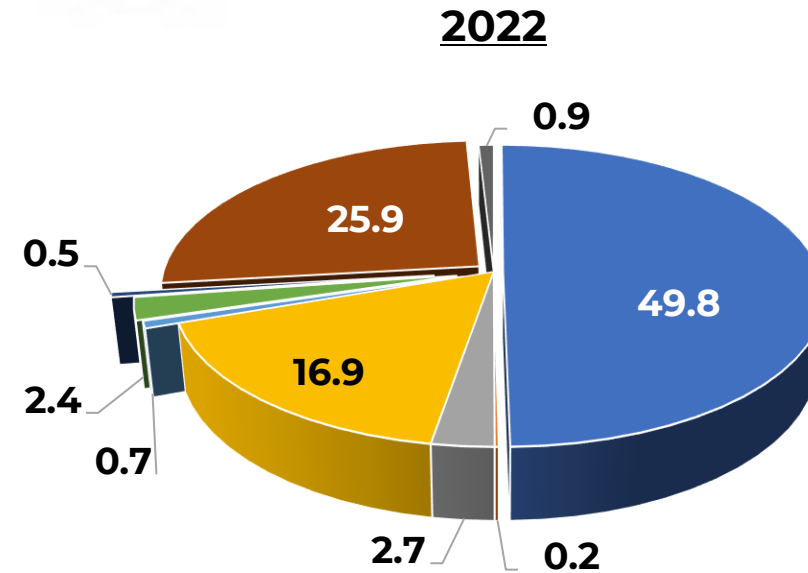
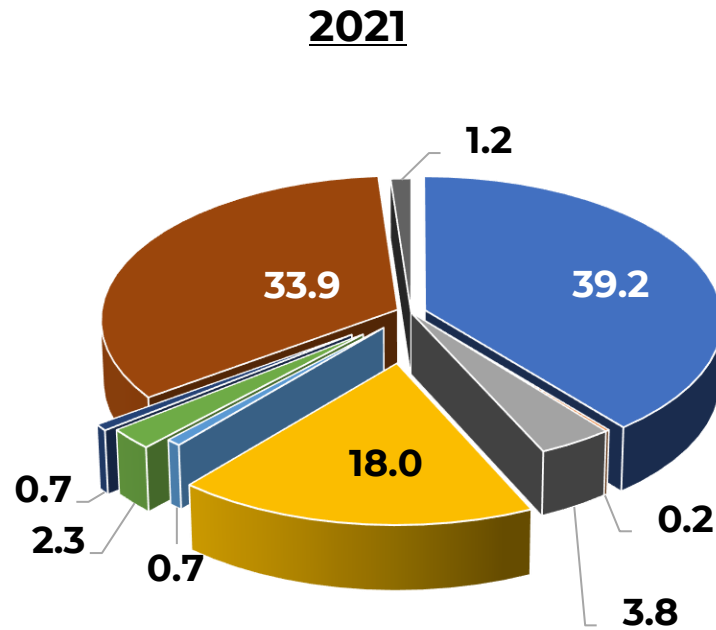
# Local budgets tax revenue structure, %

- Personal income tax
- Rent fees
- Excise tax
- Property taxes
- Single tax
- Rest of tax revenues



# Local budgets total revenue structure, %

- Personal income tax
- Rent fees
- Excise tax
- Local taxes and fees
- Administrative fees
- Own revenues of budgetary institutions
- Income from capital transactions
- Transfers
- Rest of revenues



