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# How Should Ukraine Share PIT with Local Governments?

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# How should Ukraine share PIT with LGs?

Substantively, the answer is simple:

Like 20 out of the 21 European countries that share substantial amounts of PIT with LGs, ***Ukraine should share PIT on the basis of taxpayer residency.***

And for the same reasons:

- Aligns fiscal political jurisdictions so that people vote for the local officials who use their taxes, increasing accountability and engagement.
- The vast majority of LG expenditures support services to residents, not commuters
- Personal Income can come from multiple sources, so attributing PIT to a place of employment is contrary to the nature of the tax.
- Makes possible giving some LGs (big cities) the power to set PIT surcharges



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But this hard to do:

- Firms currently send the PIT payments of their employees to the tax authorities in which these employees ***are said to work***.
- But they do this differently, depending on how they classify business units (and workers) and the capacities of their accounting and payment systems.
- As a result, nobody knows how much PIT is being allocated to local governments in which employees neither live nor work.
- The fact that Kyiv's per capita PIT revenues are 3Xs higher than average despite receiving a 40% (not 60%) share suggests the misallocation is large.
- The Ukrainian courts have also ruled that firms cannot be held liable for 'misallocating' PIT because this should be a state responsibility.



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# How should Ukraine share PIT with LGs?

- LGs that benefit from current practices defend the ‘system’, even if it is not a legally coherent and not really based on place of work.
- The national government defends current practices because it does not want to invest in the IT systems necessary to allocate PIT by taxpayer residency (or renegotiate PIT shares).
- Everybody argues that the current system cannot be fixed until the propiska is fixed and people officially change their legal addresses.
- As a result, there is a high probability that despite the Presidential Decree the law will continue to require firms to allocate PIT by where their employees work, but:
  - firms will continue to do this differently,
  - enforcement will be spotty and inconsistent
  - there will be no linkage between taxpayer



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# What should be done?

- Donors make it clear to the GoU that PIT should be allocated by taxpayer residency to enhance engagement and LG accountability.
- Donors commit to providing the technical support necessary for MoF to develop and implement the requisite IT systems.
- Initially, PIT should not be allocated according to taxpayer's legal address, but according to a simple declaration of the LG in which s/he live.
- It should take 12 to 18 months to begin allocating PIT by taxpayer residency, including simulating and adjusting tax shares and the equalization system.
- A longer period may be required to phase in the new system to prevent adjustment shocks.
- Until PIT is allocated by taxpayer residency the fiscal foundations of Ukraine's decentralization efforts will rest on sand.



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