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NET-WEALTH TAXATION: CHALLENGES FOR UKRAINE

Abstract

The investigation of theoretical bases of taxation of wealth and its prospects in Ukraine is made. The modern concept of wealth as an object of taxation is highlighted. The prospects of wealth tax introduction in Ukraine are reviewed. It is determined preconditions for effective introduction of wealth tax in Ukraine. Suggestions from its administration are grounded. The problems of its effectiveness are revealed, and recommendations for their solution are proposed.

Key words:

Wealth, cost, property, possessions, property taxes, wealth tax, wealth tax, value.

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Amid the economic downturn triggered by the global financial and economic crisis, Ukraine has recently faced a growing interest in net-wealth taxes, which are viewed not only as an additional source of budget revenues, but primarily as a tool for resolving social contradictions signified by the growing wealth of oligarch groups and the concurrently shrinking incomes of the rest of the society. According to the documents of the World Bank Group's FY 2012–2016 Country Partnership Strategy for Ukraine, «the concentration of wealth in the hands of the few and the erosion of social security and public service standards» have unfortunately taken place in Ukraine (Country Partnership Strategy for Ukraine for the Period FY12–FY16, p. 1). Events that unfolded in Ukraine in late 2013 – early 2014 came largely as the result of the social and economic tensions persisting in the country where several oligarchs set themselves above the rest of the society in their pursuit to enrich themselves with no care for the interests of the society.

The issue of implementing a net-wealth tax in Ukraine is highly relevant today. Nowadays, Ukraine faces challenges placed by the necessity of developing relevant laws that must be in line with Ukraine's general course towards European integration. The fact is that by signing in Brussels a political part of the EU-Ukraine Association Agreement on March 21, 2014 and the economic part of the EU-Ukraine Association Agreement on June 27, 2014, Ukraine legally formalized its commitment to pursue this course (Ukrainian Government Portal). In the context of a tax policy and, in particular, a net-wealth tax, this means the necessity of developing the Ukrainian legal framework that must be built on the best practices of foreign countries to the maximum extent practicable. It is also important to follow this approach because property which can be treated in Ukraine as subject to the net-wealth tax may be situated not only within Ukraine but also abroad due to the globalization of economic relations of national economies. Therefore, the Ukrainian tax laws must meet the international practices, particularly in terms of defining the notion of net wealth and determining taxable items, tax base and other elements of the net-wealth tax.

From the perspective of the Ukrainian finance law, the net-wealth tax is something new. Not withstanding this fact, the Ukrainian legal framework includes a great number of laws and regulations governing legal property relations and legal relations of taxable entities, which are a mandatory part of the social

legal relations associated with net wealth taxation. Although the Ukrainian net-wealth tax law is under development yet, its adequacy in meeting Ukraine's public needs and economic efficiency largely depend on how much this tax fits in with the existing legal framework.

The underlying principles of developing legal relations pertaining to the net-wealth tax must include an equality principle, which is enshrined in the Constitution of Ukraine as one of the underlying principles of public relations. Pursuant to Article 24 of the Constitution of Ukraine, all citizens have equal constitutional rights and freedoms and are equal before the law, and no one may have any privileges or restrictions based on a property status (Constitution of Ukraine).

The principles to underlie public legal relations in the sphere of taxation are enshrined in the Tax Code of Ukraine (Tax Code of Ukraine). In particular, the tax law transformed the constitutional equality principle into a socio-ethical principle, namely the principle of equality of all the taxpayers before the law and prevention of any manifestations of tax discrimination. The Tax Code of Ukraine affirms such principle by providing for equal treatment of all the taxpayers, regardless of their social status, race, nationality, religious affiliation, form of ownership of companies, citizenship of individuals, or country of origin of capital. This principle guarantees equal rights and obligations for entities belonging to the same group of taxpayers, although it does not rule out different tax treatment of different categories of legal subjects. However, if the tax treatment differences are introduced, they are not to be arbitrary and must be based on objective characteristics of the respective categories of subjects to prevent their discrimination. The equality principle is consonant with another taxation principle – the principle of social fairness and equity according to which taxes and duties must be designed and implemented based on the taxpayers' ability to pay.

When developing public legal relations associated with the net-wealth tax in Ukraine, it is also necessary to adhere to the fiscal and budgetary principles such as the principle of fiscal adequacy and taxation efficiency. According to the principle of fiscal adequacy, taxes must be designed and implemented to the extent necessary to achieve the balance between budget expenditures and budget revenues. The principle of taxation efficiency consists in designing and implementing a tax generating such tax revenues to the budget that significantly exceed tax administration costs. The experience of other countries regarding the net-wealth tax proves that this tax is usually collected locally. Therefore, legal relations associated with the net-wealth tax must be formed at the level of administrative units so that the tax efficiency, i.e. the difference between tax revenues and tax administration costs, is consistent with the local budget possibilities and needs.

