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The procedure of tax planning in Ukraine

Introduction

The current period of Ukrainian firms' functioning is a period of significant changes in the environment of management. These changes are taking place in increasing competitiveness, increasing pressure from large financial and industrial groups, regulatory state agencies and the social sphere. This period is characterized by high transaction costs of conducting business. Many of them fall on the administration of taxes, with their complicated structure and methods of calculating certain fees. It requires the formation of appropriate tax policies by firms, aimed at optimizing calculation processes and tax payment.

1. The content and necessity of tax planning

Tax planning is regarded as one of the functions of financial management. Ongoing firms' costs, such as financial, material, labor and other are unavoidable in doing business, while its main goal is gaining profit. The expected profit and investment payback are the criteria for incurring costs in any business. Tax expenditures are not aimed at gaining profit as they are an obligatory payment of funds to the government. A company does not receive any counter benefits from the payments to the budget.

Tax planning closely interacts with such management functions as marketing, finance and accounting and, at the same time, it is one of the basic tools for generating the indicators of management efficiency.[1] The calculation of firm's efficiency is purposeless in case of excluding tax burden, especially in Ukraine, where the tax burden on businesses is quite high.

From taxpayers' point of view — both individuals and legal entities — tax payments are expenditures of unproductive nature. Even so, they cannot avoid paying taxes because this would be an infringement on current legislation and could also bring administrative or even criminal liability. However, any individual can choose

[1] P.K. Bechko, N.V. Lysa, *Podatkovyi menedzhment: navchalnyi posibnyk*, Kyiv 2009, p. 288.

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the type of business that he wants to run, and running different types of businesses means different costs and different tax consequences. This factor is caused by the opportunity of active tax policy on the macrolevel.

Like any other expenses, tax payments are subject of planning and management. But they are very different from other payments — rules of tax calculating and their payment terms are strictly regulated by the state; that is why their management is limited.

2. The main criteria for optimization scheme of tax planning

Tax planning is a purposeful activity of the taxpayer and is focused on the maximum use of all the nuances of existing legislation in order to obtain the highest financial results by optimizing the costs of economic activity in terms of tax consequences. Tax planning is based on the active use of tax policy for the company which allows choosing the best type of economic activity in terms of tax burden and financial results. In this case the best solution is when the company pays the minimum tax and does not infringe on the legal regulations determining the way of calculation and payment of taxes.[2] The criteria for optimization scheme of taxation of firms are shown in Figure 1.

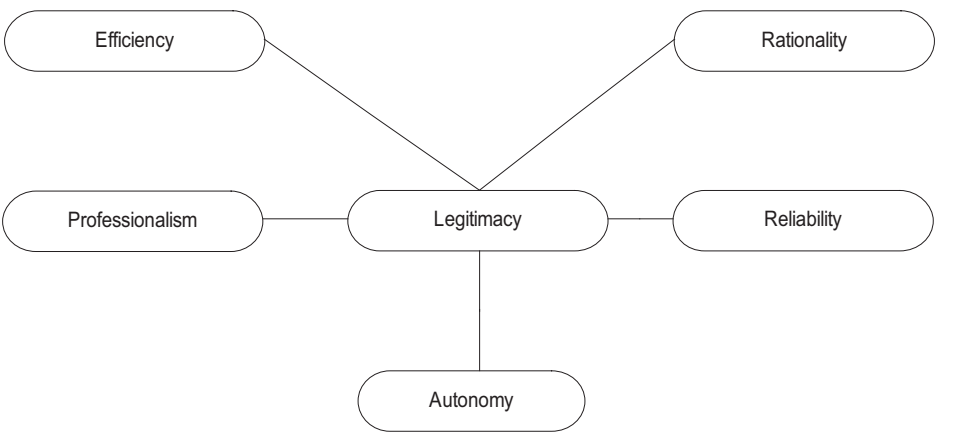

Fig. 1. The main criteria for optimization scheme of tax planning
Source: own elaboration.

[2] V. Vyshnevskyi, A. Vetkin, *Ukhylennia vid splaty podatkiv: teoriia i praktyka: monohrafiia*, Donetsk 2006, p. 62.

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The most important criterion for optimization scheme of tax planning is legitimacy.[3] It ensures compliance with all the regulations that are defined by tax law on the rules of tax calculation and payment processes.

Efficiency provides the choice of accounting methods and valuation of assets, formation of costs in accounting, which can reduce the tax base and amount of liabilities for taxes.

