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## PROBLEM OF LOSS OF ECONOMIC ENTITIES IN CONDITIONS OF LIBERALIZATION OF TAXATION POLICY

**Objective.** *Improvement of methodological approaches to identify the main causes of loss of a subject of entrepreneurial activity on the basis of a critical assessment of tax policy of country in reference to carrying loss.*

**Methods.** *During the study the following methods were used: a theoretical generalization, behavior analysis of key statistical indicators of value of deferred losses and their impact on the financial position of a economic entity such as a taxpayer, systematization of the results of the retrospective analysis of changes of tax laws and tax policy taking into account a negative value of the financial result in the process of tax assessment of corporation tax of company income, method of law comparison.*

**Results.** *Controversial aspects of handling of financial inability and loss of activity of subjects of business are defined and external and internal factors of impact on loss occurrence at business entity are marked. The behavior analysis of value indicators of deferred losses is made. The changes in the tax laws that are made annually from 2004 to 2008, the Law of Ukraine «Of the budget» are analyzed. The recommendations of advisability of improvement of tax policy and tax legislation of Ukraine concerning the loss of economic entities on the basis of a critical assessment of national practice and international experience are reasoned.*

**Academic novelty.** *Methodical approach to the implementation of retrospective analysis of legislative acts at tax assessment concerning carrying of tax loss from activity of economic entity, which allowed giving critical assessment of the prohibition on the transfer of losses, as measures against the non-payment of taxes for profit by business entities is specified.*

**Practical importance.** *Received results of the research is focused on improving tax policy concerning tax control of income and expenditure of business entity and carrying of loss in order to facilitate economic growth and deduction of tax risks of economic entity in conditions of the liberalization of tax policy.*

**Key words:** *tax return, taxation policy, carrying loss, liberalization, tax assessment.*

**Problem definition and its connection with the most important scientific and practical tasks.** At the present stage, historical process of economic liberalization has grown into a global world tendency that covers more and more countries. There is a freedom opened for action of market regulation mechanisms. The state intervention into economics in its administrative forms, as well as in forms of direct

government control is being decreased. The main function of the state becomes creation and support of competitive environment by adopting the economic and civil legislation, facilitation and cheapening of new private enterprises' creation, support of mid-sized and small business. The state of freedom development in the society and economic liberalization is one of the weighty factors upon which investors make decisions regarding investment into one or another country. That is why in the world they use several independent ratings (indexes) striving to analyze development of the countries.

According to Freedom House in 2011 Ukraine was referred to the group of politically free countries [1]. By economic freedom parameters as certified by data of the World Bank group for 2012, Ukraine has taken the 137<sup>th</sup> place [2]. These parameters determine availability of problems in Ukraine relating to state of economic freedom and implementation of freedom principles in decision-making procedures in the state administration system that has direct and indirect influence on business activity development. Yet, Ukraine makes significant steps forward. Hence, according to the report on investigation of "Conduct of business", Ukraine appeared in the ten of countries that gained the greatest success in three and more directions in the investigated spheres for years 2011-2012, one of which was taxation reforms implementation. Adoption of the main tax document – a Tax Code has significantly raised tax policy efficiency: tax load was reduced, tax administration was improved. But the Ukrainian government wishes essential economic breakthrough, that is why it is natural for the President of Ukraine Viktor Yanukovich to give commission to the State Tax Service of Ukraine relating to development of state tax policy liberalization oriented at the best world examples [3].

Liberalization of tax policy is in the first place a noninterference into economic actions of business entities through setting the restrictions for their constant development, establishment of the more reasonable taxation system that raises a share of direct taxes and decreases a share of indirect taxes.

In this connection the urgent problem of the Ukrainian economics is a significant quantity of unprofitable enterprises and, as a consequence, absence of a base for profit tax taxation. During the previous fifteen years their share has been approximately at the level of 30% in the periods of economic upturn and 40% - in the periods of economic downturn [4]. In the periods of economic downturn financial results of unprofitable enterprises are not covered by the financial results of profitable enterprises. This fact speaks for a low potential of tax delivery of profit tax which is a main source of income in terms of tax policy liberalization.

