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POLICY BRIEFING
UKRAINE

Abolishing of the VAT exemption for the simplified tax system - Summary of results -

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1. Introduction

Motivation

- » STS reform is a priority under the IMF–Ukraine EFF, with mandatory VAT registration for simplified tax system (STS) taxpayers above the UAH 1 m threshold planned for 2027.
- » Originally designed to support genuinely micro-scale businesses growth, STS is misused by larger firms to remain within the regime and outside the VAT system.
- » Sales to non-VAT registered private entrepreneurs (PEs) under STS act as structural breakpoints in the VAT chain, where invoice-based traceability ends before reaching the final consumer.
- » This weakens transaction traceability, particularly in goods-related activities involving undeclared, or grey-imported products and enables tax avoidance practices.
- » PEs under STS reported around UAH 2.5 tn (~EUR 50 bn) turnover in 2024.
- » A limitation of the analysis is that it relies on 2024 data, as the available statistics on the distribution of PEs by number and turnover are reported for 2024

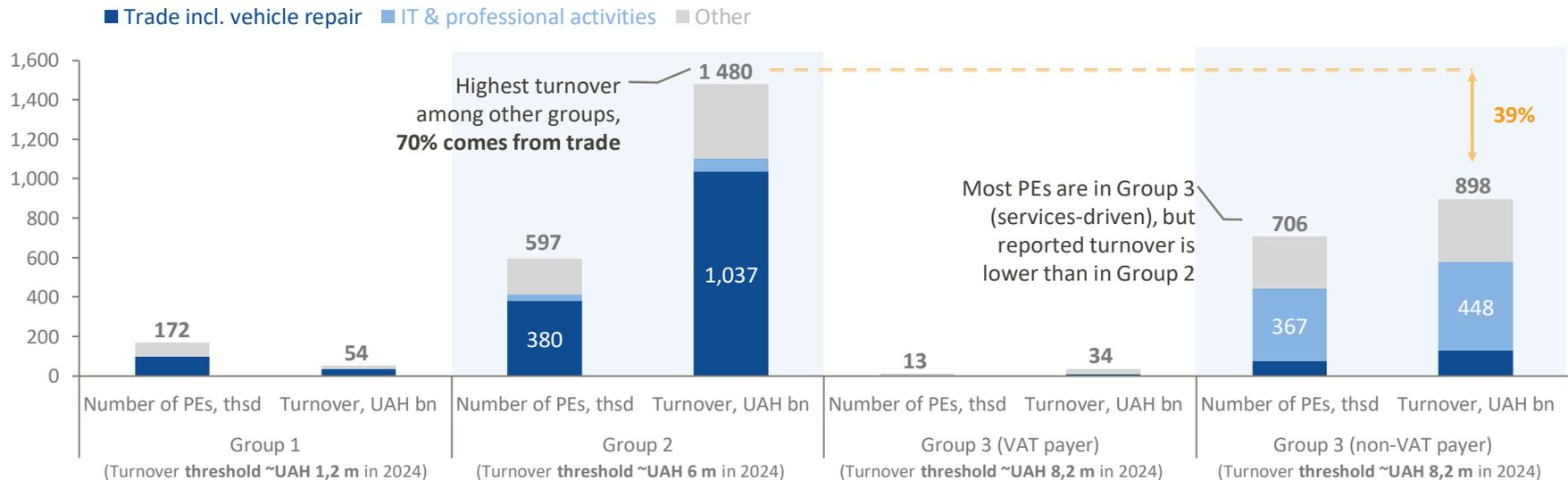
Purpose of this Policy Briefing

- » Present and discuss the key findings from the Policy Study 01 2026 (Slutskiy et al. 2026).

2. Overview of the current system

- » STS usage is highly dominated by **trade, incl. vehicle repairs, and services, especially IT and professional services**, together accounting for **~50%** of all PEs.
- » **~26%** of STS PEs operate in trade, incl. vehicle repairs and mostly use **Group 2**, paying a monthly unified tax (up to UAH 1,600 in 2024) and are exempt from VAT; they **generated 42% of total turnover** in 2024.
- » **~25%** consists of **IT and other professionals** using **Group 3**, who pay 5% of their turnover and are also VAT-exempt.
- » B2B activities are concentrated mainly in **Group 3**.
- » Group 1 accounts for **~12%** of STS PEs, **~57%** of which operate in trade incl. vehicle repair, paying a monthly unified tax (UAH 303 in 2024) and are exempt from VAT.