Public legal relations associated with the net-wealth tax must be built in a way enabling to meet fiscal interests of local budgets to the maximum extent possible, while concurrently giving due regard to the interests of the taxpayers

and the economy as a whole. Therefore, in developing the net-wealth tax laws in Ukraine, lawmakers must stick to the principles of tax neutrality, uniformity and convenience of payment as set out in the Tax Code of Ukraine. The net-wealth tax neutrality will consist in that the net-wealth tax must be introduced in a manner not affecting the increase or decrease in the taxpayer's competitiveness. As to the uniformity and convenience of payment of the net-wealth tax, it is important to establish such deadlines for payment of the net-wealth tax which would ensure the timely receipt of local budget tax revenues for making budgeted expenditures. Regarding the convenience of payment, the net-wealth tax should be due at a time and in a manner that is convenient for the taxpayer.

The net-wealth tax being the result of the relevant fiscal policy of the state is formalized in the finance law and is an object of legal relations in the society. The legal relations associated with the net-wealth tax include, in particular, ownership relations concerning property that is subject to taxation and relations giving rise to rights and obligations of the parties involved in the process of assessing and collecting the net-wealth tax.

This article will further illustrate, first of all, how the Ukrainian law interprets the notion of property, property ownership, property value, including net asset value, the notion of related parties and other important elements of legal relations that may arise in connection with the implementation of the net-wealth tax in Ukraine.

Considering that property is a cornerstone of net-wealth tax assessment, the legal definition of this notion will be considered further in more detail.

As we know, the Commercial Code of Ukraine defines property in the area of business activities as the aggregate of things and other values (including intangible assets) that have value terms, are produced or used in the activities of business entities and are recorded in their balance sheets or stated in other statutory property records of these entities (Commercial Code of Ukraine).

According to the Civil Code of Ukraine, i. e., in a wide sense, property is understood to be a separate thing, a set of things, as well as property rights and obligations (Civil Code of Ukraine). A thing is defined as an item of material world which satisfies the needs of people and with respect to which civil rights and obligations may arise. The Civil Code of Ukraine classifies the property (things) as follows (Civil Code of Ukraine):

1. Animals that are defined as specific objects of civil rights. They are subject to the legal regime of a thing, except for the cases established by law.

2. Immovable and movable things. The immovable things include land parcels and the objects located on them and inseparably attached to them, i. e. the objects that cannot be moved without disproportionate damage to their purpose. The regime of an immovable thing can be extended by law to other things, in particular aircrafts and ships, inland navigation vessels and space objects the

rights to which are subject to state registration. The movable things are defined as the things that can be freely moved in space.

3. Divisible and indivisible things. Divisible is a thing, each part of which, if divided, retains the properties of the whole and does not lose its commercial (special-purpose) use (e.g., bread, cement, liquids). Indivisible is a thing whose division results in its parts losing the properties of the original thing and changing its commercial (special-purpose) use (e.g., computers, TV-sets, motor vehicles).

4. Individually determined things and things determined by generic characteristics. The individually determined thing is a thing that possesses unique inherent characteristics (e. g., a unique picture by a certain artist). The things determined by generic characteristics are replaceable (e. g., grains, bricks).

5. Consumable and non-consumable things. Consumable are the things which as a result of one-time use are destroyed or cease to exist in their original form (e.g., foodstuffs, raw materials). Non-consumable are the things intended for multiple use that retain their original form for a long period of time (e. g., buildings, motor vehicles, clothes).

6. Principle thing and accessory. Such classification is relevant when, in addition to the principle property (e.g., a land plot being an immovable property), it is necessary to determine any property accessory to it (e. g., buildings and structures located on the land plot).

7. Products, fruits and revenues. The products, fruits and revenues are all things that are produced, obtained, derived from or brought by a thing (e.g., animal yield, fruits of fruit trees or rent earned from a leased thing).

8. Money (currency). The applicable laws of Ukraine determine currency values as national currency, as well as payment documents and other securities denominated in such currency; foreign currency and precious metals, as well as payment documents and other securities denominated in them (Decree of the Cabinet of Ministers of Ukraine «On the System of Currency Regulation and Currency Control»).

It is known that land can also be subject to the net-wealth tax. For this reason, it is important that tax laws are aligned with the provisions of the Land Code of Ukraine (Land Code of Ukraine).

It should be highlighted that the property within the above meaning of the Civil Code of Ukraine, in addition to a separate or a set of things, also consists of property rights and property obligations. The below definitions of property rights and obligations will provide an insight into why the potential definition of the net-wealth tax base must be limited to only one of the components of the notion of property defined by the Civil Code of Ukraine, namely to the notion of a separate thing. Thus, property rights (within the meaning of the Law of Ukraine «On Appraisal of Property, Property Rights and Professional Appraisal Activities in

Ukraine») are the property-related rights, other than ownership right, including rights that are components of the ownership right (right of possession, disposal, use) and other specific rights (right to carry out activities, to use natural resources, etc.) and claims (Law of Ukraine «On Appraisal of Property, Property Rights and Professional Appraisal Activities in Ukraine»). At the same time, if the taxpayer has any net-wealth tax debt, the taxpayer's personal property rights to net wealth may serve as the source of tax debt repayment. The current wording of the Tax Code of Ukraine provides that any of the taxpayer's property may serve as the source of the taxpayer's tax debt repayment, subject to restrictions imposed by this Code and other laws and regulations (Tax Code of Ukraine).