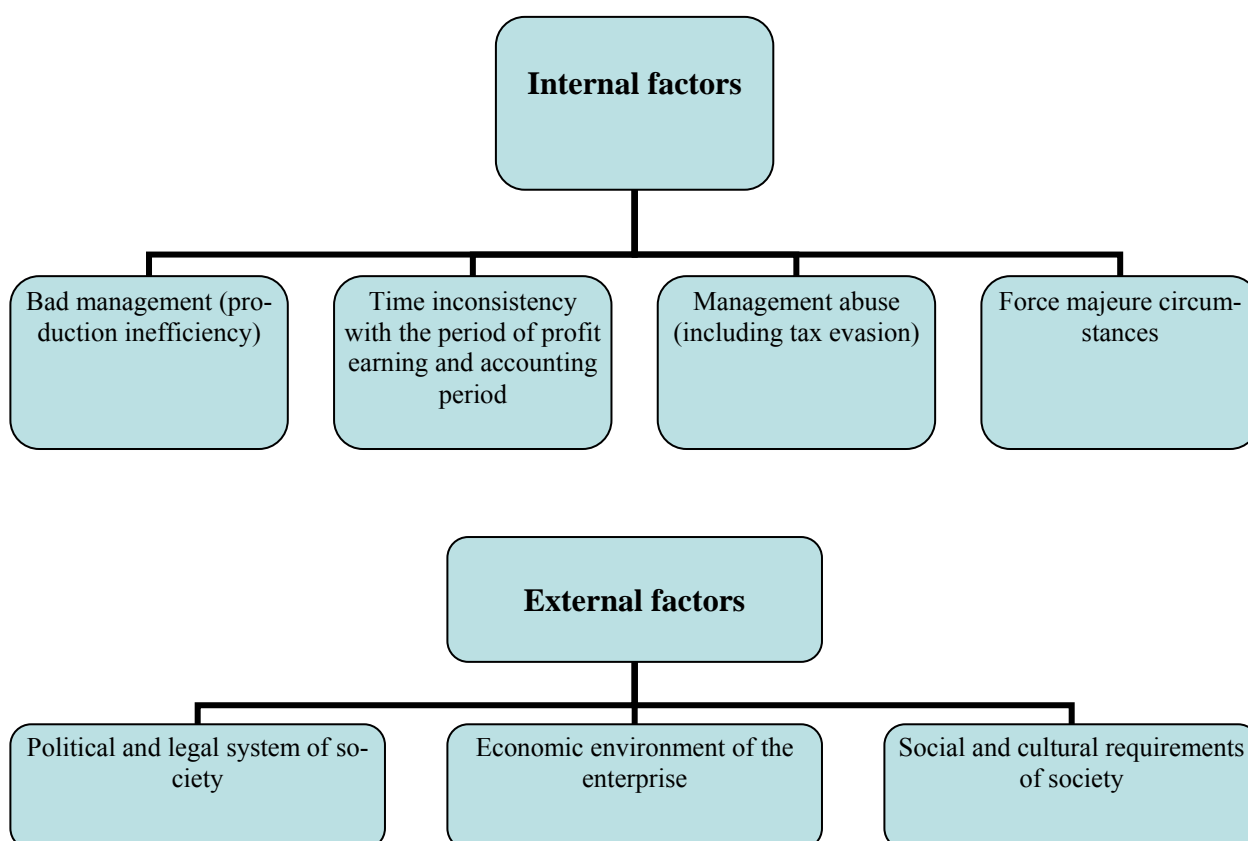
**Analysis of recent studies and publications.** Some aspects of economic entities' unprofitableness have been investigated in the studies of well-known national and foreign financier scientists, such as M. Ya. Azarov, V. P. Vyshnevskiy, T. I. Yefymenko, P. V. Melnyk, I. A. Maiburiv, V. O. Orlova, O. O. Papaika, F. O. Yaroshenko. At the same time system research of theoretical and methodical bases of loss ratio in activity of business entities remains an important and urgent problem.

**Formation of purposes of the article and task definition** – improvement of methodological approaches to reveal the main reasons of business entities' unprofit-

ableness based upon critical assessment of governmental tax policy in respect of loss carryover justification.

**Statement of basic data for study with complete justification of obtained scientific results.** There are many opinions in the economic theory as for mechanism of profit origination, that is why there may not be a single correct theory as for origination of inability, business unprofitableness.

It is possible to distinguish external and internal factors influencing alone or in totality on origination of losses of business entities (picture 1).



Picture 1 – External and internal factors influencing origination of business entities' losses

According to the specialists' research, in the developed countries with a stable political and economic system bankruptcy of enterprises for approximately by 1/3 is connected with external factors and by 2/3 – internal ones. In the context of transformational economics of Ukraine and negative world crisis effect, impact of external factors on inefficiency and unprofitableness of enterprises will be more significant.

