

MINIMUM WAGE AND WORKING UNDER THE TABLE: ISSUES AND SOLUTIONS – ACCOUNTING ASPECT

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Abstract

This article analyses problem the minimum wage and getting money under the table in Ukraine. The minimum wage is one of the most contentious issues in economics. Too many Ukrainians working legally, officially get just minimum wage but in the reality make money much more than minimum. In common practice a lot of small business owners in Ukraine used to pay their employees in cash since it's harder to trace and most of them are trying to evade taxes or cheat the government. The employee is missing out on benefits, such as the ability to earn Social Security benefits in old age or financial assistance in case of disability. The government doesn't receive individual income tax and cannot fully provide funding to the social sector. This article also compare labor law and employment, concept, methodology, explain basic principles and difference between wages, minimum wages and salary, payment taxation in USA, UK, Germany. The research suggests transform accounting system of income taxes and social security taxes in Ukraine. The article improve necessary to apply progressive payroll taxes scale, limit cash payments to minimum and compulsory automate an accounting process for all types of business.

Keywords: minimum wage, salary, wage, money under the table, accounting of payment taxation.

INTRODUCTION

In past decades, mainstream economic thinking held that the main objective of macroeconomic policy was to ensure macroeconomic stability (often narrowly defined as inflation control) since better employment opportunities and poverty reduction would then follow suit. Employment-centered macroeconomic and structural policies are vital to generate productive employment and improve living standards. Minimum wage determination is a major instrument of economic and social policy because it can be manipulated in order to achieve diverse objectives, from income distribution to economic competitiveness. Wage and salary management is essentially the application of a systematic approach to the problem of ensuring that employees are paid in full size and in an equitable and fair manner. Wage and salary for most of the employees is certainly one of the main forms of their income and constitutes powerful spring of motivations in our society.

RESEARCH RESULTS AND DISCUSSION

The term “wage” may be defined as the remuneration paid by the employer for the services of hourly, daily, weekly and fortnightly employees.

Salary is defined as the remuneration paid to the clerical and managerial personnel employed on monthly or annual basis. This distinction between wage and salary does not seem to be valid in these days of human resources approach where all employees are treated as human resources and are viewed at par. Hence these two terms are used interchangeably. As such the term wage or salary can be defined as the

direct remuneration paid to an employee compensating in services to an organization. Salary is also known as basic pay [3].

In Ukraine labor rights of citizens are traditionally defended by the norms of civil, labor and administrative legislation. According to the labor law of Ukraine there are two possible ways of employment:

- a labor agreement or labor contract;
- a civil contract on performing certain services.

Ukrainian labor market nowadays a lot of processes are irregular and uncontrollable as a result informal employment without signing an employment contract, using civil contract instead employment agreements and to pay illegal wages.

There are two types of contracts in Ukrainian legislation – labor and civil – show the difference between them.

The first and most significant difference is that the employment contract is within the scope of Labor Law, which has provisions in the Labor Code, whereas in civil contracts they are covered by the Civil Code and can't benefit from the right to leave, benefits, protection and others.

Another important difference is that labor contracts are concluded between a worker and an employer for the provision and implementation of a work force, and in the case of a civil contract, it is in the performance of a specific task and an exact deadline for implementation to see the results achieved.

In the labor contracts, there are precisely defined working conditions mentioned and stipulated in the labor contract between the parties, as the location / seat of the work process /, the duration of the working process / in days and hours /, the amount of the basic and the additional annual leave other clauses. While these civil rights and obligations between a worker and an employer are lacking in the civil contract. Only the person determines the duration of the work process and its place of execution.

The approaches to payment under the independent-work contract and the labor contract differ significantly. In the case of the civil law contract, it's better to define the price in the form of payment for certain measurements or sizes. According to Article 843 of the Civil Code of Ukraine, parties are allowed to determine the price of works in various ways in the contract itself. The price includes recovery of costs and actually the payment for the work.

The labor contract doesn't belong to this method of recovery of costs - the amount of salaries must be specified. Article 6 of the Law "On Remuneration for Work" provides for specific methods of calculating salaries (tariff scales, post salaries).

Another feature which is inherent to civil law contracts is that the work performed under the independent-work contract is delivered by acts. The labor law doesn't contain provisions on the signing of acts of acceptance-transfer, and the parties don't sign such a document.

Signed after completion of work or provision of services acts of acceptance-transfer can be the basis for their payment. It will also be a ponderable argument for concluding a civil law contract and not a labor contract.

