



Tax Revenue Outlook for Ukraine

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- The EPT revenues are estimated at UAH 1.9 bn above the government target in 2007, totalling UAH 30.0 bn.
- The VAT revenues continue to grow thanks to higher private consumption and imports, and will reach UAH 64.5 bn in 2007.
- The PIT revenues in 2007 are expected to reach UAH 31.0 bn that is UAH 1.1 bn higher than government plan.
- For 2008 the EPT revenues are forecast to reach UAH 35.5 bn or 4.5% of GDP.
- The expected continuation of consumption and import patterns allowed forecasting the VAT revenues for 2008 at UAH 82.3 or 10.5% of GDP.
- The PIT revenues are forecast to reach UAH 38.8 bn in 2008.

Forecast Period:
2007 and 2008

Forecast Variables:
EPT, VAT and PIT revenues

Basis for comparison: the State Budget Law for 2007, as amended on May 30, 2007.

EPT forecast: The government underestimates revenues from the EPT by nearly UAH 1.9 bn

Enterprise profits tax (EPT) revenues are the second most important source of consolidated fiscal revenues after the VAT. In 2006 the EPT revenues amounted to UAH 25.7 bn (4.8% of GDP). Being under-executed during the most of the year, the execution of EPT revenues reached 100.2% of the target in 2006 due to good collection rates in November and December. Such change could be explained by improved economic performance of enterprises as well as better tax administration in the end of the year.

In 2007 the government plans to get UAH 28.5 bn from the EPT, assuming that the real GDP will increase by 6.5%. The IER estimation of the macroeconomic situation is more optimistic and assumes 7.6% GDP growth rate in 2007. The situation at the main Ukrainian export markets is expected to be favourable. Also, after a slowdown in 2006, nominal profits are expected to grow faster. In addition, tax administration improved in the second half of 2006 is expected to continue influencing tax collection this year. As a result, the IER estimates the nominal EPT revenues at UAH 30.0 bn (4.6% of GDP) in 2007. It is UAH 1.9 above the government plan.

The forecast for 2008 is based on the assumption that the Tax Code will not be passed on time to become effective next year, thus, tax legislation, including the tax rate, will remain unchanged. Nominal profits are expected to decelerate slightly alongside with slower real GDP growth. As a result, for 2008 the IER forecasts nominal EPT revenues at UAH 35.5 bn (4.5% of GDP).

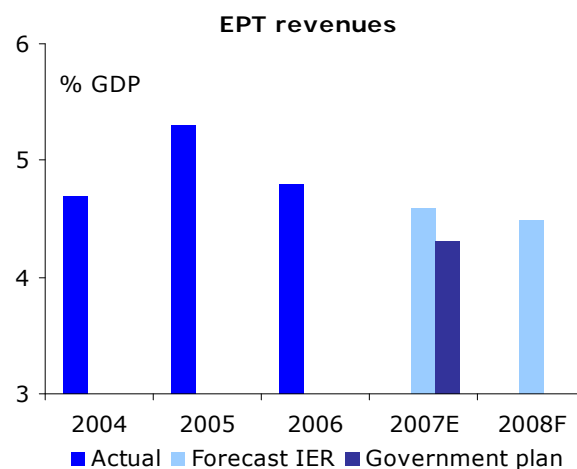
The risks of the EPT forecast for 2007 and 2008 are comprised with different than assumed economic development. The additional risk of the forecast for 2008 is related to possible changes in the EPT legislation including reestablishment of the sector privileges and special economic zones, and changed tax rate.

EPT revenue forecast assumptions:

- The EPT revenue forecast is based on macroeconomic indicators for 2007 and 2008 according to IER Macroeconomic forecast of Ukraine №1 (11), May 2007.
- The EPT legislation remains unchanged in 2007 and 2008.
- The EPT privileges in the restored special economic zones and for specific sectors are not introduced in 2008.
- The world prices for chemical and metal products remain high in 2007 with some slowdown in 2008.
- The EPT rate remains at 25%.

Fiscal indicators 2006:

Consolidated fiscal revenues/GDP: 32.0%
EPT/Consolidated fiscal revenues: 14.9%
VAT/Consolidated fiscal revenues: 27.6%
PIT/Consolidated fiscal revenues: 13.3%
Consolidated fiscal expenditures/GDP: 32.6%
Central fiscal deficit/GDP: 0.7%
Public debt/GDP: 15.1%
GDP: UAH 537.7 bn



Source: State Treasury Reports, IER forecast
E - estimate, F - forecast

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VAT forecast: Revenues in 2007 are estimated to reach UAH 64.5 bn that is above the government fiscal plan

The value added tax (VAT) has been traditionally considered as the largest tax source of the consolidated fiscal revenues, accounting for more than a quarter of total inflows. In 2006 the VAT collection was UAH 47.5 bn (8.8% of GDP), which is UAH 5.7 bn above the fiscal plan. The boost in VAT revenues is explained by several factors. First, it is the continuous household consumption growth. Second, it is the boost in imports in nominal terms linked to considerable increase in prices for energy resources, as well as imports of investment and durable goods. Finally, the important factor was an introduction of 20% VAT rate on imported gas, while previously zero rate was applied. On the other hand, the VAT refund arrears slightly decreased from 0.6 bn at the beginning of 2006 to 0.4 bn in January 2007.