STS PE breakdown by number and turnover in 2024

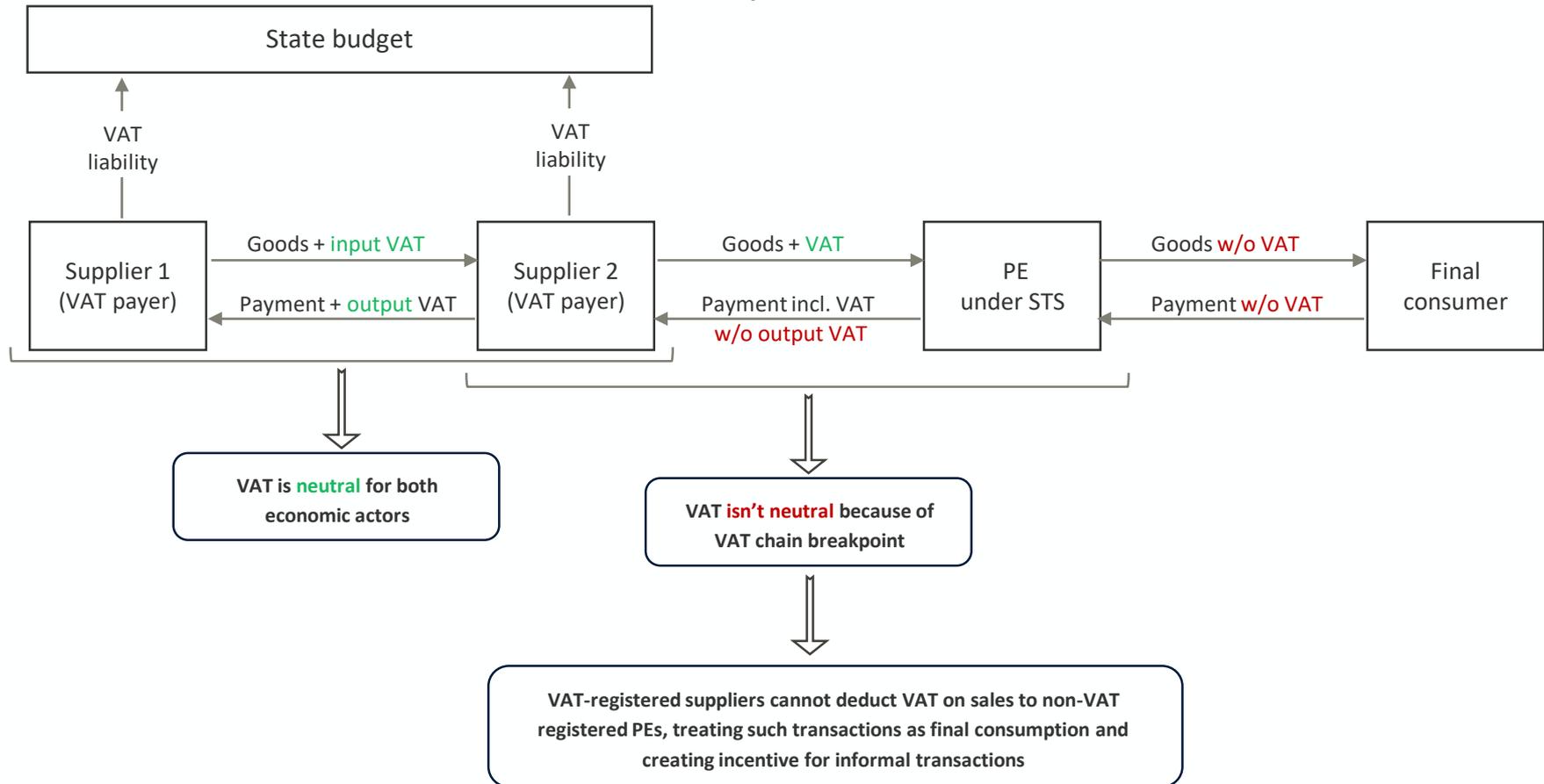


Source: Own representation based on State Tax Service (2026)