Another difference of the contracts is that the work or services under the independent-work contract are performed at their own risk (Part 1 of Article 837 of the Civil Code of Ukraine), and according to the employment agreement, the employee performs the functions which are outlined by his position and gets guaranteed salary (Part 1 of Article 21 of Labor Code of Ukraine). Performing works at your own risk means that if the contractor provides his services poorly, he will independently correct the gaps and won't be entitled to payment. Under a labor contract, non-payment of salaries is impossible - it's a criminal offense.

One of the main components of the costs of any firm is the payment of workers. Their accounting is an essential aspect of accounting. It would be appropriate to identify the similarities and differences in the characteristics of accounting for employee benefits in accordance with national accounting standards and international standards (IFRS and Accounting Standards).

In Ukraine, employee benefits are governed by the National Accounting Standards 26 "Payments to employees" [17], and in Europe, the International Accounting Standard (IAS) 19 "Payments to employees" [18].

The structure of employee benefits in Europe, according to IAS 19:

1. Short-term employee benefits, such as wages, salaries and social security contributions, paid annual leave and paid sick leave, profit-sharing and bonuses (if payable within twelve months of the end of the period) and non-monetary benefits (such as medical care, housing, cars and free or subsidized goods or services) for current employees.

2. Post-employment benefits such as pensions, other retirement benefits, post-employment life insurance and post-employment medical care.

3. Other long-term employee benefits, including long-service leave or sabbatical leave, jubilee or other long-service benefits, long-term disability benefits and, if they are payable twelve months or more after the end of the period, profit-sharing, bonuses and deferred compensation.

4. Termination benefits are employee benefits payable as a result of either: an entity's decision to terminate an employee's employment before the normal retirement date; or an employee's decision to accept voluntary redundancy in exchange for those benefits.

According to Accounting Standards 26 "Payments to employees" include:

1. Current payments for employees;
2. Payments after the end of employment;
3. Other employee benefits;
4. Payments in case of dismissal;
5. Payment of enterprise's equity instruments.

IFRS 19 "Payments to employees" has a more open and informative structure, as opposed to Accounting Standards 26. Not for nothing, the international standards of financial reporting are advisory and for keeping records in Ukraine. However, each enterprise has the right to make decisions on the adoption of a particular standard on its own. The taxation of wages in Ukraine and Germany is also significantly different.

Many Ukrainian employers started using civil law contracts with individual contractors instead of employment agreements. A contract with an individual

contractor is a wonderful civil law tool. Employment agreements require employers to pay taxes for their employees. Under civil law contracts, individual contractors who provide services or perform works are responsible for paying their self-employment tax. That is, if you pay an individual contractor a bit more, you will cover your contractor's tax obligations, but you will still spend much less than you'd spend with an employment agreement.

The taxation of wages in Ukraine, Europe and USA are also significantly different. Each employer as a tax agent is obligated to pay taxes on behalf of the employee before paying salary: military tax - 1.5% and personal income tax- 18% - payable from the salary base (paid as a cost of employee), Social Security Tax - 22% payable on the top of salary base (paid at the cost of employer). Personal Income Tax (PIT) is a national tax levied on income of individuals resident and non-residents who receive income from sources of their origin in Ukraine. Military collection (MC) is a local tax levied on income of individuals resident and non-residents who receive income from sources of their origin in Ukraine.

Trade union contribution – voluntary (optional) monthly membership fees, which are set in different sizes, namely: – for working union members 1%; – for students 0.5% of the minimum scholarship; – for non-working pensioners, 0.1% of the minimum age pension. Membership union fees are not paid from the amount of payment, a disability card, material assistance, one-time bonus. The procedure for payment of membership fees is determined by the primary trade union organization.

Income tax in Germany is calculated by applying a progressive tax rate schedule to taxable income. Employer will automatically deduct the income tax from gross wage/salary in the form of wage tax and transfer it to the tax office on behalf. An employer also transfers the “solidarity surcharge” and – if employee is a member of a religious community which levies it – the “church tax” as well. Pension, health, nursing and unemployment insurance are also deducted from wages and paid by employer.

In Germany, everyone's earnings are subject to a basic tax allowance. Up to this amount, taxable income is not subject to tax. In 2019, this basic tax allowance is 9,168 euros for unmarried and not in a civil partnership. For couples who are married or in a civil partnership is 18,336. If taxable income is higher than these amounts, employee will pay income tax on it. The taxation rates vary from 14 percent to 42 percent. The rule is: the higher taxable income, the higher the rate of taxation. However, the top tax rate of 42 percent is only payable on incomes of more than 250,731 euros a year if you are unmarried and not in a civil partnership. For couples who are married or in a civil partnership, the maximum tax rate is applicable for incomes of over 501,462 euros (Table 1).

