

Ukraine Economy of the Future (UEF) Phase II

Deshadowing the Economy

February 2026



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Summary of the UEF Deshadowing the Economy (1/6)

1. Issue Definition: the problem, the impact and underlying causes

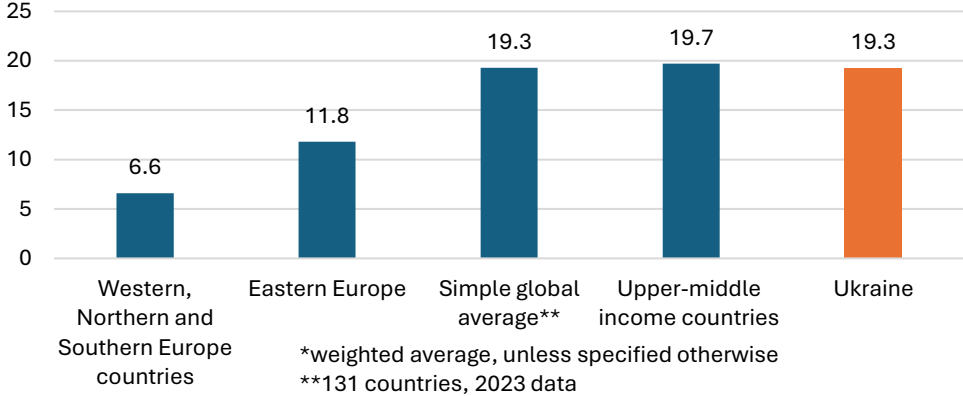
- Estimates for the size of the shadow economy in Ukraine range between 20 and 50% of GDP, more than double the estimates for other European (and more than 50% higher compared to just Eastern European) countries.
- **The shadow economy constrains growth:** Firms (and employees) constrain their income growth or bear substantial costs to hide parts, or all, of their income. They do this to minimize their tax liability (e.g. by avoiding VAT), or to engage in illicit or criminal economic activities (e.g. smuggling). This undermines incentives for innovation, income growth, and job creation, and creates an uneven playing field between firms and workers inside and outside of the shadow.
- **The shadow economy also causes considerable fiscal losses** by undermining the VAT, income, and customs tax bases.

2. Labor/Worker-level informality

Shadow economy issues: Under-reporting of salaries, non-registration of workers.
Policy focus on labor regulations, labor taxation, the social benefit system, and law enforcement.

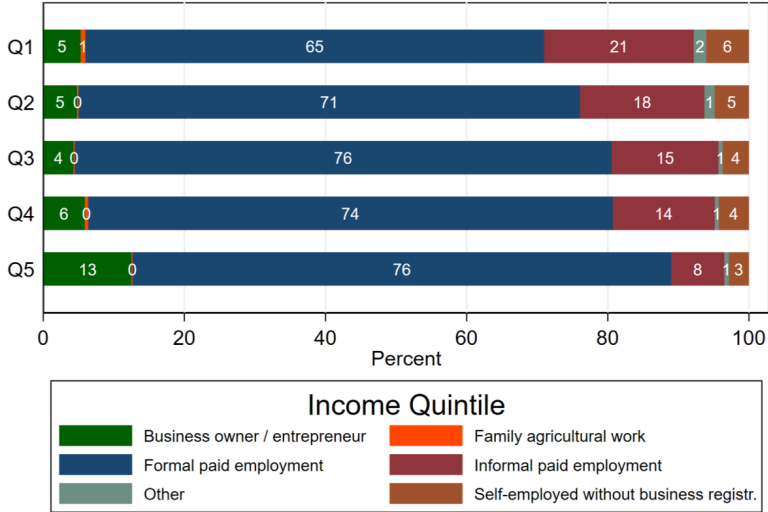
- Labor informality ranges from **full informality** (where workers are not registered) to receiving parts of the compensation **informally in envelopes**. It also encompasses the **registration of de-facto employees as sole proprietors (FOPs)**. These practices are widespread and are more prevalent among vulnerable population groups.
- They are driven by three factors: (i) **labor market rigidities** that prevent a creation of more productive formal jobs; (ii) the **perceived benefits of formalization (including social benefits) are less than its perceived costs** related to regulation and taxation; and (iii) a perceived **low cost of non-compliance** with labor regulations.
- Addressing labor informality requires **reforms to modernize the labor code and introduce a progressive personal income tax** that reduce the marginal cost of formalization for low-income workers and address labor market rigidities. It also requires appropriate and effective **enforcement, public communication, and reforms to the social benefit system** to increase incentives for formal work.

Estimates of shadow economy, % of GDP



Source: EY's Shadow Economy Exposed report (2025)

Informality by income quintile



Source: HSES (2023/24).

Summary of the UEF Denshadowing the Economy (2/6)

3. Firm-level shadow activities (resulting from tax system parameters)

Shadow economy issues: Shadow activity in response to tax parameters

Policy focus on reforming the tax system to reduce costs, distortions, and incentives to move to the shadow

- The **compliance and tax burden is substantially lower** under Ukraine's simplified tax system than under the general tax system. While MSMEs require a simplified system, the design of Ukraine's simplified tax system is so generous that **larger firms split or limit growth** to remain eligible for it. Firms also do this to **avoid VAT liability**.
- **Splitting constrains economic growth:** (i) firms that split cannot realize scale economies and have a harder time accessing foreign investment; (ii) firms that cannot split are outcompeted by those who can.
- In the general system, firms can reduce their liability by systematically **over-reporting costs**.
- Addressing these distortions to support growth requires (i) **dealing with distortions caused by policy thresholds** (through anti-avoidance rules and removal of VAT exemptions), (ii) strengthening **tax enforcement that prevents splitting and over-reporting of costs** (e.g., through targeted audits of suspected splitters and the use of third-party information to assess costs), and (iii) reducing **compliance costs of the general system** (e.g., by increasing the VAT threshold to at least UAH 2 million).

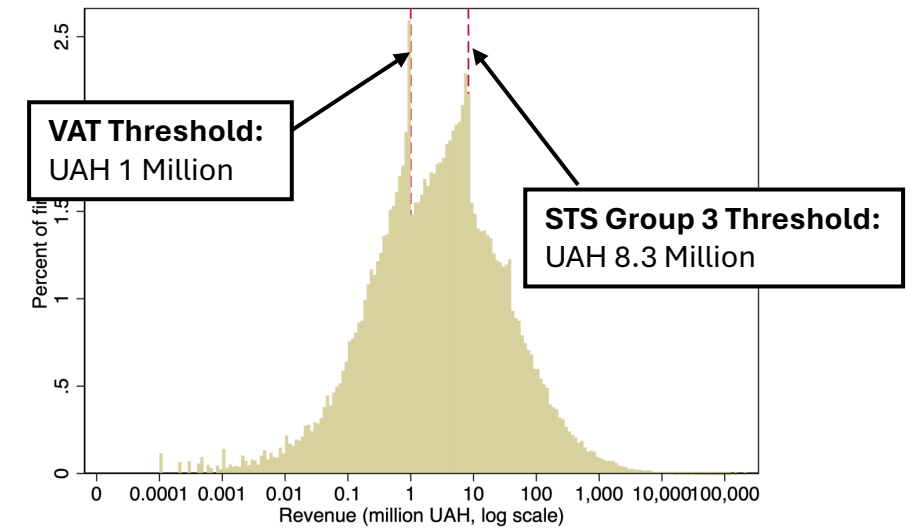
4. Firm-level shadow activities (shifting away from the shadow economy)

Shadow economy issues: Levers to reduce the costs and increase benefits for firm de-shadowing

Policy focus on fiscal institutions, law enforcement, business climate and the financial system

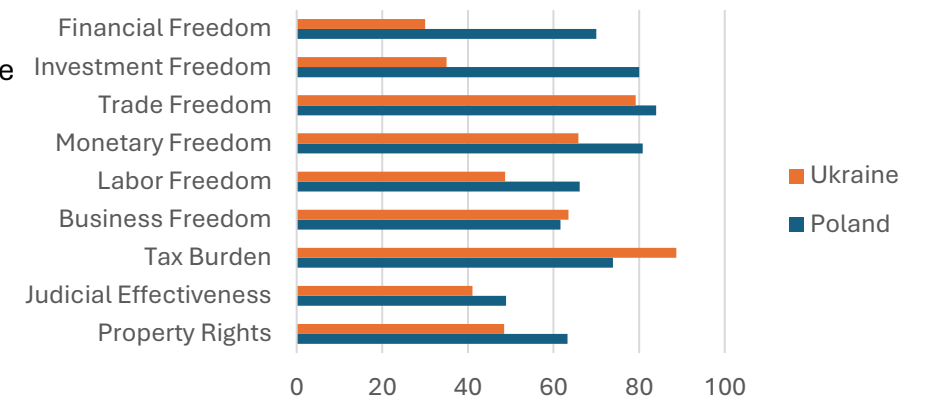
- **Firms decide on whether to engage in shadow activities based on a cost-benefit analysis.** Shrinking the shadow economy requires making being in the "light" easier, less costly and more beneficial, compared to being in the "shadow" for firms.
- Ukraine's policies to increase the benefits of formalization mostly focus on **business support programs providing monetary incentives** (subsidized interest rates, lower tax rates). However, other instruments, such as possibility of **easier settlement of tax liabilities, lighter business regulations** for new firms and **proportionate oversight for low-risk activities** are needed to reduce the costs of formalization.
- To improve effectiveness of fiscal institutions and law enforcement and increase the costs of shadow activities: **ensure adequate resources and strengthen the mandate for ESBU**; increase use of **digital tools and data analytics**; and **improve coordination between institutions** e.g., labor and tax authorities to better manage labor and tax inspections. **Tax audits, customs checks and law enforcement activities should use risk-based approaches** focusing on material shadow economy schemes.

Distribution of Firms' Reported Revenues, 2024



Source: World Bank staff estimates

Index of Economic Freedom, selected indicators



Source: The Heritage Foundation (2021 data)

Summary of the UEF Deshadowing the Economy (3/6)

5. Illicit and criminal shadow economy activities

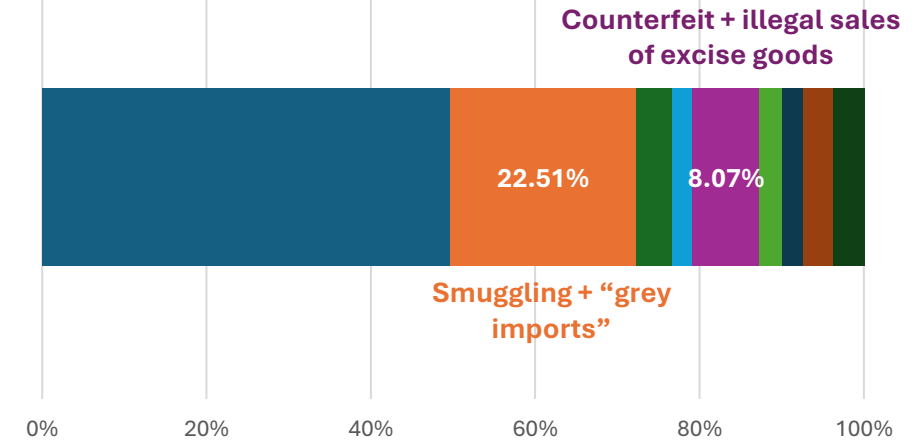
Shadow economy issues: Smuggling, counterfeit goods, conversion centers and money laundering
Policy focus on anti-corruption, customs enforcement, and financial sector regulation and monitoring

- Important shadow flows stem from **smuggling and grey imports** and **counterfeit goods** (often excisable goods like tobacco, fuel).
- **Conversion Centers** help avoid taxes, launder funds from illegal activities, and generate cash for shadow activities. The increased use of **virtual assets** provides an alternative to cash - making it easier for money laundering/moving financial flows to/from illicit and criminal shadow activities.
- Tackling illicit and illegal activities and money laundering requires strengthening the **independent anticorruption institutions (NABU, SAPO, HACC) and ESBU** and completing the reform of the **State Customs Service**. Important anti money laundering reforms include the enactment of the **Single Euro Payment Area law** with its AML-CFT provisions and the **Law on Virtual Assets**, reform and strengthening of the **State Financial Monitoring Service**.

6. Global lessons in deshadowing

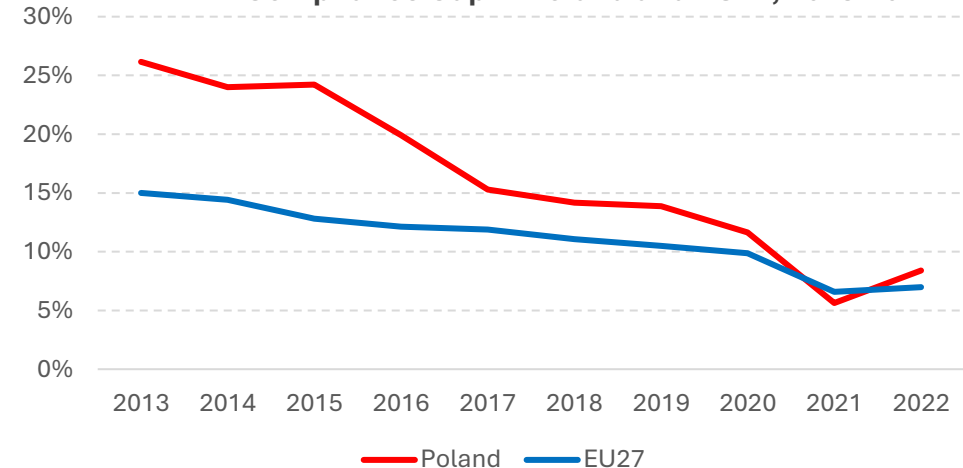
- Shadow economy drivers vary across countries: tax rates is dominant in high-income nations, while **government effectiveness and rule of law is an important factor for middle income countries like Ukraine**.
- Global lessons on interventions to deshadow and increase tax compliance highlight **improved detection using technology and advanced analytics; using third-party information; increasing taxpayers' trust** towards the public administration and tax system through **public communication**; and reducing the cost for **enterprise formalization**.
- Experience of Ukraine's peers such as Poland's efforts in reducing its VAT compliance gap (acting here as a proxy for grey economy; most efforts in Poland were put toward closing this gap) with fiscal institutional reforms and anti VAT-fraud measures over a 6-7 year period demonstrate that a **drastic reduction in the shadow economy is possible** but requires **continuous sustained effort, a whole-of-government approach, and targeted sectoral measures complementing horizontal policies**.

Illicit activities are estimated to be responsible for ~30% of total annual fiscal losses due to shadow economy



Source: CASE, ISET, Expert Economic Platform study

VAT Compliance Gap in Poland and EU27, 2013-2022



Source: UN Global Compact Network Poland

Summary of the UEF Deshadowing the Economy (4/6)

| POLICY LEVER | KEY INTERVENTIONS STARTING NOW (BEFORE THE WAR ENDS) | KEY INTERVENTIONS IN YEAR 1 POST WAR | KEY INTERVENTIONS IN YEARS 2-5 POST WAR |
|---|---|--|--|
| Labor market regulations | <ul style="list-style-type: none"> • Enact (now) and implement (year 1 onwards) a revised modern labor code that encourages more flexible work arrangements, addresses specific barriers to female employment, clearly defines employee-employer relations, enables risk-based labor inspections, improves social dialogue and reduces administrative costs for firms to employing workers formally.**,^ • Undertake risk-based labor inspections to enforce labor code provisions.^ | | |
| Skilling and Employment Programs | <ul style="list-style-type: none"> • Develop and approve regulations to overhaul the State Employment Service (SES).** ,^ • Validate and recognize skills of informal workers: Create systems to assess and certify the skills informal workers already possess, making them easier to prove to employers.^ | <ul style="list-style-type: none"> • Reform the SES training vouchers and short-term skills training to better respond to skills and labor demand.^ • Reform active labor market programs targeted at veterans and persons with disability.^ | <ul style="list-style-type: none"> • Establish and expand high-quality, job-relevant skilling and re-skilling programs for recovery and reconstruction in partnership with the private and education sectors, including PPP models.^ |
| Tax policy and administration <small>*Recommendations are consistent with the implementation of the National Revenue Strategy along envisioned sequence *, **</small> | <ul style="list-style-type: none"> • Begin a comprehensive reform of the simplified tax system. The STS remains important for MSMEs but requires reforms to prevent misuse: (i) ensure de-facto employees are registered as employees and not as FOPs (through revision of labor code); (ii) restrict STS to sectors with limited scale economies; and (iii) ensure firms under the STS with turnover above the VAT threshold are not exempt from the VAT system. • Investment in State Tax Service's IT capacity based on sound modernization and interoperability principles (e.g., Digital by Design, API first) with a focus on taxpayer experience and internal capability transformation. • Strengthen anti-avoidance provisions to prevent firms from splitting to take advantage of the simplified tax system or to avoid VAT and target audits at potential splitters. • Lower cost of tax compliance for firms in the general tax system by increasing the VAT threshold, implementing easier tax reporting, digitalization of returns and finetuning the account pre-funding and VAT invoice blocking approach to transition to a system of ex-post risk-based controls and audits. • Introduce a simplified framework that includes gig-workers employed through digital platforms into the tax system.^ | <ul style="list-style-type: none"> • Complete State Tax Service upgrade to enable application of data analytics and strengthen risk management systems. | <ul style="list-style-type: none"> • Introduce a progressive personal income tax, with a tax-free minimum allowance and incentives for former employees under the simplified tax system to register (e.g., in-work tax credits) to reduce the marginal cost of formalization for low-income workers.^ • State Tax Service to implement provisions of the EU's VAT in the Digital Age directive to facilitate VAT compliance. |

* Existing reform commitments (EU Enlargement report, IMF program conditionalities, WB DPL and WB PforRs – as per the reform matrix) that should be met even if the war continues.

** Impactful reforms which are not existing commitments, but which are feasible to do under current security conditions and could still be done without waiting.

^ Measures with enhanced potential to tackle unregistered activity (business/labor).

