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**Swedish Association
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**Швеція
Sverige**

How does business pay the Personal Income Tax (PIT) to local budgets?

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What is the research about?

- PIT is one of the key sources of local budget revenues, and therefore one of the key instruments for financing local expenditures.
- A PIT tax agent is **an employer who pays it for his employee to the local governments in which he/she works.**
- In other countries, the distribution of personal income tax to local authorities is carried out by the **national government**
- Due to the vagueness of legislation, there is **no single established practice in Ukraine** as to which local budget the employer company, as a tax agent, should pay PIT

The aim of the research

- Finding out the principles on which the largest Ukrainian companies distribute the PIT payments for their employees among the local communities in which their employees work
- How often do the largest companies pay PIT to the budget of a community other than the one in which their employee works?
- Under what conditions can/are they willing to readjust the payment of the PIT to the budgets of the communities in which their employees work?
- How should the system of PIT distribution among communities be built so that the revenues from this tax are received by those communities in which employees of companies work, but there is no increase in the administrative burden on business?

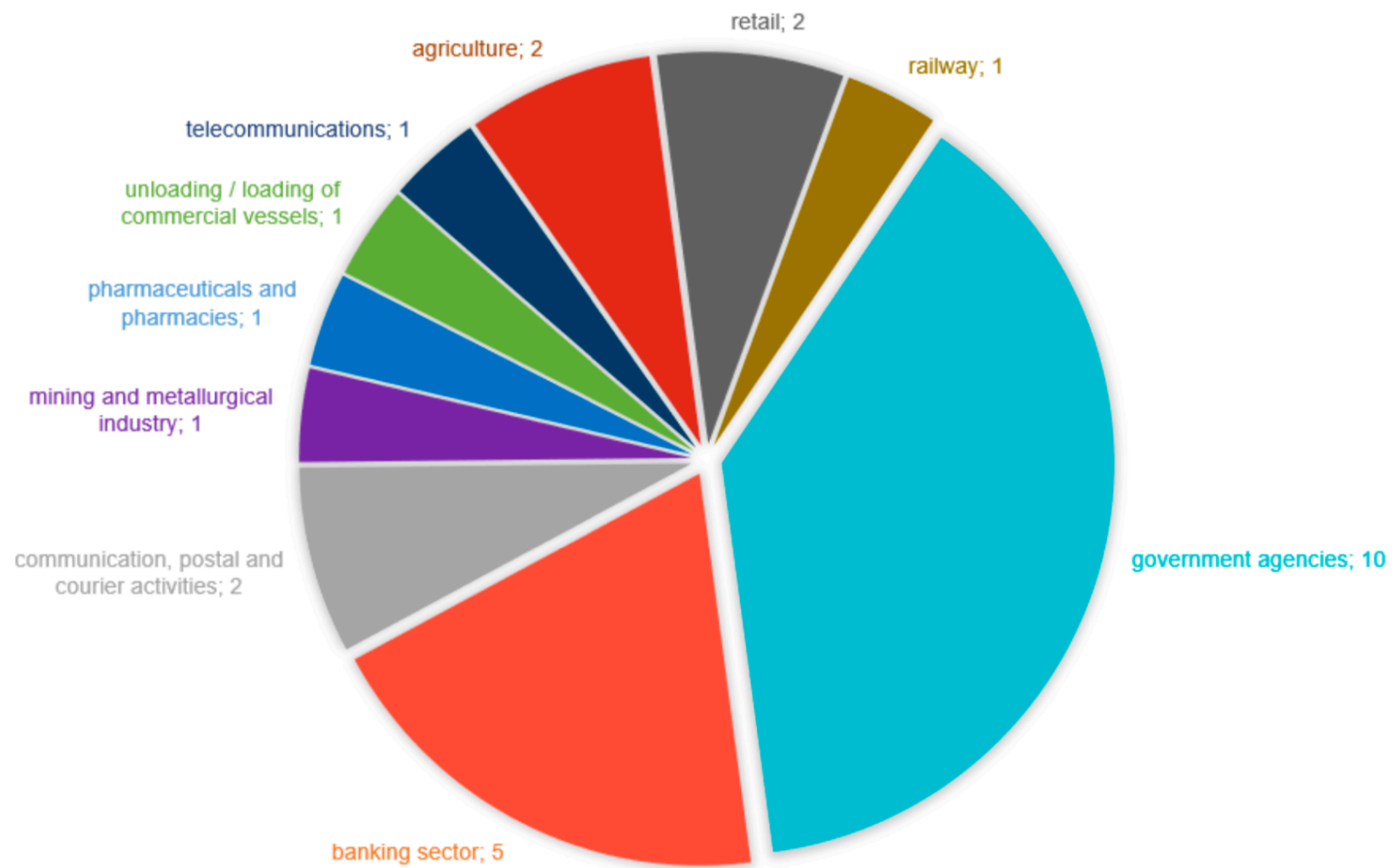
Methodology

The study was conducted in **three stages**:

- analysis of the history of legislation
- collection of **available statistics** from authorized government agencies
- in-depth **interviews with companies**:
 - Inquiries were sent to **60 companies and government agencies** with an extensive system of regional offices / offices / divisions
 - **32 responses** received
 - 15 government agencies
 - 17 businesses
 - 13 private companies
 - 4 state-owned companies
 - **25 responses are** of sufficient quality and / or continued by direct communication (in-depth interviews)

Structure of respondents by industry

Fig. 1. The surveyed employers by industry



Description of the respondent companies

- The answers were used impersonally (to minimize the risks of using the answers by the tax authorities against companies)
- The total number of employees in the surveyed organizations - about **650 thousand people**:
 - *in government agencies - about 150 thousand people*
 - *in public and private companies - about 500 thousand people*).
