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Work Models in the Ukrainian IT Industry: Between Employment and Contractor Models

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Abstract. The field of labour is one of the most dynamic in the society and develops under the influence of the general social progress. Rapid development of digital technologies, to which public regulators appeared not to be ready in many aspects, has also changed the field of labour by stimulating search and application of new forms of employment. Resulting from technological changes, they also often appear to be beyond legal regulation, thus posing risks both for the state or business, and for employees. Normally new, hybrid forms of labour relations are considered in the context of tax and employment law. That is because they are also related to human rights as it is individual rights and freedoms that are exposed to risks. Respectively, all hybrid models and public initiatives require scrupulous attention and analysis, since their effect may go beyond the framework of employment law or fiscal consequences. In the present article we will consider the key factors affecting launching of such hybrid models, their pros and cons, as well as public initiatives aimed at regulating relations in the field, as exemplified by different forms of labour organization in the Ukrainian IT industry.

Keywords: gig economy, employment law, tax law, private entrepreneur, employee, IT industry, Ukraine.

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1. INTRODUCTION

The digital society is drastically changing all aspects of our life. This also refers to the economy and legal forms of economic relations and labour organization. Such models as *sharing economy, platform economy*, or *gig economy* are becoming more and more common forms of economic activity. At the same time, they present some challenges for the state's regulatory policy and labour rights. As Andrew Stewart and Jim Stanford rightfully state: "The growth of

the gig economy, typified by online platforms and isolated independent workers, poses fundamental challenges to traditional models for regulating work and setting minimum standards" (Stewart & Stanford, 2017, p. 361).

However, in spite of the criticism voiced by the advocates of classical economy and traditional forms of labour relations, hybrid forms of labour are actively used in the sectors that are developing most dynamically due to the use of new digital technologies. In particular, they appeared to be most convenient for the industry of software development as well as applicable in the developing economies.

Ukraine, from this point of view, belongs to the economies where new or hybrid economic models are most actively used. It is also interesting due to the fact that the state is trying to regulate them, both setting some restrictions within the employment law, and introducing special economic regimes that, along with regulation, presuppose some state guarantees for the application of such labour organization models.

In this article we will consider the role of the state in the regulation of hybrid labour organization models in modern economy as exemplified by Ukraine. We will consider the case of labour relations in the IT industry that employs such models in its work on a most extensive basis. We will discuss two approaches applied by the Government of Ukraine: restrictive and promotional, their advantages and disadvantages, as well as the key factors affecting application of those models and effectiveness of the Government's decisions.

2. UNDERSTANDING OF THE HYBRID WORK MODELS

Transformation of economic processes leads to the appearance of new phenomena in the field of labour relations, the understanding of which is only developing. For instance, the International Labour Organization (hereinafter referred to as the ILO), while analyzing global experience, in particular, the EU. OECD practice, etc., points out three basic forms of *hybrid* labour relations available in the modern world:

- Undeclared work – any paid activities that are lawful as regards their nature but not declared to public authorities;
- Concealed employment – the employment that, while not illegal in itself, has not been declared to one or more administrative authorities;
- Informal economy – all economic activities by workers and economic units that are – in law or in practice – not covered or insufficiently covered by formal arrangements (International Labour Organization, 2018).

The very "hybrid" nature of those models lies in the fact that they consist in the application of the forms of work envisaged by the law, provision of services or carrying out of entrepreneurial activity in the way not envisaged for certain labour and business models. It is also manifested in a number of other characteristics. For example, Andrew Stewart and Jim Stanford point out several following special features of labour organization in "gig-economy":

- irregular work schedules, driven by fluctuations in demand for their services;
- the workers provide some or all of the capital equipment used directly in their work (bicycles, personal computers, etc.);
- the workers provide their own place of work: at home, in their car or elsewhere;
- jobs are compensated on a piecework basis, with payment defined according to specific tasks rather than per unit of time worked;
- jobs are usually understood to be organised around some form of digital mediation, like a web-based platform (Stewart & Stanford, 2017, p. 362).