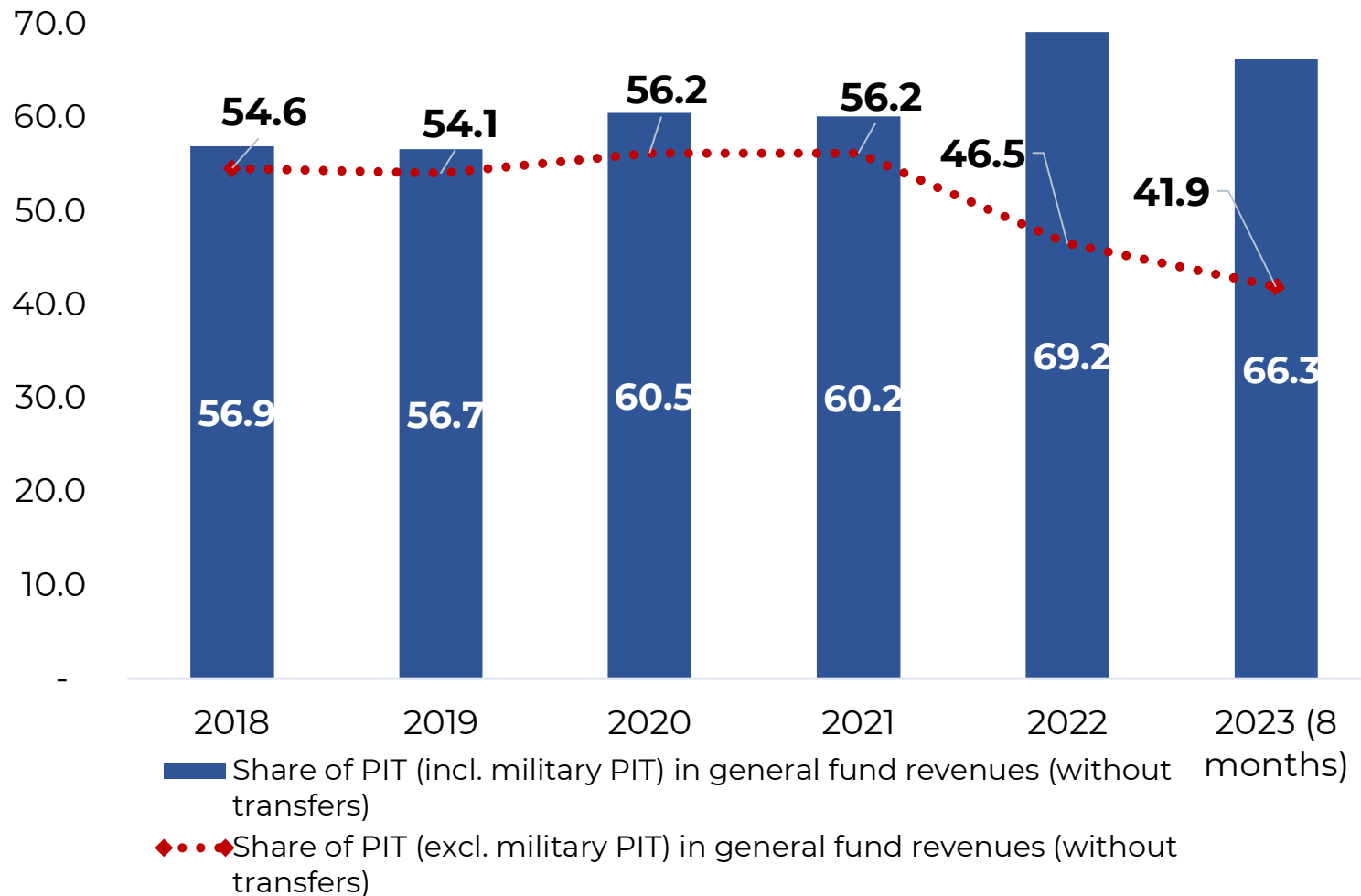
# PIT PAYMENT SYSTEM IN UKRAINE: OPTIONS FOR REFORMATION



Міністерство  
цифрової трансформації  
України



# PIT share in local general fund revenue, %



1. PIT was and has still remained an important revenue source for local budgets.
2. Since 2022 (after full-scale Russian invasion) share of PIT in local budget revenues maintains its upward trend. However, it is mainly explained by the significant raise in military PIT.
3. When taking into account PIT revenues excluding military PIT, share of 2022 (46.5%) decreased by 9.7 percentage points against 2021 (56.2%).

# Shortcomings of PIT Payment System

01

According to the legislation, PIT is allocated to the local government's budget of the territory where an employer is registered

02

None of agencies of the national government has reliable information on where taxpayers work or live

03

Legal entities when deciding on PIT payments for their employees may negotiate a place of their business units registration and, thus, budget-recipient of PIT with local governments

04

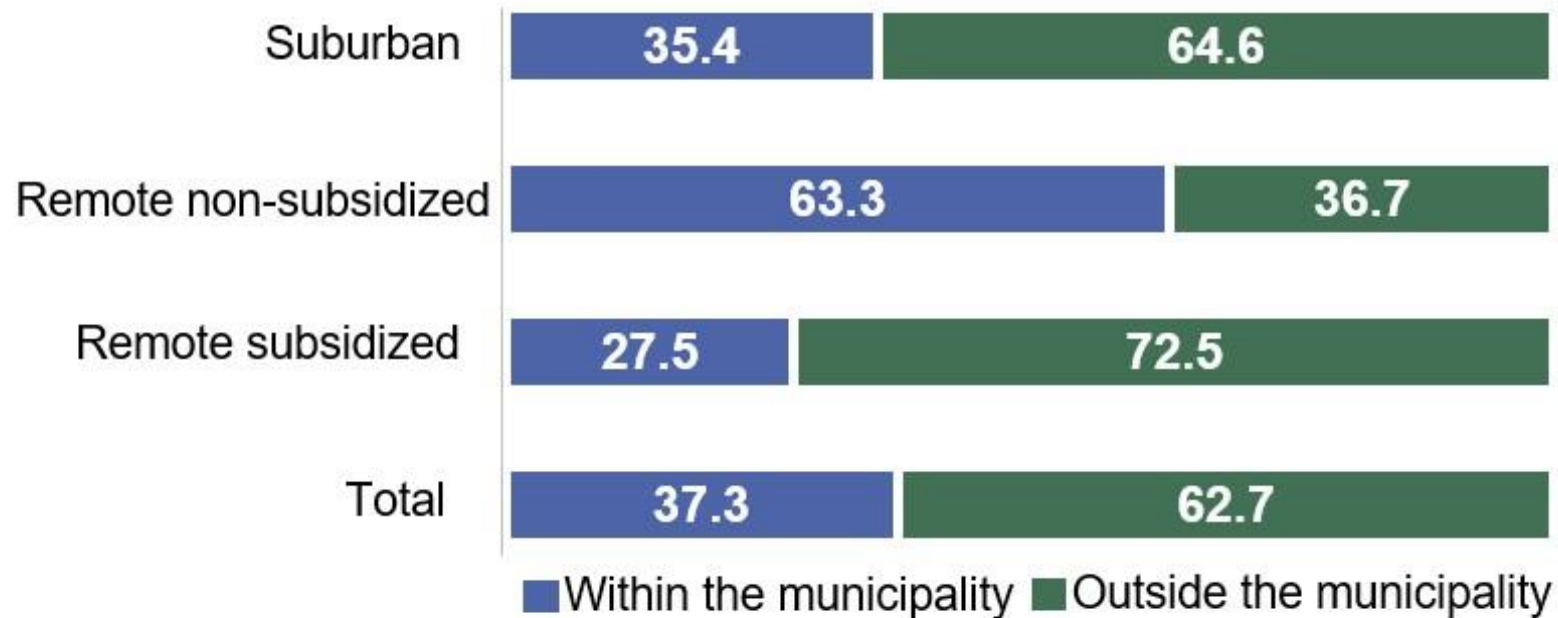
Legal entities do not have reliable information on where their employees live and do not have the legal right to require this information from their employees.