It is reasonable to consider the importance of internal factors influencing the unprofitableness of enterprises.

The problem of the Ukrainian economics is a professional incompetence of managers, i.e. inability to predict and foresee changes in the external environment and adapt the company's activity thereto. Lack of appropriate qualification and work experience in market-oriented economy combined with influence of external factors

of market immaturity and world crisis are the main causes of inefficiency and unprofitableness of the Ukrainian enterprises.

Another reason for unprofitableness of enterprises is inconsistency of accounting and operational period. It is especially peculiar for the newly created enterprises, those making capital investments, implementing new technologies and yielding new kinds of products, and those that have essential continuous general production expenses in order to sweep the market.

An important factor influencing the unprofitableness of enterprises is tax evasion. This factor is a basic one in formation of the governmental tax policy in part of loss carryover. It is possible to follow the change of legislative regulations and their content with the table 1 below.

The analysis made in table 1 allows saying that loss carryover is an important problem for tax policy of Ukraine. Up to 2004 the legislation in respect of loss carryover was adopted prospectively, and loss carryover had been allowed for future 5 years, even in the crisis of 1998 losses of enterprises were indexed. Since 2002 indexation of losses was cancelled, but restriction up to 5 years of the loss carryover period has also been cancelled.

Table 1 – The retrospective analysis of tax legislation changes and tax policy in respect of consideration of negative value of the object of taxation by profit tax

Date	Regulatory document	Basic provisions
1	2	3
1997	Article 6. Procedure of book loss carry-forward (Law of Ukraine dated 28.12.1994, no. 334/94-BP “On taxation of companies’ profit (in edition of the Law of Ukraine no. 283/97-BP dated 22.05.97)”) [5]	Restriction for loss carry-forward was introduced: - loss carry-forward is possible during five years; - amount of losses that are carried forward are not restricted; - losses are subject to indexation.
2002	Article 6. Procedure of recording of negative value of the tax object in the results of future tax periods (Law of Ukraine dated 24.12.2002, no. 349-IV “On introduction of changes to the Law of Ukraine “On taxation of profit of enterprises”)	The mechanism of loss carryover was changed: - losses are not carried over, but are recorded as part of the gross expenditures; - restriction of loss recording during 5 years was cancelled; - possibility of unsheduled check-out was introduced in case, when the negative value of the tax object is declared by the tax-payer during four subsequent tax periods. - indexation of losses was cancelled.

Continuation of table 1

1	2	3
2004	Article 95 of the Law of Ukraine "On government balance of Ukraine for the year 2004" dated 27.11.2003 no. 1344-IV	<p>For the first time there was imposed a ban for loss carryover of the two-year time limit - as of January 01, 2002. This ban was introduced by the Law of Ukraine "On government balance" in violation of:</p> <p>1) the article 1 of the Law of Ukraine "On taxation system" dated 25.06.1991, no. 1251-XII (as amended by the Law of Ukraine dated 02.03.2000 no. 1523-III): "changes and additions... relating to granting of preferences, change of taxes, duties (mandatory payments), mechanism of their payment are introduced in this Law, other laws of Ukraine on taxation six months prior to beginning of the new budget year at the latest ...";</p> <p>2) the article 21.5 of the Law of Ukraine "On profit tax of enterprises": "Mandatory for execution by the tax-payer are only acts of central tax authority issued in cases directly stipulated by this Law and registered by the Ministry of Justice of Ukraine".</p>
2005	Article 89 of the Law of Ukraine "On government balance of Ukraine for the year 2005" dated 23.12.2004 no. 2285-IV	The second year in sequence in violation of the Laws on taxation, by the Law on government balance, the ban is introduced for loss carryover of the two-year time limit – as of January 01, 2003.
2006	Article 86 of the Law of Ukraine "On government balance of Ukraine for the year 2005" dated 20.12.2005 no. 3235-IV	The law on State budget repeated the illegal practice of restriction of loss carryover started in subsequent two years with a difference that the ban for carryover is extended for losses not of two-year time limit, but one-year time limit – as of January 01, 2005.
2007	<p>The Law of Ukraine "On introduction of changes to some legislative acts of Ukraine on issues of taxation" dated 30.11.2006 no. 398-V</p> <p>Methodological recommendations in respect of peculiarities of conduct of checks for the economic entities declaring the negative value of tax objects (unprofitable enterprises) Letter of the State Tax Administration of Ukraine dated 02.04.2007 no. 6448/7/23-5017</p>	<p>Losses of one-year time limit – as of January 01, 2006 were prohibited also in 2007, at this time through making changes in the Law of Ukraine "On taxation of profit of enterprises"</p> <p>The schemes for minimization of tax liabilities were described and recommendations for their ruining were given</p>