- Most respondents refused to disclose the amount of PIT paid, calling it confidential information
- It is estimated that this amount is **7-10 billion hr.**

History of legislation

- In Ukraine, **there has never been a system that would clearly oblige employers to transfer PIT for employees to the budget of the territory where they physically worked**
- **In the 1990s**, legislators focused on general issues related to the regulation of PIT payment:
 - employers are obliged to transfer the tax to the local budget in proportion to the share of their employees working in the district/settlement in the total number of employees of enterprises
- **2003**: the law on state registration of economic entities and the law «On personal income tax»:
 - the term “separate subdivision” was introduced for the purpose of personal income tax.

Legislative basis of problems

- Law requirement - **„separate units“** must pay PIT for their employees at their location. The company is mandated to register its **„separate units“**

BUT! Lack of a single unambiguous legislative definition of “separate unit”

- It is not clearly defined **whether** any unit belongs to the legislative term **„separate unit“** - are these any subdivisions (productions, shops, branches, sections, brigades, bureaus, laboratories, etc.), or functional structural subdivisions of the management staff (departments, divisions, bureaus, services, etc.).

+ Lack of penalties for payment of PIT to budgets other than the location of the separate unit

= The law was **interpreted ambiguously by companies** that **did not always register their structural regional divisions** with the tax authorities.

Legal cases

- **Ukrainian courts side with employers, not tax service,** in determining how to pay personal income tax
- **Litigation between Lviv Railway and State Tax Inspectorate**
 - The Supreme Court of Ukraine has ruled that tax service didn't provide any proper and admissible evidence regarding the authority of the Lviv Railway stations to act on behalf of the Separate Subdivision
- **Local Government against the tax authority regarding the payment of PJSC “Ukrtelecom” PIT.**
 - According to the court, the functions, rights and responsibilities of structural units of the enterprise are determined by the enterprise itself - the provisions, which are approved in the manner prescribed by the company's charter or other constituent documents
- **Local government against the taxpayer**
 - The case was not considered on the merits, as the court held that none of the requirements declared by the plaintiff will not lead to the restoration of the plaintiff's rights