05

There is considerable disparity in how companies designate their business units and therefore whether or not they in fact allocate PIT to the local governments budget of the territory where their employees actually work

# U-LEAD study findings

Employees by place of work, %



In three quarters of the surveyed rural municipalities, more than half of all taxpayers worked outside the municipality in which they live.

As a result, their PIT payments did not reach those local governments delivering major public services to those PIT taxpayers.



# U-LEAD study findings

## PIT revenues increase in municipalities



Allocating PIT by place of residence will significantly increase the financial capacity of subsidized rural municipalities and decrease their need for equalization (base) grants. Among the surveyed municipalities, PIT revenues might be expected to increase by 50-70% if allocated by place of residence.

At the same time, municipalities whose labor force is being attracted from neighboring municipalities will lose some part of the PIT revenue.

# Ways to develop reform strategy

01

Until the national government has reliable information on both where taxpayers work and live, it will be impossible to simulate how changes in the way PIT is allocated to local governments will impact their budgets, or to develop policies that will ensure that these impacts can be phased in over time.

02

The legislation on PIT sharing should clearly state that allocation of PIT is a national government responsibility. It should require the national government to develop the IT capacity to track all PIT payments by both place of work and residence.

03

It should also give the national government time to develop these capacities and assess different proposals of PIT allocation before the decision whether to split PIT between place of residence and place of work.