Continuation of table 1

1	2	3
2008	Letter of the State Tax Administration of Ukraine no. 7618/7/15-0217 dated 11.04.2008.	<p>In 2008 loss carryover was not restricted. However, the question arose: what to do with the losses not included to the gross expenditure before on the basis of ban for their carry-over in 2007? Because in the changes to the Law of Ukraine no. 398-V as for the loss it is determined: “not subject to recording during the year 2007 as part of gross expenditure of the tax-payer”.</p> <p>In its explanations, the State Tax Administration of Ukraine is definite with its fiscal policy that tax losses are prohibited forever as they were not represented in the Declaration for the profit for 2007, i.e. they do not actually exist and there is nothing to be carried over.</p>
2010	The Law of Ukraine “On introduction of changes to some legislative acts of Ukraine” dated 20.05.2010 no. 2275-VI	In May 2010 the ban is introduced for recording in the gross expenditure of 80% loss of the previous tax period, i.e. formed as of January 01, 2010, with obligation to recognize it fully in the 1 <sup>st</sup> quarter of 2011.
2010	Art.150.1-150.3 “Tax Code of Ukraine” no. 2756-VI dated December 02, 2010.	<p>The Tax Code took back loss record to the Law of Ukraine “On taxation of profit of enterprises” in statutory wording of the Law of Ukraine no. 349-IV dated 24.12.2002:</p> <ul style="list-style-type: none"> <li>- losses are included into those of the first quarter of the next year;</li> <li>- there are no restrictions as for amount and period of losses recording;</li> <li>- an unscheduled check-out may be conducted in case, when the negative value of the tax object is declared by the tax-payers during four consequent tax periods.</li> </ul> <p>But according to paragraph 123.1 of article 123 the fine sanctions were introduced for illegally declared amounts of negative value of the tax object by profit tax.</p>
2011	<p>Law of Ukraine dated 07.07.2011 no. 3609-VI.</p> <p>Letter of the State Tax Administration of Ukraine no. 828/3/15-1212 dated 08.09.2011.</p>	<p>It cancelled the norm in paragraph 123.1 relating to fine sanctions for the illegally declared amounts of the negative value of the tax object by profit tax.</p> <p>The State Tax Administration of Ukraine interprets the norm of loss carryover of 2010 for 2011 by results of the 1<sup>st</sup> quarter of 2011 only.</p>

Continuation of table 1

1	2	3
2012	<p>The Law of Ukraine “On introduction of changes to the Tax Code of Ukraine regarding improvement of some tax norms” dated 24.05.2012 no. 4834-VI</p> <p>The Law of Ukraine “On introduction of changes to the Tax Code of Ukraine regarding state tax service and in connection with conduct of administrative reform in Ukraine on July 05, 2012 no. 5083-VI</p>	<p>There was made a restriction regarding tax losses of 2011, which are installed for 4 years. Id est from 2012 till 2015 the loss of 2011 at the rate of 25% and the amount of outstanding negative value in the previous period will be recorded.</p> <p>The ban was imposed for the right to get automatic budget compensation of the tax to the big tax-payers, which declared a negative value of the tax object by profit tax according to results of the last accounting (tax) year.</p>

Financial crisis of 2004 has become a reason for actions of the government regarding introduction of changes to the taxation laws illegally through the Law of Ukraine “On government balance”. These changes dealt with annual bans on carry-over of losses of a definite year. It is apparent that bans in respect of loss carryover were applied only as a temporary means for budgetary recharge without economic justification.

This temporary means had become permanent even up to 2008, when the situation stabilized and economic upturn of 2007 allowed abolishing this unliberal norm.

The subsequent financial crisis that became apparent to the full extent in 2009 became a reason for origination of new draft laws relating to restriction of loss carry-over, which were not adopted due to pointed retorts of parliamentary opposition.

However, significant non-fulfillment of the budget 2010 resulted in introduction of the legislative restriction for loss record of the current year, 80% of which was carried forward to the 1<sup>st</sup> quarter of 2011.