Summary of the UEF Deshadowing the Economy (5/6)

| POLICY LEVER | KEY INTERVENTIONS STARTING NOW (BEFORE THE WAR ENDS) | KEY INTERVENTIONS IN YEAR 1 POST WAR | KEY INTERVENTIONS IN YEARS 2-5 POST WAR |
|---|--|---|---|
| Fiscal agencies | <ul style="list-style-type: none"> • Creation of KPIs for State Tax Service and State Customs Service that aim at reducing the tax gap and disincentivize putting undue pressure on formal firms. • Limit controlling bodies' discretion to be exercised only within a clear framework, create clear and effective channels for complaints (such as PULSE system), provide timely feedback and consider publishing anonymized explanations of individual complaints and their resolution. • Initiate taxpayer communication campaign to obtain buy-in for tax base broadening efforts.^ • Complete the institutional reform of the State Customs Service as provided for in the 2024 law, including selection of a new head and audit of SCS staff.* • Fiscal data governance reform and IT investment to establish cross-agency data warehouse to strengthen use of fiscal data analytics to detect shadow economy activities while enhancing oversight/controls to prevent data misuse.** | <ul style="list-style-type: none"> • Reform of State Customs Service operations: Use of the track and trace system and staff rotation. • Reform of State Tax Service: finalizing the Single legal entity reform, enabling centralized control over regional offices of the State Tax Service. | |
| Cost-Benefit from formalization i.e., Carrots and sticks | <ul style="list-style-type: none"> • Eligibility for access to (i) firm support programs such as 5-7-9 and (ii) public procurement opportunities could be limited to registered firms in the general tax system. The design of firm support programs should further encourage growth. • Deregulation and reporting simplification for low-risk activities and for newly registered firms.^ • Ensure adequate resources (including access to data and enhanced investigative tools, human resources, budget) and strengthen the legal mandate for ESBU to tackle the shadow economy through their analytics and investigative work on the shadow economy. | <ul style="list-style-type: none"> • Enhanced coordination to enable use of existing and (potentially) new mechanisms allowing easier settlement of tax violations to reduce costs of deshadowing for business. • Strengthen data management, security standards, digital tools and data analytics by fiscal and law enforcement bodies, including on bank accounts, to enable risk-based inspections and improve enforcement without expanding administrative burden.^ • Reform/enhance tax audits, labor inspections, customs checks and law enforcement activities to use risk-based approaches so that they focus on material shadow economy schemes with proportionate oversight for lower-risk activities.^ | |

* Existing reform commitments (EU Enlargement report, IMF program conditionalities, WB DPL and WB PforRs – as per the reform matrix) that should be met even if the war continues.

** Impactful reforms which are not existing commitments, but which are feasible to do under current security conditions and could still be done without waiting.

^ Measures with enhanced potential to tackle unregistered activity (business/labor).

Summary of the UEF Deshadowing the Economy (6/6)

| POLICY LEVER | KEY INTERVENTIONS STARTING NOW (BEFORE THE WAR ENDS) | KEY INTERVENTIONS IN YEAR 1 POST WAR | KEY INTERVENTIONS IN YEARS 2-5 POST WAR |
|--|--|---|---|
| Anti money laundering and elimination of conversion centers | <ul style="list-style-type: none"> • Establish a national register of money mules (“drops”) to limit use of individuals’ accounts for money laundering / tax evasion through identifying cardholders selling access to their accounts. • Enactment of the Single Euro Payment Area (SEPA) law with its Anti-Money Laundering and Combating the Financing of Terrorism provisions, aligned with EU requirements.* • Enactment of a Law on Virtual Assets, largely aligned with MiCA (Regulation of the European Parliament and of the Council of 31 May 2023 on markets in crypto-assets transactions). | <ul style="list-style-type: none"> • State Financial Monitoring Service (SFMS): Reform and strengthen the independence and capacity of the financial intelligence unit to detect illicit flows, starting with a transparent, competitive leadership selection involving international experts (year 1). | <ul style="list-style-type: none"> • State Financial Monitoring Service (SFMS): Complete reform with the full re-attestation of staff (year 2). |
| Cross Cutting | <ul style="list-style-type: none"> • A whole-of-government approach is required, with increased coordination and data sharing between government agencies[^] involved in deshadowing efforts – for example, the recently announced cooperation and data sharing between ESBU and State Labor Service of Ukraine to combat labor informality – as well as with other actors e.g., between the State Tax Service and banks to identify tax evasion. • Improve trust in fiscal and law enforcement institutions and strengthen tax morale through transparency and communication with clear messaging on the costs of working in the shadow economy, coupled with tax education and literacy programs.[^] • Efforts to fight corruption and increase integrity of all controlling and law enforcement bodies (incl. State Bureau of Investigations, National Police etc.) must be strengthened to increase trust toward the state and buy-in of any difficult reforms. | | |

In addition, sector and shadow scheme-specific strategies and actions - for example in retail and food chains, alcohol, tobacco, fuel, electronic goods, digital platforms, e-commerce, construction sectors - **will need to complement the above-mentioned horizontal policy levers.**

The policy agenda for strengthening anticorruption institutions and the rule of law is strongly linked to the deshadowing agenda (see *Policy Levers component of the UEF for details on this*).

* Existing reform commitments (EU Enlargement report, IMF program conditionalities, WB DPL and WB PforRs – as per the reform matrix) that should be met even if the war continues.

** Impactful reforms which are not existing commitments, but which are feasible to do under current security conditions and could still be done without waiting.

[^] Measures with enhanced potential to tackle unregistered activity (business/labor).

Outline

1

Issue Definition: the problem, impacts, underlying causes and areas of policy interventions

2

Topic 1: Labor informality: Policy focus on labor regulations, income tax, the social benefit system, and law enforcement

3

Topic 2: Firm-level shadow economy activities (1/2): Policy focus on reducing tax-induced distortions

4

Topic 3: Firm-level shadow economy activities (2/2): Policy focus on lowering the costs and increasing the benefits of leaving the shadow economy. Topics covered include the role of law enforcement and fiscal institutions and business climate.

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Topic 4: Illicit and criminal shadow economy activities: Policy focus on anticorruption, customs enforcement, and financial sector regulation and monitoring

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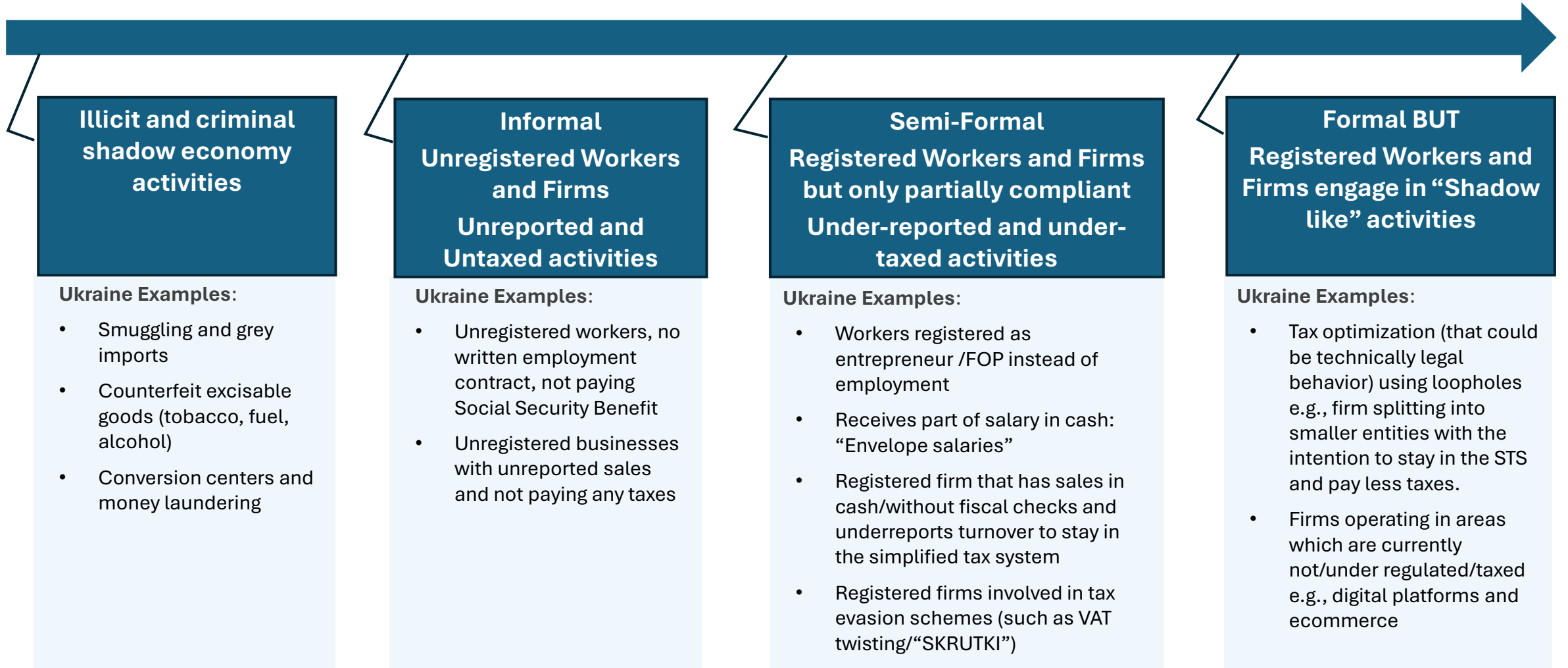
Global lessons on deshadowing: International and Poland case

1 Issue Definition

Defining the problem, the impacts, and underlying causes

There is no single definition of the Shadow Economy

The Shadow Economy can be conceptualized as a continuum of firm and worker's economic behavior



Available estimates for Ukraine's shadow economy vary – reflecting different definitions and inherent difficulty in estimating activities – but are large relative to the rest of Europe

The Shadow Economy exists everywhere in the world: However, Ukraine's scale and pervasiveness pose a particular problem in the context of EU integration and post-war recovery. The upper bound estimates of the Shadow Economy in Ukraine is similar to many low middle income countries but higher than EU comparators.

Ukraine Estimates

23.8% of GDP (2018)

EY's Ukraine study
Definition: Cash shadow economy – unreported economic activity related to cash transactions
+ **Non-monetary production** (household production of goods for own final use)

32% of GDP (2021)

Ministry of Economy
(latest available estimate)
Definition: Unregistered economic activity, output of which is in part used in production of GNP but is not fully reflected in official statistics, **is untaxed**, violates established norms

30-50% of the GDP

Rada's tax and financial policy committee
(latest available estimate)
Definition: legal but untaxed economic activity or economic activity directly aimed at avoiding taxes (counterfeit, smuggling etc.)

Global Comparisons

Western, Northern and Southern Europe countries average, weighted: 6.6%

Eastern Europe: 11.8%

Ukraine: 19.3%

Simple global average of 131 countries: 19.3%

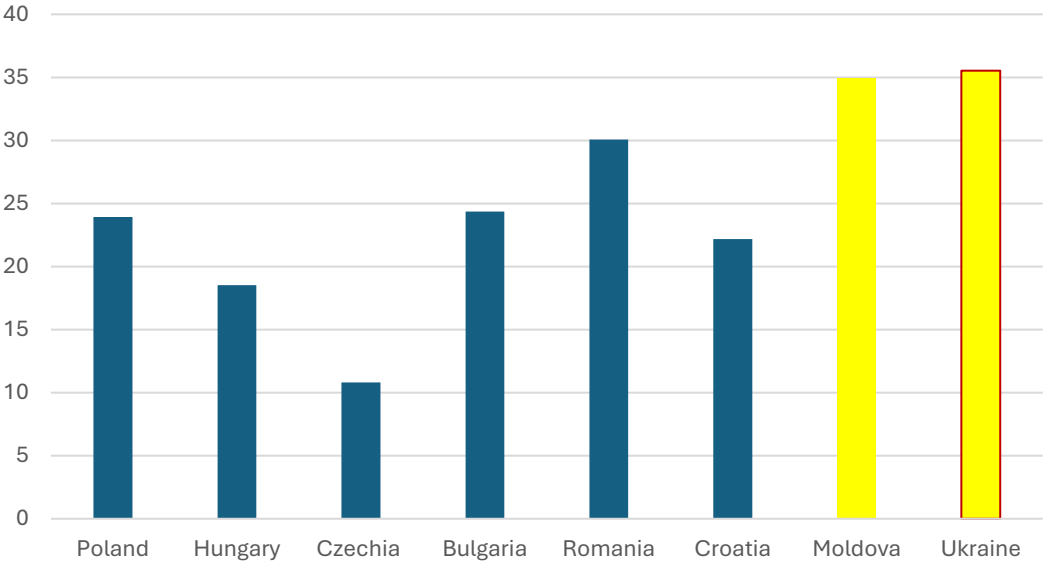
Upper-middle income countries average: 19.7%

EY's global 2025 estimate (based on 2023 data)

Definition: “non-observed” or “unregistered” economy. It involves unreported economic activity from both registered and unregistered entities, where no invoices or fiscal receipts are issued, rendering transactions unreported and taxes unpaid

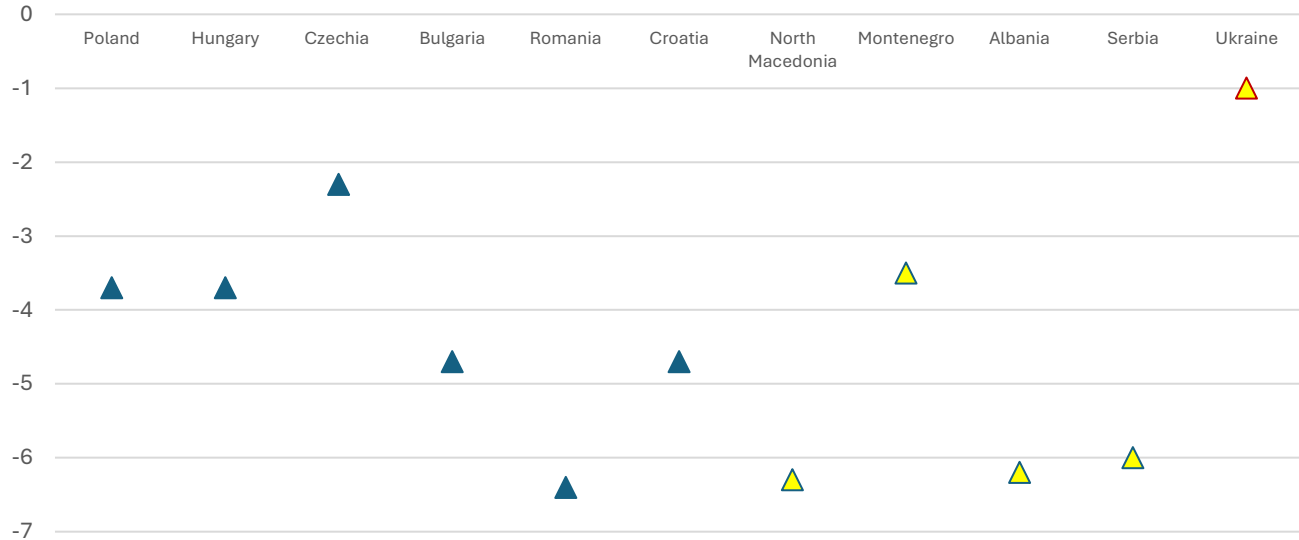
Ukraine's shadow economy level remains elevated relative to most recent European members at time of accession, and dynamics have been slow as compared to peers

Informal Economy level (year of accession/candidacy status), % of GDP



Source: Asllani et al., Mapping the Informal Economy Around the World with an Enhanced MIMIC Approach: New Estimates for 110 Countries from 1997-2022 (October 14, 2024). CESifo Working Paper Series No. 11416

Shadow Economy change 2013-2023*



* Measured as percentage-point change in share of GDP.

Source: EY (2025)

EU members EU candidates

The Shadow Economy is found across many sectors of the economy, involves numerous “schemes”, and involves large fiscal losses. Example (1) AmCham

1. Retail and food chains

- Wages are often paid partly “in envelopes”
- Abuse of simplified tax system (STS) with some chains having only one employee per outlet and/or registering branches as separate entities.
- Tax losses reached **UAH 37 billion in 2024** and UAH 27 billion in the first nine months of 2025. VAT losses of around UAH 3–4 billion in 2025.

2. Alcohol and tobacco

- Counterfeit production in hidden facilities or at registered factories working covertly.
- An estimated **UAH 26 billion** in losses in 2025 despite regular tax increases in tobacco market alone.

3. Electronic goods

- Sales of electronic goods for cash and/or without fiscal checks.
- **4 out of 5 iPhones enter Ukraine without customs clearance and are sold without paying taxes.**
- Estimated **UAH 10 billion** of fiscal losses in 2025, in VAT and duties just from Apple products

4. Digital platforms

- Most individuals providing services/selling goods via platforms like (Glovo, Bolt, Kabanchik etc) do not pay taxes.
- Potentially **UAH 7–10 billion** foregone annually if taxed at 5% PIT and 5% military tax

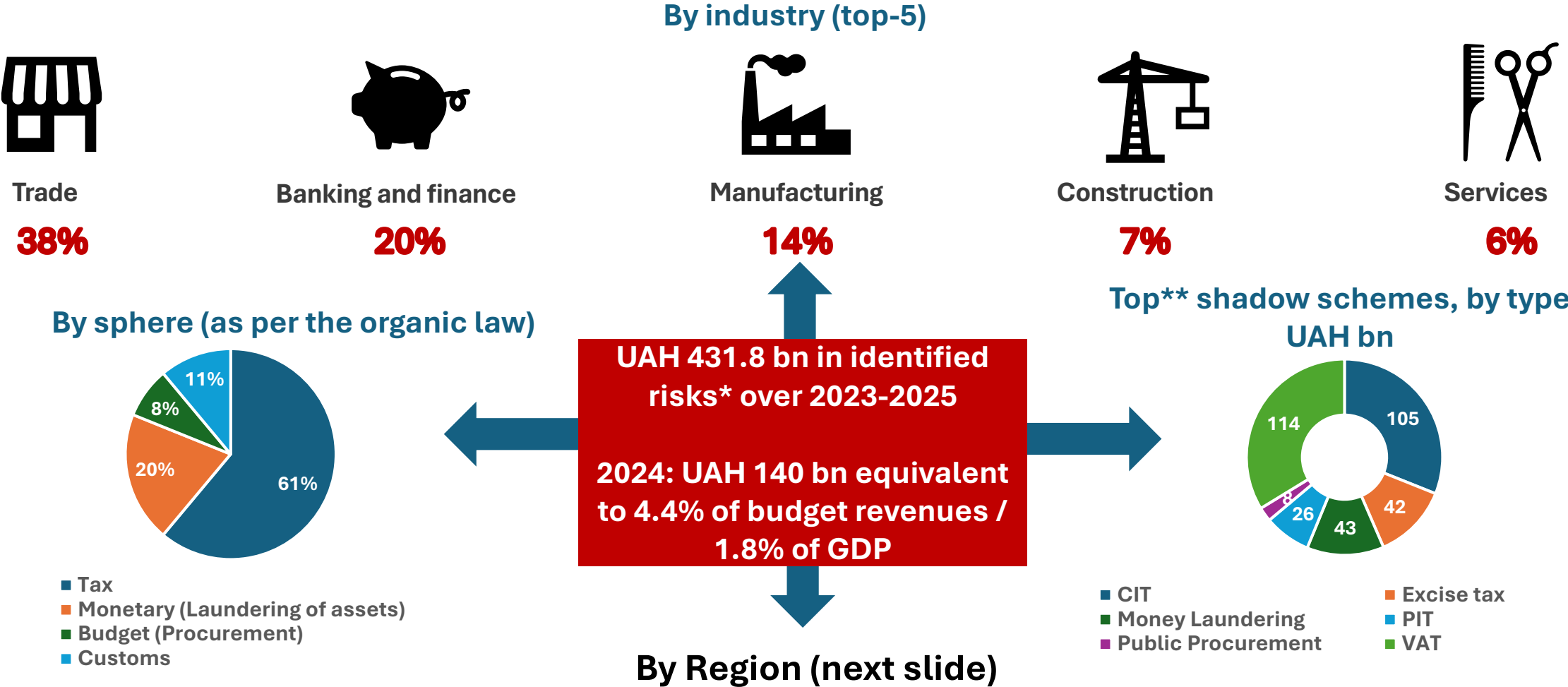
5. E-commerce

- Global marketplaces avoid many taxes that local shops and producers must pay.
- **In 6 months 2025, around 50 million parcels received from abroad, with goods typically untaxed.**
- Estimated fiscal losses reach **UAH 20 billion** in 6 months 2025 and growing.