3. STS impact on shadow economy and tax evasion (1)

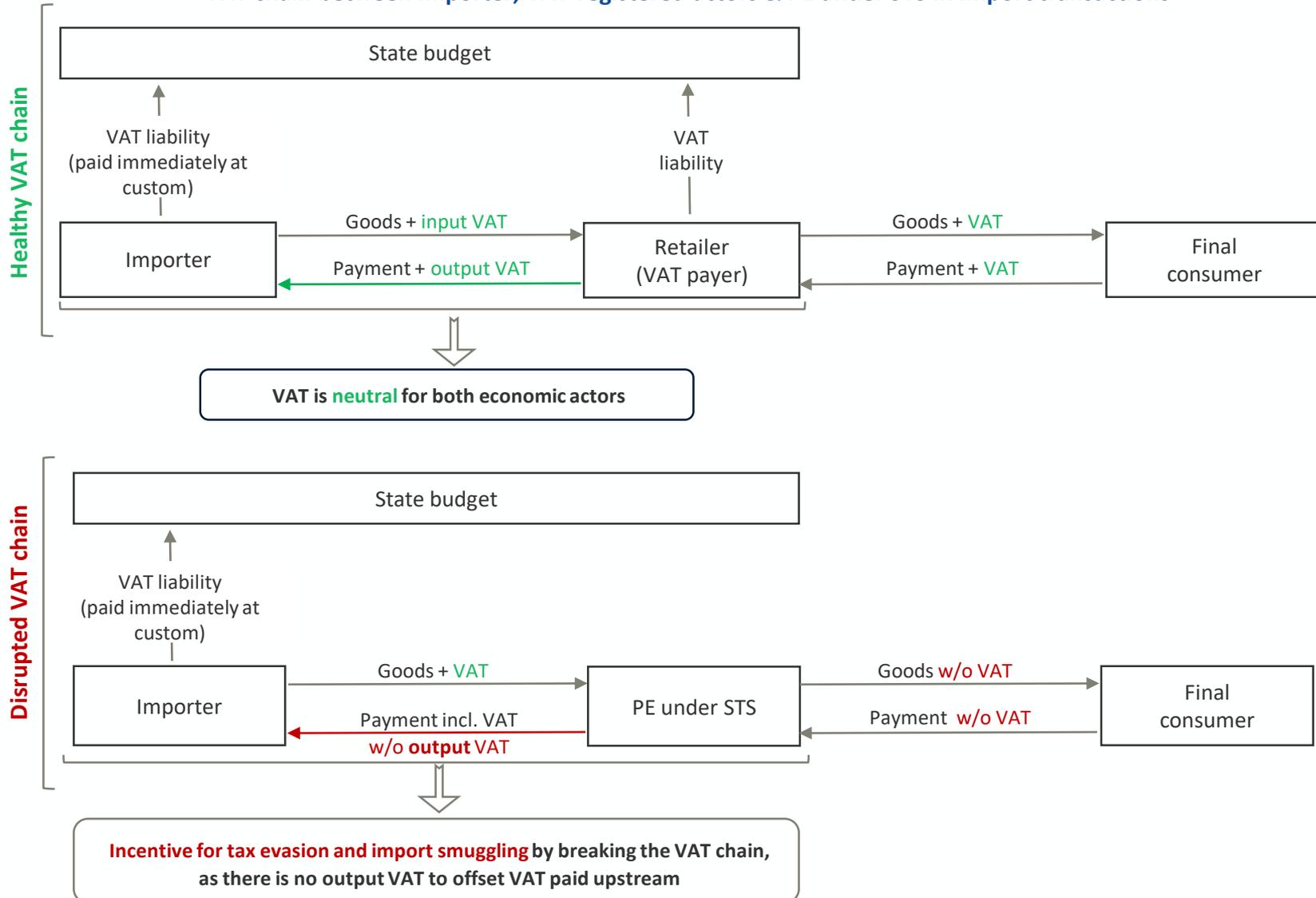
- » The STS VAT exemption enables shadow economic practices and creates competitive distortions, as economically identical businesses cannot remain subject to fundamentally different VAT treatment without undermining competitive VAT neutrality.

VAT chain disruption on domestic sales



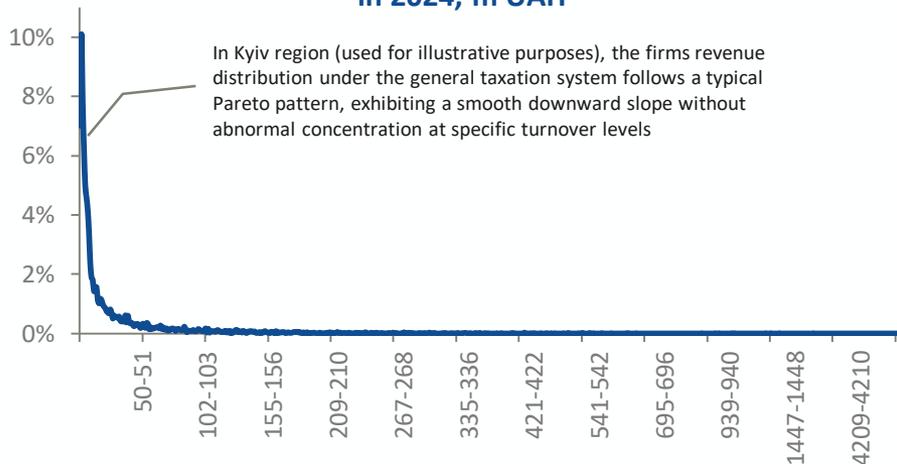
STS impact on shadow economy and tax evasion (2)

VAT chain between importer, VAT-registered actors & PE under STS in import transactions



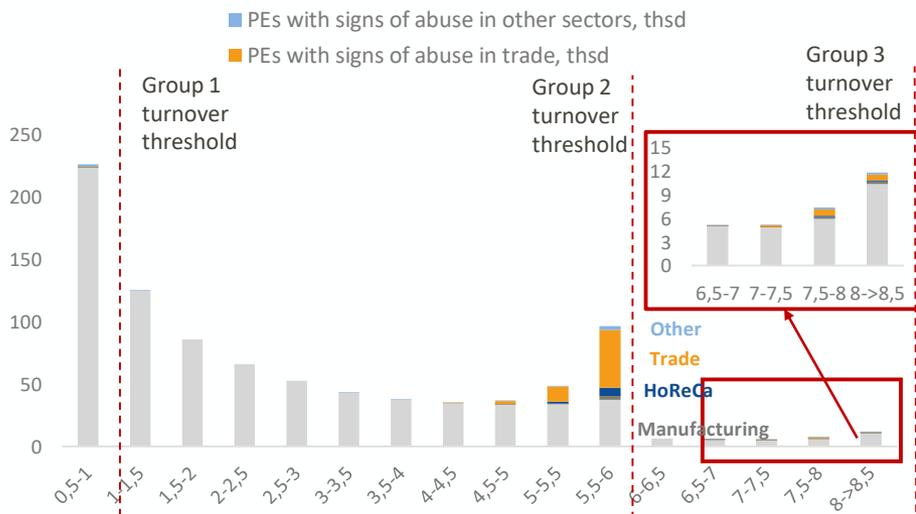
4. Statistical evidence of the misuse and tax avoidance (1)