Professionalism is defined as adequate and sufficient knowledge of the law that determines the rules of calculation and payment of certain taxes and the opportunity to eliminate double taxation of individual objects.

Rationality can be interpreted as the forming of such a model of taxation which allows counting transparently all taxes and fees at the lowest cost and in the shortest time.

Reliability is defined as the absence of errors and distortions in determination of certain taxes and fees calculation, correct application of tax rates and calculation of the correct amount of taxes and payments for the period conducting which they have been defined.

Independence implies the necessity of taking into account the peculiarities of doing business of a separate entity that is the taxpayer; who in Ukrainian legislation is regarded as a tax agent.

3. The main stages of firm's tax planning

The system of tax planning of each company has its own characteristics due to the peculiarities of its activities, the availability of privileges and donations, the choice of tax (general, simplified) and others. Tax plan includes determining a list of taxes that the company has to pay, forming the framework for their calculation, the organization of the tax base for calculating certain taxes, the process of calculating liabilities for taxes, ensuring the correct calculation and payment of taxes to the relevant budgets (state or local), preparing and presenting tax reports.

To arrange tax planning a company has to go through the stages which are summarized in table 1.

Table 1. The main stages of firm's tax planning

Stage of tax planning	Determining the task of the stage of tax planning
I	identifying tax list
II	forming the legislative base and bylaws which define the rules of tax fees calculation

[3] P.K. Bechko, N.V. Lysa, op. cit., p. 288.

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Stage of tax planning	Determining the task of the stage of tax planning
III	accounting procedures for tax base for calculating the tax
IV	scheduling tax fees calculation
V	firm's tax fees calculation
VI	control of procedures of tax fees calculation
VII	scheduling tax fees payments
VIII	control over tax fees payment
IX	preparation and submission of tax reports
X	detection of tax optimization reserves

Source: own elaboration.

The final stage of tax planning in the enterprise ought to be the valuation of the effectiveness of tax planning, which involves identifying the reserves of tax optimization. Actual consequences of tax planning procedure for construction companies are examined in Table 2.

Table 2. Actual consequences of tax planning procedure for construction companies in Lviv, 2009 (in thousands UAH)

Tax/charge name	JSC "Lvivmiskbud"		State-owned company "Lvivmiskbudindustria"		JSC "Svitanok"		Benefit from tax optimization
	Before planning	After planning	Before planning	After planning	Before planning	After planning	
Corporate income tax	151.1	143.9	0	0	21.1	18.5	9.8
Value added tax	329.8	313.5	212.0	207.6	985.8	981.4	25.1
Personal income tax	337.9	337.9	109.1	109.1	381.2	381.2	0
Land value tax	180.4	180.4	36.6	36.6	3.0	3.0	0
Charge for social insurance	1078.4	1065.2	312.8	308.6	846.2	834.1	29.5
Other taxes and charges	39.6	39.6	11.4	11.4	32.8	32.8	0
Total	2117.2	2080.5	681.9	673.3	2270.1	2251.0	64.4

Source: State Tax Service of Ukraine in Lvivska oblast.

As it is shown in the table, owing to the implementation of tax planning in construction companies of Lviv 64.4 thousand UAH were saved. The savings from corporate income tax amounted to 9.4 thousand UAH and were gained as a result of the implementation of legislative regulations concerning double taxation expenses. The savings from VAT — 25.1 thousand UAH — were due to the analysis of the amount of tax credit from VAT. The savings from charge for social insurance were a result of the analysis of tax base for charges.

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One reason for the deviations from the tax plan, which occur in practice, is making unplanned decisions or rejecting the previously anticipated ones. The aim of tax planning in this case is to minimize the number of such decisions which result from the lack of experience in terms of taxation, operational analysis of changes and adjustments to the plan.[4]

There may also be certain shortcomings of tax planning. These can include: incorrect evaluation of financial and production indicators, which are the basis for determining the tax base; inaccurate predictions of certain changes; the lack of processing of individual decisions in terms of tax consequences, etc. Moreover, in practice there are shortcomings of the implementation plan resulting from the lack of coordination between planning, production, legal services and accounting with finance department, which provides tax calculations.[5]

4. The main principles of tax planning

Regardless of the tax planning features of some firms, the general principles of tax optimization should be determined. Among these principles we can highlight: the principle of costs adequacy, legal congruence, confidentiality and accountability, acceptable combination of form and content, neutrality, diversification, and autonomy (Figure 2).