6. Fixed internet

- **Large fixed internet operators splitting into smaller entities under the STS.**
- Thanks to legislative changes, in Jan - May 2025, internet providers paid UAH 2.6 billion in taxes, which is a 50% increase compared with the same period in 2024: VAT: +56.1%, CIT: +29.4%, PIT +80.4%

Example (2) ESBU analysis (data analytics and investigations) also show numerous schemes, sectors and large fiscal losses from the Shadow Economy (1/2)

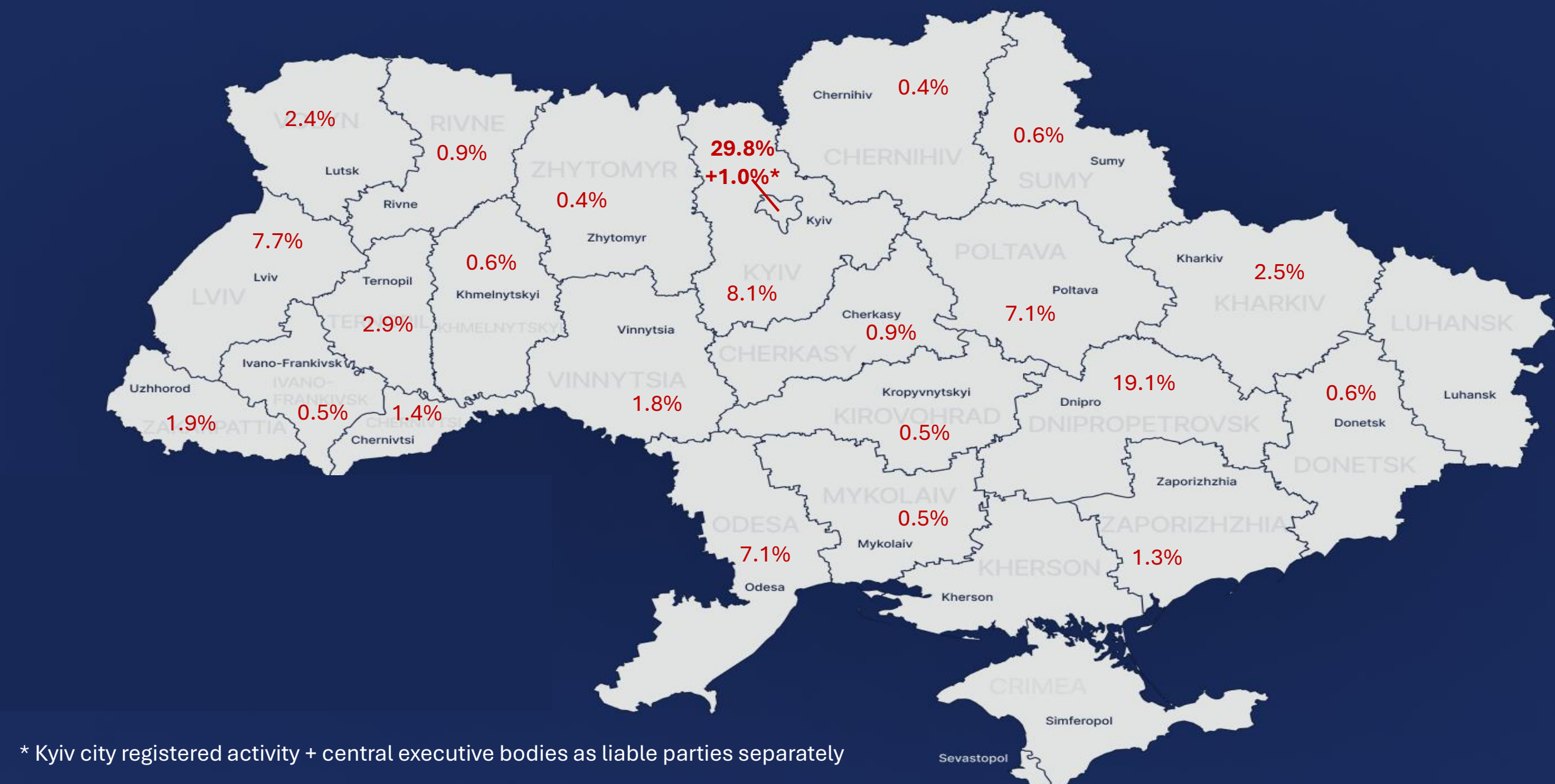


Source: ESBU data (as of November 2025), World Bank staff calculations

* Risk signify losses to the state, through elevated procurement prices, unpaid taxes etc., and money laundering (according to the ESBU law – a threat that leads to increase in shadow economy or weakening of economic security of the state).

** Schemes totaling over UAH 6 bn over 2023-2025 were selected (14 out of 122 defined schemes).

Example (2) ESBU analysis (data analytics and investigations) also show the geographical distribution of Shadow Economy activities and risks (2/2)



* Kyiv city registered activity + central executive bodies as liable parties separately

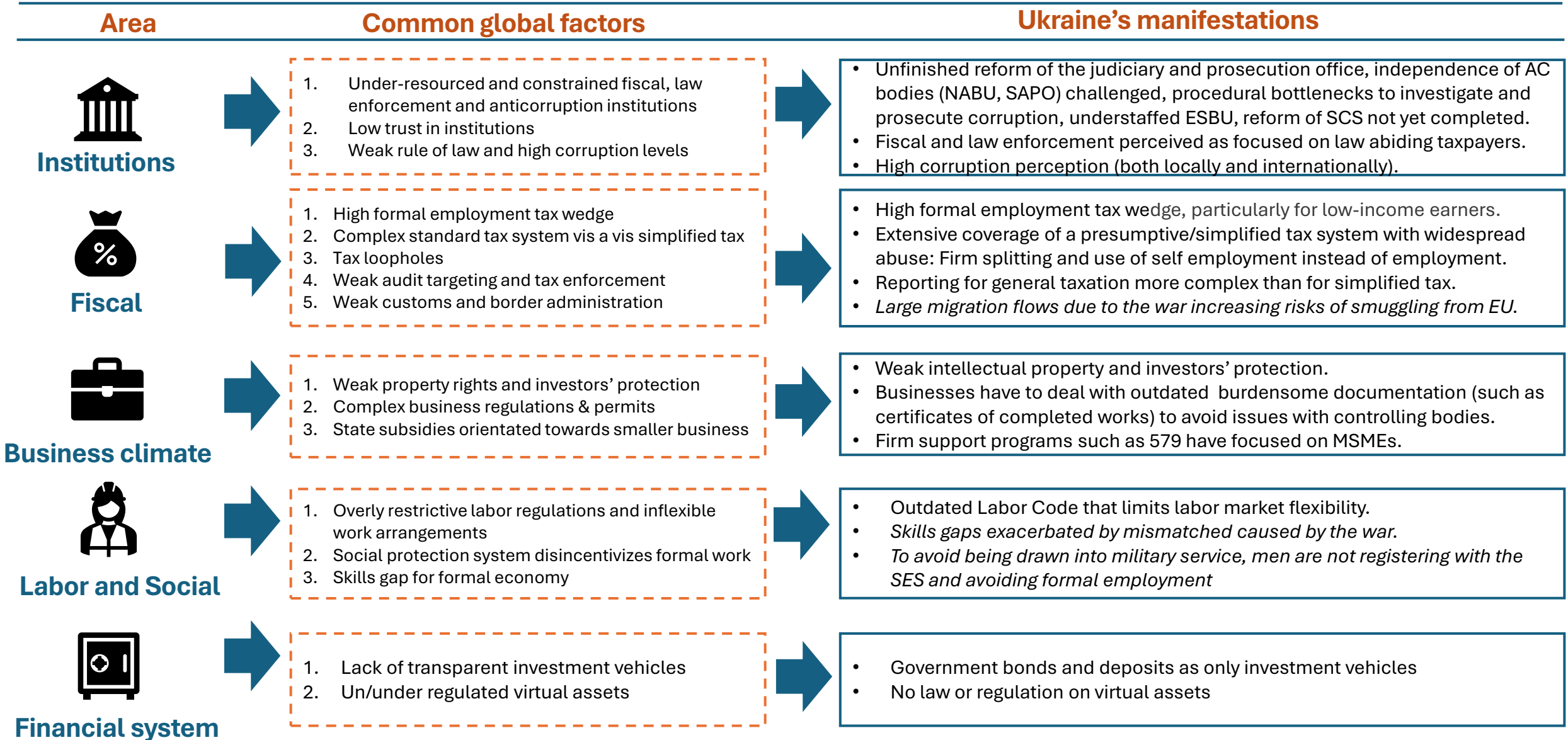
Example (3): CASE Ukraine, ISET, Expert Economic Platform analysis of schemes and estimates of annual turnover and fiscal losses (2024 data)

| Shadow Economy Scheme | Estimated Amount of Economic Activity, UAH bn | Estimated Fiscal Loss, UAH bn (USD billion equivalent)* |
|---|---|---|
| Unregistered workers + envelope wages | 400-510 | 200-265 (4.8-6.4) |
| “Grey imports” + smuggling | 300-360 | 105-120 (2.5-2.9) |
| Informal self-employed | 260-400 | 16-24 (0.4-0.6) |
| Simplified tax system under reporting and splitting | 220-240 | 10-13 (0.2-0.3) |
| Counterfeit and illegal excise sales | 126-140 | 39-43 (0.9-1.0) |
| VAT “skrutki” evasion schemes | 78-90 | 13-15 (0.3-0.4) |
| Offshore schemes | 55-65 | 12-14 (0.3) |
| “Self-employed” workers instead of employment | 38-45 | 16-19 (0.4-0.5) |
| Land and real estate schemes | - | 18-20 (0.4-0.5) |
| TOTAL | 1,477- 1,850 | 429-533 (10.3-12.8) |

Source: CASE Ukraine, ISET, Expert Economic Platform. Experts estimate that around UAH 10 bn is additionally lost due to other schemes

*Average official exchange rate for 2025 used (41.69 UAH/USD)

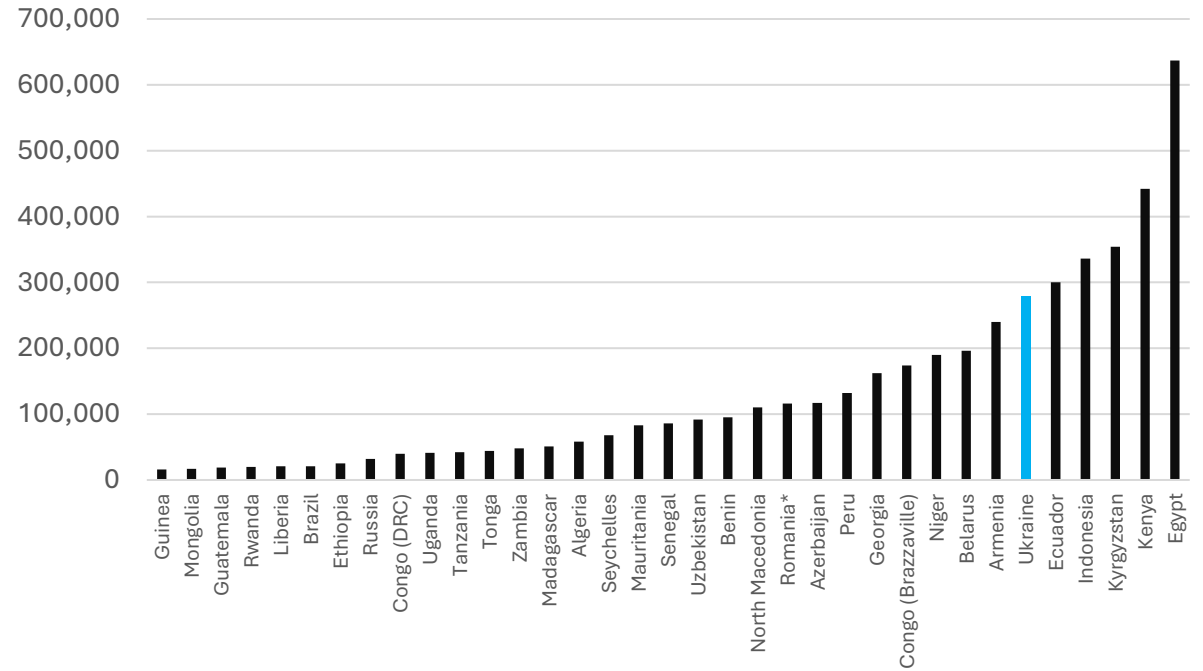
The underlying causes of the Shadow Economy are multi-faceted and can be observed elsewhere. *The war has led to new drivers of informality*



Unique to Ukraine is the extensive use of a simplified tax system (STS) over the standard tax system, which provides strong incentives to engage in *shadow-like* activities

- In Ukraine, MSMEs can choose whether to participate in the normal tax system or in a simplified tax system (STS).
- The STS allows firms to use revenue as a single tax base: Instead of 20% VAT and 18% CIT, firms can pay 5% of revenue.
- Many countries have simplified tax systems, but Ukraine’s is more generous than those of comparators:
 - In the EU, most simplified systems use (calculated) profits as the base and apply **standard or concessional CIT rates**.
 - All EU countries require firms above the VAT threshold to **participate in the VAT system**, even if they qualify for a simpler CIT systems.
 - Among countries with revenue-based systems, Ukraine has the **6th highest maximum eligibility revenue**.
 - Many advanced economies opt for a **profit-based STS** rather than turnover-based, encouraging costs transparency and with potential for enhanced deduction for declaring formal workers.

Maximum Revenue under which firms are eligible for a Turnover Tax (2021, in 2021 US\$)



Source: IMF (2023). Designing a Presumptive Income Tax Based on Turnover in Countries with Large Informal Sectors. WP/23/267

- The STS is popular: 1.6 million taxpayers were registered in December 2025 .
- Because of its generosity, firms and individual workers engage in shadow-like activities to channel revenue through entities eligible for the STS: Firm splitting into smaller entities; Employees registered as sole proprietors (FOPs) under the STS; Salaries paid to employees using a single FOP sub-contractor under the STS that subsequently distributes salaries as “cash in envelopes” to employees.

The negative impacts of the Shadow Economy go beyond fiscal losses: worker welfare, risks to vulnerable groups, firm competition and productivity, rule of law and corruption

Labor informality / Worker-level shadow economy activities

Examples:

- Unregistered workers, no written employment contract, not paying Social Security Contributions
- Registered as sole proprietors instead of employment
- Receives salary in cash: “Envelope salaries”
- Unpaid family work

Main impacts:

- Revenue Loss (PIT)
- Social Security Contributions
- Lack of Social Security Benefits
- Lower Job Quality (pay and rights)
- Risks for Vulnerable Populations as informality higher at lower income levels

Firm-level shadow economy activities *(includes unregistered firms and informal/shadow activities by registered firms)*

Examples:

- Operating without registration
- Abuse of the simplified tax system: underreporting turnover and firm splitting
- Sales in cash/without fiscal checks
- Tax evasion schemes (such as VAT twisting/“SKRUTKI”, Offshore structures)

Main impacts:

- Revenue Loss (VAT, CIT, Excises)
- Unfair Competition with formal firms
- Firm-level Productivity Loss (e.g., small firms lack access to finance and unable to exploit scale economies)

Illicit and criminal shadow economy activities (activities that can't be legal)

Examples:

- Smuggling and grey imports
- Counterfeit excisable goods (tobacco)
- Conversion centres and money laundering

Main impacts:

- Revenue Loss
- Undermining Rule of Law and Anti-corruption Efforts

2

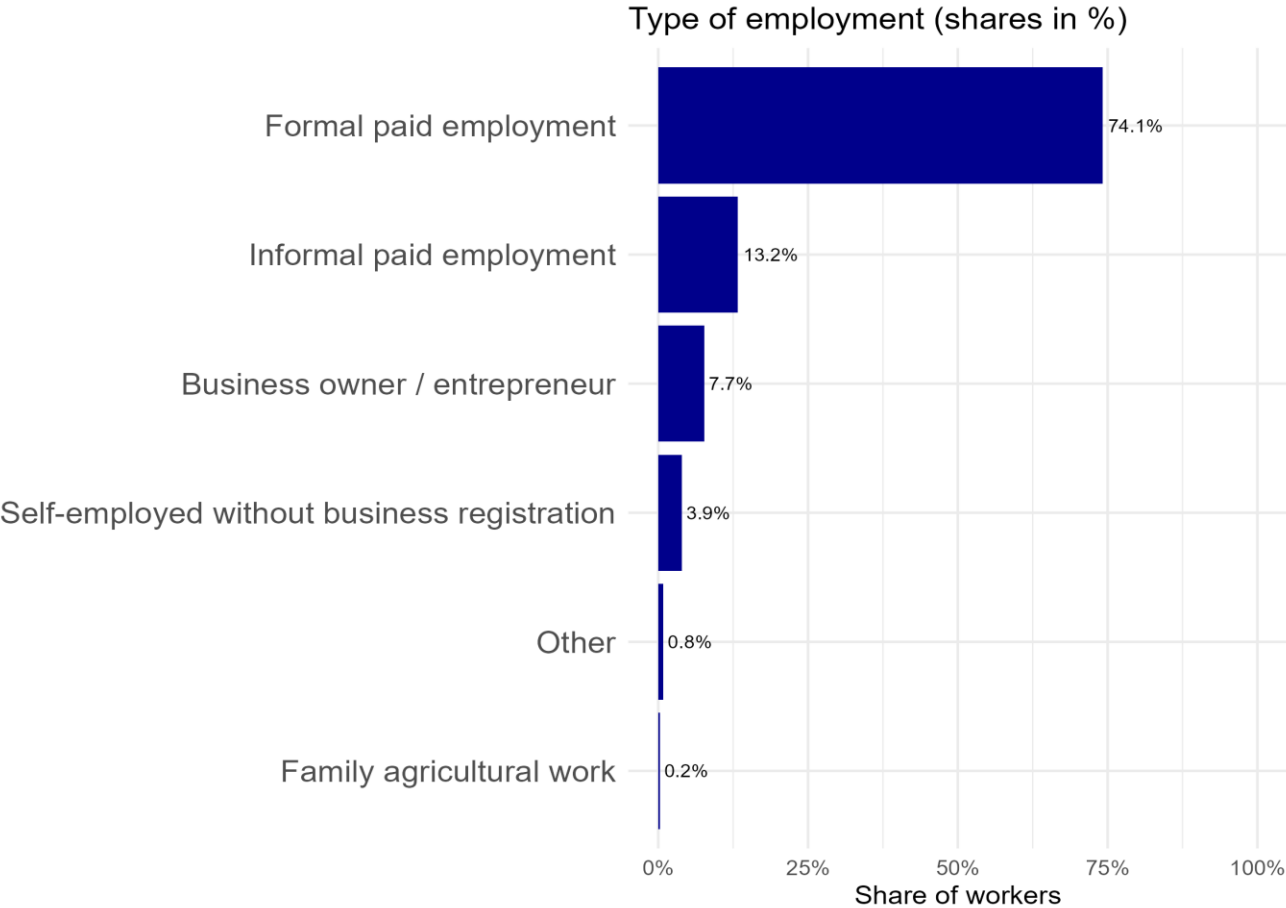
Labor informality/Worker-level shadow economy activities

Shadow economy issues:

Unregistered workers, employees registered as sole proprietors, envelope salaries.