In addition to the income tax rates indicated above, the following taxes and surcharges are additionally levied on all types of income:

- solidarity surcharge: 5.5 percent of the income tax;
- church tax: 8.0 or 9.0 percent of the income tax – church tax is only levied if the taxpayer is a member of a church that is recognized for church tax purposes [4].

Depending on the personal situation of the employee in Germany, he is assigned a tax class. There are six such classes.

Table 1. Income tax scheme in Germany

Taxable income bracket	Taxable income bracket	Tax rate on income in bracket
From EUR	To EUR	Percent
0	9,168	0
0	18,336	0*
9,169	55,960	14-42
18,337	111,920	14-42*
55,961	265,326	42
111,921	530,652	42*
265,327	No limit	45
530,653	No limit	45*

*married couple filing a joint return

Tax class 1 applies to persons who are unmarried or divorced, and also to married persons whose spouse lives abroad, and to couples registered in a civil partnership. Married couples, who are permanently separated, as well as widowed persons, are also covered by tax class 1.

Tax class 2 takes into consideration an allowance for alone parents. This refers to persons who are unmarried and whose household includes at least one child (the child must be registered with the person in question in the primary or secondary residence, and the person must also have a children's allowance or receive child benefit payments). Another requirement for classification according to tax class II is that the lone parent does not live in a cohabitation union or in a registered civil partnership.

The 3rd class is assigned to married/unmarried persons who do not live separately and if the 4th class is not selected. In this case, another member of the marriage is assigned the 5th class. The 3rd class is usually chosen by a man who has considerably more monthly earnings than the other.

Married dual earners can apply for the tax class 4. This is recommended if both partners have relatively similar net wages. Tax class 4 applies to both spouses in that case. The requirement here is again that both earners reside in Germany and do not permanently live apart.

Tax class 5 with factoring refers to the same group of persons as tax class IV, except that in the factoring alternative the benefits of tax class splitting is already considered during the year.

Should not each spouse be classified as belonging to tax class 4, one shall be assigned to tax class 5, and the other to tax class 3.

Tax class 6 applies to persons with more than one employment position. The employer paying the lowest wages should deduct the income tax according to tax class 6.

The U.S. income tax system is supposed to pay income tax on both the federal and state level. Federal taxes include social security and FICA. Each state also has its own form of income tax that employers also withhold from your paycheck. If employee earn over a certain amount, \$6,750, he must file both federal and state taxes before April 15th of each year [2].

The overall system of taxation in the United States is progressive. By a progressive tax system the percentage of income an individual (or household) pays in taxes tends to increase with increasing income. Not only do those with higher incomes pay more in total taxes, they pay a higher rate of taxes. This is the essence of a progressive tax system (Table 2).

Table 2. Marginal income tax rates for 2019 in USA

Marginal Tax Rate	Single Taxable Income	Married Filing Jointly or Qualified Widow(er) Taxable Income	Married Filing Separately Taxable Income	Head of Household Taxable Income
10%	\$0 – \$9,700	\$0 – \$19,400	\$0 – \$9,700	\$0 – \$13,850
12%	\$9,701 – \$39,475	\$19,401 – \$78,950	\$9,701 – \$39,475	\$13,851 – \$52,850
22%	\$39,475 – \$ 84,200	\$ 78,951 – \$ 168,400	\$ 39,476 – \$ 84,200	\$ 52,851 – \$ 84,200
24%	\$ 84,201 – \$ 160,725	\$ 168,401 – \$321,450	\$ 84,201 – \$ 160,725	\$ 84,201 – \$ 160,700
32%	\$160,726 – \$ 204,100	\$321,451 – \$ 408,200	\$160,726 – \$ 204,100	\$160,701 – \$ 204,100
35%	\$ 204,101 – \$510,300	\$ 408,201 – \$612,350	\$ 204,101 – \$306,175	\$204,101 – \$510,300
37%	\$510,301+	\$ 612,351+	\$ 306,176 +	\$ 510,301+

For example, a single taxpayer John making \$32,000 in a year. That person would be in the 12 percent tax bracket but wouldn't actually pay 12 percent of the full \$32,000. Instead, they pay would 10 percent on the first \$9,700 and 12 percent on the rest

- amount in the first income bracket = \$9,700; taxation of the amount in the first income bracket = $\$9,700 \times 10\% = \970.00 ;
- amount in the second income bracket = $\$32,000 - \$9,700 = \$22,300$; taxation of the amount in the second income bracket = $\$22,300 \times 12\% = \$2,676$;
- total federal income tax is $\$970 + \$2,676 = \$3,646$.