Supporters of the use of such hybrid work models in the economy advocate the standpoint that formal legitimacy of those forms guarantees their admissibility. At the same time, these models face considerable criticism voiced by officials, economists, and lawyers. While considering hybrid forms of labour, we may have some doubts as to their compliance, primarily, in the tax and labour dimensions. Due to the popularization of the *gig-economy*

concept, researchers rightfully state that: "This has led to increasing pressure on public finances due to differences in tax treatment across these categories, as well as a rise in the number of individuals who seem to fall outside the scope of traditional employment law" (Adams et al., 2018, p. 476).

It may be generalized that the key doubts about the effectiveness of those models are as follows:

(a) low tax load, which is most attractive for business but reduces the direct economic effect obtained in the form of fiscal duties;

(b) creation of unequal conditions for some sectors of the economy and types of business as compared to the ones using more conservative models;

(c) correspondence of those models to the legislative norms and principles of law.

Now we are faced with the situation when the government's regulatory policy cannot qualify such hybrid work models or squeeze them into the current legal regulation framework. Marie Quirke and Katie Winder rightfully state that: "This evolving situation highlights the fact that the societal development of the platform economy has proceeded at a rate and speed with which legislation has not necessarily kept pace and is indicative of the Courts grappling with issues arising in society that have not always been provided for or legislated for" (Quirke & Winder, 2021, p. 57).

These doubts are also present in the field of public legal regulation, when in some states, decisions are passed to impose restrictions on some forms of economic relations or to get them back within the more rigid regulatory framework. Among the latest examples is decision of the Supreme Court of the United Kingdom of February 19, 2021, supporting the decisions of the previous instances stating that Uber service drivers are hired workers (The Supreme Court, 2021).

Anyway, hybrid work models exist and are used more and more widely, in spite of the fact that so far, they are in the *grey area* of legal regulation and employment law standards. Gradually, their regulation will become more active either via decisions of legislative and executive authorities, or via development of court practice in this respect. And since there are no universal approaches thereto, the experience of policies of specific states in this field is extremely interesting and valuable.

2. HYBRID WORK MODELS IN THE UKRAINIAN CONTEXT

The appearance and application of hybrid labour organization models in different countries and industries does not just result from the appearance of technological opportunities, but from a set of political and economic reasons that affect the society as well. Particularly true this statement is in relation to transition economies suffering from corruption, bureaucracy, fiscal pressure, crisis phenomena, etc. Ukraine is not an exception here.

In spite of the fact that tax load in Ukraine is relatively proportionate to that in other states, in the conditions of high level of corruption, ineffective law enforcement and property protection system, as well as low level of trust in the judiciary, a large share of the economy is shadow economy. Thus, according to the data of the Rule of Law Index, Ukraine ranks 72nd out of 128 countries (World Justice Project, 2020), while according to the USAID poll, only 10% of the general public admitted that they fully or mostly trust the judiciary (USAID, 2021) and the study of Shadow Economy performed by the National Bank of Ukraine (2020) has found that nearly a quarter of Ukraine's GDP, or 846 billion UAH, is in shadow. Besides that, outdated employment legislation (the Labour Code of the Soviet Ukraine of 1971 is still valid) creates obstacles for normal regulation of relations between employees and employers, offering outdated guarantees and bilaterally inflexible forms of labour relations.

This causes the search of hybrid models of work by Ukrainian businesses, that would allow to combine high marginality, low tax load, and would guarantee staying of business within the legal field. In Ukraine such model is doing business using the status of private entrepreneurs (Ukr. natural person-entrepreneur (*фізична особа-підприємець)*, FOP (sole proprietor), hereinafter - PE) instead of official employment to optimize tax load and to regulate labour relations in a more flexible way.