The IER estimates that the VAT revenues will amount to UAH 64.5 bn in 2007. The VAT revenues relative to GDP will reach 9.8% compared to 8.8% in 2006. The estimate is based on the assumption about the continuation of the macroeconomic trends of 2006 including dominance of imports and favorable consumption outlook. The current VAT forecast also assumes that the privileges for agricultural sector were prolonged till the end of 2007 and new privileges for the special economic zones are not introduced. The fiscal plan of VAT collection envisaged in the Budget-2007 is UAH 64.2 bn. Thus, the government fiscal plan is expected to be slightly over-executed in 2007.

The IER forecast of the VAT revenues for 2008 is UAH 82.3 bn, which equals to 10.5% of GDP. The driving force for the revenue increase will be further growth of domestic consumption and continued dominance of imports in foreign trade. Additionally, it is assumed the measures taken in 2006-2007 to enhance VAT administration will be strengthened, that would help to increase VAT incomes. Also, we assume the cancellation of special tax regime for the agricultural producers and introduction of a 20% VAT rate in the agricultural sector, replacing the present 0% VAT rate.

The risks inherent in the VAT revenue forecasts for 2007 and 2008 are associated with an economic development different from what is expected now. The other risks are comprised with the changes in the legislation, although the early parliamentary elections in September minimize the chance that any legal changes, e.g., Tax Code, will be adopted in 2007. Among factors that could reduce tax collection is the possible introduction of VAT privileges in special economic zones. Finally, there is a risk that VAT refunds are not paid in time in 2007-2008, which would temporarily boost the cash VAT revenue at the expense of future revenues.

VAT revenue forecast assumptions:

- The VAT revenue forecast is based on macroeconomic indicators for 2007 and 2008 according to MEFU №1 (11), May 2007.
- The VAT rate remains at 20%.
- The measures taken in 2006 to enhance VAT administration on customs will be continued in 2007 and 2008.
- VAT refund arrears are not accumulated in 2007 and 2008.
- VAT privileges for special economic zones are not changed.
- The VAT rate at the level of 20% will be introduced in 2008 for the whole agricultural sector.

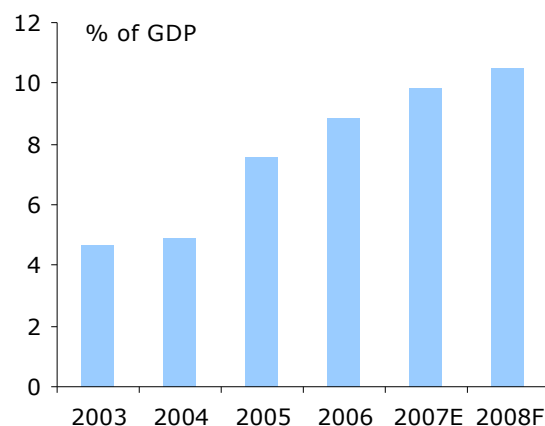
Parameters of EPT and VAT forecast:

	2006	2007E	2008F
GDP, UAH bn	537.7	655.4	785.1
GDP real growth, % yoy	7.1	7.6	6.9
Household consumption, UAH bn	315.3	379.4	445.3
Exports of goods and services, UAH bn	253.7	316.5	385.4
Imports of goods and services, UAH bn	269.2	340.1	432.0
CPI inflation, % yoy aop	8.0	10.2	8.3
PPI inflation, % yoy aop	9.6	16.9	11.6

E - estimate, F - forecast

Source: Macroeconomic Forecast Ukraine №1 (11), May 2007, IER

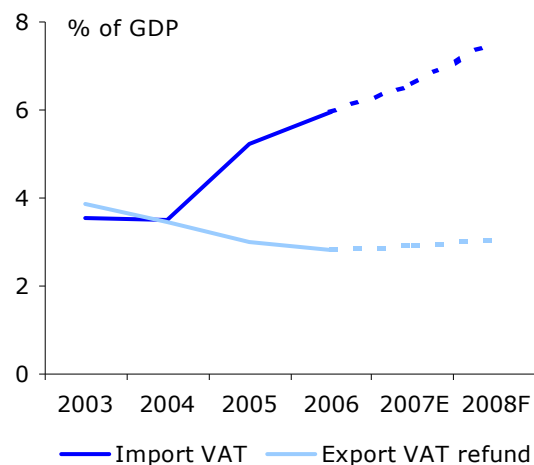
VAT revenues



Source: State treasury, IER forecast

E - estimate, F - forecast

Export refund and import VAT



Source: State treasury, IER forecast

E - estimate, F - forecast



PIT forecast: The PIT revenues will reach 4.7% of GDP in 2007

The personal income tax (PIT) remains the third major revenue source that generates nearly one fifth of consolidated tax revenues. The PIT collections in 2006 reached UAH 22.8 bn (4.2% of GDP) slightly surpassing adjusted government plan. The major engine of the PIT collections was gradual increase in the minimum wage that pushed all wages upwards. In 2006 the PIT brought around 57.2% of local budget revenues (not accounting for transfers) and was streamlined for financing delegated responsibilities of local government, primarily health care and education.