The notion of property obligation is interesting from the perspective of defining the net-wealth tax base, i.e. what liabilities related to the taxable item should be deducted for establishing the tax base. However, the current laws of Ukraine do not provide an express definition of this notion. At the same time, the Civil Code of Ukraine contains the general definition of the notion of obligation, which is defined as a legal relation in which one party (the debtor) is obliged to take a certain action (transfer property, perform work, render a service, pay funds, etc.) for the benefit of the other party (the creditor) or refrain from taking a certain action and the creditor has a right to demand that the debtor perform its obligation (Civil Code of Ukraine).

As to the ownership right to a thing (property), the Civil Code of Ukraine defines it as a person's right to a thing (property), which is exercised by the person under the law, of his/her own free will, and regardless of the will of any other persons. The person having an ownership right to property shall have a right to own, use and dispose of the property, regardless of the person's place of residence or location of the property. The owner shall possess, use and dispose of his/her property at his/her own discretion and shall be entitled to perform any actions in relation to his/her property provided that these actions do not contravene the law (Civil Code of Ukraine).

According to the Commercial Code of Ukraine, ownership right is the main proprietary right in the sphere of business activities. Furthermore, property used in business activities may be co-owned by two or more owners (Commercial Code of Ukraine).

As was already specified, the net wealth is property owned by a taxpayer and the tax base is only the net value of such property. In other words, what is taxed is the amount by which the value of property is in excess of the value of liabilities. In this respect, the applicable legislation can determine the net value on the basis of a market value, a fair (ordinary) value, or a book value of such property.

The notion of net value is expressly defined only in the Law of Ukraine «On Joint Stock Companies.» This Law defines that the notion of 'net worth of a joint stock company' is identical to the notion of 'net asset value of the company.' It further provides that the net asset value is equal to the difference between the

total value of the company's assets and the value of its liabilities to third parties (Law of Ukraine «On Joint Stock Companies»).

The practice of most of the foreign countries proves that in calculating the net-wealth tax the net asset value is computed on the basis of a market value of the taxable item. The notion of 'market value' is defined in National Standard 1 «General Framework for Valuation of Property and Property Rights,» according to which the market value is the amount for which the valued property can be sold in the market of similar property as of the valuation date under an agreement entered into between the buyer and the seller after proper marketing provided that each of the parties acts knowledgeably, prudently and without compulsion (Resolution of the Cabinet of Ministers of Ukraine «On Approval of National Standard 1). The Tax Code does not define the notion of market value. It instead provides the definition of a market price, which is defined as the price at which goods (works, services) are transferred to another owner, provided that the seller wishes to transfer such goods (works, services) and the buyer wishes to acquire them on a voluntary basis, and both parties are mutually independent de jure and de facto, have sufficient information about such goods (works, services) and about prices prevailing in the market of identical (or similar, if the former are unavailable) goods (works, services) in comparable economic (commercial) conditions (Tax Code of Ukraine). Besides, the Tax Code contains the notion of a regular price, which is the price of goods (works, services) determined by the parties to a contract, unless otherwise provided in the Code. It is believed that such regular price corresponds to the market price level, unless proved otherwise (Tax Code of Ukraine).The tax law also provides a definition of the book value of fixed assets, other non-current and intangible assets, which is understood to be the amount of the residual value of such assets that is defined as the difference between the historical cost, adjusted for the revaluation, and the accumulated depreciation (Tax Code of Ukraine).

The fair value within the meaning of National Standard 1 may be equal either to the market value or to the residual value of an asset. The fair value of an asset that may be attributed to the specialized property, special-purpose or special-structure property is equal to its depreciated replacement (reproduction) cost (Resolution of the Cabinet of Ministers of Ukraine «On Approval of National Standard 1). The specialized property is defined as any property that is generally not sold in the market as a separate item and is most useful and valuable as part of an integral property complex (Resolution of the Cabinet of Ministers of Ukraine «On Approval of National Standard 1).

It is important to analyze the applicable laws from the perspective of the practice of evading the net-wealth tax payment through the disposal of the property (i. e. transfer of ownership right, e. g., in case of execution of the sale and purchase, exchange, gift, lifelong maintenance agreements) to related parties. Thus, the Tax Code defines related parties as legal entities and/or individuals the

relations between which can affect the environment or the economic results of their activities or the activities of the persons they represent.

In recognizing persons as related parties, consideration is given to the impact that can be made through the holding by one party of corporate rights in other parties under the contracts executed between them or if there is another opportunity for a party to influence the decisions made by other parties. Furthermore, such influence is taken into account, regardless of whether it is being made by the party directly and independently or together with other related parties recognized as such in accordance with this sub-clause (Tax Code of Ukraine).