Current practice

- The problem of transferring the PIT at the employee's place of work concerns relatively small number of companies. **But some of them are the largest employers in the country.**
- The study revealed **two typical and one atypical model of PIT payment** for their employees among Ukrainian companies:
 - payment of the PIT **at the place of actual work of the employee**
 - payment of the PIT **at a place other than the place of actual work of employees**
 - payment at the **place of actual residence of employees**

Model №1:
Payment of
personal income
tax at the place of
actual work of the
employee

- **19 respondent companies follow this practice**
 - 10 state institution transfer PIT for employees to the local budget of the community where their separate subdivision is located, regardless of the status of such subdivision (legal entity or not, as well as the type of separate subdivision).
 - **2 state and 7 private companies and banks**
- Among private companies of this model there are some exceptions to the payment of personal income tax. In several companies, the **general practice does not apply to employees of support functions, such as security, IT function**

Model №2: Payment of personal income tax in a place other than the place of actual work of employees

- **5 companies among the respondents adhere to this model**
- The goal is not to crush the administration of payments at the level of villages and small settlements.
- + **method of "bargaining" with the leadership of local communities on security issues, working conditions for employees, etc.**
- One large company with **several thousand branches, transfers more than 95% of PIT centrally, at the regional level subdivisions** - ie to the budget of the regional center in which such subdivisions are located.
- Another company with about 30,000 employees transfers PIT to the budgets of 127 communities, although it has several thousand structural units
- The third company has a staff of more than 600 employees, but the whole business is organized in one legal entity. The company does not define its structural subdivisions as separate subdivisions, therefore it does not pay PIT for the respective employees at the actual location of these structural units.

Model №3: Payment of personal income tax at the place of actual residence of employees

- Practiced by **one respondent company**
- According to the head of the company, the company took such a step to **increase the loyalty of the leaders of the communities** in which it works
- *“We were asked to do so by local authorities. For us, as a company, it was not important in which budget to pay personal income tax for employees - so we went to a meeting with local authorities, and pay at the place of actual residence of employees. It is extremely important for our industry to have good relations with local authorities,”* - the respondent explains. In turn, according to him, local authorities are making efforts to address security issues for this company.

Payment of personal income tax for employees of "back office" functions

- **All three types of companies** (except public authorities) list cases when companies are still forced to transfer personal income tax at the place of registration of the **central/regional office**. These cases can be summarized as follows:
 - staff of management companies in which PIT for employees is paid at the place of registration of companies (coinciding with the location),
 - end-to-end functions of the central office (security service, IT support);
 - the nature of the employee's work is flexible.

Recommendations

- The function of PIT distribution between local budgets **should be not lay at the enterprise, but at the state**, due to the use of IT tools of the State Tax Service, SCSU.
- To facilitate this process, **the tax returns filed by companies when paying the PIT should be supplemented by a territory code** (for example, COATUU, for which the employee actually works / lives).
- Alternatively, **some companies are proposing to create a single government database** that compares individual tax codes and addresses of actual residence.
- Relevant **changes should also be recorded at the level of the Tax Code.**
- **The Tax Code should eliminate the conflict, which allows employers to freely interpret the concept of "separate unit"**, and thus - to choose the method of payment of personal income tax per employee
- It is advisable to consider the establishment of legislative measures (eg ., penalties) for companies that do not comply with the requirements of the Tax Code, without registering their units as a taxpayer in the relevant territory at their location

Recommendations

In case of introduction of the norm on obligatory payment of personal income tax on the employee's income at the **place of his actual residence**, the following should be added to the above:

- At the legislative level, it is necessary to oblige the employee to inform the employer about **his current place of residence**.
- The data of this register should be linked to the taxpayer identification number.
- Companies should not be responsible for whether a citizen has provided information about their place of residence / work.
- The state should also **ensure the absence of penalties for a sufficient transitional period** until the approach is fully and universally implemented, according to which personal income tax is paid at the employee's place of residence.



Thank you!