Policy focus on Labor regulations, Income tax, Social benefit system, Law Enforcement.

One in five Ukrainian workers held an unregistered or contract-less job in 2023/24



Notes: Informal paid employment is work for a salary without formalization documents, and on the basis of a verbal agreement. Self-employed without business registration are those who worked individually for themselves in order to receive income without registration of an enterprise and without other persons (repairs, consultations, services, resale, taxi driver, etc.). Source: HSES Labor Survey (2023/24).

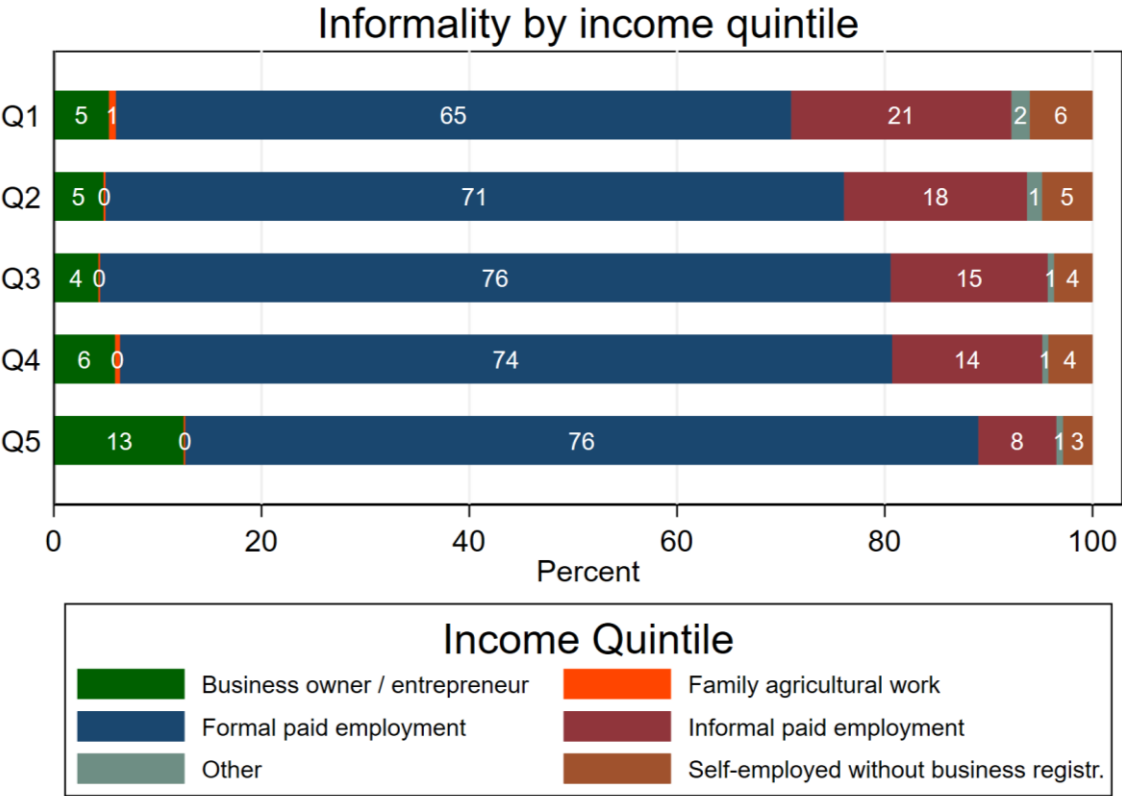
The HSES Labor Survey (2023/2024)

- **13.2 %** of employed people are **informal salary workers**, and **3.9 %** are **self-employed without a business registration**.
- **7.7%** are **registered as business owner/entrepreneur** – could include those that are actually employees registered as sole proprietors (FOPs).

Caveats

- **The HSES labor survey does not capture prevalence of envelope salaries.**
- **The HSES labor survey may not be capturing war dynamics** including that of men not registering with the SES and staying out of formal employment to avoid being drawn into military service. *For example, in the Listening to Ukraine Survey: 19.0 % of individual entrepreneurs were not officially registered in Q3 2025 (L2UKR).*

Labor informality is connected to poverty and vulnerability and is more prevalent in certain industries (construction, wholesale & retail) and regions



Notes: Informal paid employment is work for a salary without formalization documents, and on the basis of a verbal agreement. Self-employed without business registration are those who worked individually for themselves in order to receive income without registration of an enterprise and without other persons (repairs, consultations, services, resale, taxi driver, etc.).

Source: HSES (2023/24).

The HSES Labor Survey (2023/2024)

- **Informality rates are higher among poorer households, youth, elderly, men, IDPs, and the low-skilled** in Ukraine's labor market.
- **Informal jobs are of lower quality:** lower earnings (39.1% earning gap between informal and formal self-employed; 22.7 % wage gap between informal and formal salary workers), lower job satisfaction, and lower labor mobility.
- **Informality rates vary significantly across economic sectors: Construction (31.2 %), Wholesale & Retail (23.5%),** while the public sector has the lowest informality rates (less than 5 %).
- **Informality rates show strong subnational patterns,** with some areas exhibiting much higher rates (6% - 44%).

Envelope wages and employees registered under STS instead of formal employee status are another prevalent part of labor informality in Ukraine

Envelope wages:

- The **proportion of employed persons** that are believed to receive an **under-reported salary** is about **one-third in Ukraine**.^[1] This is much higher than the **average 3% in EU28 countries**. ^[2]
- A **large observed share of minimum wage workers** could be an indicator of **underreporting** activity.^[3]
- **Large discrepancies between average wages for employees in similar jobs** in the same sector between firms could be an indicator of **underreporting** activity – for example, in food retail the difference in average official salaries between supermarket chains can be as high as 5 times.^[4]
- The **perceived probability** of being **caught** for underreporting salaries (paying envelope wages) is 44.4%. ^[1]

Employees registered under STS:

- **61.2 %** of L2UKR respondents **agree** that workers are **officially registered as individual entrepreneurs (FOPs)**, but in reality, they work like **regular employees**.
- **64.6 %** of L2UKR respondents **believe** that **people registered as FOPs** may be afraid to change jobs or industries because it could affect their **tax status**.

[1] Shadow Economy Index for Ukraine 2017-2018. https://kiis.com.ua/materials/pr/20191107_Shadow/Shadow%20Economy%20Index%20Ukraine.pdf; Horodnic, I. A. W., & Colin, C. (2021). Cash wage payments in transition economies: consequences of envelope wages. IZA World of Labor.

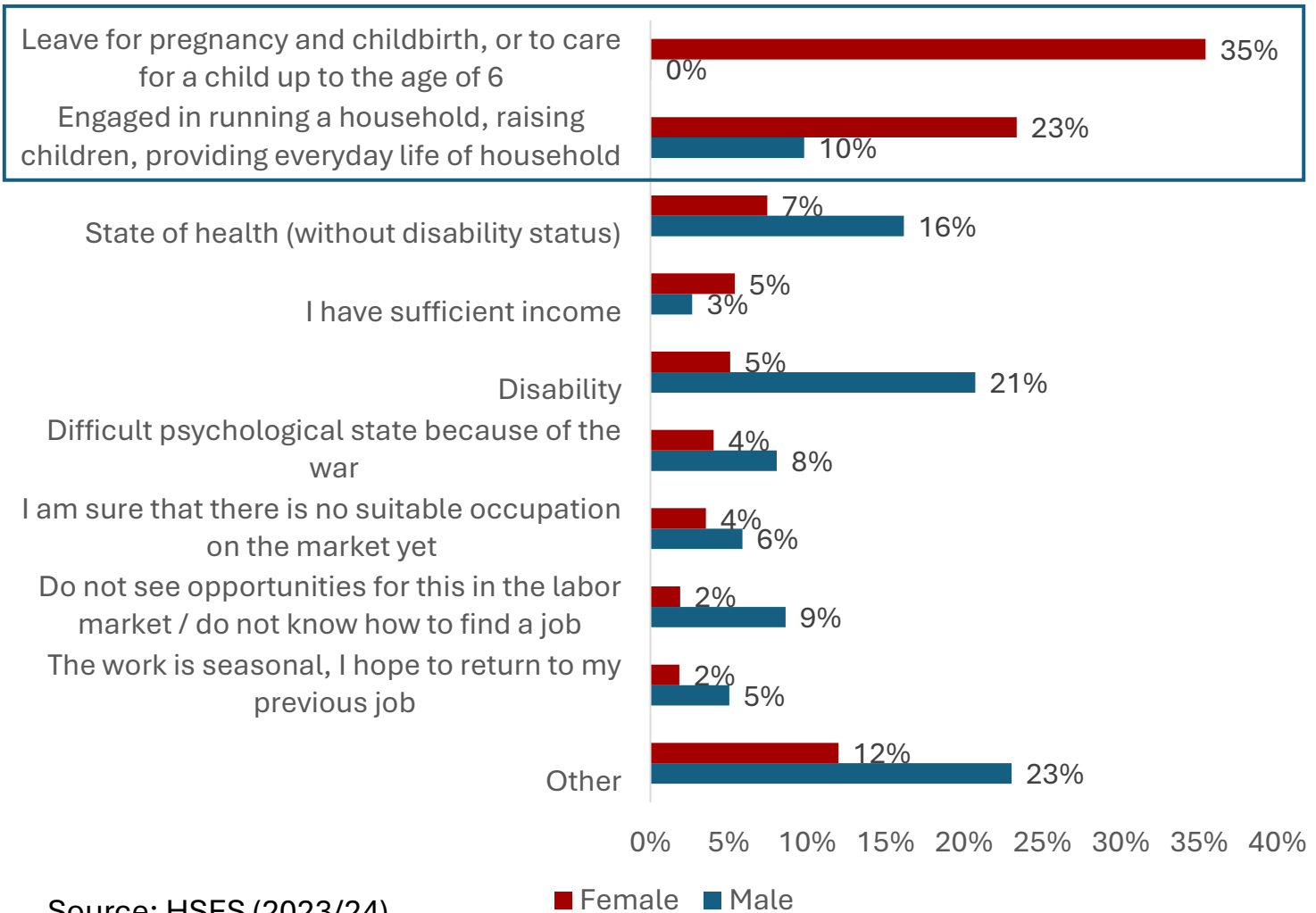
[2] Data from Eurobarometer 2020. https://data.europa.eu/data/datasets/s2250_92_1_498_eng?locale=en

[3] Antonova, A. (2018). Macroeconomic Effects of minimum Wage Increases in an Economy with Wage Underreporting. Visnyk of the National Bank of Ukraine, (246), 10-33.

[4] Expert Economic Platform analysis, provided by authors (available by request).

Unpaid family work and care work are another dimension of the informal economy and a driver of labor informality

Reasons to not look for a job



Source: HSES (2023/24).

- **Care work and domestic work** primarily affects women, with stark gender gaps.
- **Russia’s invasion of Ukraine further widens this burden**, with women increasingly caring for vulnerable household members, such as persons with disabilities, war veterans, persons with mental health problems, elderly, and children.
- **Care burden and related need for flexible work arrangements** drive women into informal jobs.

International evidence highlight three main drivers of labor informality, and evidence suggests that all are present in Ukraine

1. Labor market rigidities and low productivity

- **2 out of 10 firms** perceived **labor regulations** as a major or severe constraint in 2019 - difficulty of hiring, rigidity of working hours, difficulty of dismissal, dismissal costs.
- **Productivity is low and firms are not incentivized to formalize, which contributes to labor informality.** Higher productivity capacity would enable businesses and workers to comply with tax and social contribution obligations.

2. Workers' valuation (benefits and costs) from labor income tax and social policies and systems

- The **tax system** is **not progressive**: workers face **similar effective tax rates** across the welfare distribution and **low-income workers face high marginal cost of formalization** (from informal jobs and from those registered as FOPs).
- Gradual withdrawal of **social assistance** as labor income raises but some **inefficiencies**.
- **More than half** of L2UKR respondents consistently think that **government wastes the revenue it collects in taxes**.

3. Perceived low cost of non-compliance with labor regulations

- **Nearly 9 out of 10** L2UKR respondents perceive **low government performance in fight against corruption**.

Box 1: The cost of formalization




- **When an informal worker becomes formal, their take-home pay drops sharply*** because they are required to pay 22% social security contribution (SSC) + 18% personal income tax (PIT) + 5% military tax, while losing eligibility for some means-tested benefits (such as housing subsidies, GMI, and IDP support). Because Ukraine applies a flat income tax and social contribution rate without a tax-free allowance, even very low earners face high taxes and contributions from the first hryvnia of declared income.

*except in limited instances where a social tax benefit of 50% subsistence minimum applies as a tax-free allowance

- As a result, for many low earners, the financial return to going formal is close to zero or even negative. This steep marginal cost at the bottom—not simply the tax system's lack of progressiveness—creates strong incentives to remain informal.

Source: World Bank analysis based on L2UKR (2023/2024/2025), Enterprise Survey (2019), and HSES (2023/2024).

Potential Policy Levers for tackling labor informality in Ukraine: priority reforms

| Reduce marginal cost of formalization for low-income workers  | Address labor market rigidities  | Ensure appropriate and effective enforcement  |
|---|---|---|
| <ol style="list-style-type: none"> 1. Lower marginal tax rate at the bottom through a more progressive income taxation, aligned with the plans in the National Revenue Strategy. 2. Tax-free allowances for the most vulnerable / newly formal employees. 3. Lower tax compliance costs for formal workers with a simplified yet accountable tax arrangements, particularly for sectors such as restaurants. 4. Smooth the phase-out of means-tested benefits to avoid benefit traps, parallel investment in data systems to accurately measure income; transitional benefit protection. 5. Consider lower SSC for low-wage workers with pension credits (within a broader pension reform) following strengthening of enforcement and monitoring measures, implemented as part of a broader formalization strategy. 6. Introduce a simplified framework that includes gig-workers employed through digital platforms into the tax system. | <ol style="list-style-type: none"> 1. Increase labor market flexibility through the modernization of the outdated Soviet-era labor code. 2. Validate and recognize skills of informal workers: Create systems to assess and certify the skills informal workers already possess, making them easier to prove to employers. 3. Strengthen the effectiveness of education and training (e.g., dual VET system). 4. Strengthen capacity of the State Employment Service. | <ol style="list-style-type: none"> 1. Define clear criteria that identify employees vs. FOPs in the modernized labor code which will lay the ground for enforcement. 2. Risk-based labor inspections: geographic approach and sector-focused enforcement (construction, wholesale& retail trade, primary sector) and systematic work with companies with abnormally low tax burdens related to employees. 3. Cooperation and data sharing between government agencies to address labor informality (see next slide for example). 4. Digitalization and data synchronization across labor-related systems are needed to enable risk-based inspections, reduce pressure on compliant (“white”) businesses, and improve enforcement without expanding administrative burden. |

Additional interventions can support these priority reforms in parallel



Public Communication

Address hidden incentives for informal work



1. **Communication campaign** to raise awareness about the disadvantages and risks of informal work.
2. **Tax education** about public services paid by taxes.
3. **Address stereotypes** about vulnerable population groups (e.g., migrants, women, persons with disabilities) through **social norms interventions**.
4. Support **worker representation**, including of informal workers.
5. Improve **pension system credibility** and **communication**.

1. Ensure the **provision of and access to affordable quality childcare and other care services**.

Box 2: Example of cooperation and data sharing between agencies: the Bureau of Economic Security of Ukraine (ESBU) and State Labor Service of Ukraine

The memorandum on cooperation and information exchange signed in January 2026 aims at strengthening efforts to combat informal employment and the payment of "envelope" wages.

The key areas of cooperation include countering tax evasion and avoidance of the single social security contribution. Under the memorandum, the agencies are introducing a data exchange mechanism on business entities whose activities show signs of violations of labor or tax legislation.

The parties also plan to jointly analyze risks to economic security and develop proposals for amendments to current legislation to prevent offenses. In addition to operational cooperation, there will be joint awareness-raising efforts among employers and employees regarding the importance of complying with official employment standards.

Joint measures will be implemented at the level of the central offices of both agencies and through their territorial units. The agencies expect that such coordination will contribute to deshadowing the labor market and increasing tax revenues to the budget by creating transparent conditions for business operations.

Source: <https://en.interfax.com.ua/news/general/1140325.html>

Topic 2: Firm-level shadow economy activities (1/2)

Shadow economy issues: Firms disrupting their production or structure, or moving parts of their activity into the shadow, because of the design of the tax system

Policy focus on reforming the tax system to reduce costs, distortions, and incentives to move to the shadow

Distortions created by tax policy parameters: Firms tailor their reported revenues to qualify for Group 3 of the simplified tax system and to avoid VAT liability (1/2)

The STS is split into four groups:

1. No employees, revenue < 167 minimum wages, retail trade and household services. Individual entrepreneurs (FOPs).
2. Up to 10 employees, revenue < 834 minimum wages, services/production and sale of goods, restaurants. FOPs.
3. **Unlimited employees, revenue < 1,167 minimum wages (~8.3 million UAH in 2024, all sectors (with some exceptions)). FOPs and LLCs (Legal Entities with limited liability protection).**
4. Agriculture.