The authors of this article believe it more expedient for net-wealth taxation purposes to use the definition of related parties, which is currently applied in the context of transfer pricing. For transfer pricing purposes, the following persons are recognized as related parties:

(a) legal entities — if one of such persons directly and / or indirectly (through related parties) holds corporate rights in a legal entity in the amount of 20 or more percent; (b) an individual and a legal entity — if an individual directly and / or indirectly (through related parties) holds corporate rights in any other legal entity in the amount of 20 or more percent; (c) legal entities — if one and the same person directly and / or indirectly holds corporate rights in such legal entities and the share of the corporate rights in each legal entity is 20 or more percent; (d) a legal entity and a person who has the authority to appoint (elect) a sole executive body of such legal entity or to appoint (elect) 50 percent or more of the members of its collective executive body or supervisory board; (e) legal entities in which sole executive bodies are appointed (elected) by a resolution of the same person (owner or its authorized body); (f) legal entities in which 50 percent or more of the members of the collective executive body or a supervisory board are appointed (elected) by a resolution of the same person (owner or its authorized body); (g) legal entities in which 50 percent or more of the members of the collective executive body and / or the supervisory board are represented by the same individuals; h) a legal entity and an individual – if an individual exercises powers of the sole executive body of such legal entity; (i) legal entities in which the powers of the sole executive body are exercised by one and the same person; and (j) individuals: a spouse (husband or wife), parents (including adoptive parents), children (adult children, minor/underage children, including adopted children), siblings and half-siblings, trustees, guardians, children under trusteeship or guardianship. For an individual, the total share of corporate rights in the taxpayer (votes in the governing body) which he or she holds is defined as a share of corporate rights directly held by such individual and a share of corporate rights held by legal entities that are controlled by such individual. If an individual is recognized as related to other persons, such persons shall be recognized as related to each other (Tax Code of Ukraine).

In addition, the efficient administration of the net-wealth tax requires a prompt information exchange between government bodies, which is possible only provided that a system of electronic interaction of government electronic information resources is in place. It can be stated today that the formation of such system in Ukraine is in its infancy as the Concept of Formation and Operation of Information Systems of Electronic Interaction of Government Electronic Information Resources has just recently been approved (Instruction of the Cabinet of Ministers of Ukraine «On Approval of the Concept of Formation and Operation of Information Systems of Electronic Interaction of Government Electronic Information Resources»). If no such electronic interaction is maintained between government bodies, a burning problem of information duplication will then remain unsolved and, besides, different government bodies will then collect and process different information.

In our opinion, the study of legal framework of public legal relations must cover the currently effective international treaties ratified by the Ukrainian Parliament since the Law of Ukraine «On International Treaties» provides that they are part of the national legislation of Ukraine. Besides, when developing the net-wealth taxation law, it is necessary to consider that if an international treaty provides for other rules than those provided by the applicable Ukrainian laws, the rules of the international treaty shall apply (Law of Ukraine «On International Treaties»).

The currently effective treaties ratified by the Parliament of Ukraine and potentially relating to the net-wealth taxation include, in particular, the effective bilateral intergovernmental conventions for the avoidance of double taxation of capital gains and the Convention on Mutual Administrative Assistance in Tax Matters.

Considering that the net-wealth taxation in Western countries has its peculiar feature, which is the taxation of a person's high-value assets that have been registered in the person's name both in the territory of the person's domicile and abroad, it is very important for the Ukrainian lawmakers developing the net-wealth taxation laws to give regard to the provisions of the effective intergovernmental conventions relating to the administration of taxes, in particular, property-related taxes.

For the time being, there are: (a) 66 effective intergovernmental conventions on double tax avoidance, which were executed with Ukraine, including 54 conventions for the avoidance of double taxation of income and property; (b) three international treaties executed with the Soviet Union, which are applied by Ukraine pursuant to the Law of Ukraine «On Legal Succession of Ukraine» (Law of Ukraine «On Legal Succession of Ukraine»), including one international treaty for the avoidance of double taxation of income and property; (c) one ratified intergovernmental treaty for the avoidance of double taxation of income and property, which is not valid yet; (d) three executed bilateral intergovernmental

treaties to be ratified, including one treaty for the avoidance of double taxation of income and property; (e) four initialed international conventions that are open for signature (Qatar, Malaysia, Switzerland, Sri Lanka). Besides, negotiations are currently underway for the execution of international treaties with 12 other countries.

Before proceeding to summarizing the intergovernmental conventions, regard should be given in Ukraine to whether the effective tax law establishes the procedure for applying international double taxation treaties ratified by Ukraine regarding the full or partial exemption from tax of non-residents' incomes generated in Ukraine (Tax Code of Ukraine). It is necessary to understand that it is only a matter of time that the national tax laws currently do not contain any provisions governing the application of the international treaties ratified by Ukraine for the avoidance of double taxation of non-residents' property located in the territory of Ukraine because the absence of such procedure violates the statutory principle of the equality of all the taxpayers before the law and prevention of any manifestations of tax discrimination (Tax Code of Ukraine).

Pursuant to the intergovernmental conventions for the avoidance of double taxation of property, such conventions shall apply to taxes on property imposed on behalf of a Contracting State or of its political or administrative subdivisions or local authorities, irrespective of the manner in which they are levied. Furthermore, the choice of the state in which the person's property situated in a Contracting State will be taxed is given to the taxpayer, depending on the property type.

Thus, in most cases, the taxpayer shall have such choice in respect of the taxation of immovable property situated in a Contracting State. However, the term 'immovable property' must have the same meaning as provided by the legislation of the Contracting State in which such property is situated. At the same time, based on the analysis of a number of intergovernmental double taxation treaties, Ukraine has priority in taxation of non-residents' property situated in the territory of Ukraine.