The IER forecasts the PIT revenues for 2007 at UAH 31.0 bn. The share of the PIT revenues in GDP is estimated to increase by 0.5 p.p. to 4.7%. One of the major reasons for that is raised tax rate to 15%. This legislative change is expected to counterweight the reduced tax base in 2007 caused by an increase in the "social privilege" (tax allowance) for people with incomes lower than 1.4 of the subsistence minimum. The social privilege was raised to 100% of the minimum wage.

The previous forecast was revised upwards as the government increased the minimum wage at a higher pace than it was previously foreseen, which will push the gross wages up. Besides, the decision on the implementation of the second stage of the Unified Tariff Scale in the public sector will also contribute to a higher wage bill. Though, we estimate this effect as rather marginal. Another factor for revision is better than previously expected economic growth. The PIT revenue forecast for 2007 is UAH 1.1 bn higher than planned by the government.

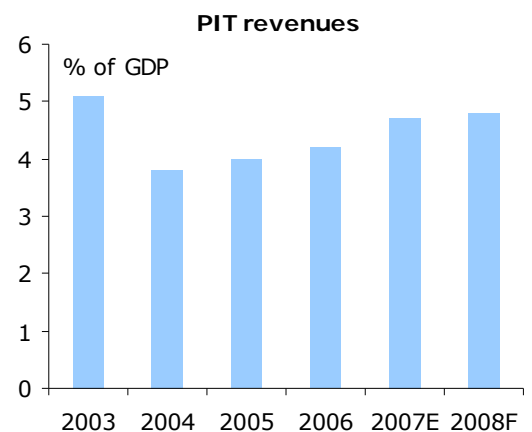
The PIT revenue forecast for 2008 is UAH 38.0 or 4.8% of GDP. We expect that gross wages will continue growing rapidly, though at a lower pace than in 2006 and 2007. The legislation basis is assumed to remain stable, as it is not likely that the Tax Code will be approved in time for being introduced in 2008.

The risks inherent in the PIT revenue forecasts for 2007 and 2008 are associated with lower than assumed wage growth. In addition, the forecast for 2007 could be challenged if the government introduces further increases of minimum wage and subsistence minimum growth, which will increase the level of the social privilege and affect the wage bill.

Parameters of PIT forecast:

	2006	2007E	2008F
PIT rate, %	13	15	15
Gross wages, UAH bn	162	202	240
Minimum wage, at the beginning of the year, UAH	350	400	480
Subsistence minimum for persons able to work, at the beginning of the year, UAH	483	525	580
Social Privilege, UAH	175	400	480

Source: legislation of Ukraine, IER estimates
F - forecast

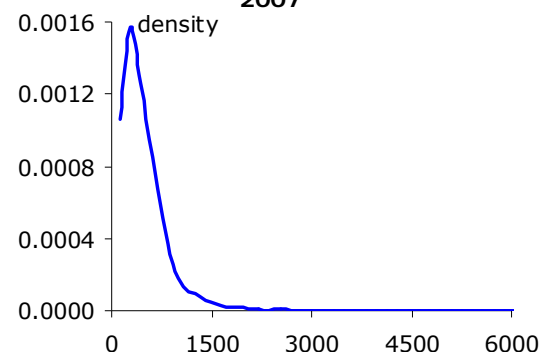


Source: State Treasury reports, IER forecast
E - estimate, F - forecast

PIT revenue forecast assumptions:

- The nominal wage bill in the economy in 2007 is equal to UAH 200.0 bn.
- The PIT rate remains flat at the level of 15% starting from January 1, 2007.
- People, whose wages are lower than 1.4 subsistence minimums for persons able to work, are eligible for the social privilege set at 100% of the minimum wage in 2007 and 2008.
- The minimum wage is expected to be raised to UAH 480 on January 1, 2008.
- The subsistence minimum for individuals able to work will be equal to UAH 580, on January 1, 2008.
- Nominal wage bill will increase by 20% in 2008 and reach UAH 240 bn.
- The wage distribution remains the same as in 2005.

Distribution of monthly wages, 2007*



Source: Household Survey (Derzhkomstat), own calculation
* Kernel density function of monthly wage