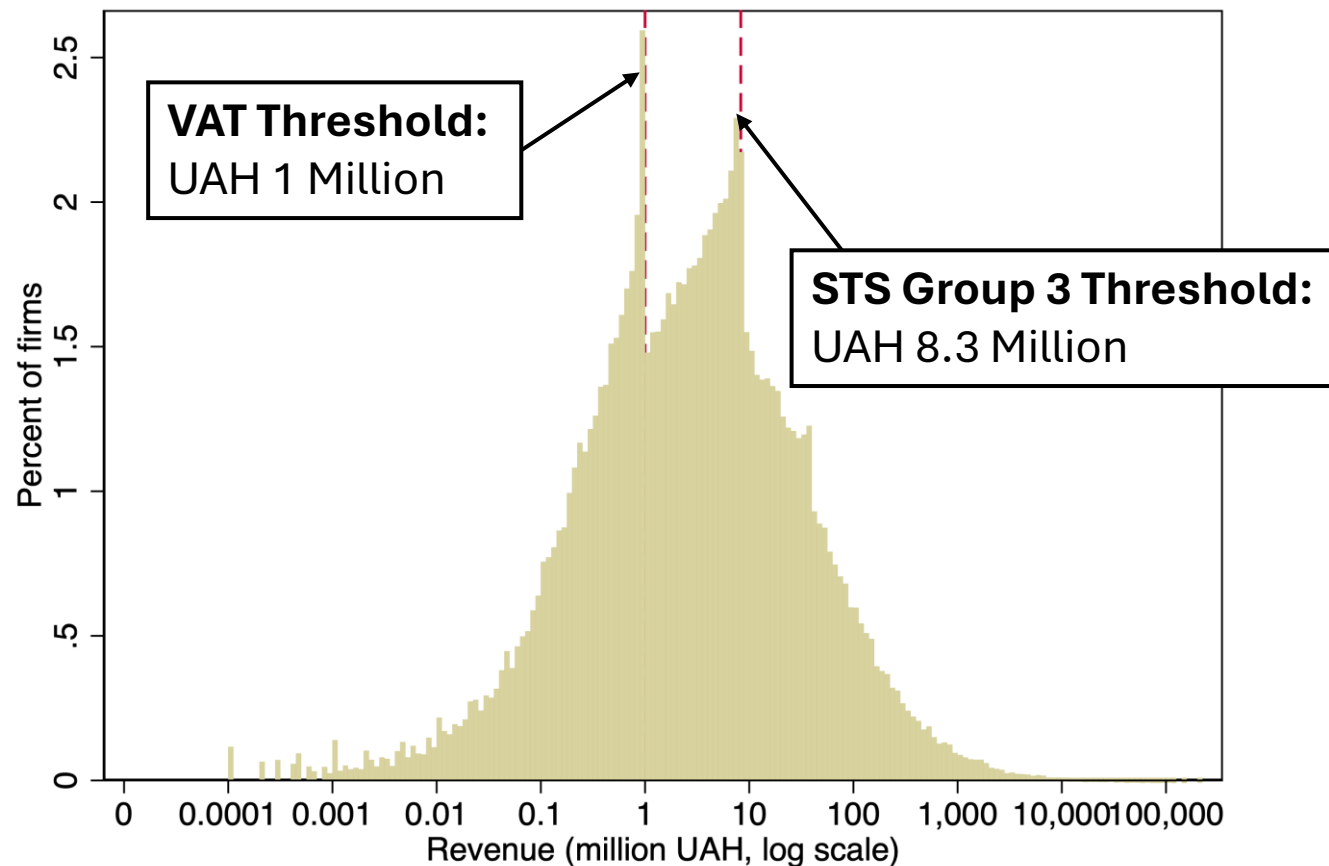
(See Annex for a more detailed explanation)

Group 3 participants benefit from:

- Easier filing
- Lower tax burden
- Optional participation in the VAT system if revenue > UAH 1 million (STS tax rate on revenue: 3% if in VAT net, 5% otherwise).

→ **Generates large revenue reporting response because firms want to take advantage of the benefits.**

Distribution of Firms' Reported Revenues, 2024

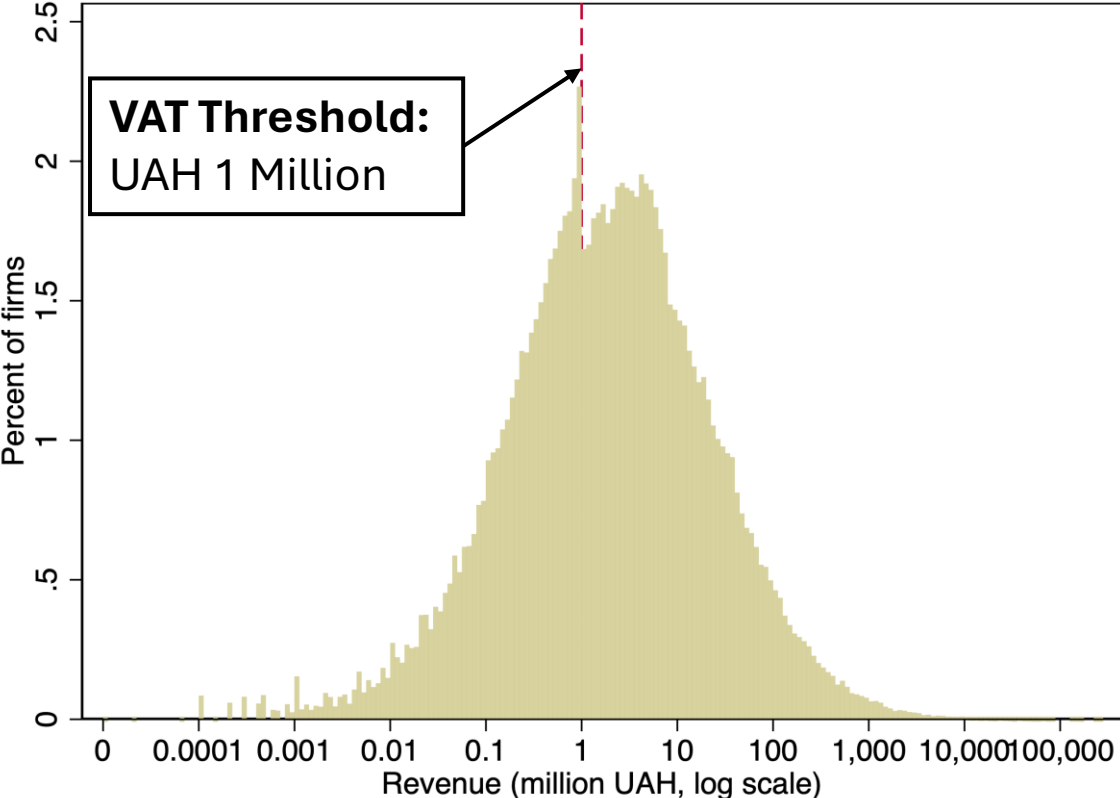


Source: World Bank Staff Calculations based on firm financial statement data compiled by KSE and the State Statistics Service.

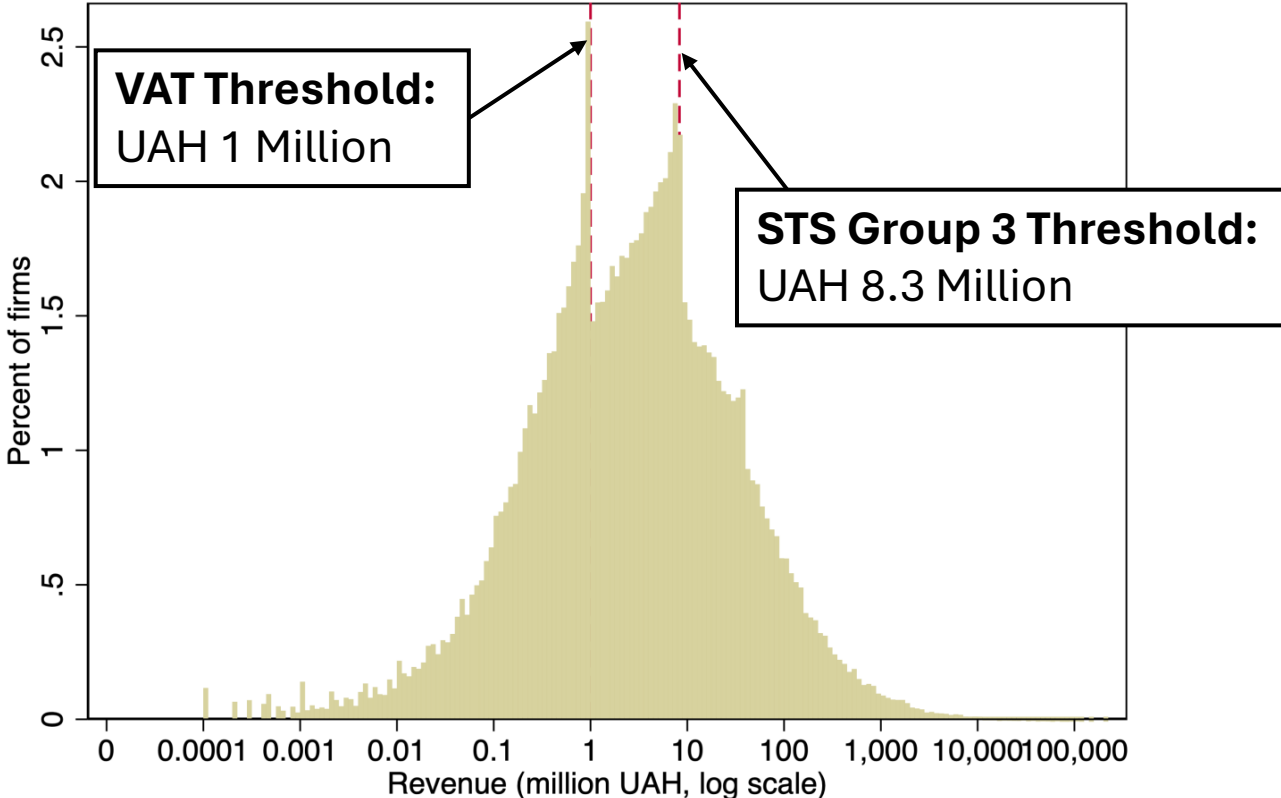
Distortions created by tax policy parameters: Firms tailor their reported revenues to qualify for Group 3 of the simplified tax system and to avoid VAT liability (2/2)

2022: Legal entities in general taxation system and firms in Group 3 with revenue up to **UAH 10 billion** could switch to a **2% single tax regime**.

→ **De-Facto Elimination of Group 3 Upper Limit**



2024: Reinstatement of upper limit that defines STS eligibility (UAH 8.3 million in 2024).



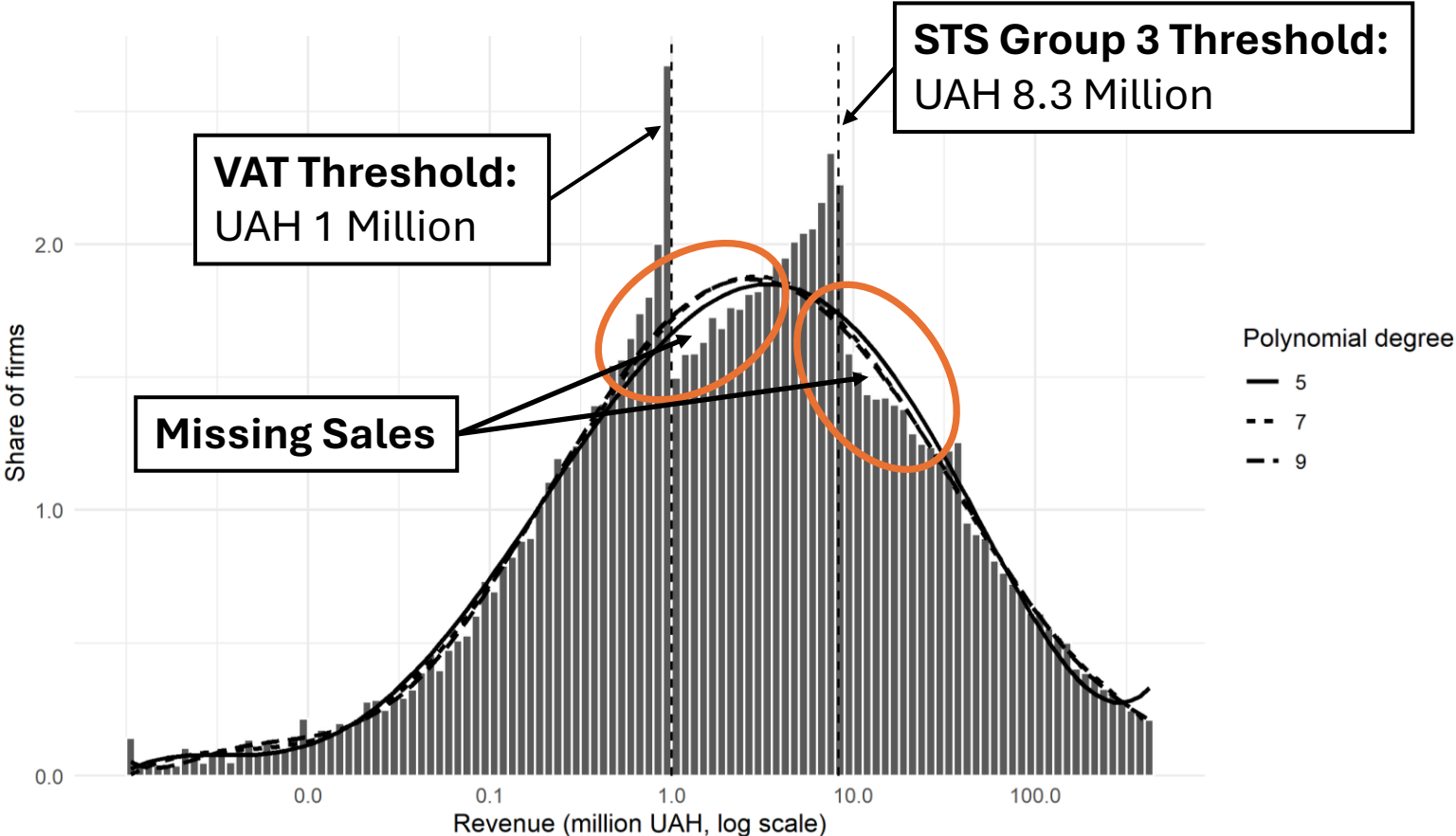
Source: World Bank Staff Calculations based on firm financial statement data compiled by KSE and the State Statistics Service.

Tailoring reported revenue to the VAT and the group 3 threshold generates significant “missing” sales which then leads to fiscal losses...

Estimated shadow activity in 2024:

- 1. VAT Threshold:** ~UAH 23bn (US\$550mln) in missing sales revenue.
- 2. Group 3 Threshold:** ~UAH77bn (US\$1.8bn) in missing sales revenue.

Counterfactual Distribution of Firm Revenue, 2024



Source: World Bank Staff Calculations based on firm financial statement data compiled by KSE and the State Statistics Service.

...and drives firms to artificially split up into smaller entities which impacts their ability to access finance and benefit from scale economies

Anecdotaly, firms are splitting up to reduce reported revenue:

- Difficult to detect in practice.
- **Proxy:** Firms registered at the same address at both sides of the STS upper limit for group 3 (and on both sides of the VAT threshold).
- Firms might well co-locate at the same address, but this shouldn't vary across the threshold.

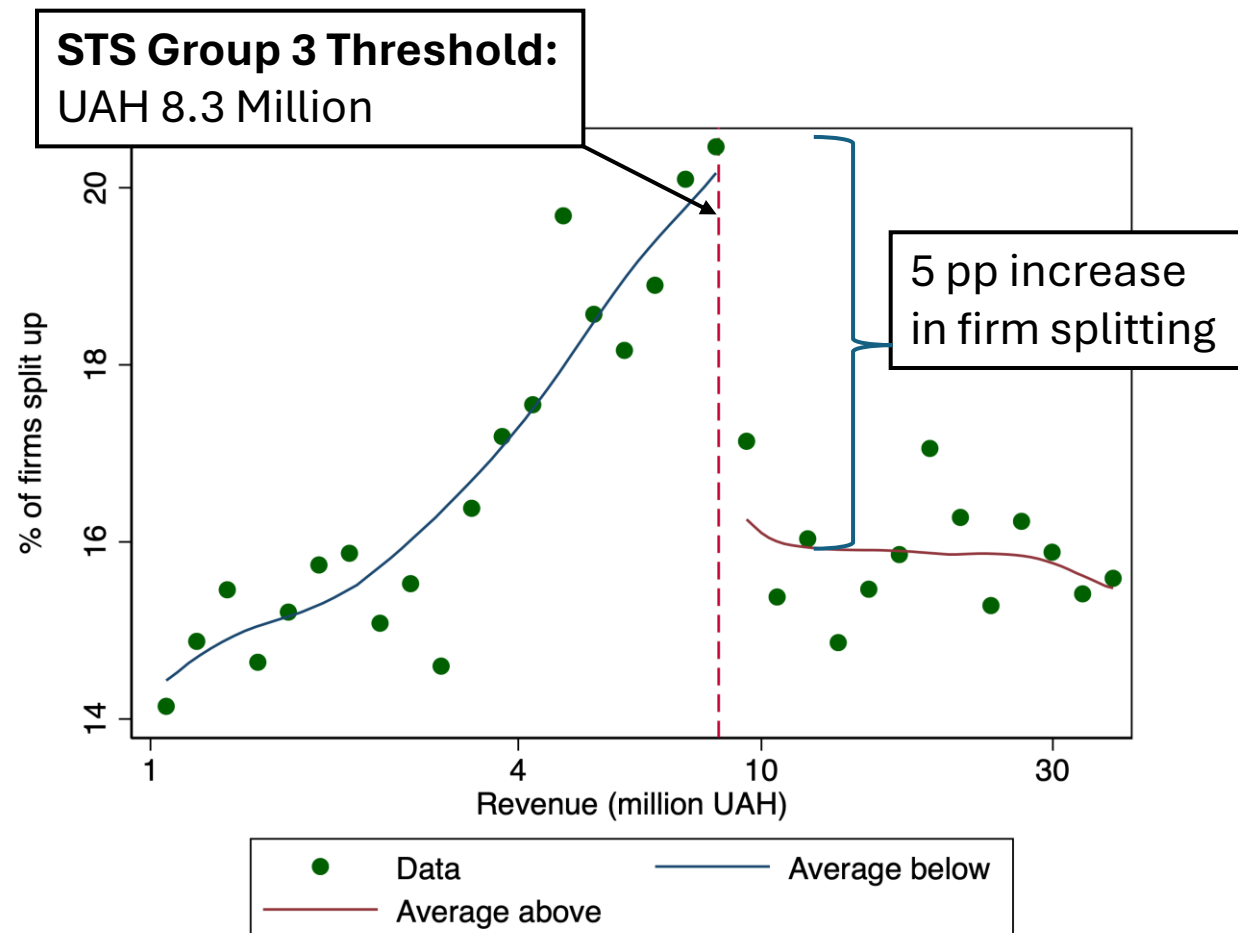
The group 3 threshold triggers a 5-percentage point increase in firm splitting:

- Average share of firms that have another firm at the same address **just below the threshold: 21 percent.**
- Average share of firms that have another firm at the same address **just above the threshold: 16 percent.**

This behavior slows firm growth:

- **Firms that split cannot achieve scale economies** and may struggle with attracting external financing.
- Evidence from a 2012 tax reform shows that when the threshold for joining the simplified tax system was removed, businesses that had previously been close to that cap grew faster than others. Their total revenues rose by about 10 percent, and their revenue per employee increased by around 5 percent, compared with similar firms not affected by the change.

Share of legal entities that have another entity registered at the same address, by revenue groups



Source: World Bank Staff Calculations based on firm financial statement data compiled by KSE and the State Statistics Service.