Distribution of the share of companies in Kyiv Region by revenue in 2024, m UAH



Source: Own representation based on YouControl (2026)

STS PE breakdown by number and turnover in 2024

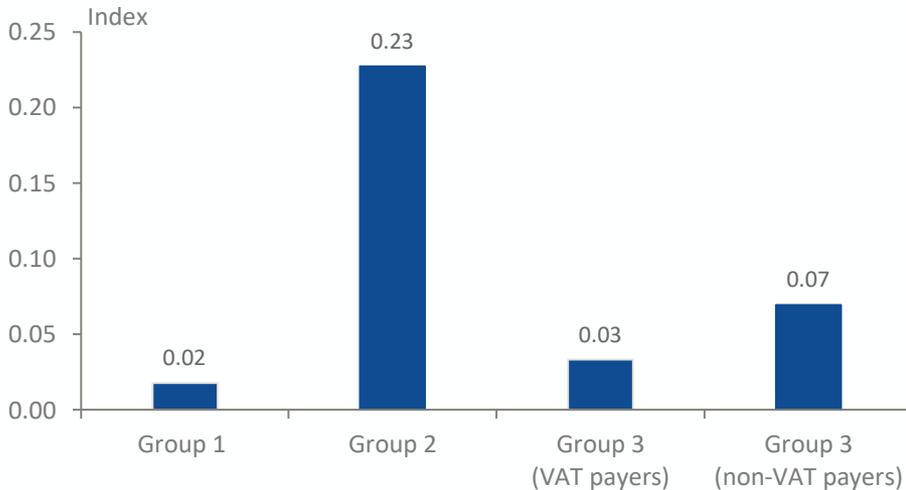


Source: Own representation based on State Statistics Service (2026), own estimate

- » As turnover increases, the number of firms naturally declines, typically following a Pareto distribution (see Policy Study for details).
- » PEs cluster around turnover thresholds, deviating from the expected distribution, indicating systematic tax avoidance.
- » **Clustering begins around an annual turnover of UAH 4–4.5 m** and is most pronounced near the Group 2 threshold.
- » While individual PEs report ~UAH 6–8 m annual turnover, **interconnected networks of PEs** operate beyond the intended STS scale with a minimal regulatory oversight.
- » In **trade**, around 63 thsd PEs show signs of abuse. We estimate, they generate UAH 356 bn in turnover p.a. (**29% of sectoral turnover**).
- » In **HoReCa**, around 5 TH PEs show signs of abuse. We estimate they generate UAH 50 bn in turnover p.a. (**35% of total sectoral turnover**).
- » In **manufacturing**, around 5 TH PEs show signs of abuse. We estimate they generate UAH 27 bn in turnover p.a. (**20% of sectoral turnover**)

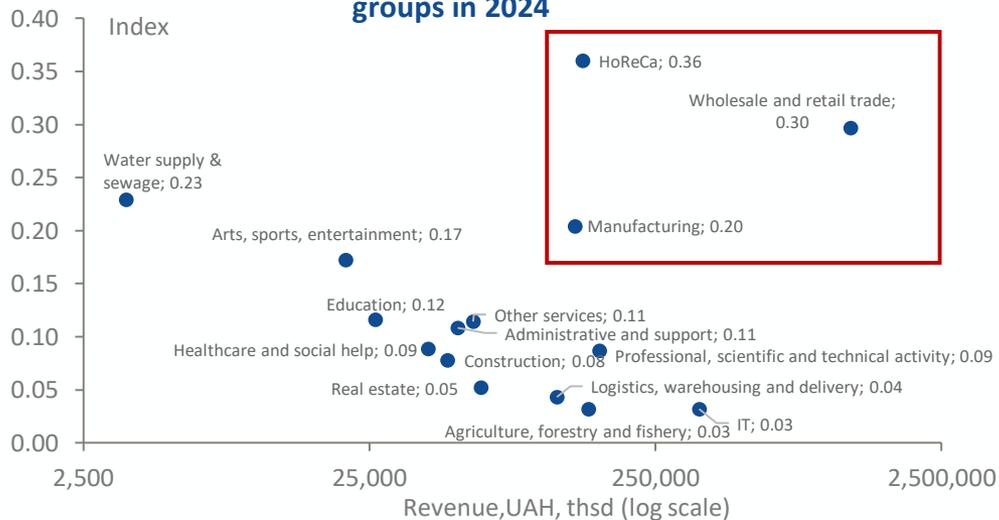
Statistical evidence of the misuse and tax avoidance (2)

Splitting index by STS groups in 2024



Source: Own representation based on State Statistics Service (2026), own estimate