Similarly, in most cases, there is a free choice regarding the taxation of property represented by movable property involved in doing business in a Contracting State and by corporate rights deriving the greater part of their value directly or indirectly from immovable property. However, the property represented by ships and aircrafts is in most cases taxable in a Contracting State in which the respective person is resident. All other types of property that are not contemplated by the convention shall be taxable in the person's country of residence.

Besides, each double taxation convention contains a provision on the exchange of information between the Contracting States. This means the information that may be necessary for carrying out the provisions of the convention or the national laws of Ukraine or the domestic laws of any other Contracting State concerning taxes covered by this convention.

The facilitation of the intergovernmental administrative assistance in tax matters is the purpose of the Convention on Mutual Administrative Assistance in Tax Matters, which was executed between Member States of the Council of Europe, of which Ukraine has been member since 1995, and Member Countries of the OECD (Convention on Mutual Administrative Assistance in Tax Matters). This Convention establishes not only the procedure for information exchange between competent authorities of the member states of the Convention, but also the procedure for facilitating cooperation with respect to tax examinations abroad, simultaneous tax examinations, and assistance in recovery of taxes and tax arrears.

Besides, Ukraine adopted the Protocol Amending the Convention, which entered into force for Ukraine on September 1, 2013. As a result of the adoption of this Protocol, the Convention on Mutual Administrative Assistance in Tax Matters has been extended to a number of offshore jurisdictions. These are a total of 13 offshore jurisdictions, namely: a number of overseas territories of the United Kingdom (Anguilla, Bermuda, British Virgin Islands, Gibraltar, Cayman Islands, Montserrat, Isle of Man, Turks and Caicos), Netherlands (Aruba, Curacao, Sint Maarten) and Denmark (Greenland, Faroe Islands), where no information exchange was previously possible.

It should be reminded that, as of today, the Cabinet of Ministers of Ukraine has established a list of offshore jurisdictions, which includes 36 jurisdictions (Instruction of the Cabinet of Ministers of Ukraine «On the List of Offshore Jurisdictions»). However, Curacao, Saint Maarten, Greenland and Faroe Islands (4 jurisdictions in total) are not included in the list of offshore jurisdictions. Thus, in order to determine offshore jurisdictions constituting a potential risk for Ukraine in connection with the underpayment of estimated taxes to the Ukrainian budget and financial security of the country as a whole, the following jurisdictions should be removed from the general list of offshore jurisdictions (36), namely: jurisdictions listed in the Protocol (13) and jurisdictions determined as not included in the list of offshore jurisdictions (4). As a result, we will come up with a list of 27 offshore jurisdictions constituting a potential risk for Ukraine: the risk associated with the underpayment of tax to the budget and financial security of the country as a whole.

The review of information requests sent by Ukraine to the competent authorities of foreign countries shows that the number of such requests is very low. And this is despite the fact that the effective conventions allow the exchange of information in tax matters between Ukraine and other countries. For example, in H2 2013 Ukraine sent only three information requests to the competent authorities of foreign states, namely to the USA, Mexico, and Panama. On the other hand, Ukraine received more than a thousand information requests from the competent authorities of foreign states and processed 1,077 information requests (Report on Performance of the Action Plan of the Ministry of Revenues and Duties of Ukraine for Q3 2013, Section 11; Report on Performance of the Action

Plan of the Ministry of Revenues and Duties of Ukraine for Q4 2013, Section 12). In H1 2014, the situation slightly improved, mainly because of the events that unfolded in the late 2013. Thus, in H1 2014 the Ministry of Revenues and Duties of Ukraine prepared already 36 information requests to the competent authorities of such states as Azerbaijan, Belarus, United Kingdom, Hong Kong, Estonia, Ireland, Latvia, Lithuania, Marshall Islands, Netherlands, Germany, Panama, Russian Federation, Slovakia, United States, and Hungary (Report on Performance of the Action Plan of the Ministry of Revenues and Duties of Ukraine for Q1 2014, Section 13; Report on Performance of the Action Plan of the Ministry of Revenues and Duties of Ukraine for Q2 2014, Section 13).Notwithstanding the foregoing, we have to state that such process of information exchange does not facilitate the fiscal security of our country, despite the fact that the country has all necessary mechanisms to assist it in this process.

As far back as in 2012 the Cabinet of Ministers of Ukraine included the introduction of a net-wealth tax into the list of actions aimed at performing the social policy tasks (Instruction of the Cabinet of Ministers of Ukraine «On Approval of the Action Plan for Performance of Social Policy Tasks for 2012). A lawmaking process was put in place for the purpose of drafting the net-wealth tax laws (Draft Law on Luxury Tax No. 3405; Drafts Law on Amendments to the Tax Code of Ukraine). Thus, we may state that the domestic tax policy is aimed in the short term at drafting and developing the net-wealth tax laws. The efficiency of implementing the net-wealth tax in Ukraine will depend on the understanding of the notion of net wealth by lawmakers, executive authorities and the rest of the society and on the correctness of determination of the taxable item, tax base, tax amount and other elements of the net-wealth tax. At the same time, foreign experience must be critically analyzed and applied in the domestic practice with due regard to the social and historical factors that are peculiar to our country.