Firms also systematically over-report their costs in the general system to reduce CIT liability

The STS Group 3 threshold creates a discontinuity in reporting incentives:

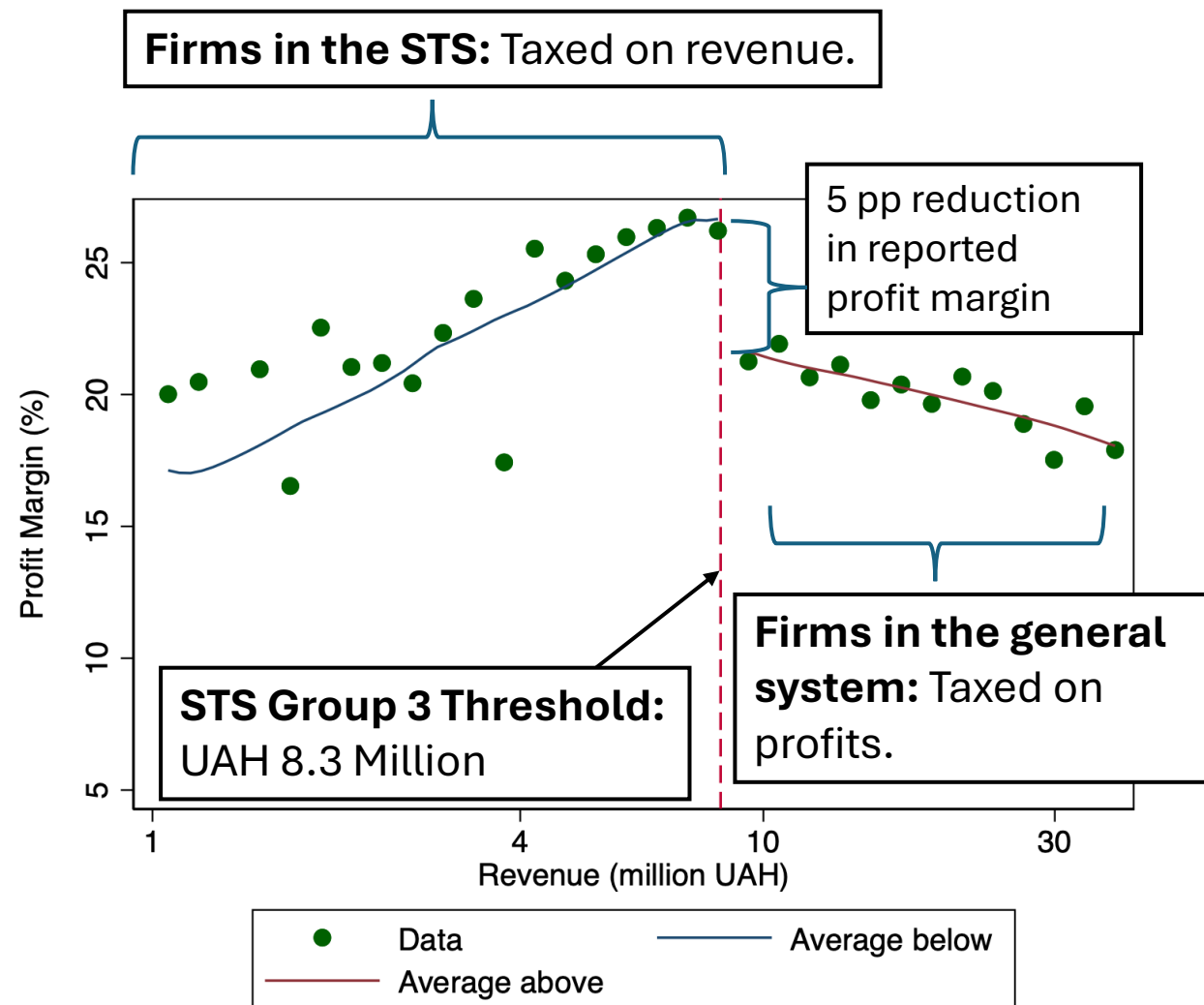
- **Below the threshold:** Taxation depends only on revenue, not on costs. **Firms have no incentive to mis-report costs.**
- **Above the threshold:** Taxation depends on profits. **Firms have an incentive to report higher costs to reduce profit margin.**

The group 3 threshold triggers a 5-percentage point reduction in reported profit margins.

- Average profit margin **just below the threshold:** 26 percent.
- Average profit margin **just above the threshold:** 21 percent.

This shows that firms move parts of their activity into the shadow to evade corporate income taxation but may also be partially driven by different firms reporting costs under the STS than under the general system.

Reported profit margin, by revenue groups



Potential Policy Levers for tackling firm-level distortions caused by tax policy and administration: Priority reforms

Why do we care?

- **Splitting firms miss out on an opportunity to grow** – both because they intentionally stay smaller and because splitting prevents scale economies and access to foreign direct investment.
- **Firms that cannot reduce their profit margin or split suffer from undue competitions** – they have cost disadvantage compared with firms that abuse the system, even though they may be more productive.
- **Shadow activity in response to tax parameters means that the state loses tax revenues (CIT and VAT).**

What can be done?

MSMEs need a simplified system but it needs to be limited to only MSMEs to avoid distortions:

- **Potential restriction of STS through a negative list** to exclude activities which require scale (e.g. fixed telecom).
- **Smoothing the STS discontinuities:** Either by progressively increasing the STS tax rate or by maintaining revenue-based taxation for groups 1 and 2 and transitioning to profit-based taxes for group 3.
- **Anti-avoidance rules to stop splitting:** Assess eligibility based on total revenue of all related firms, defined unambiguously in legislation.
- **Enforcing the VAT threshold:** Aligning with standards in EU countries to mandate VAT compliance for all firms above the threshold. This limits STS benefits to simplified CIT.

Administration needs systems and approaches that deter splitting and cost over-reporting:

- **Fully enforce use of cash registers and issuance of fiscal receipts**, including through rewards/lotteries for taxpayers identifying non-compliant businesses.
- **Invest in the data warehouse (on-going) and develop detection algorithms using entity-linked data** to detect firm splitting, cost over-reporting, and other evasion schemes.
- **Investment in State Tax Service's IT based on sound modernization and interoperability principles** (e.g., Digital by Design, API first) with a focus on taxpayer experience and internal capability transformation.
- **Target audits** at firms at high risk of violating anti-avoidance rules (e.g. those registered under the same address/owner/with the same phone number) and at firms whose reported costs are significantly higher than estimated through third-party data.

Complementary reforms to the general tax system are also needed:

- Consider **modestly increasing the VAT threshold** to facilitate transition (main considerations are enforcement capacity and compliance burden – e.g. UAH 2 million; similar to Polish threshold) while keeping registration for lower turnover optional.
- Address the **complexity of the VAT and CIT reporting requirements:** Pre-filling of VAT returns using electronic VAT invoice register data, facilitated accounting.
- Reconsider the practice of VAT invoice pre-funding (not aligned with EU rules) and invoice blocking to **transition to a system of ex-post risk-based controls and audits.**
- **Economy-wide tax incidence review** to identify further opportunities for leveling playing field.

These proposals are aligned with the National Revenue Strategy (NRS)

NRS Reform 4.3.1: Reform STS by narrowing scope, introducing safeguards to reduce abuse, raising rates to general regime.

NRS Reform 4.2.2 (a): Implement compliance risk management system; improve data analytics.

NRS Reform 4.2.2 (b): Improve audit process.

NRS Reform 4.2.2 (f): Cash register system link with State Tax Service.

NRS Reform 4.2.3 (a): Invest in data warehouse.

NRS Reform 4.3.1: Increase VAT threshold.

NRS Reform 4.2.2 (a): VAT compliance risk management.

NRS Reform 4.3.11: Tax incentive monitoring.



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Topic 3: Firm-level shadow economy activities (2/2)

Shadow economy issues: How to lower the costs and increase benefits of being in the “light”? How to balance sticks/penalties with carrots/incentives?

Policy focus on the roles of fiscal institutions, law enforcement, business climate and the financial system

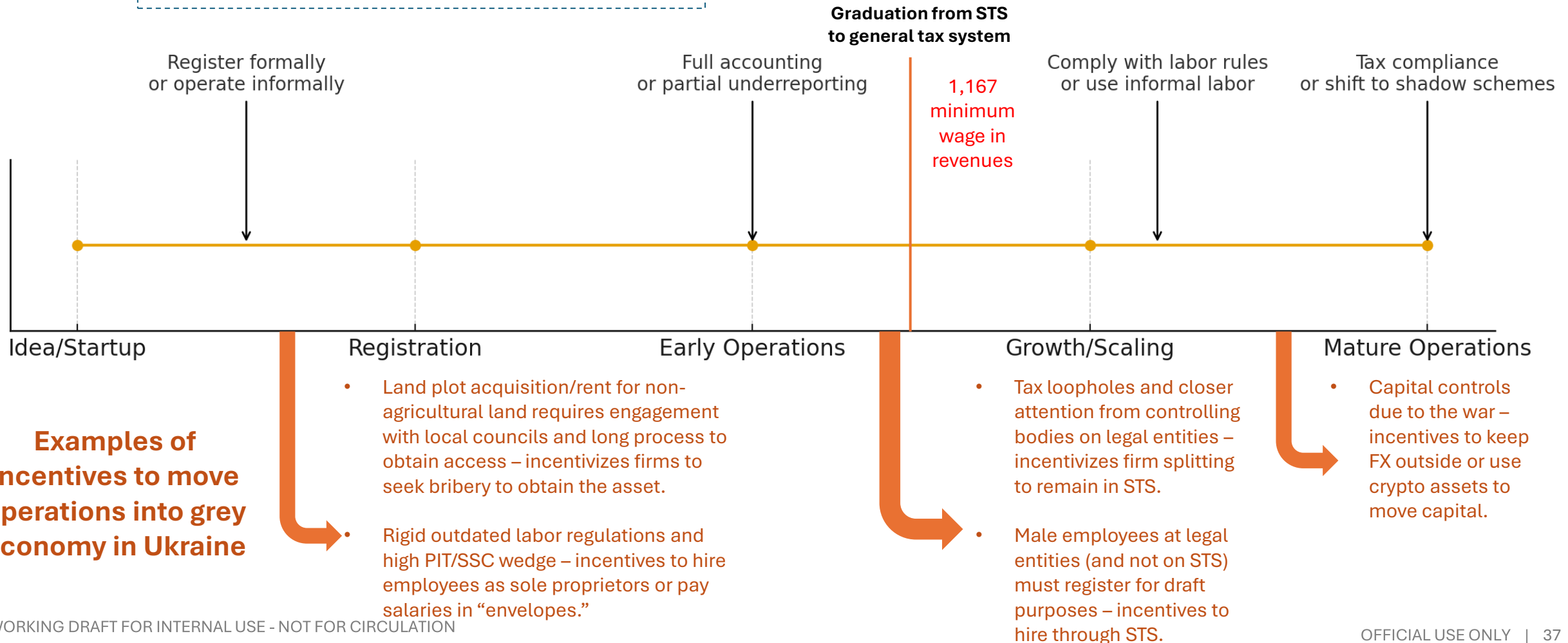
Firm lifecycle: every step is a choice between formality and compliance and gradual/partial disengagement from the formal route into the shadow economy



DIGITALIZATION (such as registration through Diia) makes the start relatively simple...

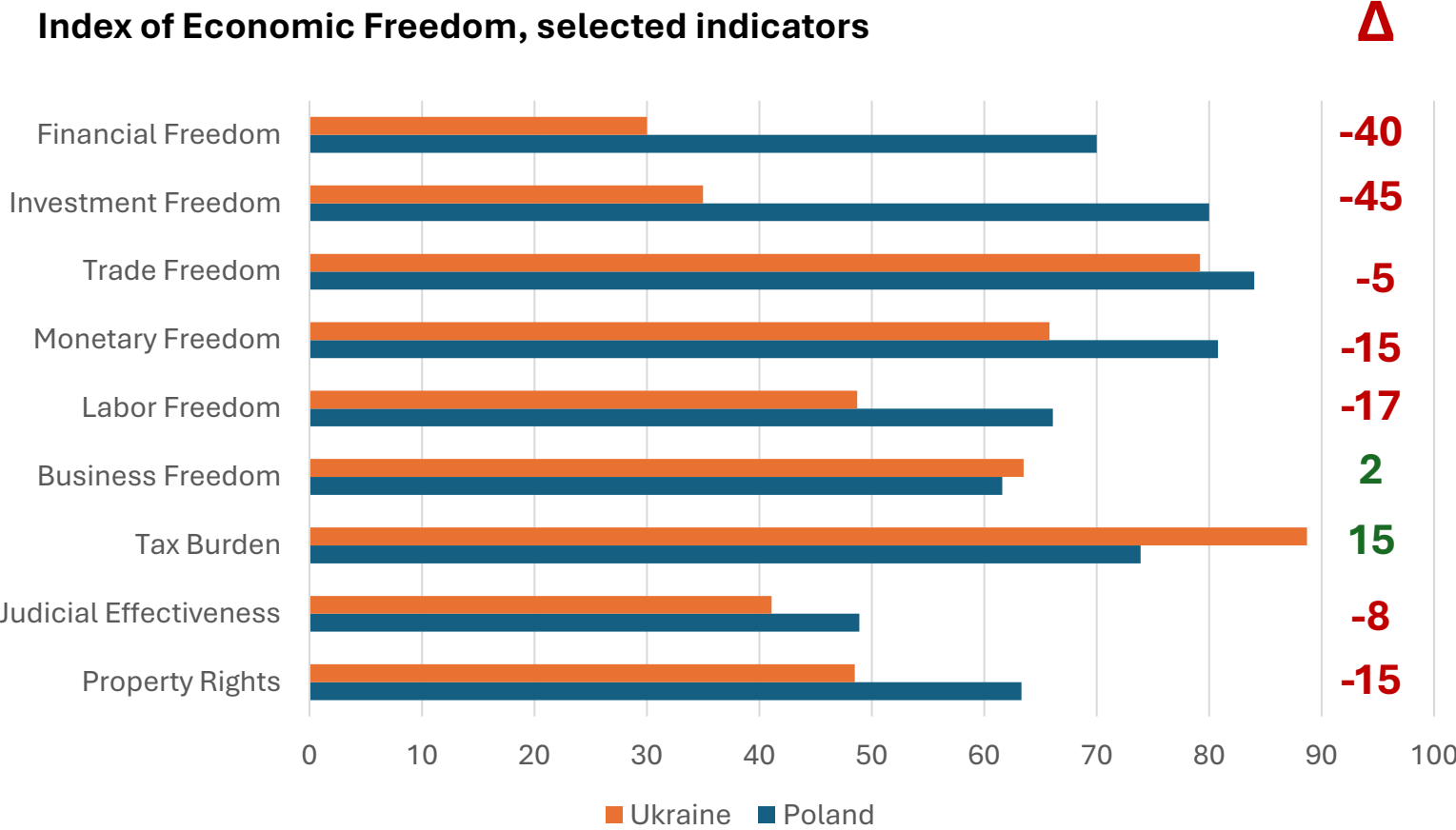


...But many pitfalls remain on the road ahead



Shrinking the shadow economy requires making being in the “light” easier, less costly and more beneficial, compared to being in the “shadow” for firms (1/2)

Doing formal business in Ukraine is costly because regulations and institutions restrict core enterprise freedoms. Firms’ shadow-like choices are a rational response to the burden of doing formal business in Ukraine.



Source: The Heritage Foundation (2021 data)

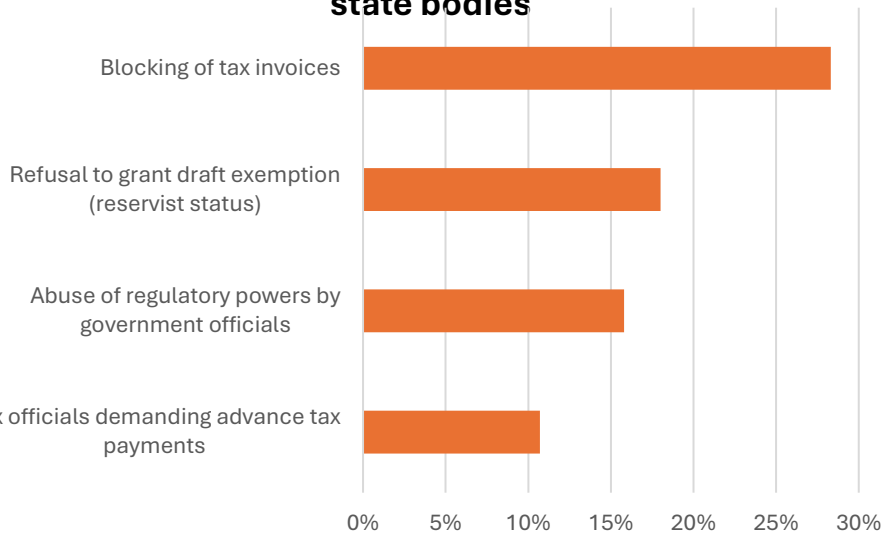


Source: EY’s Shadow Economy Exposed report (2025)

Shrinking the shadow economy requires making being in the “light” easier, less costly and more beneficial, compared to being in the “shadow” for firms (2/2)

Costs of being formal are perceived as high because firms become the target of tax and law enforcement, whereas costs of being in the shadow are small

% of business experiencing issues with the state bodies



Source: Advanter Group survey (2024)

According to a recent EBA survey, in Dnipro region 67% of entrepreneurs say that lower pressure on business is needed to continue operations, second only to the need for war risk insurance (72%).



The state support programs could encourage formalization but require fine-tuning



ЗРОБЛЕНО В УКРАЇНІ

5-7-9 & Grants

National cashback program

- + Targeted at MSMEs, banks monitor the borrower / grantee for potential long-term clients.
- Targeted for MSMEs to encourage growth, but data show it is widely used by large and tax-evading firms.
- + Only firms on general taxation system allowed.
- Expensive, and not clear if actually motivates businesses to formalize.

Potential Policy Levers: Fiscal institutions, Law enforcement, Business climate and the Financial system can all help make being in the “light” easier, less costly and more beneficial



Fiscal Institutions

1. **Enhance use of risk-based tax audits** (building on tax authorities' tools) and **customs checks** using data analytics.
2. **Fiscal data governance reform and IT investment** to strengthen use of fiscal data analytics to detect shadow activities while enhancing oversight / controls to prevent data misuse.
3. **Creation of KPIs for State Tax Service and State Customs Service** that aim at ↓ the tax gap and disincentivize undue pressure on formal firms; **reducing discretion and need for face-to-face interaction with taxpayers.**
4. **Focus on reducing tax compliance costs rather than lowering tax rates** (despite availability of lower tax rates in Diia, IT firms do not move away from the simplified tax system due to compliance costs). Tools such as World Bank’s Tax Compliance Cost Survey results can be used to inform interventions.



Law Enforcement

1. **Provide ESBU with a special executive status and strengthen their institutional capacity** (access to data and enhanced investigative tools, human resources, budget) to **tackle the shadow economy** through prevention and enforcement.
2. **Enhance coordination between ESBU and tax authorities** to provide opportunities for benevolent business/first time violators to use existing and (potentially) new mechanisms **allowing easier settlement of tax violations to reduce costs of deshadowing.**
3. **Improve trust in fiscal institutions, law enforcement and strengthen tax morale** through transparency, incorporation of feedback and communication.