# Development of information-analytical system based on registers



Formation of a system of relevant indicators



Selection of registers



Linking registers with indicators - keys



Data integration



Data depersonalization



Output data for users

# Local taxation and property taxes

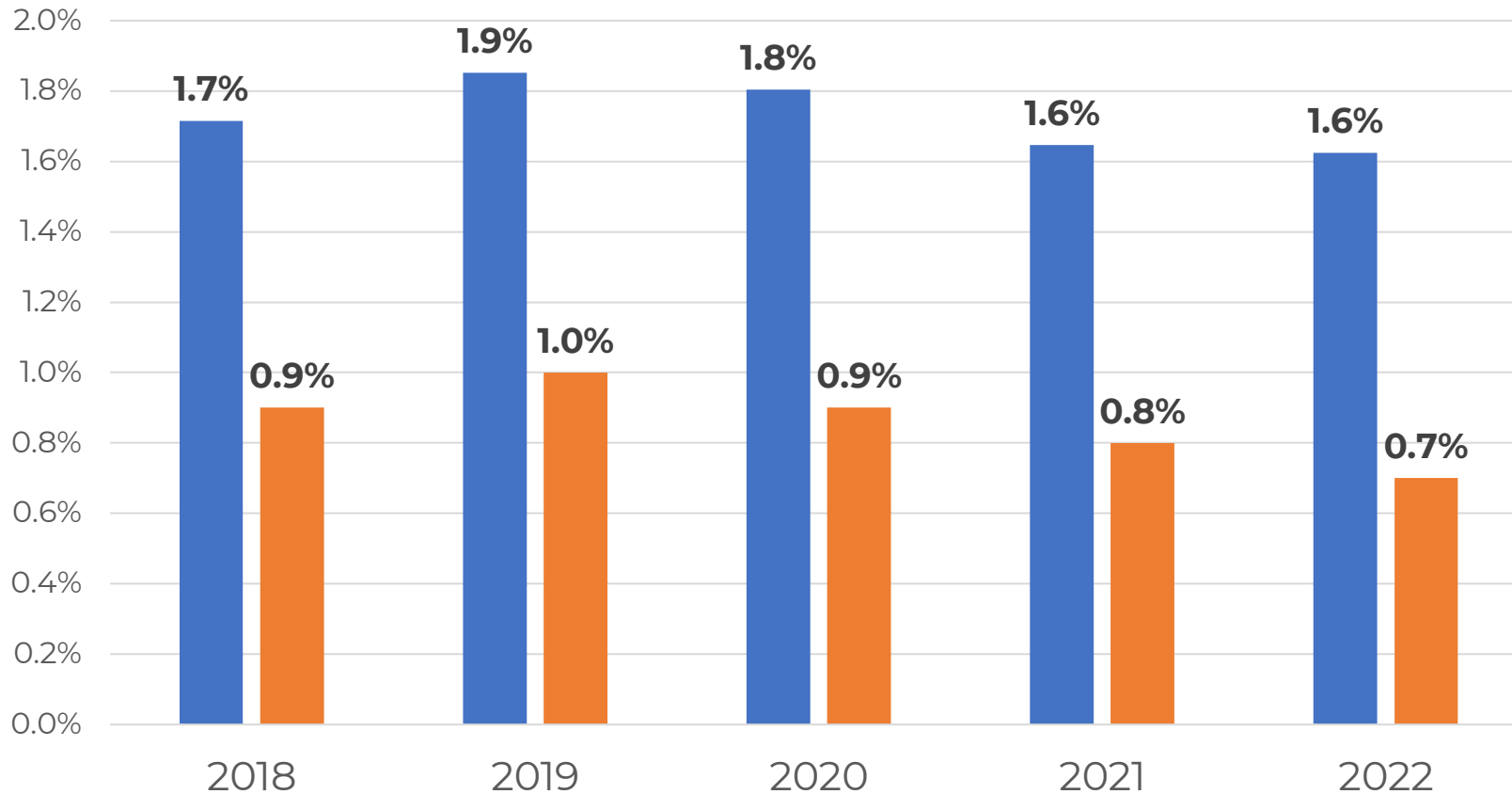


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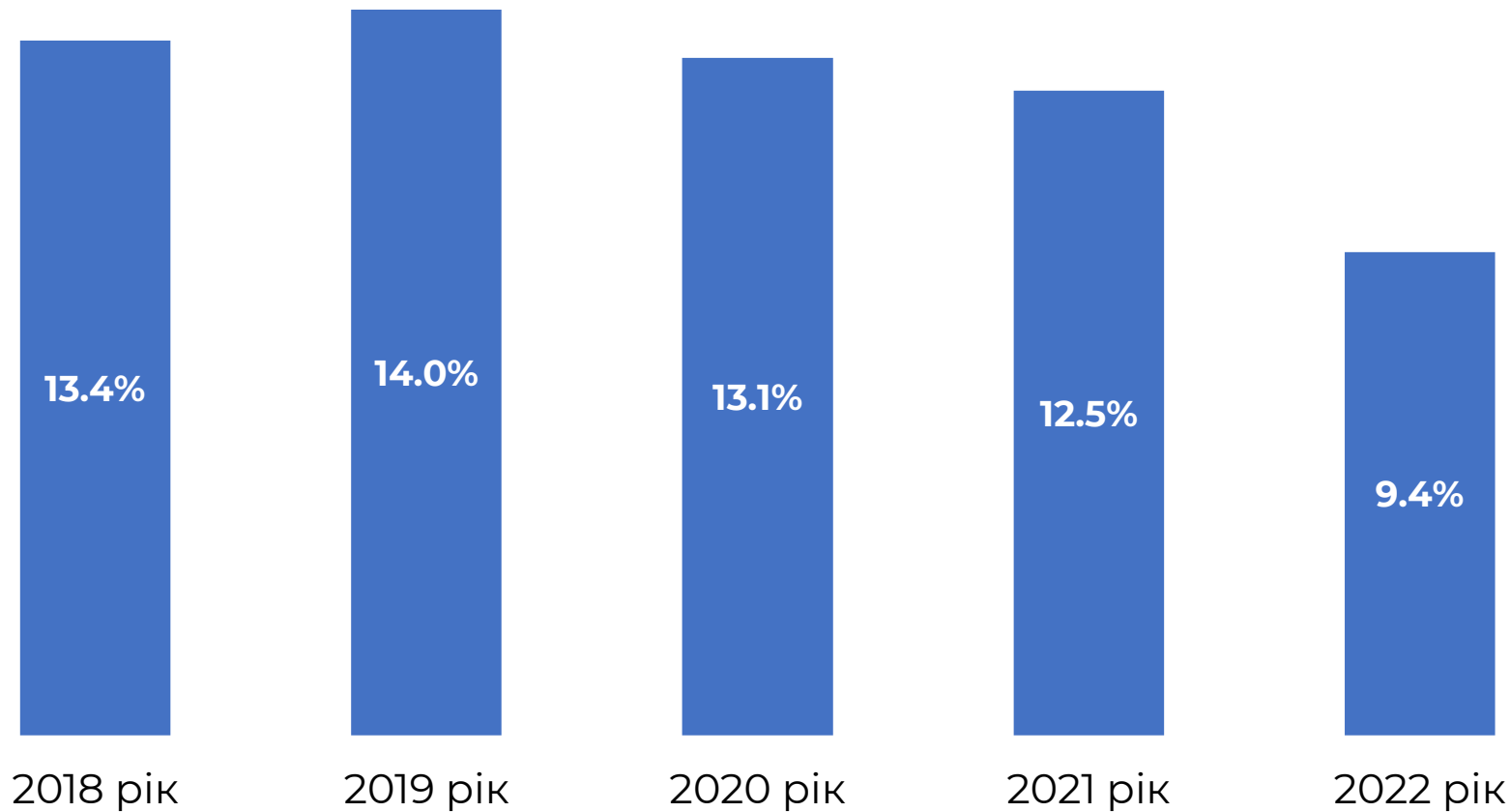
# Share of local taxes and fees, property tax in GDP, %