According to the principle of expenses congruence, the value of the introduction of a tax planning scheme cannot exceed the amount of reduction of tax liabilities for the company. This limit should be set at 50–80% of the tax decline.

Optimization scheme has to be compliant both with domestic and foreign legislation. Contradictions or loopholes in the current tax laws must not be the basis of its construction. Resolving of discrepancy conflicts is often made in favour of the government, and existing gaps can be quickly filled. In case of Ukraine this can even be applied to previous reporting periods, as repeatedly observed.

The principle of confidentiality involves restricting access to information about the actual purpose and consequences of business transactions. This means that ordinary workers involved in the process of optimization of taxation should not know its general mechanism for the enterprise, and are guided only by local regulations.

The principle of accountability has to achieve the desired outcomes from the use of optimization schemes as a result of the existence of real levers of all officials and at all stages.

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[4] V. Vyshnevskyi, A.Vetkin, op. cit., p. 62.

[5] P.K. Bechko, N.V. Lysa, op. cit., p. 288.

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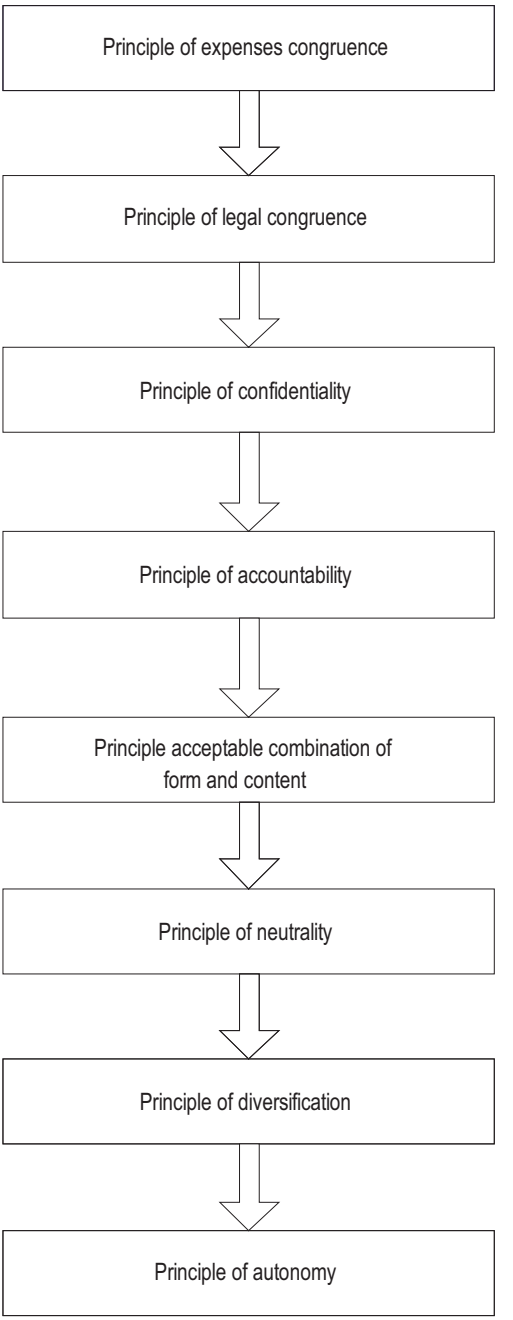

Fig. 2. Basic principles of taxation optimization
Source: V. Vyshnevskyi, A. Vetkin, op. cit.

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Compliance with the current legal state is important not only to provide protection from unconscientious workers, but also from suspicion of controlling agencies. It is provided with the use of the acceptable combination of content and form.[6] This is caused by the terms existing in the Civil Code of Ukraine, such as invalid transaction, apparent transaction, imaginary operation, incapable citizen, and the existence in the Criminal Code of Ukraine of articles on liability for tax evasion, fake business, fake bankruptcy, money laundering funds, etc. In addition, the Tax Code of Ukraine contains the interpretation of the meaning of "rational economic reasons" that may be available only if the taxpayers are able and intend to obtain economic benefits from conducting business.

The principle of neutrality provides carrying out the optimization of tax payments by the company from its own sources and not by increasing the subscriptions of independent contractors. This principle can still be called "the principle of communicating vessels." This means that the increase in payments to the budget from one participant in contractual relationship often causes their decline from the other. This mostly includes the value added tax and the income tax.