While John paid a maximum tax rate of 12%, we can see that his effective tax rate is much lower. An effective tax rate can be calculated based on total income, AGI, or taxable income. Suppose we wish to calculate John's effective tax rate based on his total income of \$32,000. Given that his federal income tax is \$3,646, her effective tax rate is only 11.4%, $((\$3,646/\$32,000) \times 100)$.

In addition to income tax, a wage earner would also have to pay Federal Insurance Contributions Act tax (FICA). FICA tax is a combination of a 6.2% Social Security tax and a 1.45% Medicare tax the IRS imposes on employee earnings. For 2019, only the first \$132,900 of earnings is subject to the Social Security part of the tax. A 0.9% additional Medicare tax may also apply if earnings exceed \$200,000 if you're a single filer or \$250,000 if you're filing jointly [1]. Typically, employers deduct FICA tax from employee paychecks and remit the money to the IRS on behalf of the employee. FICA stands for Federal Insurance Contributions Act.

- o $\$32,000 \times 6.2\% = \$1,984$ (Social Security portion)
- o $\$32,000 \times 1.45\% = \464 (Medicare portion)

The UK income tax rates and brackets for 2019-20 is shown in Table 3.

This means that taxation begin from the minimum income (£12,500) which person have to earn in a year. Similarly, the basic tax rate of 20 percent, which currently applies if employee earn up to £46,350 a year, has been extended.

For example, accountant Bill, his total income after deducting allowable expenses is £54,000 a year. Let's show how much tax he'd pay under the current income tax rules and how much he'll pay in 2019-2020 [5].

Table 3. The UK income tax rates for 2019-2020

Tax Rate (Band)	Taxable Income	Tax Rate
Personal allowance	Up to £12,500	0%
Basic rate	£12,501 to £50,000	20%
Higher rate	£50,001 to £150,000	40%
Additional rate	Over £150,000	45%

Under the current thresholds:

- £12,500 is tax-free.
- This leaves Bill with a taxable income of £12,450 (£50,000-£12,500), which falls within the basic rate threshold.
- The remaining £4,000 falls within the higher rate and is taxed at 40 percent, that is £1,600.
- So, his total tax liability would be 20 percent of £12,450 plus 40 percent of £4,000 that is $£2,490 + £1,600 = £4,090$.

National Insurance has to be paid by both employed and self-employed workers. National Insurance contributions depend on employment status and how much a person earns. For 2019-20, the Class 1 National Insurance threshold is be £8,632 a year. If an employees earn less than this amount he'll pay no National Insurance contributions. If a person earns more, she'll pay 12% of earnings between £8,632 and £50,000. She'll pay 2% on any earnings above £50,000.

When Ukrainian employers hire new employees under employment agreements, there are at least two ways how they can pay them:

1) an employer indicates his employee's real wage in an employment agreement and instructs an accountant to assess all payroll taxes. If the basic wage is, let us say, 15 000 UAH (+/-600 USD), then this employer is required to pay 22%, which is 3300 UAH (+/-135 USD), of unified social tax, withhold 1,5%, which is 225 UAH (+/-9.2 USD)of war tax (war tax is due since the beginning of the anti-terrorist operation in the eastern Ukraine), and 18%, which is 2700 UAH (+/-110 USD) of income tax. In the end, the employee gets 12 075 UAH (a little less than 500 USD) of take-home pay;

2) an employer indicates a minimum wage rate (currently, it is 4173 UAH(+/- 170 USD) in Ukraine) in an employment agreement, but in reality wage is 15 000 UAH (+/-600 USD). This employer has to pay 22%, which is 918,06 UAH (+/-37,5 USD) of unified social tax, withhold 1, 5%, which is 62,60 UAH (+/- 2,55 USD), of war tax, and 18%, which is 751,14 UAH (+/- 30,65USD) of income tax. The rest is $15000 - 62,60 - 751,4 = 14 186$ (+/- 579 USD) - a backdoor salary or money under

the table, also employer is on 3300-918,06 = 2381,94 UAH (+/- 97,55 USD) less than in first option. The second way was called “grey”.