Economic activities by turnover and splitting index within STS groups in 2024

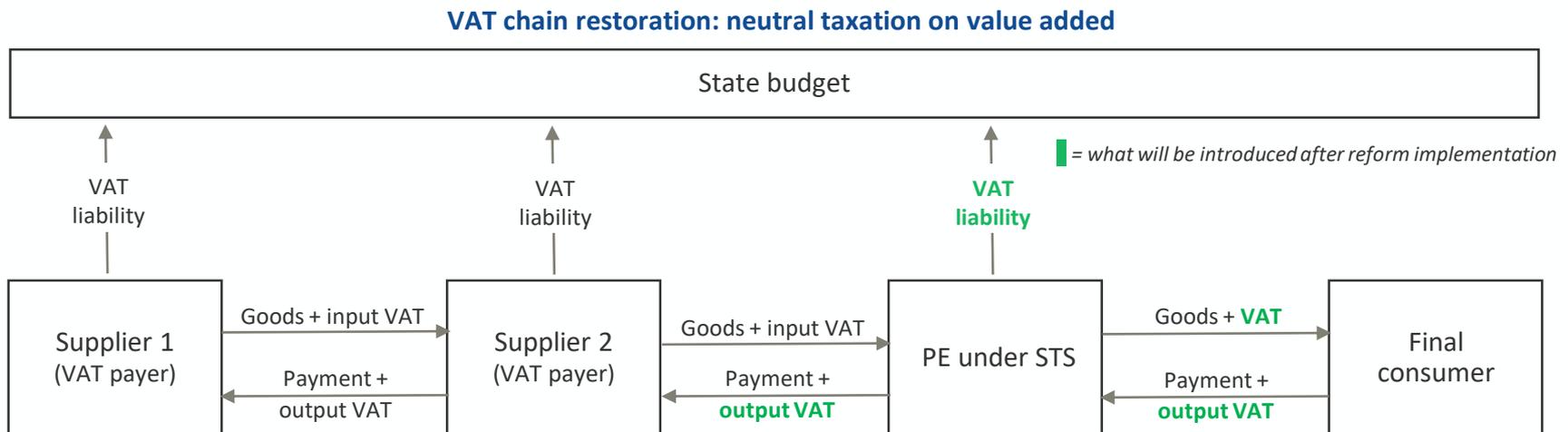


Source: Own representation based on State Statistics Service (2026), own estimate

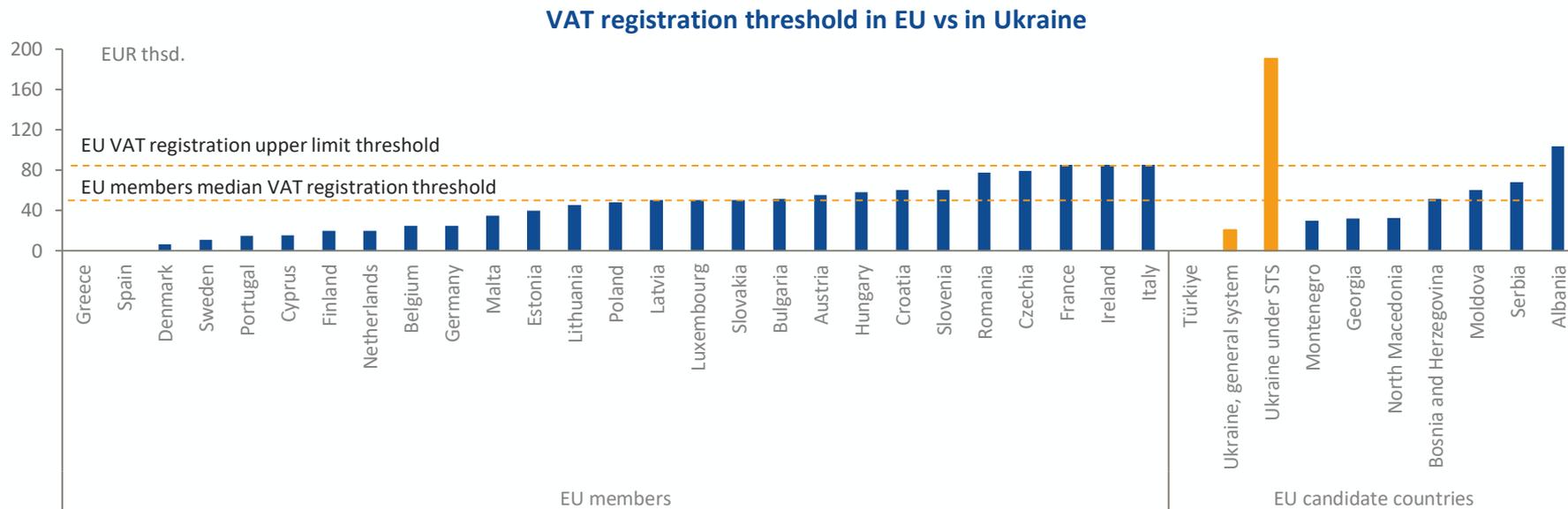
- » Splitting index – a measure of potential STS misuse, based on revenue clustering around statutory turnover thresholds, reflecting the deviation from the Pareto distribution.
- » Most PEs exhibiting signs of abuse in these sectors are concentrated in **Group 2**, benefiting from **minimal taxation (unified tax of UAH 1,600/month)**.
- » **HoReCa, wholesale and retail trade, and manufacturing** sector combine high turnover volumes with high abuse indices.
- » Such misuse measures, especially, in goods-related sectors, allows to stay under STS once they approach the turnover threshold by splitting and multiplication of PEs and avoid **the VAT system** and standard accounting requirements.