The principle of diversification suggests that optimization of enterprise's fiscal charges may be under the impact of various negative factors, including changes in tax and criminal legislation. As a result, the actual benefits received in earlier tax savings may be negligible compared to the penalties of the state tax administration, as well as of criminal liability for failing to pay taxes.

According to the principle of autonomy, the enterprise has to be as little dependent on the actions of external contractors as possible. To ensure the optimization of tax payments the company has to gain as much independence as possible from the actions of other participants in contractual relations, changing the subject and scope of taxation.

5. Risks of tax planning and their diversification

Instability of external and internal environment often determines the occurrence of business risks of its administration, and as a result — the risks of existing tax optimization schemes.

Under the notion of tax risks we often understand the uncertainty that may lead to negative consequences — large fines, extra amounts of taxes, payment of penalties for late payment of tax liabilities.

The effectiveness of risk management is largely determined by the identification and classification of risks. Major tax risk groups are listed in Table 3.

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[6] V. Vyshnevskyi, A. Vetkin, op. cit., p. 62.

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Table 3. The main groups of taxation risks and their interpretation

Risks	Interpretation of risks
Information risks	The risk of ambiguous interpretation of the law by the taxpayer and tax administration, which often brings the correct determination of taxes to a standstill.
Process risks	Incorrect determination of tax liabilities, errors in tax accounting, discrepancy in representation in individual transactions, mistakes, oversight, and inadequate documentary confirmation of transactions.
Environment risks	Uncertainty of application of tax legislation by tax and judicial authorities, authorities change, etc.
Reputation risks	The risk of injuring the reputation of a firm due to disparity of interpretation of tax legislation by firm, which results in mistrust of suppliers, customers, banks and other counter parties.

Source: own elaboration.

To reduce a tax risk rate the company usually applies different methods, the most common among which are: diversification, particularization, limitation, self-insurance, and insurance.

Diversification is the process of applying different variants of the conclusion for similar transactions, which vary in degree of risk from zero to a level acceptable to the company. Management information plays an important role in tax risk. Limited information can lead to inaccurate results of tax planning, and, therefore — to the incorrect calculation of tax liabilities. Often the company is ready to pay auditors and lawyers for such additional information.

Tax risk management is largely dependent on the availability of information about the probability of occurrence of tax risks and magnitude of their consequences, expressed in value indices (Figure 3).

The most reasonable solutions in terms of impact on the taxation will be accepted if all their consequences are accurately evaluated (Figure 3). If there are probabilistic terms concerning taxation, the company will be able to make antecedent estimates and management in tax risks prior to the date of occurrence, which will provide their minimization. Under conditions of uncertainty it is necessary to complete work on obtaining enough information, the use of which will lead to a preferred probabilistic version and create the opportunity to analyse the consequences of such decisions.

Limitation is a set of restrictions that bound the amount of transactions that are risky in terms of taxation. It is used by enterprises in case of the presence of significant portfolio risks.

Self-insurance (back-up) involves forming by a company significant reserve funds by partially inflated tax liabilities for individual taxes, overpayment of taxes in the budget, understatement of costs, reducing the object of taxation.