The analysis of draft laws pertaining to the introduction of the net-wealth (luxury) tax that have been registered with the Parliament of Ukraine allows to state that these laws need to be substantially improved. The first attempts to develop the net-wealth tax law were made in 2008 (Draft Law on Luxury Tax No. 3405). Following the analysis of this draft law, we can say that in drafting this law the lawmakers violated one of the underlying principles on which the tax law must be built, namely the principle of a uniform approach to designing and implementing the tax, with mandatory determination of all the tax elements. In particular, this draft law lacks the express provisions which would define the taxpayer, the taxable item, the tax rate, the tax period, the tax payment deadline and procedure, and the tax reporting deadline and procedure. Regarding the definition of the notion of luxury, we believe that the respective provision of the abovementioned draft law would not work. The draft law proposes the definition of the notion of luxury as a product, work or service whose cost is 100 or more times higher than the average cost of similar products, works and services (Draft Law on Luxury Tax No. 3405). We believe that such definition of the notion of

luxury is inexplicit. The practice shows that inexplicit definitions, especially those of taxable items, may have an opposite effect than that originally intended by such tax. By determining the supplier of products, works or services as the taxpayer's actual tax agent, the draft law thereby shifts to the supplier the responsibility to categorize any product (work or service) as a luxury. Such approach is inconsistent with the dynamics of the development of markets of products (works, services), including their pricing dynamics. If introduced, such regulations are likely to result, in our opinion, in the State being ultimately forced to: (1) spend additional administrative resources on the efforts to constantly redefine taxable items, or (2) amend the applicable laws in respect of the items subject to the luxury tax, or (3) repeal this tax.

Considering chronologically the draft laws pertaining to the introduction of the notion of luxury into the Ukrainian legal framework, it is worthwhile to mention the Draft Law of 2011, which proposed to ban Ukrainian citizens from purchasing luxury items abroad (Draft Law on Banning Ukrainian Citizens from Purchasing Luxury Items Abroad No. 8598). According to this draft law, luxury items are understood to include land plots, buildings, flats, cottages, houses, cars, planes, helicopters, ships, motor boats, yachts and documents confirming title to or interest in such property, and works of art and jewelry worth more than twenty thousand hryvnias, including documents confirming title to or interest in such property (Draft Law on Banning Ukrainian Citizens from Purchasing Luxury Items Abroad No. 8598). As of the date of this draft law, this amount was equivalent to USD 2.5K or EUR 1.9K. No explanation is given of why the threshold of luxury is set as equal to UAH 20K. However, in substantiation of the necessity of adopting this law, the lawmakers refer to much higher figures regarding the value of assets owned by the Ukrainians abroad, e. g. USD 161m for real estate (Explanatory Note to the Draft Law on Banning Ukrainian Citizens from Purchasing Luxury Items Abroad No. 8598).We believe that such obvious incongruity along with the lack of official statistics concerning the real amounts of assets owned by Ukrainian citizens and situated in the territory of Ukraine (title to which is held by non-residents) unfortunately distort the real state of things, which can hardly help introduce the net-wealth tax in Ukraine with an additional tax burden placed on the middle stratum of the population.

The draft laws on net-wealth taxation that have been registered with the Parliament of Ukraine since 2012 take very similar approaches towards net-wealth taxation. Therefore, we have conducted a generalized analysis of these draft laws. First of all, we should stress that these instruments have unfortunately been drafted without any regard to the practice of net-wealth taxation in the Western countries.

First, this concerns a taxable item. The fact is that, unlike the international laws, these draft laws have no provisions on the taxation of the worldwide assets of the residents of Ukraine. This omission may result in the taxation of property

(net wealth) situated in the territory of Ukraine and the unjustified exemption from taxation of the worldwide assets of the Ukrainian citizens.

Second, attention should be paid to the tax base proposed by the draft laws. The approach to establishing the tax base totally differs from the worldwide one, where the tax base represents a net value of an asset (taxable item). The draft laws mainly establish the tax base without reference to the asset value, but rather based on the asset's quantitative characteristics, for example, such as: engine cylinder capacity for cars, total area of real property, maximum take-off weight of aircrafts, and engine power of yachts. Besides, in calculating the tax base, owner's debt obligations are not taken into account. In other words, the draft laws refer not to the net value of an asset, but to its total value.

Third, regarding the proposed tax rates, they vary depending on a taxable item. We believe that the introduction of several tax rates, especially at early stages of tax administration, will make the administration of this tax more difficult. Furthermore, the items on which this tax is charged once only, i.e. when the item (wealth) is purchased, are taxed at a rather high tax rate, considering that the tax base is the total purchase value of an asset. For example, Draft Law No. 10558 dated June 5, 2012 applies this taxation principle by establishing the rate of 40% of the purchase value for taxation of passenger cars, motorcycles and yachts and the rate of 10% for taxation of precious metal ware or jewelry, firearms, furs and artworks. The draft law further sets out that this tax shall apply only to individuals-owners of the respective property. In our opinion, it is highly probable that the high tax rate will prompt many taxpayers to evade the tax. The examples of the abovementioned observation are provided below. The luxury tax on vehicles can be avoided by using the scheme where business entities (legal entities and individual entrepreneurs) who own the abovementioned assets will transfer the assets to individuals under lease agreements. Regarding other assets taxed at the rate of 40%, such high tax rate can provoke the taxpayers to purchase the same items abroad. This situation will have an adverse effect on the domestic demand for such products resulting in the curtailment of production and reduction of supplies on the domestic market.