5. The VAT reform proposal under STS (1)

- » Under the new IMF–Ukraine EFF, the introduction of general VAT registration (UAH 1 m) for STS taxpayers is under discussion, which would also be consistent with Ukraine’s National Revenue Strategy until 2030 and OECD policy recommendations.
- » The VAT reform proposal **restores the core logic of VAT as a neutral tax** on value added by closing gaps in the VAT chain and reduces **competitive distortions between STS and general system participants within the same sectors**.
- » The **VAT 1 m threshold doesn’t apply** to those STS actors, who’s turnover is more than UAH 1 m. VAT registration depends on the amount of transactions that fall within the VAT base, rather than by a total turnover.
- » **Current enforcement mechanisms address only the resulting abuses rather than eliminating the root cause**, as they are limited to analytical work of the State Tax Service, financial monitoring system, and the Economic Security Bureau (BEB) through interventions when STS activity indicates potential criminal conduct.



The VAT reform proposal under STS (2)

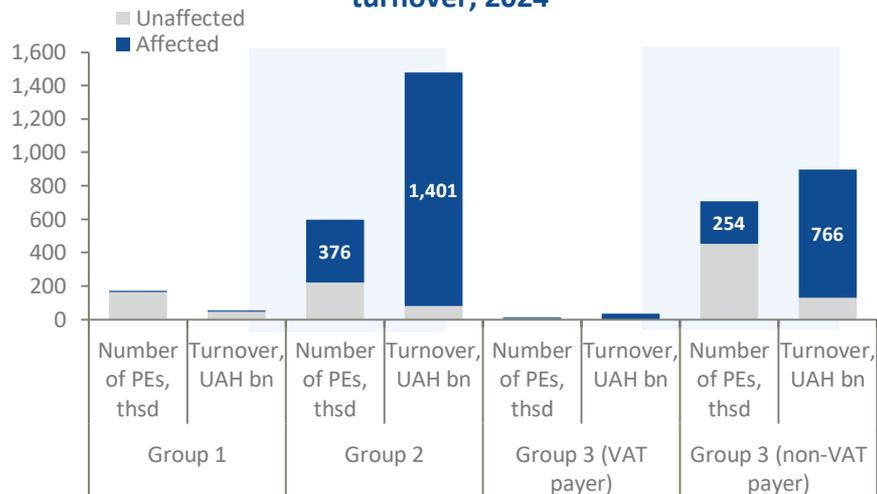


Source: Own representation based on European Commission (2026) and Tax Codes of EU candidates countries, own analysis

- » **Ukraine's current VAT design contradicts EU principles:** unlike the EU, which applies a **single turnover-based threshold** to all economic agents, Ukraine determines VAT registration using **both legal form and turnover**, resulting in **two separate thresholds**— EUR 20,000 for companies under the general taxation system (entities registered as companies) and €EUR 86,000 for private entrepreneurs under the STS.
- » Implementing e-invoicing, transaction-level reporting, and standardized invoice-blocking rules strengthens compliance, reduces discretionary decisions, and prevents revenue leakage without overburdening compliant businesses.
- » Poland's targeted bank-account monitoring and Portugal's SAF-T e-reporting illustrate practical approaches to transparency and simplification; early preparation and clear communication are essential to implement reforms effectively by 2027.

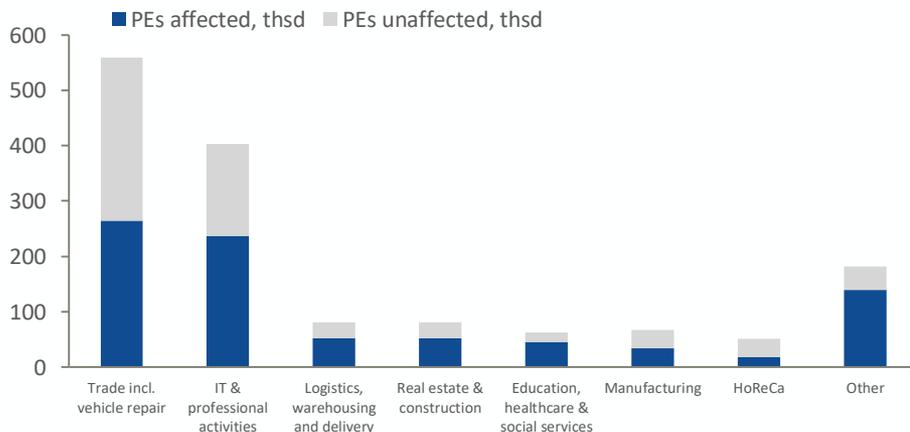
6. Impact assessment: group-by-group basis (1)

Effects of VAT introduction for STS taxpayers by number and turnover, 2024



Source: Own representation based on State Statistics Service (2026), own estimate

Sectoral distribution of STS PEs affected and unaffected by VAT registration threshold, all groups combined, 2024



Source: Own representation based on State Statistics Service (2026), own estimate

- » The UAH 1 m VAT threshold primarily affects Group 2 PEs, covering around 63% of PEs and 95% of their turnover, and Group 3 PEs, affecting around 36% of PEs and 85% of their turnover.
- » The VAT introduction will have the largest impact on the trade, services sectors.
- » For goods-related activities, the key transmission channel is the restoration of VAT supply chains. It reduces the advantages of business models: based on grey imports, unreported turnover, and non-transparent product origin, with strongest effects observed in the B2C segment.
- » For services, the main effect is the removal of fiscal benefits.
- » It is associated with scaling activity outside the VAT system, reducing incentives for “self-employment instead of employment” arrangements, while preserving VAT neutrality in B2B transactions and for service exports.