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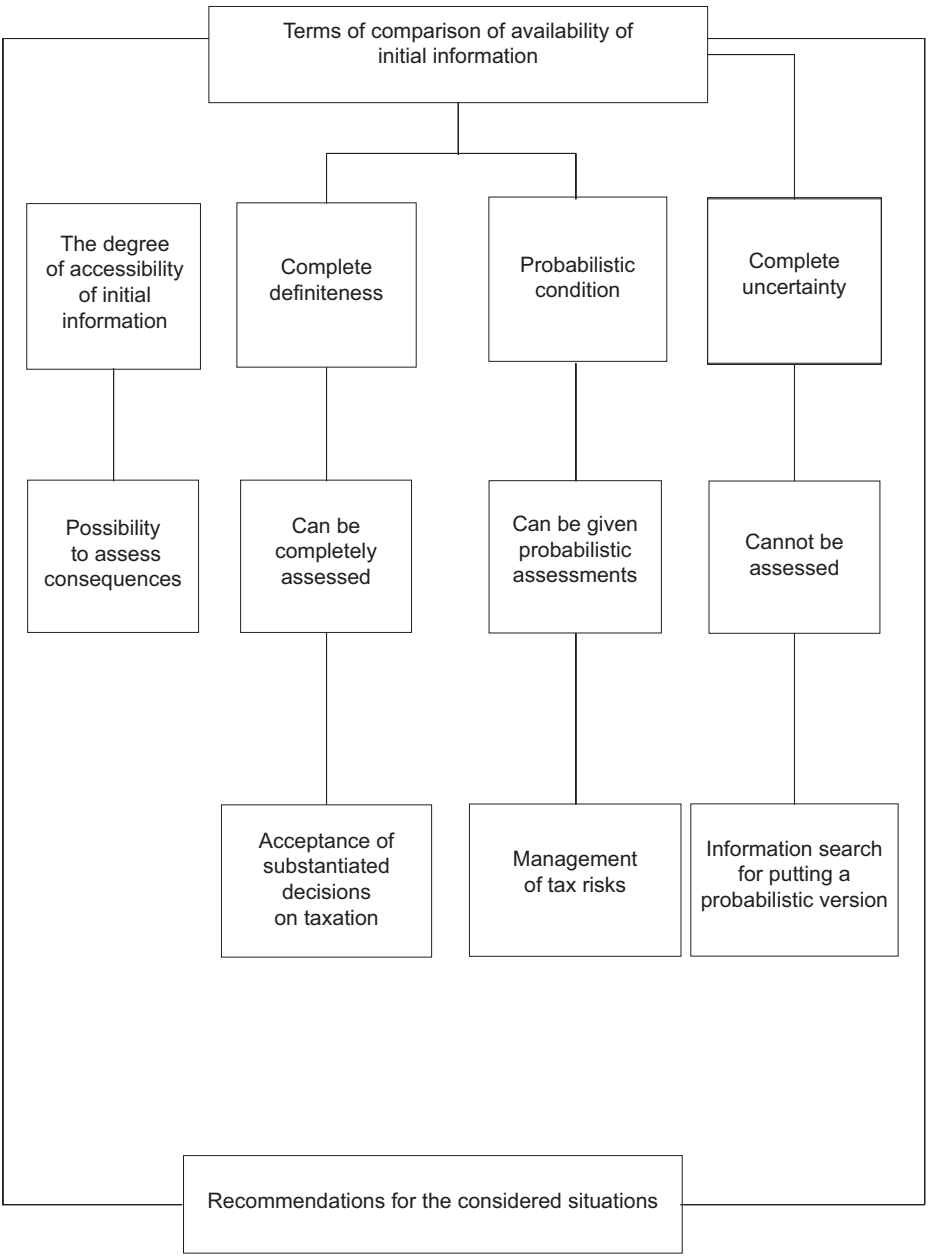

Fig. 3. Information situations of making tax decisions

Source: own elaboration.

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Risk insurance taxation in Ukraine is carried out by large insurance companies, but they do not guarantee the return of all amounts in received damages in case of fines and penalties for failing to pay the full amount of tax liabilities.

The special techniques peculiar to tax risk management include:

- improving the process of calculation and payment of taxes by the relevant responsible persons from enterprises and attracting professionals from the outside — auditors, lawyers, tax consultants;
- economic justification of business transactions and their correct display;
- initiation of litigation in the case of absence of similar judicial practice.

Tax risk management is largely dependent on the presence of a transparent legal framework, the correct tax accounting, as well as the availability of qualified specialists.

Conclusions

The formation of optimal system of tax planning in Ukraine and reduction of tax risks will result in reduction of tax burden for companies, which, in turn, will cause the increase in the effectiveness of their activities.

For the formation of tax planning techniques of particular enterprises it is required to establish the general principles of tax optimization. Among them we can highlight: the principle of expenses congruence, the principle of legal congruence, confidentiality, accountability, the principle of acceptable combination of form and content, the principles of neutrality, diversification and autonomy. The main criteria for optimization scheme of tax planning in the enterprise are legitimacy, efficiency, professionalism, rationality and reliability.

In the conducted research the main risk groups of optimization can be highlighted as following: information, process, environment, reputation. To reduce the risk different techniques should be applied, the most common being: diversification, particularization, limitation, insurance and self-insurance.

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Summary

In the article a review is made of the content of tax planning procedure as one of the functions of financial management of a company whose goal is the optimization of taxation with the requirements of civil and tax legislation of Ukraine. The author has researched the features of entity and its basic criteria for optimization — legitimacy, reliability, rationality, autonomy, professionalism and efficiency. The research establishes the basic principles of optimization of taxation of companies and defines its stages and types of risks that affect the increase in taxation: information, process, environment, reputation.

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