In addition to the abovementioned draft laws, another two draft laws were registered with the Parliament of Ukraine after 2012, namely: No. 10558-1 dated June 8, 2012 and No. 2343 dated February 20, 2013. The first of these draft laws introduces a luxury tax on passenger cars that cost more than 300 times the minimum wage for all-wheel-drive vehicles (over UAH 321.9K as of 2012, which is equivalent to USD 40.3K or EUR 31.2K) and 400 times the minimum wage for other vehicles (over UAH 429.2K as of 2012, which is equivalent to USD 53.7K or EUR 41.7K). In addition, the draft law proposes an annual 10 percent reduction of the tax base (with the aggregate reduction not to exceed 50%). It is worthwhile to note that even the Main Scientific and Expert Department specifies in its conclusion that it can be argued whether or not passenger cars priced at more than 300 times or more than 400 times the minimum wage must be classi-

fied as luxury items because, in this case, medium passenger cars are subject to the luxury tax and this can result in the violation of the principle of social fairness and equity (taxes must be based on the taxpayers' capacity to pay) (Conclusion of the Main Scientific and Expert Department dated July 2, 2012 to Draft Law No. 10558-1).

Authors of the second draft law (Draft Law on Amendments to the Tax Code of Ukraine Regarding the Taxation of Luxury Items No. 2343) made an attempt to align the draft luxury tax law with the laws of the Western countries. However, it transpires from this draft law that the proposed tax calculation method is different from that practiced in the Western countries and reduces the potential effect of this tax.

According to this draft law, luxury tax must be computed by reducing the product of the appraisal value of the taxable item and the tax rate by the amount of costs incurred in connection with the appraisal of such taxable item. By way of illustration of the above calculation method, we will now consider an example of taxation of an apartment appraised at UAH 11.2m, with the appraisal costs equal to UAH 600 and the tax rate set at 0.5% of the asset appraisal value. In this case, the tax effect in 2012 would be equal to UAH 54.4K (UAH 11.2m * 0.5% – UAH 600). Now consider the net-wealth taxation according to the worldwide method where the tax base is calculated as the difference between the value of an asset and the liabilities related to such asset (within the meaning of the proposed draft law, this would be the property appraisal costs). In such case, the tax revenue from real estate would be UAH 597 higher, i.e. UAH 55K = (UAH 11.2m – UAH 600) * 0.5%. The tax revenues received from one taxable item seem to be rather small. However, given the taxation of all assets that could be classified as net wealth, the tax revenues would be quite substantial. As we will propose below, the asset value will be reduced not only by the amount of appraisal costs, but also by the amount of other liabilities associated with the purchase of the respective asset, which may have a smaller tax effect in the first years than described above. However, in the above example, we attempted to draw your attention to the expediency of giving preference to using the worldwide taxation method as it helps achieve a potentially better effect from net-wealth taxation in the future.

The authors of this article further propose their own version of the net-wealth tax law which is based on the best practices of the net-wealth taxation in the Western countries, with due regard to the specific conditions peculiar to Ukraine and in compliance with the principles underlying the national tax law.

At the same time, we are inclined to believe that for this tax to be efficiently implemented and administered in Ukraine there should be in place a proper system of information support for tax administration, which is required first and foremost. The information support system is understood to be, without limitation:

(a) generation by government authorities responsible for property registration of the grouped data on the value of privately owned property by the following subgroups and in the respective hryvnia equivalent (at the official rate of the National Bank of Ukraine in effect as of January 1 of the reporting year): up to EUR 10K, EUR 10K to EUR 100K, EUR 100K to EUR 1m – such division is practiced worldwide today;

(b) implementation of the proper information exchange (according to the best world practices) between tax authorities and other agencies and institutions as well as legal entities (e. g., leasing companies) involved in keeping a property register; and

(c) wide use by Ukraine of the advantages of the provisions contained in international treaties regarding the possibility of the automatic exchange of information between tax authorities.

In addition, in order to promote the principle of social fairness and equity and avoid any future disputes associated with the unfair tax assessment on the property owned by the middle class, we propose that, before implementing the tax, the legal framework must be properly elaborated to provide an explicit classification of items that must be subject to the net-wealth tax. We would like to stress that our proposals regarding the taxation of luxury items are not focused on all possible assets that can be classified as net wealth, but rather relate to those assets that are more difficult to conceal from taxation. In particular, we believe that such luxury items must include the following property owned by the taxpayers:

- deluxe residential real estate;
- luxury cars;
- civil aircrafts;
- yachts;
- funds on deposit accounts; and
- shares.