Business Climate

1. **Deregulation and reporting simplification for low-risk activities** and for newly registered firms.
2. Consider **limiting access to (i) firm support programs** such as 5-7-9 and (ii) **public procurement opportunities to registered firms in the general tax system.** The design of firm support programs should further encourage growth.
3. **Strengthen intellectual property rights and investors’ protection** – e.g., expand application of English law for some types of disputes.



Financial system

1. **Establish a cap on interchange commission rates** to encourage electronic transactions and **increase cooperation with other countries** to allow uninterrupted flow of electronic transactions.
2. **Increase cooperation between the State Tax Service and banks** to identify tax evasion activity.
3. **Balance calibration of capital controls with clear communication** to disincentivize unofficial capital flows.
4. **Design and implement a mechanism to reengage with tax authorities and financial system** for assets acquired from untaxed activities.
5. **Consolidate corporate income tax incentives** and close tax loopholes that exist through Joint Investment Institutions.

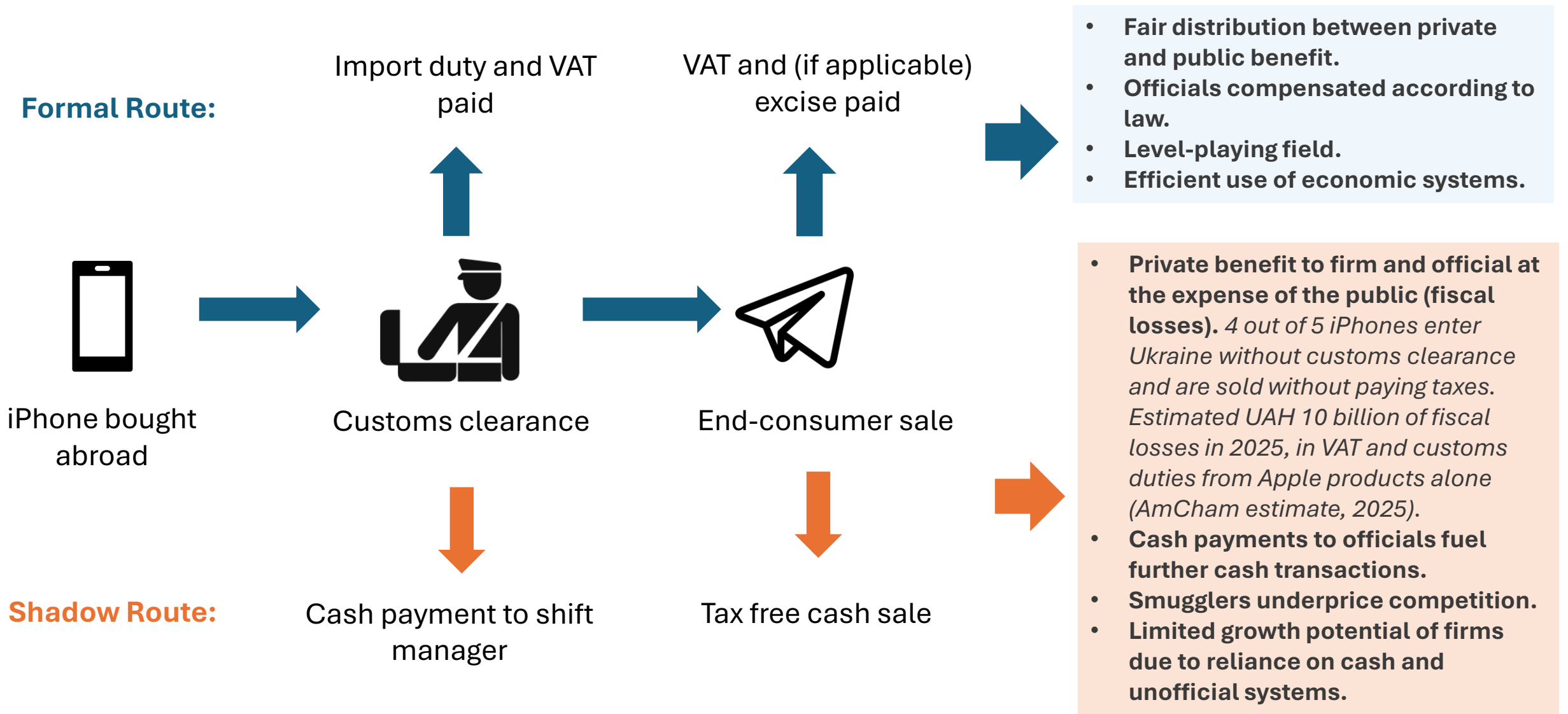
Topic 4: Illicit and criminal shadow economy activities

Shadow economy issues: Smuggling and Grey Imports, Counterfeit goods, Conversion centers and Money Laundering

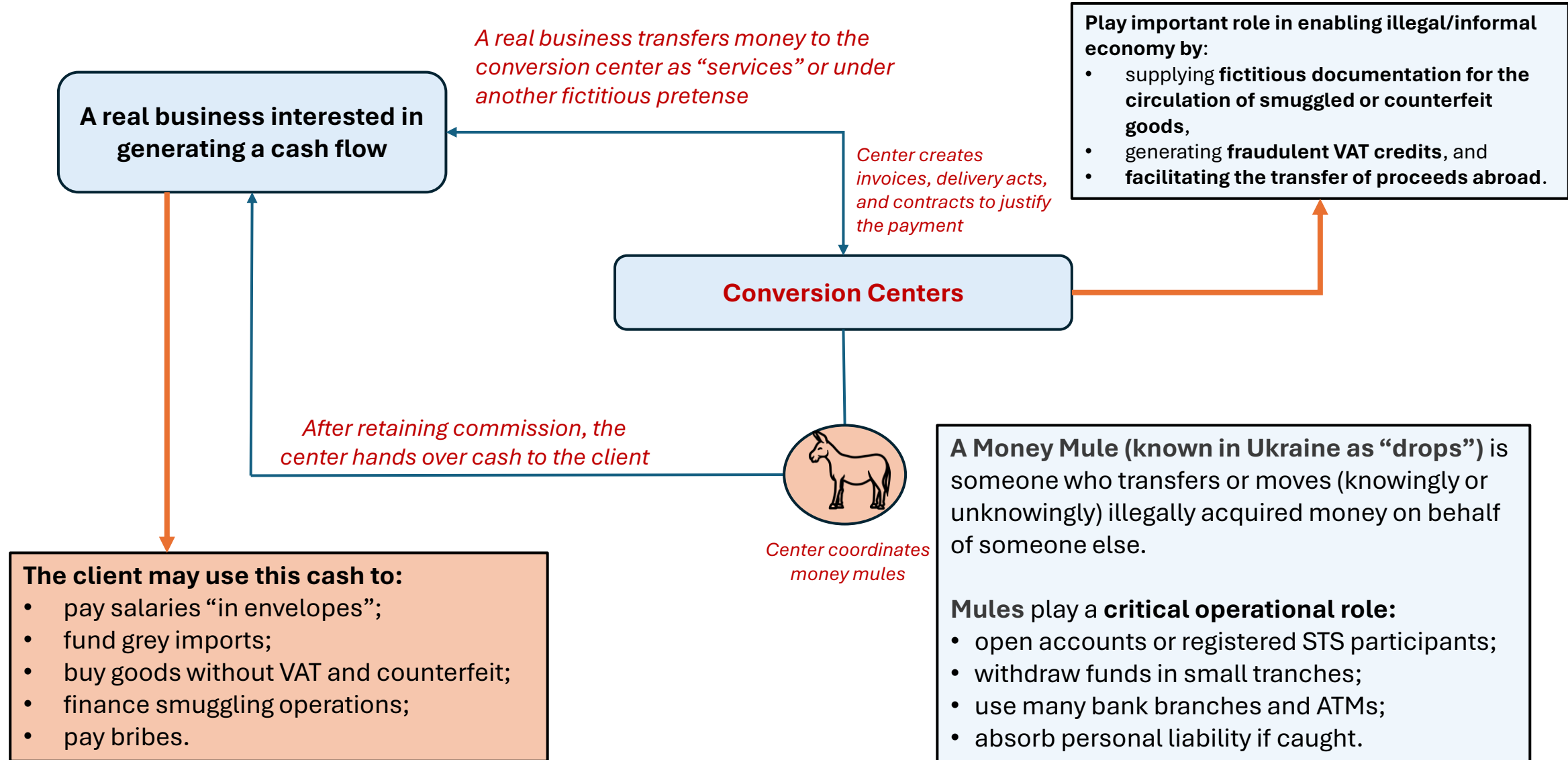
Policy focus on Anticorruption, Customs enforcement, and Financial sector regulation and monitoring

Illegal activities take from the public and give to private firms and officials

Example: Smuggling and Grey Imports

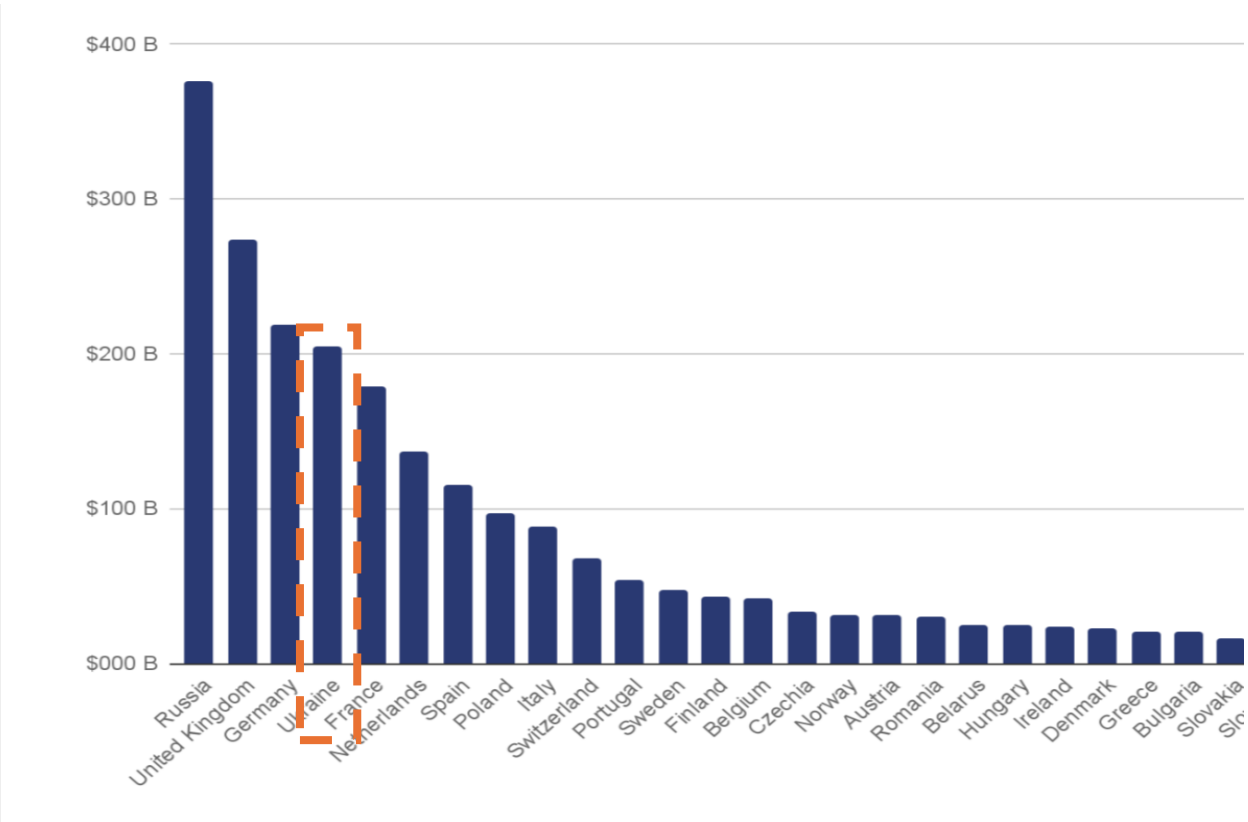


Conversion Centers help avoid taxes, launder funds from illegal activities, and generate cash for shadow activities (example below)



The increased use of virtual assets provides an alternative to cash - making it easier for money laundering/moving financial flows to/from illicit and criminal shadow activities

Top countries within wider European region by total value received*, July 2024-June 2025



Source: [Chainanalysis](#)

*Provides a measure of how much **cryptocurrency value (in USD terms)** flows into each country's on-chain ecosystem over a given period

- **Despite the introduction of tight capital controls** after the start of the full-scale invasion, which cut the option to buy cryptoassets from bank accounts, the data from Chainanalysis shows that **Ukraine had close to 50% growth in transaction volume in Jul 2024-Jun 2025 compared to Jul 2023-Jun 2025.**
- **This strong growth manifested despite an already large market as of mid-2024**, which also occurred in other markets in the wider region, possibly suggesting presence of significant network effects.
- **Cryptocurrencies are believed to be widely used to circumvent NBU's FX restrictions**, as well as **to fund overtly illegal activities including bribes and kickbacks** (such as in the recent Energoatom corruption case), and to pay for drugs.

Tackling illicit and criminal activities requires particular focus on anticorruption and rule of law, customs enforcement, and financial sector regulation and monitoring

Anti-Corruption and Rule of Law

- **Strengthen the independent anticorruption institutions:** complete filling in vacant positions at High Anti-corruption Court, ensure access to independent forensics and implement legislative reforms (including revision of statute of limitations) to enable National Anti-corruption Bureau of Ukraine and Special Anti-corruption Prosecution Office staff to effectively investigate and prosecute.
- Adopt legislation for **transparent and merit-based selection of personnel of the Office of the Prosecutor General.**
- **Reform the State Bureau of Investigations,** by ensuring transparent and merit-based selection, and professional vetting of the SBI personnel, as well as the National Police & other law enforcement bodies with powers to interfere with business activities.

Customs Enforcement

- **Complete the institutional reform of the State Customs Service** as provided for in the 2024 law, including selection of a new head and audit of SCS staff.
- **Reform of SCS operations: Use of the Track and trace system and Staff rotation.** Need to balance inspections with avoiding undue pressure on formal businesses.
- **Hardware and database consolidation at SCS to support risk-based inspections.**
- **Ensure ESBU has access to customs zones** to ensure full enforcement of customs duties and effectiveness of penalties.

Financial sector regulation and monitoring

- Enact the **Single Euro Payment Area (SEPA)** law with its Anti-Money Laundering and Combating the Financing of Terrorism provisions, aligned with EU requirements.
- **Adoption of a Law on Virtual Assets,** largely aligned with MiCA (Regulation of the European Parliament and of the Council of 31 May 2023 on markets in crypto-assets transactions).
- **Establish a national register of money mules (“drops”)** as a potential step to limit usage of individuals’ accounts for money laundering / tax evasion through identifying cardholders selling access to their accounts.
- **State Financial Monitoring Service (SFMS):** Reform and strengthen the independence and capacity of the financial intelligence unit to detect illicit flows, starting with a transparent, competitive leadership selection involving international experts.

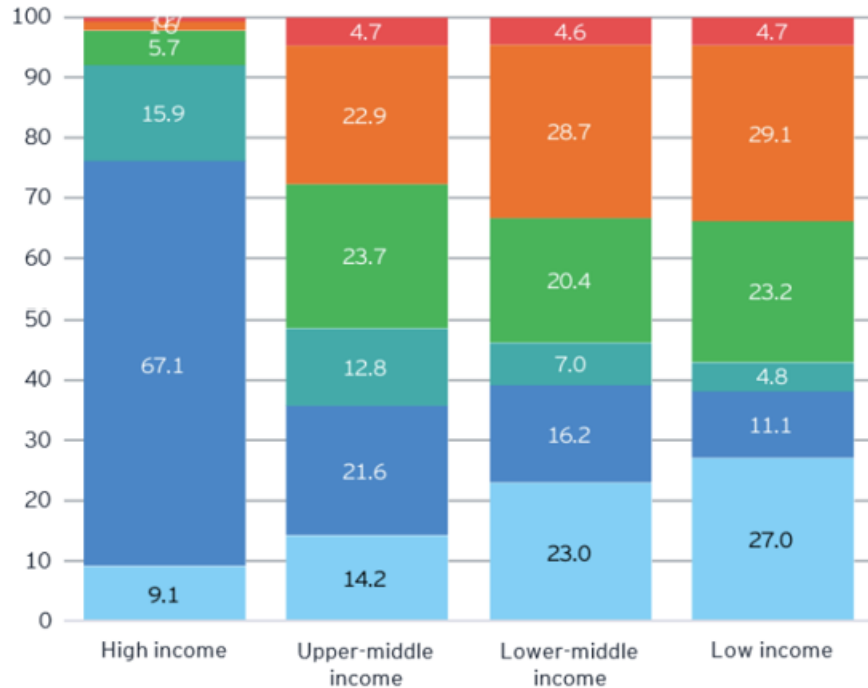
Global lessons on deshadowing: International and Poland case

This section is based on studies of two organizations:

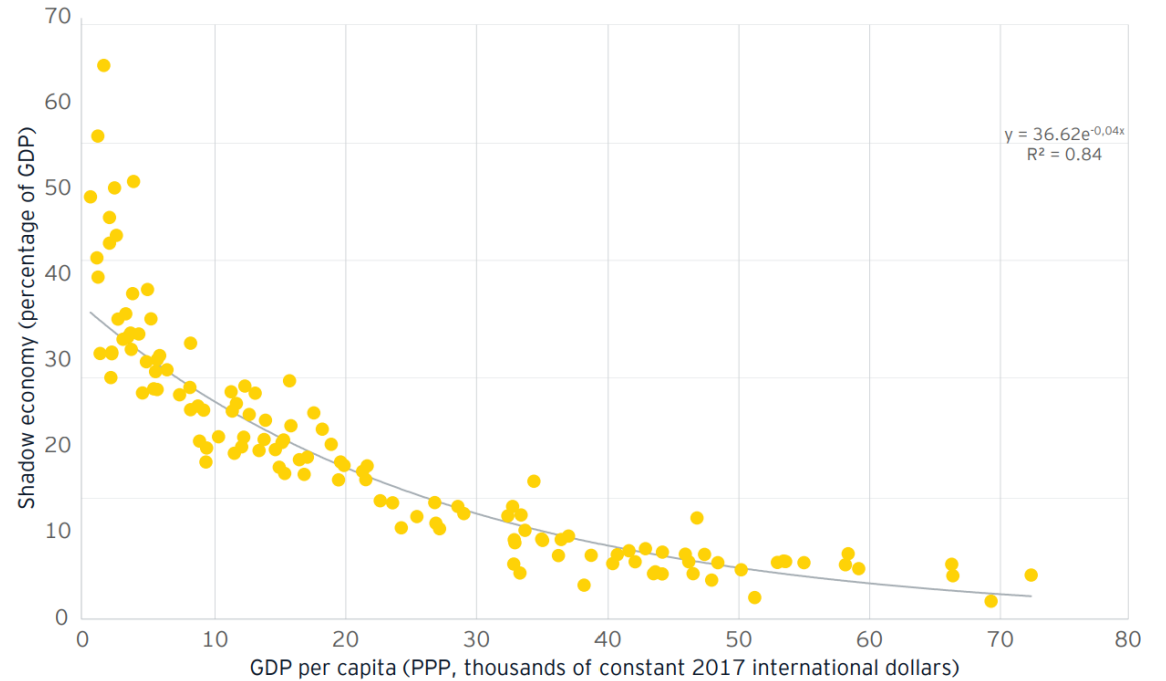
- **EY** – primarily 2025 report *Shadow Economy Exposed: Estimates for the world and policy path*
- **UN Global Compact Network Poland** – various studies in cooperation with the Polish Government on policies to reduce grey economy

EY (2025): Shadow economy drivers vary across countries: tax rates is dominant in high-income nations, while government effectiveness is an important factor everywhere else

Shadow economy by income groups: role of different drivers, % of the average level per group



Correlation between shadow economy and GDP per capita



Source: EY (2025).