■ Share of local taxes and fees in GDP ■ Share of property taxes in GDP

1. Local taxes and fees share doesn't exceed 2%, property tax share is 1% of GDP.
2. Share of local taxes and fees, including property tax, in GDP remains negligible.
3. On average, property tax is about 2.2% (including recurring tax - 1.1%) of GDP in the EU-countries.

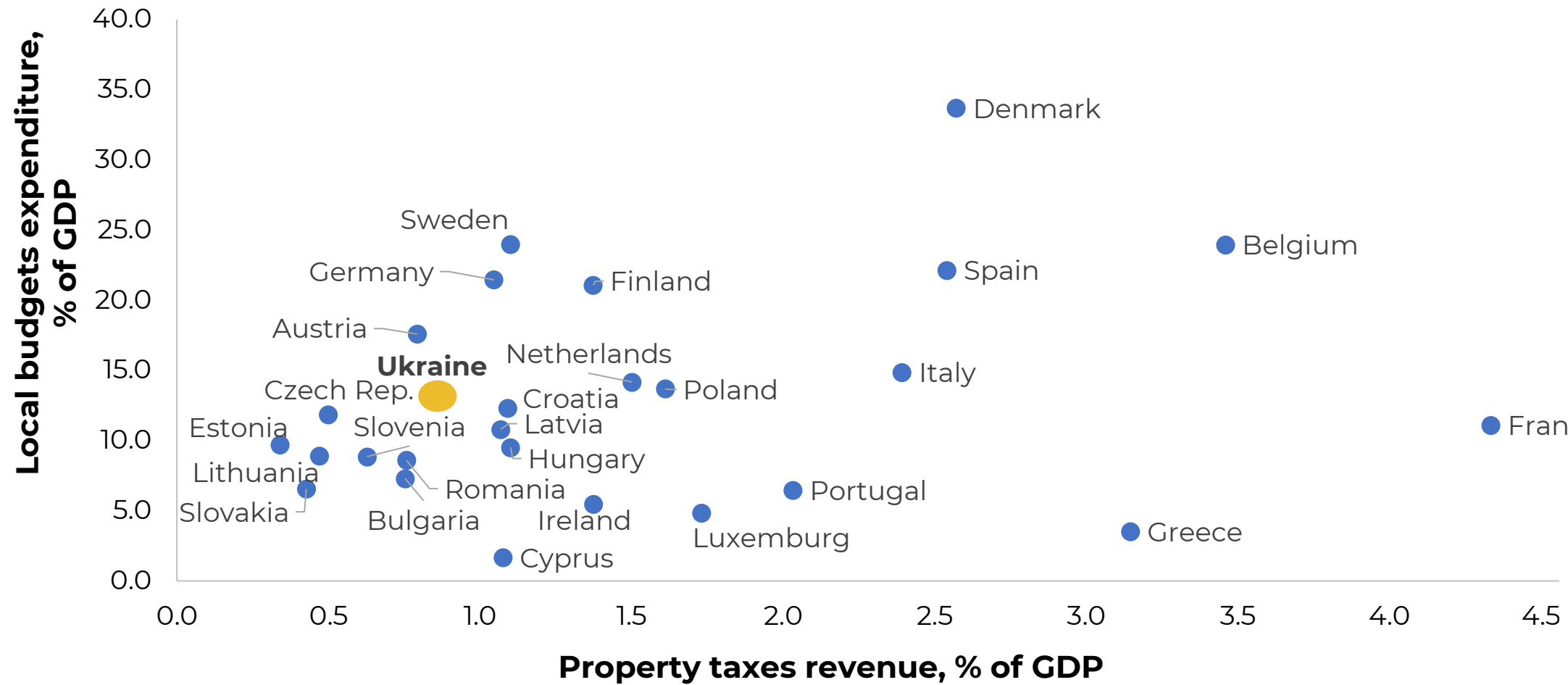
# Share of property tax in tax revenues of local budgets