As far back as in 2006, the Ukrainian Construction Association developed a residential property classification, which divided the residential property into 5 classes: social, economy, business, premium and deluxe classes (Official website of the Ukrainian Construction Association). The classification, which was developed based on the experience of the Baltic countries, was designed to provide a transparent and clear method for determining a fair price of any residential property. If enacted into law, this classification would provide for the registration of the relevant residential property class in technical documents, after the examination of such property by experts for its compliance with the criteria of the respective property class. We believe that such approach taken by the Ukrainian

Construction Association is expedient and more reasonable from the perspective of the taxation of residential property. As we can see from the criteria proposed by the Association to classify the residential property, the total area along with the location of the property is only one of great many other criteria. However, the price currently set by the market often does not correlate with the living conditions in the respective residential property. The criteria to be met by the deluxe residential property include, in particular, combined heating (water and space heating) system, better security guarding, social facilities that must be provided within the building (a swimming pool in a fitness center, laundry and dry cleaning facilities, fur storage refrigerator, etc.), no more than 30 apartments in a building, which must have no more than seven stories in height and be equipped with an elite elevator.

Regarding the classification of passenger cars we propose to consider the classification offered by the European Commission, which divides passenger cars into several segments based on the established objective criteria (Regulation (EEC) No. 4064/89).

According to the research conducted by the International Council on Clean Transportation, the cost of luxury passenger cars is the highest, with a new passenger car priced at EUR 95K (inclusive of taxes) as of 2010 (Campestrini and Mock, 2011).

Regarding other taxable items such as civil aircrafts, yachts, garden houses, summer cottages and individual residential houses we believe that absence of any classification in respect of these assets at this stage is not a problem so far.

We stick to the opinion that this tax must be paid by both individuals and legal entities (residents and non-residents) to mitigate the risks of the tax underpayment to the state budget in connection with the nominal registration of net-wealth ownership right in the name of legal entities. We should however note that the representatives of Western corporations are indignant about them being subjected to an increased tax burden arising from the net-wealth tax imposition on their assets, with their indignations mainly sparked by their disagreement with the tax authorities applying the classification of items that are not used by businesses in their business activities. For the avoidance of any misunderstanding in the future, we propose that the net-wealth tax laws must not differentiate between luxury items that are used by business entities in their business activities and those that are not used. For this purpose, we earlier recommended to particularly focus on the necessity of having the property classification passed into law for it to serve as a guide in administering the net-wealth tax on any property type.

Besides, we deem it expedient to follow the practice of Western countries, which treat the taxable net wealth in conjunction with related parties. Data on the

related parties are partially formed by Ukrainian tax authorities in connection with the transfer pricing rules that have been introduced into the national tax law.

Meanwhile, the items that are listed as owned by:

(a) a resident (individual or legal entity) are those situated in the territory of Ukraine and those owned by the resident abroad;

(b) a non-resident (individual or legal entity) are those owned by the non-resident in the territory of Ukraine.

Regarding the tax base, we insist on the expediency of applying the generally accepted rule recognized in Western countries, according to which liabilities incurred by the purchase of wealth must be subtracted from the appraisal (market) value of taxable items. In this case, should an asset be disposed to a related party that purchases the asset by incurring liabilities, such kind of liabilities as well as the liabilities incurred in connection with pledging the asset, will not be taken into account.

Getting back to the tax rate issue, we are inclined to believe that, instead of using a progressive tax scale, it would be better to use a proportional tax system with a tax rate of 1% at an early stage of tax administration for the purpose of minimizing tax administration costs.

Besides, we deem it expedient to follow the practice of Western countries when setting a net-wealth tax threshold, i.e. the tax base level at which the net wealth will be charged. Such threshold varies in different countries from EUR 21K in the Netherlands to EUR 800K in France. We propose that such threshold must be set in Ukraine as equal to EUR605K (or UAH 10m at the official exchange rate set by the National Bank of Ukraine as of October13, 2014).

Like in other countries that collect the net-wealth tax, the fiscal period must be a calendar year and the net-wealth tax must be regularly paid on an annual basis.

When computing the net-wealth tax, the amount of tax will be assessed by the taxpayer himself as of January 1 of the fiscal year. If the taxpayer has any doubts as to the correctness of his tax return, the taxpayer will be guaranteed a right to apply to tax authorities for advice regarding the taxation of the taxpayer's net wealth three months prior to the tax return filing deadline. At the same time we hope that in the future tax calculations will be made by tax authorities on the basis of the accurate, up-to-date information which will be obtained thanks to the use of advanced information technologies and comprehensive implementation of the automatic data exchange between government authorities both within Ukraine and abroad.

And if an ownership right to net wealth arises during a year, the net-wealth tax will be assessed from the date on which such ownership right accrues.

We also believe that such tax must be implemented locally and paid to local budgets until August 1 of the year following the fiscal year.

Considering possible amounts of net-wealth tax payments to local budgets in Ukraine, it should be stated that, according to our estimations, they may constitute 0.5% to 5% of the aggregate tax revenues of such local budgets.

We believe that the foregoing proposals regarding the development of the net-wealth tax legislation in Ukraine will help shape the net-wealth taxation system, which will entirely meet the best practices of Western countries and comply with the principles of social fairness and equity and economic feasibility of such tax.

We must, however, understand that net-wealth taxation represents only a small part of the policy aimed at building a democratic society where the State should be committed to promoting the most equitable distribution and redistribution of the gross domestic product. Nevertheless, even such a small part is a litmus test of what direction is taken by the State and the society.

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