- There is a **strong negative correlation between economic development and levels of shadow economy**. This is likely explained by a third variable relating to **strength of and trust towards public institutions**.
- This is further corroborated by **government effectiveness** (from the Worldwide Governance Indicators database) **being among the most important factors of shadow economy estimates in all income groups** except for high-income countries. For the latter, high tax rates play the critical role.
- **These patterns should inform domestic policies aimed at the deshadowing of the economy.**

EY (2025): 5 areas of intervention for reducing shadow economy activities and enhancing tax compliance – many could be particularly effective in Ukraine’s context (bullets in bold)

Improved detection through technology and advanced analytics

- Mandating the use of electronic fiscal devices
- Limiting overreporting of various deductions with electronic invoicing
- **Using well-calibrated advanced analytical tools to improve detection of high-risk actors/transactions**

Taking advantage of third-party information

- Improving financial inclusion and promoting use of electronic payments
- Encouraging consumers to request receipts (e.g. tax receipt lotteries)
- **Making adjustments (where needed) in third-party reporting mechanism of VAT and income taxes**
- Collecting third-party information from online platforms

Promoting whole-of-government approaches and international cooperation

- **Joining forces of various state actors**
- **Improving information sharing and efficiency of collaboration through digital transformation**
- Establishing and expanding international cooperation

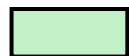
Increasing taxpayers' trust towards the public administration and the tax system

- **Taxing and spending better**
- **Counteracting corruption and abuse among tax officials and public service providers**
- **Educating on why and how to pay taxes**
- Increasing transparency on how tax revenues are spent
- Encouraging tax compliance by tax nudges

Enterprise formalization

- **Cutting red tape by introducing one-stop shops and enhancing e-government**
- Simplifying legal status and tax obligations for micro & small firms
- **Increasing benefits of formalization with more financing opportunities**

Source: EY (2025).



Effects may partially materialize in the short term



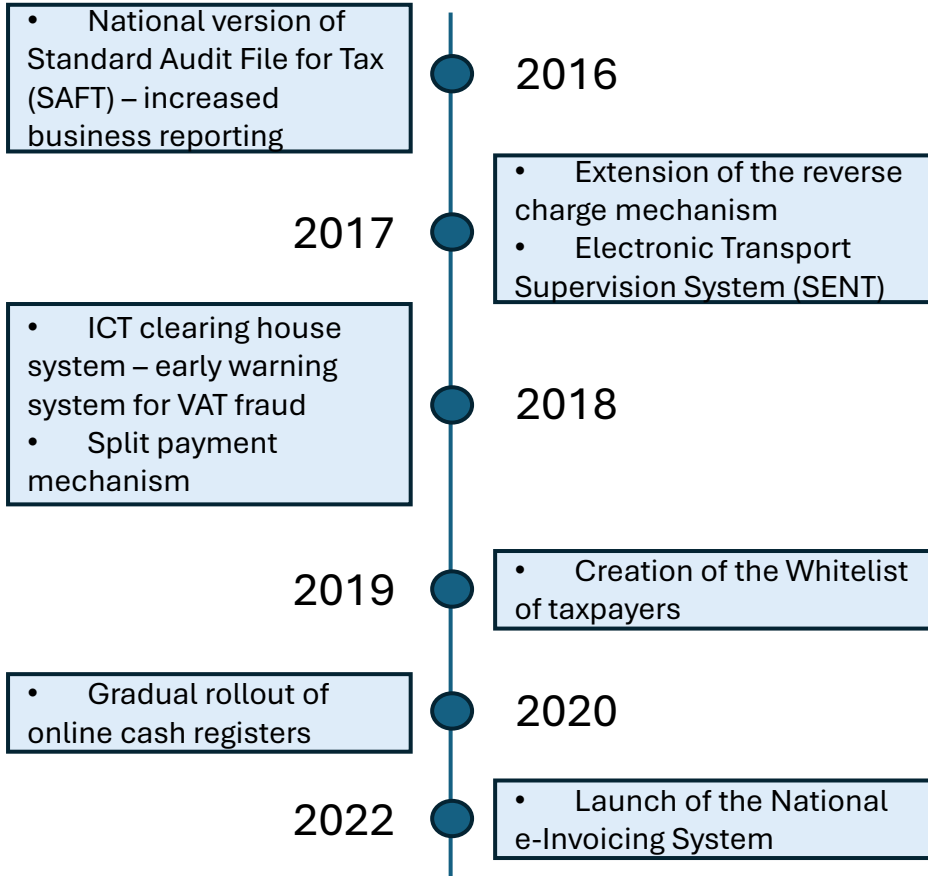
Effects usually materialize in the long term

UN Global Compact Network Poland studies: **Deep institutional reform** and **anti VAT-fraud measures** over a 6-7 year period achieved a large drop in the VAT compliance gap

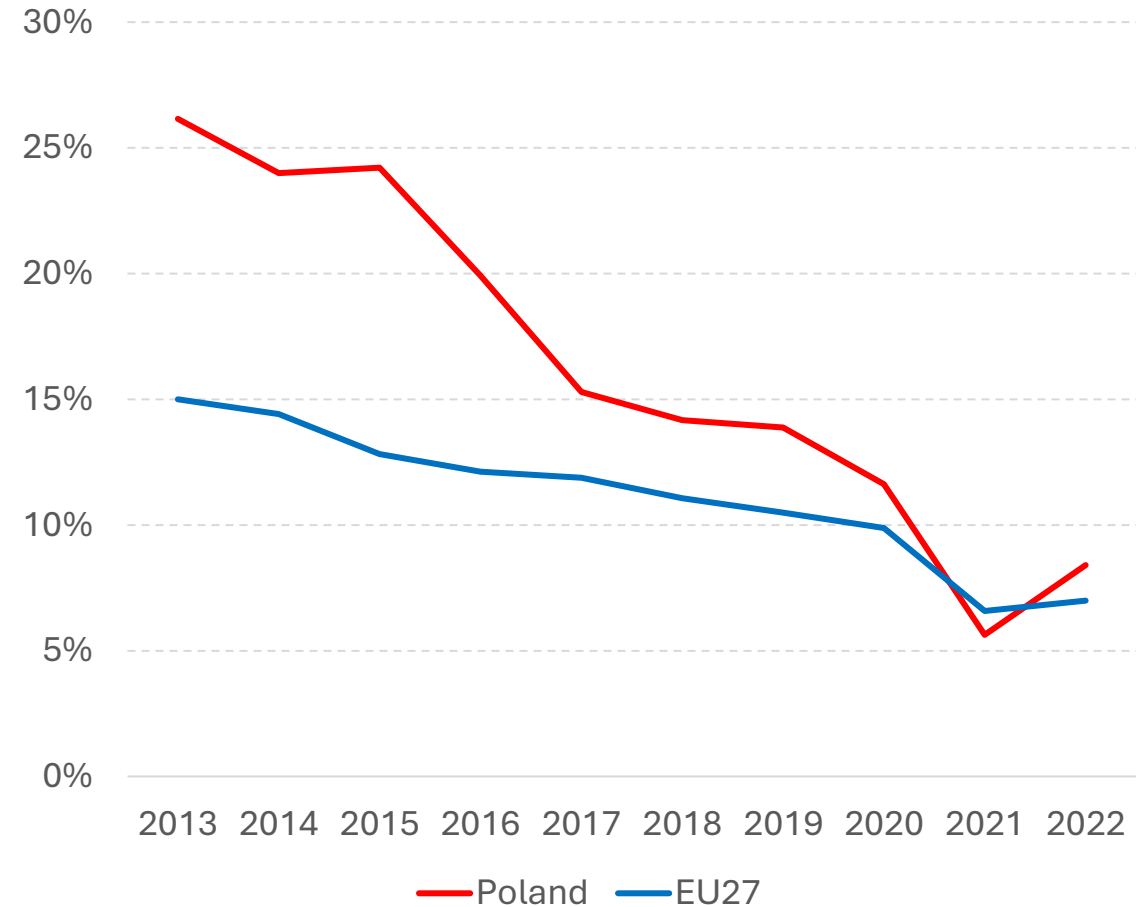
Establishment of the National Revenue Administration (KAS):

consolidation of tax services, customs, and fiscal control to improve the effectiveness of government administration actions and reduce administrative costs

Critical anti VAT-fraud measures

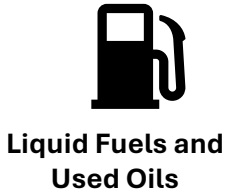


VAT Compliance Gap in Poland and EU27, 2013-2022



Source: UN Global Compact Network Poland „Przeciwdziałanie szarej strefie w latach 2014-2022”, EC „VAT Gap in the EU – 2024 report”

UN Global Compact Network Poland studies: Denshadowing efforts in Poland are continuous, and take a whole-government approach, complemented by sector-specific policy tools



- Specialized "Fuel Package" and "Energy Package" (2016).
- "Fast VAT" mechanism.
- Increased controls and restructuring of incentives.



- Intensification of anti-smuggling activities and services cooperation with legal producers.
- Update of the Excise Tax Act (2016) - registration requirements for tobacco intermediary entities.



- Update of Pharmaceutical Law (2019) introduced specific obligations, penalized entities involved in the reversed distribution chain, and increased powers of pharmaceutical inspectors.



- Increase in non-cash payments is a positive change.**
Problems persist:
- High VAT rate compared to food encourages underreporting.
 - Fictitious employment/unreported wages.



- Horizontal tools helped limit VAT carousels.**
Problems persist:
- Cost savings sought by using lower quality materials.
 - High share of personnel costs led to fictitious work dimensions, understating wages.

- **De-shadowing is recognized to be a continuous battle** with various reports assessing that it increased significantly in the aftermath of COVID-19 and Russia's full-scale invasion of Ukraine.
- In **2025**, the **Inter-ministerial Team for Counteracting the Informal Economy** (chaired by the DM of Finance) was created **to develop a strategy against the grey economy and coordinate actions and monitoring of effectiveness of related government's measures.** The inaugural meeting included representatives of 12 ministries, as well the Social Insurance Institution, Internal Security Agency, tax authorities, police, border guard and Statistics Poland.

Annex

Simplified taxation system (STS) in Ukraine: Structure, Scope, and Key Features

The Simplified Taxation System (STS): Design and Application

A special tax regime designed to reduce the tax burden and stimulate small and medium entrepreneurship created in 1999.

The system nowadays is **divided into 4 groups**, defined by: Type of taxpayer, Type of activity, Annual revenue, Number of employees.

Available for:

- **Individual Entrepreneurs (FOPs)** (with full personal liability): Groups 1–3, and Group 4 (if registered as family farms meeting legal criteria).
- **Legal Entities** (limited liability protection): can operate under Group 3 (and Group 4 if agricultural producers).

Simplified Taxation System:

Main idea: Minimal bookkeeping, simple reporting, fixed or percentage-based tax.

1. Reporting:

- **FOPs (Groups 1–2), FOPs and legal entities (Group 4):** file a single tax declaration **once per year**.
- **FOPs (Group 3) and legal entities:** single tax declaration filed **quarterly**.
- No full accounting required — only **revenue records** (expenses are not tracked).

2. Mandatory payments:

- Single tax (rate depends on the group).
- Single Social Contribution (SSC) – at least 22% of the minimum wage.
- From 2025 – Military levy (rate depends on the group).

3. VAT reporting and payment:

Legal entities and FOPs on **Group 3 can voluntarily choose to register as VAT payers, while Groups 1 and 2 cannot be VAT payers. Group 4 are required to register as VAT payers if their 12-month turnover exceeds UAH 1 million**; otherwise, they may register voluntarily.

General Taxation System:

Main idea: Full accounting of income and expenses; more complex reporting obligations.

1. Reporting:

- **FOPs:** file an **annual income declaration**, maintaining **income and expense records** to determine net profit.
- **Legal entities:** file a **Corporate Income Tax (CIT) declaration (18%)**, usually **quarterly**.
- Must maintain **full accounting records** in line with national or international standards (IFRS).

2. Mandatory payments:

- Corporate Income Tax (18%) or Personal Income Tax (18%) for FOPs.
- VAT (20%) – **mandatory** if 12-months turnover exceeds **UAH 1 million**.
- Single Social Contribution, military levy, and local taxes (land, property, transport – depending on assets and activities).

Criteria for Simplified Taxation System in 2025

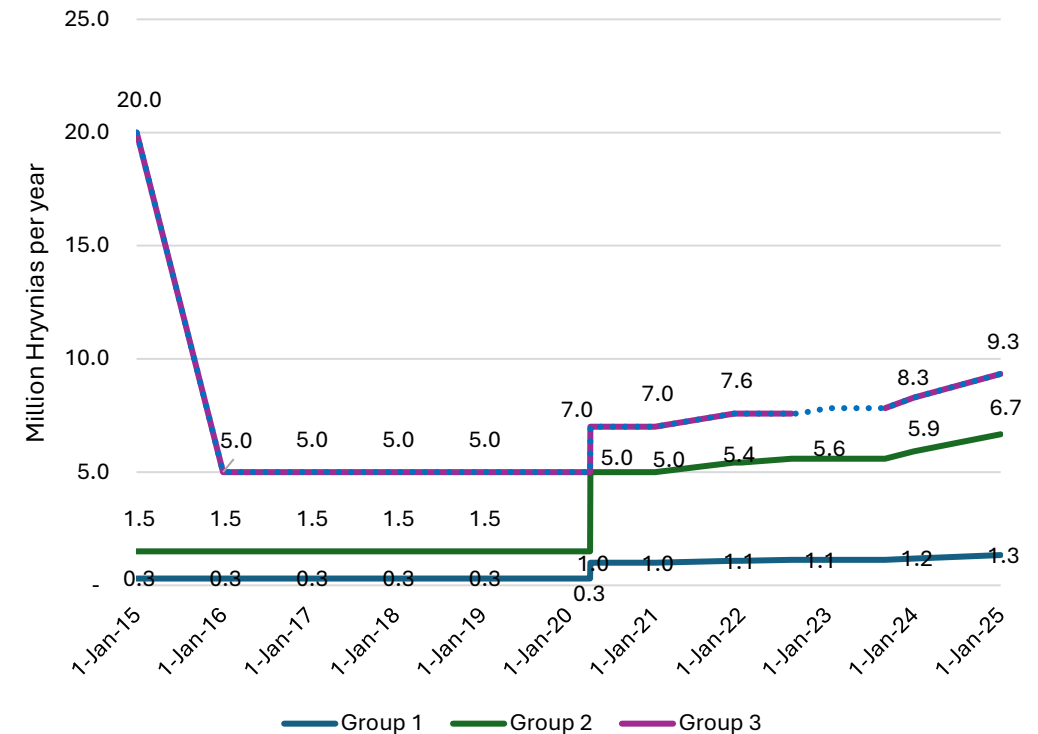
| | | Group 1 | Group 2 | Group 3 | Group 4 |
|-------------|--|--|---|---|--|
| Eligibility | Type of taxpayer | Individual entrepreneurs (FOPs) | Individual entrepreneurs (FOPs) | Individual entrepreneurs (FOPs) and legal entities/LLCs | Agricultural producers - individual entrepreneurs (FOPs) (with less than 20 hectares) and legal entities (unlimited size) |
| | Revenue threshold | 167 minimum wages per year (UAH 1.336 mln in 2025) | 834 minimum wages per year (UAH 6.672 mln in 2025) | 1,167 minimum wages per year (UAH 9.336 mln in 2025) | At least 75% of revenue comes from agricultural production |
| | Number of employees | No employees are allowed | <10 | unlimited | No employees in case of FOPs, Unlimited in case of legal entities |
| | Types of activities | Retail trade and household services | Services, production/sale of goods, restaurant business | Any type of activity permitted under the STS | Agricultural producers |
| Taxation | Single Tax Rate (for those that are not VAT payers) | Up to 10% of the subsistence minimum income | Up to 20% of the minimum wage | 5% of revenue | The tax base is the normative monetary valuation of one hectare of agricultural land, adjusted by the indexation coefficient which depends on the category (type) of agricultural land, its location |
| | Single Tax Rate (for those that are VAT payers) | -- | -- | 3% of revenue | |
| | Military tax | 10% of the minimum wage | 10% of the minimum wage | 1% of revenue | 10% of the minimum wage |
| | Single Social Contribution | At least 22% of the minimum wage | At least 22% of the minimum wage | At least 22% of the minimum wage | At least 22% of the minimum wage |

Simplified Taxation System during the wartime

Tax compliance was relaxed at the beginning of the invasion, but was then restored and tightened

- **March 2022 – December 2024:** FOPs were **exempt from paying their own social contribution** (months without payment not counted toward insurance). Penalties and interest were suspended.
- **April 2022 – August 2023:**
 - **FOPs in Groups 1–2** could **suspend single tax payments**.
 - **Legal entities on general taxation system and Group 3 FOPs** with revenue up to **UAH 10 billion** could switch to a **2% single tax regime** (instead of CIT or VAT). Measures excluded sectors like: gambling, currency exchange, excise goods, mining, and finance.
- **Most tax inspections were initially suspended;** only desk and select factual audits continued (mainly for VAT refunds or specific violations). Regular inspections resumed gradually from mid-2023 and are expected to be fully restored by 2025.
- **FOPs under Groups 1–2** may remain **exempt from the single tax if located in areas of active hostilities or temporary occupation** as of the start date of hostilities.
- **From 2025, FOPs** under the simplified system became **subject to the military tax**, which had not been applied previously.

Evolution of Revenue Thresholds for Simplified Tax System Groups, UAH million per year



Source: Tax Code, State Statistics Service, WB Staff.

Note: Starting from 2020, the thresholds have been tied to the minimum wage in effect at the beginning of the calendar year.

From April 2022 to August 2023, legal entities under the general taxation system and FOPs under Group 3 with annual revenue up to UAH 10 billion were allowed to switch to a 2% single tax regime, introduced to ease reporting and auditing during the initial phase of the war. This measure effectively raised the Group 3 revenue threshold to UAH 10 billion for this period.