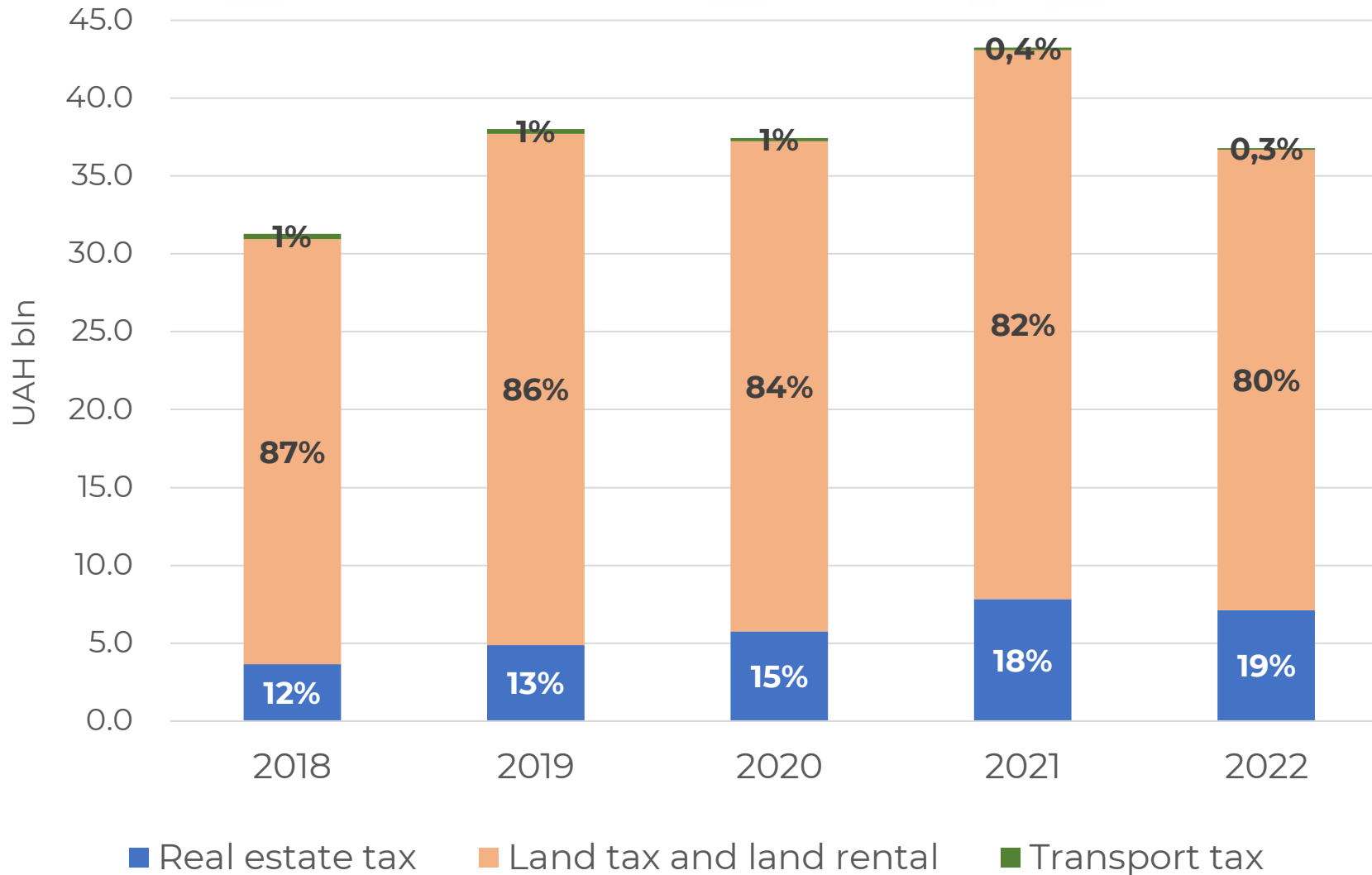
1. The share of property tax in tax revenues has decreased by 4 % since 2018.
2. The largest decrease in the share in 2022 was primarily caused by the military actions and the tax benefits for the payment of property taxes adopted by the Parliament in March 2022.