The Tax Code adopted in 2011 did not contain restrictive norms regarding loss carryover, except for the general term of 5 years [6]. However, by the alterations made in 2012 in the Tax Code of Ukraine the loss of 2011 is installed for 4 years [7].

The norm of loss carryover restriction during 5 years in the amount of 20 percent was worked out and abolished in Russia as ineffective [8], [9]. Similar norm was proposed by the Ukrainian government in 2010 by the draft law no. 6337. Conclusion of the Central experts administration regarding proposal of the Draft law was as follows: “the specified regulation requires more profound justification as it is not clear, why it is proposed to carry over to the gross expenditure of the tax-payer only 20% of losses. Besides, in the submitted documents there are no calculations in respect of such decision influence on the financial state of tax-payers” [10].

Relating to introduction of loss payment by installments during 4 years, there wasn't any conclusion of the Central experts' administration at all, as well as of economical justification from the draft law initiators.

Let us calculate influence of the restriction regarding loss carryover according to the Law of Ukraine “On introduction of changes to the Tax Code of Ukraine re-

garding improvement of some tax regulations” dated 24.05.2012 no. 4834-VI for financial state of a tax-payer for a company that got loss in 2011 in the amount of 1 000 000UAH (table 2).

Table 2 – Calculation of the given costs of deferred losses in case of their recording in the amount of  $\frac{1}{4}$  of a share at the discount rate of 20%

Indexes	2012	2013	2014	2015	Total
Amount of losses as of January 01, 2012					
Amount of recorded losses	250 000	250 000	250 000	250 000	1 000 000
Discount rate	20	20	20	20	
Loss compensation norm (capital value factor)	1,2	1,44	1,728	2,0736	
Capital value of deferred losses	208 333	173 611	144 676	120 563	647 183
Discounted loss	41 667	76 389	105 321	129 437	352 817
Profit tax rate	21	19	16	16	
Profit tax	8 750	14 514	16 851	20 709	60 824

So, the tax-payer’s loss till the end of 2015 will be discounted by 35% that will result in financial losses of 61 ths. UAH. In fact the tax-payer’s losses may be greater due to lack of profit gain synchronism.

Table 3 – Calculation of ordinary unrecorded losses for 2011 due to lack of profit gain synchronism.

Period	Limit of losses	Profit of the period	Used losses of 2011	Ordinary losses of 2011
2012	250 000	100 000	100 000	150 000
2013	250 000	500 000	400 000	0
2014	250 000	500 000	250 000	0
2015	250 000	0	0	250000
Total	1 000 000	1 100 00	750 000	

Thus, despite of the fact that for the period 2012-2015 the enterprise gained more profit than it had losses at the beginning of the period, it is not able to record the whole loss.

Besides, the tax-payer will have additional financial losses due to introduction in 2013 of advance profit tax from the amount of previous period profit that does not account for losses of 2011.

Based upon the calculations made it is possible to make a conclusion about the tax policy in the part of loss carryover as the one that has a significant negative impact on the tax-payers’ financial state. But this negative impact of the tax policy is much greater for investment risk perception by the tax-payers.

One of the liberalization purposes of the government tax policy is creation and support of stability and balance conditions. Loss carryover is the most unstable and



unbalanced phenomenon of legislative initiatives due to which the business entity is inclined to risk of change in the investment project result in any moment both in part of future financial placements, and in part of previous ones.

Thus, problem of state tax policy in part of loss carryover is in lack of system approach. Covering of budget deficit and lack of economic justifications are characterized by restrictions and bans for loss carryover from the year 2004 until present time. The only economic justification, from the lawgiver's point of view, was that the enterprises understate the taxable profit as result of tax evasion, the so-called fake unprofitableness.

In general, fake unprofitableness is a result of fictitious actions. Struggle with the result, but not with the underlying causes is incorrect and illegal. That is because the enterprises may evade taxes in any quantity, but they will be punished in the amount of the displayed loss only. Struggle with unprofitable enterprises has gained significant magnitude from the part of legislative and executive authorities that is why the enterprises that deliberately evade taxation will not attract attention by showing losses.

Tax evasion is a system indicator that concerns also the profit tax, and VAT, and PIT, and UST. For example, conducting the operation on fictitious expenditure payment through fictitious counteragent for the purpose of gaining cash for payment of employee's remuneration. This operation results in failure to pay to the budget all four taxes, wherein wage taxes and VAT are much greater than the profit tax.