Impact: trade in goods (2)

- » VAT registration restores VAT chains for goods transactions and reduces fiscal advantages associated with grey market activity.

Domestic market

- » **B2B:** VAT remains economically neutral – input VAT is creditable and does not inflate reported turnover
- » **B2C:** VAT applies to final consumption, aligning pricing conditions across sellers

Cross-border trade

- » **Imports:** VAT paid at customs becomes creditable as input VAT
- » **Exports:** VAT refunds ensure that VAT does not become a cost for exporters

Economic effect

- » Reduced circulation of grey market goods
- » Restored supply-chain traceability
- » More level-playing field condition

Impact: trade in services (3)

- » VAT registration primarily affects domestic B2C transactions and remains neutral for B2B transactions and for cross-border services covered by Article 186.3 of the Tax Code of Ukraine

Domestic market

- » **B2B:** VAT remains economically neutral – input VAT is creditable and does not affect margins or inflate reported turnover
- » **B2C:** VAT applies to final consumption of services

Cross-border trade

- » **Imports:** VAT treatment of imported services remains unchanged and neutral
- » **Exports:** Services supplied to non-resident clients and covered by Art. 186.3 are treated as supplied outside Ukraine and remain outside the scope of Ukrainian VAT; such transactions are excluded from VAT registration threshold. Services supplied to non-resident clients where the place of supply is Ukraine may increase the gross price for the foreign client or reduce the provider's net price

Economic effect

- » VAT neutrality preserved for B2B transactions
- » VAT neutrality preserved for cross-border services covered by Article 186.3
- » VAT applies to final consumption of services in the domestic market

7. Implementation challenges (1/2)

- » **Threshold calibration.** The current VAT registration threshold (UAH 1 m), introduced in 2015, has remained unchanged for a prolonged period and is now low relative to current macroeconomic conditions.
 - A moderately higher threshold in the range of UAH 2–3 m (with an indicative level of about UAH 2.5 m) would better balance additional revenue with administrative and compliance costs, in line with OECD practice and IMF-recommended VAT threshold design (Keen–Mintz framework).
- » **Administrative capacity** and discretion risks. Expanding VAT registration increases demands on tax administration.
 - Ukraine’s transaction-level invoice control model creates risks of discretionary decisions, registration delays, and temporary liquidity constraints.
 - A key implementation challenge is shifting toward more automated, risk-based, predictable procedures.
- » **Compliance costs for small businesses.**
 - VAT registration entails non-trivial accounting and reporting costs, particularly for newly registered taxpayers.
 - These costs should be mitigated through simplified reporting, standardized digital tools, and clear guidance, especially during the transition phase.

7. Implementation challenges (2/2)

» Trust, behavioural, and political risks.

- Low trust in tax authorities may amplify resistance, political opposition, and short-term underreporting during the transition.
- These risks are best addressed through phased implementation, predictable timelines, and communication framed around fairness and competitive neutrality rather than revenue extraction.

» Misinterpretation of the VAT burden.

- VAT registration does not imply a uniform 20% increase in the tax burden.
- In B2B transactions VAT remains neutral, as output VAT is fully creditable.
- Net tax effects arise mainly in B2C transactions, while registration often converts non-deductible VAT embedded in costs into input VAT credit rather than increasing the effective tax burden.

8. Policy recommendations

» Recalibrate the VAT registration threshold.

- Set the mandatory VAT threshold at around UAH 2.5 m to balance revenue mobilisation with compliance and administrative costs.
- Thresholds of UAH 4 m and above are unlikely to materially deter artificial fragmentation of business activity.
- The fiscal implications will depend on the final threshold design and require further assessment, given potential spillover effects on both the simplified and general tax regimes.

» Offset VAT base expansion with administrative simplification.

- Any widening of the VAT base should be accompanied by simplified administration, including the cash accounting method, streamlined reporting, and standardized digital tools, in order to limit liquidity constraints and compliance pressures for small taxpayers.

» Harmonise the VAT treatment of cross-border services.