According to some estimates, in Ukraine, a “hidden” salary, at tax-free is about 16.6% of the country's gross domestic product. In addition, a survey conducted among representatives of domestic small and medium-sized businesses showed that each legally paid hryvnia accounts for approximately \$ 1.5 in earnings issued “in grey”.

In common practice a lot of small business owners in Ukraine used to pay their employees in cash since it’s harder to trace and most of them are trying to evade taxes or cheat the government. The employee is missing out on benefits, such as the ability to earn Social Security benefits in old age or financial assistance in case of disability. The government doesn’t receive individual income tax and cannot fully provide funding to the social sector.

In our opinion, the Ukrainian taxation system needs to be reformed on progressive with increasing marginal tax rates at the institutional level. Progressive tax embodies the concept that those with high incomes should pay more of their income in taxes because of their greater ability to pay (Table 3).

Table 3. Reformed income tax scheme in Ukraine

Taxable income bracket	Taxable income bracket	Tax rate on personal income in bracket For employer	Tax rate on Social Security in bracket For employee
From UAH	To UAH	Percent	Percent
0	Minimal wage	0	5
Minimal wage+1	10,000	12	10
10,001	15,000	15	15
15,001	20,000	18	18
20,001	25,000	22	18
25,001	30,000	26	18
30,001	40,000	30	18
40,001	50,000	35	22
50,001	No limit	40	22

Let’s show how it’s deal on example. Accountant Maria earns 11,000 UAH (+/- 445 USD).

1) When an employer indicates Maria real wage (11,000 UAH) in an employment agreement in suggested tax rate 12 and 15 %. 4,173 UAH is tax-free.

Maria’s first taxable income is UAH taxed in 12%, which is 699,24 UAH (+/- 28 USD);

– amount in the first income bracket = 10,000- 4,173 = 5,827 UAH; taxation of the amount in the first income bracket = 5,827 × 12% = 699.24 UAH;

– amount in the second income bracket = 11,000 –10,000 = 1,000 UAH; taxation of the amount in the second income bracket = 1,000 × 15% = 150 UAH (+/- 6 USD).

Total income tax is 699.24+ 150 = 849.24 UAH (+/- 35 USD)

Maria's an effective tax rate can be calculated based on total income and it's only 7.7% $(849.24/11,000)*100$).

This employer is required to pay 5%, 10% and 15%, which is 3300 UAH (+/- 135 USD), of unified social tax:

– amount in the first social security bracket 4173 UAH; taxation of the amount in the first social security bracket = $4,173 \times 5\% = 208.65$ UAH (+/- 8 USD);

– amount in the second social security bracket = $10,000 - 4,173 = 5,827$ UAH; taxation of the amount in the social security bracket = $5,827 \times 10\% = 582.7$ UAH (+/- 23 USD);

– amount in the third social security bracket = $11,000 - 10,000 = 1,000$ UAH; taxation of the amount in the social security bracket = $1,000 \times 15\% = 150$ UAH (+/- 6 USD);

Total social security is $208.65 + 582.7 + 150 = 941.35$ UAH (+/- 37 USD).

2) When an employer indicates Maria real wage (11,000 UAH) in an employment agreement in current tax rate 18%. She will pay 1,980 UAH (+/- 80 USD) $(11,000 * 0.18)$ of income tax. The employer has to pay 22%, which is 2,420 UAH (+/- 98 USD) of unified social tax.

3) When an employer indicates a minimum wage rate (currently, it is 4173 UAH (+/- 170 USD) in Ukraine) in an employment agreement, but in reality wage is 11 000 UAH (+/- 445 USD). She will pay 751 UAH (+/- 125 USD) $(4,173 * 0.18)$ of income tax. The employer has to pay 22%, which is 918,06 UAH (+/- 37,5 USD) of unified social tax

As we see the most favorable variant is the first for each side:

1) employee has to pay little bit more amount of income tax (98.24 UAH or 0.40 USD) as from minimum wage and can earn Social Security benefits in old age;

2) in the same time employer has to ability indicated all official wage which is almost 3 times higher than minimum wage rate without any risk and backdoor salary and pay almost the same unified social tax.

CONCLUSION

In our opinion, proposed mechanism of reforming the income and social security taxation system is the way to economic transparency and stability on Ukrainian labor market. In support these activities Ukrainian government should set also a limit for cash payments, lead on it to minimum and compulsory automate an accounting process for all types of business.

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