# Property tax revenues and local budget expenditures in EU-27 and Ukraine in 2001-2021 (average index)



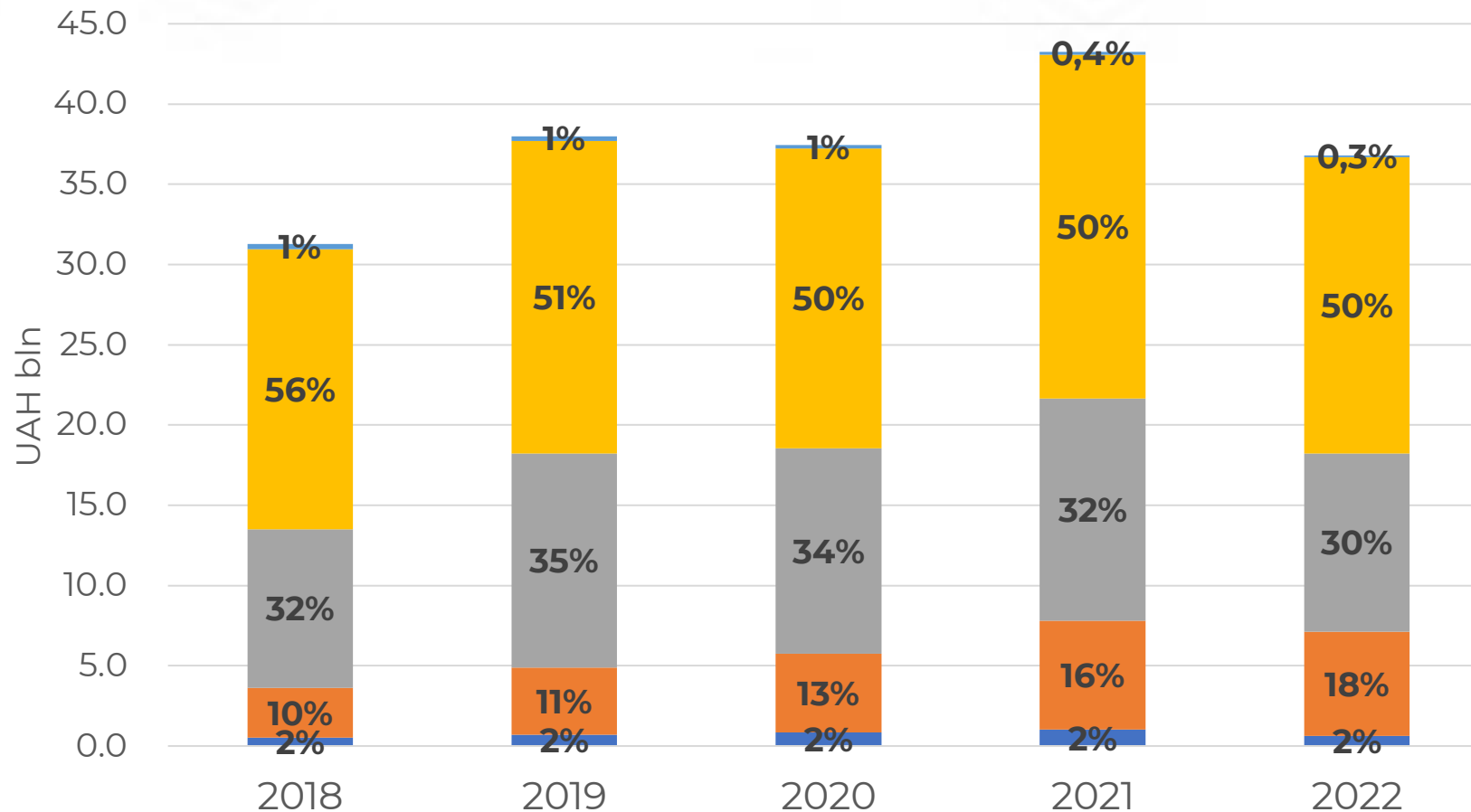
# Property tax components



- 1. Land tax and land rental** share in overall property tax are dominant and exceed 80%.
- Share of **real estate tax (excluding land tax and land rental)** tends to be increased annually.
- 3. Transport tax** revenues are relatively low and amount to 1% max.



# Property tax structure



1. The highest share goes to **land rental** (more than 50 %).
2. Revenues from taxation of **non-residential** property significantly exceed ones from **residential** real estate taxation.
3. The share of revenues from taxation of **non-residential property** has been almost doubled since 2018.

■ Residential real estate  
■ Land tax  
■ Transport tax  
■ Non-residential real estate  
■ Land rental

# Key lessons from the interviews with LGs

1. The effectiveness of the cooperation of LGs with STS authorities varies across municipalities.
2. STS authorities experience lack of resource and motivation to property tax administration.
3. It's typical for many TCs when completeness of the State Property Rights Register does not exceed 50%, and the State Land Cadastre – 80%.
4. Significant number of unregistered real estate objects.
5. LGs' view regarding readiness for independent LTF administration at the local level also varies across municipalities – from full-scale responsibility to partial one. There is no unequivocal position.
6. In most cases, LGs declared readiness to enhance full-fledged cooperation with STS authorities with regards to LTF administration.
7. Introduction of value-based approach to property taxation is difficult to be completed until the existing problems in tax administration and updating of property registers are solved.
8. Ensuring of normative monetary valuation of land in timely manner has a positive effect on local budget revenues.