There are several models (groups) of private entrepreneurs, however, most frequently the model of private entrepreneurs of the III-rd taxation group is used to optimize labour relations. It presupposes payment of a 5% unified tax to be imposed on all income obtained by private entrepreneurs and social tax amounting to 22% of one minimum salary (1,320 UAH as of 01.08.2021). Such tax conditions make it extremely attractive for employers. Its popularity is also caused by an opportunity to provide services to legal entities with no limitations, which makes them more flexible as compared to groups I, II, and IV, for which such restrictions are in place.

ILO describes private entrepreneurs as the manifestation of labour relations, as "actual labor relations that are formally declared as self-employment or are based on civil, commercial, outsourcing etc. contacts" (International Labour Organization, 2018). Indeed – many representatives of the government and experts qualify relations with private entrepreneurs as *concealed labour relations*. We may only agree here that this model (the same as other counterparts in other countries) is within the *grey* area of legal regulation, however, it is too early to claim that it is a priori illegal.

First of all, it should be indicated that optimization of tax load by itself by business does not constitute an offence. As it was mentioned in one decision classical for tax law – case "Inland Revenue Commissioners v. Duke of Westminster" of 1936: "Every man is entitled if he can to order his affairs so as that the tax attaching under the appropriate Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then, however unappreciative the Commissioners of Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax" (The House of Lords, 1935).

However, as it has already been mentioned, there are some doubts as to in what cases the use of models that are more economic in the tax sense will be justified. Ukrainian model of private entrepreneurs was initially conceived as a form of micro-business activity. However, gradually, it started being used for structuring higher-level business as well. In particular, for already more than 10 years this model has been the key one for the software development industry (IT business).

It should be indicated that besides IT business this model replacing labour relations is actively used in retail or hotel and restaurant business. However, in these fields most frequently there takes place fictitious service provision, when only the status and account of private entrepreneur is used, while the people themselves do not carry out any activity. At the same time, in IT people registered as private entrepreneurs are, the same time, service providers, and in this case this model is used only as another way of labour relations organization.

It should primarily be pointed out that Ukrainian legislation does not contain any direct prohibition for the use of private entrepreneur (sole proprietor) model instead of hired labour registration. But the Ukrainian government keeps introducing regular respective legislative prohibitions that will be considered below.

The key advantages of using this scheme in the Ukrainian IT business are growing competitive ability of the Ukrainian IT business in the international markets. Ukrainian IT companies could offer the lowest prices for software development services due to a relatively lower price. At the same time, IT companies may offer higher salary for developers who really belong to the middle class by the level of their income. And the money coming to Ukraine via IT business acts as a multiplier creating additional jobs. For example, according to the poll conducted by the Business Association Lviv IT cluster, 2,8 workplaces in adjacent industries are created by one IT specialist in Lviv (*see:* Lviv IT Cluster, 2021).

Also, private entrepreneur model enables IT business to be more flexible as far as relations with developers are concerned, since in this case companies are not limited by the provisions of the 1971 Labour Code. Instead, they may regulate the procedure for work provision and social guarantees of developers following a contractual procedure, determine the mode of work, vacation, and sick-leaves, etc. And due to the competition between companies for developers, that does not lead to their social exploitation and discrimination.

3. LEGAL CHALLENGES OF THE PE MODEL APPLICATION IN THE UKRAINIAN IT INDUSTRY

In spite of all positive aspects of using PE model, it has a number of disadvantages for which it is regularly criticized, the same as the IT industry that uses this model the most. First of all, legal admissibility of the application of this model as an alternative for labour relations is criticized. In fact, relations between the PE and IT companies, by some features, are labour relations, and absence of direct prohibition still does not make them absolutely legally admissible.

Such dilemma is a common and typical challenge for a new economy type. For example, in the case of sharing platforms Robert Redfearn calls "one of the most challenging issues", the question whether "sharing platform workers should be classified as employees or independent contractors" (Redfearn, 2016, p. 1024).

Also, state budget loses some revenues from direct taxes, in particular, in the form of income tax and social tax. Hence, there comes the state's reaction to fiscal loses from the application of hybrid work models. That is also confirmed by Andrew Stewart and Jim Stanford: "Concern over loss of fiscal revenues has been a key motivation for many regulatory responses to the rise of platform businesses" (Stewart & Stanford, 2017, p. 365).

