

Ukrainians paying more taxes than due! It is war-time tax behaviour, stupid!

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the institution of state, taxation is, beyond the pale of debate, one of the most sneered and vilified discretions. Noted stand-up comedian Chris Rock once said - **"You do not pay taxes, they take taxes"**

! On the other side of the stick, proponents of the modern public choice theory argue that tax choice or taxpayer sovereignty largely means - individual taxpayers should have a say in how their taxes are spent! They claim that taxpayers respond favourably if they are allowed to allocate portions of their taxes to specific activities of the state. They also believe that taxpayers part with their sovereignty and endow such powers to the state in exchange for the protection and the provision of public services. Thus, the existence of the state's tax sovereignty is attributed to the taxpayer. They also propose that taxation should be based on the principle of value and counter-value! Thus, state earns not only the right to tax, but also the obligations, which correspond to the taxpayer's rights!

Let's now whiz past the tantalising debate to a taxing scenario which may sound amazeballs under normal circumstances - taxpayers voluntarily paying more taxes than what is due as per the law; paying taxes more frequently than what is prescribed by the statute; large number of taxpayers paying taxes to their mother country even if their territory is under occupation by a neighbouring country - a few even bribing the occupying military; even the state reducing high corporate tax rate and VAT to a uniform 2% turnover tax; personal income tax lowered to less than 5% at a time when the state needs to marshal more resources; and millions of firms and individual taxpayers splurging donations to the treasury. This scenario hems in a story about 'fiscal fantasyland' which does not exist in the real world! Holy taxes! Some portions of this scenario may mirror a tax regime only during war times. True, the global history of taxation is imbued with a few such instances. Taxes are never popular, but they are never more popular than during wars!

Before we dive into history, let's first discuss what is happening in Ukraine, which is at war with Russia.

The Ukrainian Finance Minister reportedly said that he expected the revenue to plummet as much as economic activity but it did not come out true! Ukraine's GDP shrivelled by 29% in 2022 but its revenue was down only by 14% as compared to 2021! An eye-popping mismatch for any fiscal economist! But, keen to support their state at war, firms and taxpayers paid more taxes than required and also paid them early. Millions also made donations close to USD 900 million. Excluding donations, Ukraine mopped up revenue worth USD 37 billion in 2022! Big Four partners recently claimed that over 95% of their clients have been prepaying

their taxes! Interestingly, in the rush of patriotic blood, over 20 lakhs individual and business taxpayers in Russia-annexed areas paid close to USD 9.5 billion in taxes to Ukraine. One of the possible reasons is their fear that if Russia finally prevails over, their riches would ultimately be purloined. Ergo, it is better to support their own state! Secondly, it also makes good PR-sense, with many companies opting for drumbeats about their patriotic gesture in the media.

On its part, the Ukrainian government has also done what is generally unimaginable during war times. Rather than imposing new taxes and hiking the existing tax rates to fund the war, it has done the reverse - unbelievable! In place of 18% corporate tax regime and 20% VAT rates, Ukraine last year introduced a new simplified tax regime - pay only 2% unified tax in place of VAT and corporate tax. This scheme is available to all businesses except for a negative list containing gambling, alcohol and tobacco products. Since prices of petroleum products had jumped by 50% after the onset of the war, excise duty was reduced to zero and VAT to 7%. Of course, to tamp down inflation! The government also exempted all imports from Customs duty

except alcohol and tobacco products. Even motor vehicles are exempted. Additional tax reliefs in terms of waiver from ecology tax, land tax, lease fee and real estate tax was also granted. In addition, procedural reliefs were granted for loss of documentation; no fines and penalty for delayed payment of taxes and tax audit moratorium. Not to disappoint its Western donors, Ukraine also launched a crackdown on corruption and dismissed dozens of tax officials. As per these legislations, all these reliefs and lower tax rates are co-terminus with the Martial Law. Once a peace agreement is stitched and martial law is withdrawn, the old tax rates and provisions of law would spring back to life. A case of typical war-time fiscal response to skirt a military disaster!

The Ukrainian Government's policy response during the war time appears to be a leaf borrowed from the US fiscal playbook. If one analyses some of the wars the US has fought in the recent decades, mobilising additional resources was never treated as a political necessity. Take the case of Iraq war. During the entire period of this war, the Bush Administration did not seek fresh funds from the Congress. President Bush once said - "Read my lips - No new taxes!" And he rather went on granting income tax reliefs to the taxpayers on several occasions as if there was no extraneous strain on the US finances. This was perhaps a political strategy to defuse antagonistic public opinion against the unwarranted war. A similar chapter was written during the Afghanistan war.

However, the past history, going back to the World War II, was just the opposite. Though America was caught in a scenario of trade-off between guns and butter but President Roosevelt knew that the on-going war would gobble up more resources and he was not keen to fund it by borrowings or through deficit routes. He got the Congress to raise tax rates on wealthy individuals and profitable businesses which outlasted the war. As the momentum of the war gathered more pace, the US needed more resources and the President wanted to fund it in the ratio of 60% from taxes and 40% from public debts. This nudged him to lower the income tax threshold to a level which propelled the number of taxpayers seven-fold and the 'class tax' was transformed into 'mass tax'

. Paycheque withholding made income tax a regular fact of life for American workers who, as per a survey, supported such a form of taxation by a majority. To mop up more resources, President Roosevelt also got the Congress to impose what is now known as "Victory Tax of 1942". The Federal Government also aggressively implemented the Wealth tax of 1935 and prosecuted tax evaders with a vengeance!

Prior to the Second World War, there are numerous examples in the fiscal history of the world where common taxpayers supported states imposing new taxes to fund war. Of course, such sentiments had the origin in patriotism and security of the nation but a similar shade of sentiment was seen during the peak of the COVID pandemic in some of the rich countries when the tycoons of all stripes wanted to pay more to help socially-vulnerable sections of the society. As per a survey, a large number of wealthy taxpayers in UK and the US were willing to pay more taxes to reduce social inequality and they finally paid as per the British donation data

. The UK Government had provided a window for donation to the Exchequer with a string of conditionalities. Though it did not turn out to be an enormous sum but it was several times the sum which was the highest during pre-Covid period. True, one may describe such a fiscal behaviour as 'virtue signalling' or even 'tax washing' like green-washing by the rich but the fact of the matter is that what is generally unimaginable during peace period, becomes a new normal during wars. Wars tend to write new fiscal rules for the history book as economics during such periods overshadow all other rationalities of taxpayers, buoyed by strong patriotic sentiments. This is what explains the rationale behind the huge extra tax payments being made by taxpayers in Ukraine! For the rich, this is the only sure-shot way to protect their wealth stored in manicured lawns and marble columns! Indeed, gawking time lies ahead for the bemused world!