Hence, decision of the problem of evading the profit tax through struggle against losses is ineffective, it has no effect except for a nonrecurrent budget replenishment and aggravation of financial state of compliant enterprises.

It is necessary to cardinaly change the approach to this problem of tax evasion by unavailability of punishment and elimination of corruption element.

The practice of checking the same enterprises, with providing them with fine plan is very destructive. It is impossible to liberalize tax system without objective and economically justified approach to checking each of tax-payers, its fair and unavoidable punishment. Tax rates may be decreased endlessly. However, there will be no economic effect in tax system liberalization without expansion, unshadowing of tax objects. Lack of economic effect will cause budget deficit and approval of legislative decisions, which not only inconsistent with the world practice of liberal economy, but also do harm to the business entities.

That is why in the context of tax policy liberalization the role of tax administration grows significantly.

The shortcoming of the administration control function is assessment of tax payment by the tax-payers in some taxes – VAT and profit compared to the average industrial payment and approval of decisions based upon these factors: from inclusion of checks into the schedule till rejection to accept declarations.

The enterprise must be assessed by a complex indicator of tax payment. This indicator must account for all taxes and duties paid by the enterprise. Indicator of complex tax payment required to assess the company's efficient activity, degree of its importance for the state, issue of preferences for subsequent motivation of voluntary tax payment, for example, ban for execution of tax checks in case if definite value is

achieved. The indicator of complex tax payment must be compared with the average industrial value and deviations are to be analyzed. At the next stage there must be discovered deviations in tax payments by some taxes and those factors must be analyzed that influence their amount, for example, prime cost structure, remuneration amount, analysis of counteragents.

Introduction of electronic accounting was of great importance in tax administration. Due to it the information field for distant economic analysis of the enterprise expanded. Introduction of information with a breakdown into counteragents, registration of significant amounts in the uniform electronic register is a significant step forward in revelation of fictitious transactions. In the whole, the government authorized bodies must establish a constant control over incomes and expenses of business entities for the purpose of providing the tax authorities with information, which directly or indirectly characterizes the entity and a tax base for each tax-payer.

A good information field is financial statements, which the tax-payers deliver in electronic form according to art. 46.2 of the Tax Code of Ukraine. The financial statements data are to be used for revelation of business entities that carry out imaginary and deliberately low-gain or unprofitable activity for reduction of tax payments, and for this purpose it is necessary to work out a tax payment ratio by indirect method based upon financial statements.

**Conclusions from the defined problems and prospects of follow-up studies in the given direction.** The executed study resulted in development of such conclusions and recommendations.

1. Conditions of up-to-date Ukrainian tax policy in part of loss carryover not only facilitate economic growth of enterprises, but also strengthen the business risk due to realization of its purely fiscal function:

- lack of economical justification of legislative initiatives, especially in part of influence on the business activity results;
- enhancement of tax load for financing the current budget problems;
- lack of consistency, succession and stability;
- disregard of supremacy of law;
- lack of favorable relationship of tax authorities and tax-payers, lack of presumption of innocence of the latter and existence of opinion that taxes are collected due to efforts of tax administration only.

2. Restrictions regarding loss carryover contradict the main bases of tax legislation in Ukraine:

- social justice – establishment of taxes and duties according to solvency of tax-payers;
- neutral taxation – establishment of taxes and duties by the way that does not influence enhancement or reduction of the tax-payer's competitiveness.

3. Restriction regarding loss carryover affects financial activity of economic entities depriving the sources of finance for renewal of their mains assets and upgrade, thus making it impossible for the competitive product to develop. Finally, it will cause reduction of taxation base in future.

4. It is necessary to change the approach to the problem of departure from taxation through unavailability of punishment and elimination of corruption element. From the part of bodies authorized by the state there must be a permanent control over revenues and expenses of business entities with the purpose of providing the tax authorities first of all with information that directly or indirectly characterizes the tax object and a tax base per each tax-payer.

5. A business entity must be assessed by a complex indicator of tax payment. This indicator must take into account all taxes and duties paid by the enterprise and be a regulatory one when definition of control measures relating to a tax-payer.

6. Improvement of profit tax administration must be through revelation of those business entities that carry out imaginary and deliberately low-gain or unprofitable activity for reduction of tax payment. For this purpose it is necessary to work out a tax payment ratio by indirect method based upon financial statements.

**Prospects of follow-up study** in this direction is development of methodical recommendations regarding loss ratio of economic entities in terms of tax policy liberalization.

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