# Shortcomings of digital products used for LTF administration

01

tax revenues across TCs are not available

02

information on property tax debt is accessible only upon request

03

information on tax debt across taxpayers (individuals) and taxable objects is not available

04

there is no information on tax debt date

05

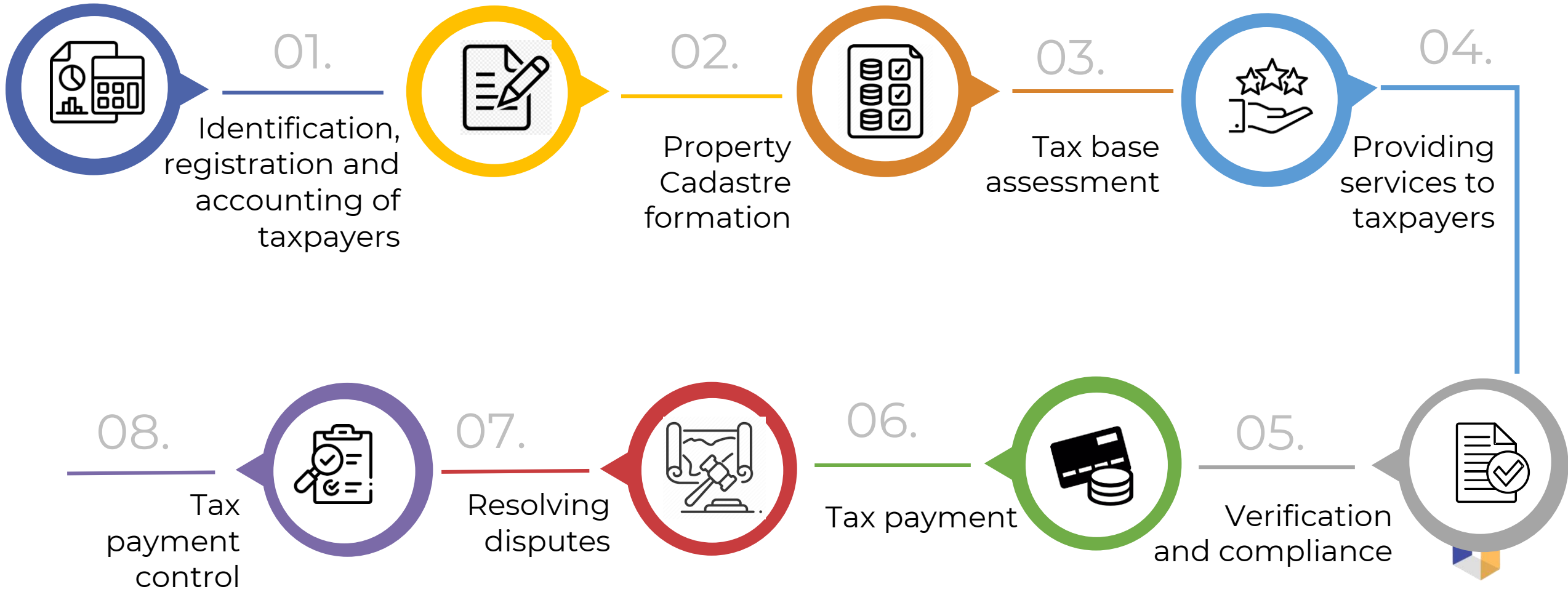
tax payment data is presented only as a cumulative total

06

information on adjustments to real estate objects submitted by LGs to STS on an annual basis, is not saved after its entry



# Our research covered analysis of a full cycle of tax administration:



# Analysis conclusions

1. Correspondence in a paper form with taxpayers is ineffective.
2. High workload per one worker.
3. Data integrated in ICS "Tax Block" are "erased" after updating the database according to the State Register of property rights.
4. Insufficient quality and quantity of the State Register of property rights and the State Land Cadastre in terms of its providing with respective information on taxable objects.
5. 85 % of tax notice-decisions (TND) contain the tax liability size less than the claim work limit.
6. Cameral tax audits are applied to all tax declarations submitted, while documentary tax audits are conducted if some risks occur.
7. Considering a specific nature of the property tax, accounting of taxable objects (property items) should be an initial step (instead of accounting of taxpayers, that is relevant for majority of taxes).
8. Tax administration issues are not connected to region or community and are common for the whole country.
9. Effectiveness of cooperation of LGs and STS authorities in the field of LTF administration largely depends on the "human factor".



# Tax gap: key figures

**1,5%**

Minimum wage in 2021 prices



**8,6 UAH bln**

Additional revenues from real estate tax paid by individuals.

At the same time, reserve size will decrease proportionally to the increase of an average effective tax rate

**5,43 UAH bln**

Additional land tax and land rental revenues

**14,8 UAH bln**

Tax expenditure related to property tax

 **≈ 2/3**

of property tax revenue actually paid in 2021 – it's a property tax gap due to the tax rate and tax base diffusion

# Property tax gap reasons



insufficient stakeholders'  
institutional capacity



low coverage of existing data  
base (State Register of Property  
Rights, State Land Cadastre)



shortcomings and gaps of  
legislation



lack of single data base on  
taxable objects



shortcomings of tax  
administration process