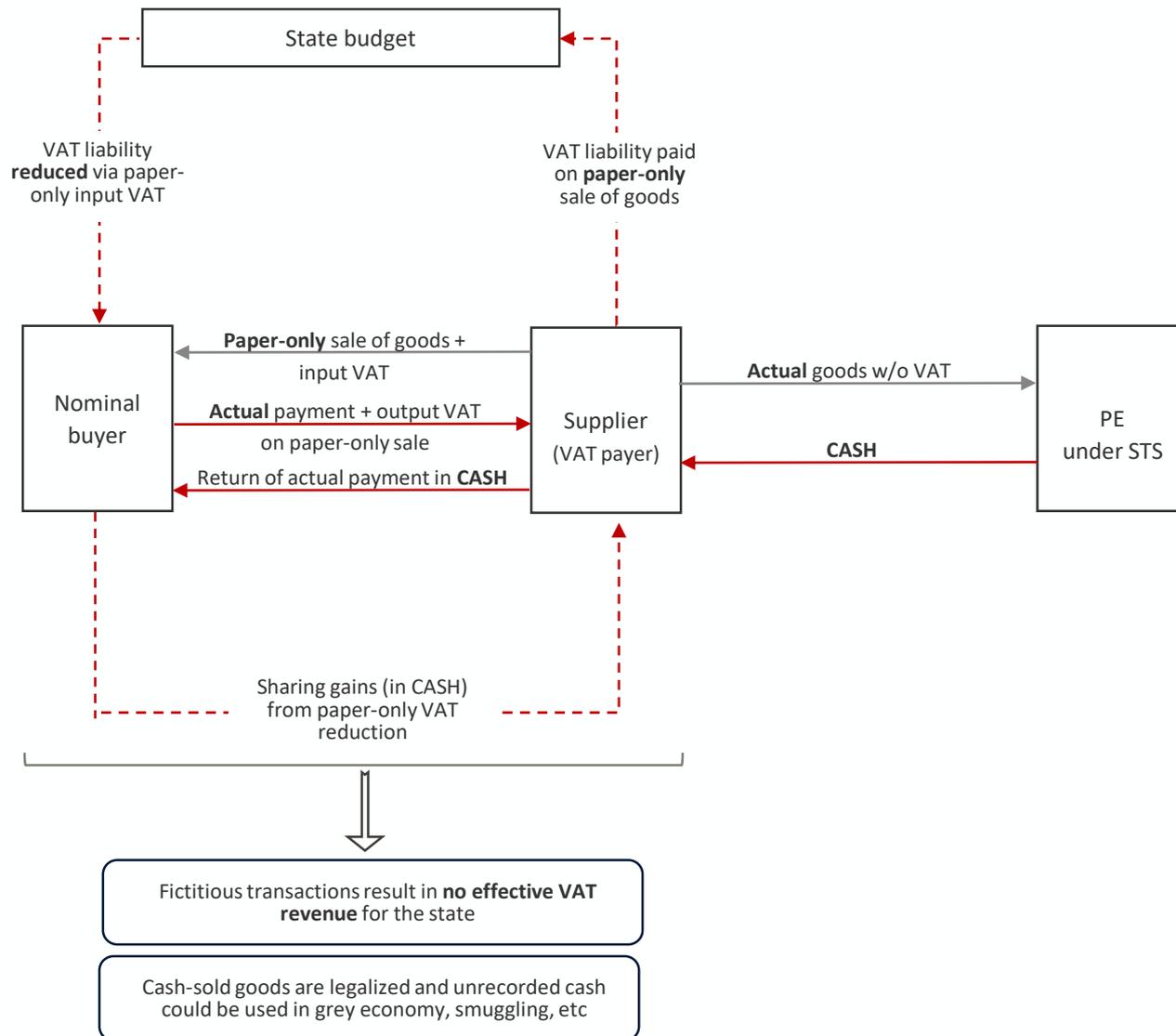
- Replace the selective list in Article 186.3 of the Tax Code with a unified place-of-supply rule for cross-border services, streamlining the determination of the place of service provision in line with international VAT practice.

» Restore the VAT base before considering rate reductions.

- Reductions in VAT rates (for example, for basic foodstuffs) should be considered only after VAT chains are fully restored and de-shadowing effects materialise, in order to avoid revenue losses and competitive distortions.

Annex

Annex 1. Consequences of VAT chain disruption: fictitious transactions and cash leakage



Annex

Annex 2. Rationale for the VAT threshold recommendation

- » The average turnover of sole proprietors of all groups is UAH 1.7 m
- » The average turnover of sole proprietors of all groups (excluding those with an annual turnover of up to UAH 500 000) is UAH 2.7 m
- » The average turnover of sole proprietors of all groups (excluding those with an annual turnover of up to UAH 1 m) is UAH 3.4 m
- » The average turnover of sole proprietors engaged in wholesale and retail trade is UAH 2.2 m
- » In wholesale and retail trade, Group 2 shows an abnormal increase in the number of PEs, starting with a turnover of UAH 4.1 m. In HoReCa, Group 2 shows an abnormal increase in the number of PEs, starting with a turnover of UAH 4.6 m. **This indicates that the introduction of a threshold of UAH 4 m and above will not make the fragmentation scheme more expensive, effectively leaving it at the current level.** At the same time, the threshold should remain not lower than the limits for the smallest microbusinesses in Group 1, so as not to undermine the very logic of the simplified system.

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About the German Economic Team

Financed by the Federal Ministry for Economic Affairs and Energy, the German Economic Team (GET) advises the governments* of Ukraine, Belarus, Moldova, Kosovo, Armenia, Georgia and Uzbekistan on economic policy matters. Berlin Economics has been commissioned with the implementation of the consultancy.

**In Belarus and Georgia advisory activities are currently suspended.*

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