Also, the situation is that tax-payers with lower income pay higher taxes than IT industry specialists. That may cause certain social tension around high profits of IT company employees (whose salary is linked to dollar and who are not affected by currency fluctuations) along with their low direct tax contribution.

It should be indicated that this model creates tax benefits for the IT business and is not widely used in other fields of business. That causes somewhat unequal conditions for other industries that bear a nominally higher tax load due to the use of the model of labour relations, and for employees who get lower income. That results in the situation when other industries cannot compete with IT in terms of labour remuneration and, hence, are affected by the outflow of qualified staff members who seek jobs not just as developers, but as lawyers, HRs, administrators, etc. in IT companies.

In spite of the flexibility in labour relations and conscious choice of contractors in their favour, they presuppose payment of a minimum social tax. That means that if they work all their lives long as private entrepreneurs, in the future they may expect only a minimum state pension. That creates the risk of potential appearance of the situation when some private entrepreneurs will not manage to effectively dispose of their income and after they retire the group of low-income persons of pension age will become larger.

4. GOVERNMENT INITIATIVES TO REGULATE CONTRACTOR RELATIONS IN THE IT INDUSTRY

The Ukrainian government suggested several initiatives to regulate the issues using this model. Two main methods suggested presupposed increasing a unified tax rate and development of the criteria for concealed labour relations, that would enable to re-quality the relations between the company and private entrepreneur from contractual to labour ones, using tax rates set for employees.

Thus, in 2015 Deputy Chairperson of the Tax Committee of the Verkhovna Rada Andriy Zhurzhiy initiated increasing the unified tax rate for private entrepreneurs up to 20%. The representatives of the IT industry opposed it and indicated that 20% are approximately equal to the margin, and that may eliminate profitability of the Ukrainian IT business and reduce its competitive ability, due to the services cost rise. And they stressed that they do not object to the increase in the unified tax rate, let us say, up to 10% over 5 years.

In 2019 the Government of Ukraine suggested introducing the criteria for concealed labour relations:

1. Regular payments to one private entrepreneur by the customer.
2. Personal performance of assigned works, under control.
3. Remuneration from the customer makes 75 and more per cent of the private entrepreneur's income over six months.

4. The work is performed at the workplace determined by the customer and in accordance with the internal regulations.

5. The private entrepreneur performs work similar to the one performed by staff members.

6. Terms of labour (equipment, materials, workplace) are provided by the customer.

7. Work time duration and period of rest are determined by the customer.

If three of these criteria were applicable to the relations between a private entrepreneur and a customer, the relations would be subject to re-qualification into labour ones, and the company-customer would be subject to fine payment. This, a bit radical and one-sided approach of the Government to solving the problem of hybrid work models, is characteristic not only of Ukraine. Thus, the court practice of Ireland where this topic is also relevant shows that "employment relationship in practice is more significant than the terms used by companies, and Irish courts will look at what is actually occurring as opposed to what is stated in words to be occurring" (Quirke & Winder, 2021, p. 51).

This initiative faced harsh criticism from the IT business that perceived it as the one primarily designed against it. Thus, the largest sectoral association "IT Ukraine" in its official standpoint stressed that: "for the Ukrainian IT industry this draft law is unacceptable since it puts the industry development at risk. We are convinced that before resorting to regulatory changes that will affect this industry that is of critical importance for the country the government should launch a dialogue with the sectoral association, consider all potential consequences, and develop a joint solution that would work towards the common goal – economic growth" (IT Ukraine Association, 2019).

Creation of a separate group of private entrepreneurs for IT developers could become this solution, in the opinion of the IT business, and this idea was first suggested in March 2019. It presupposed gradual increase in the unified tax rate up to 10% over 5 years and double amount of unified social tax as compared to other private entrepreneurs. A year later other initiatives related to the creation of a special group of private entrepreneurs for the IT business appeared, some of them were developed by the government. However, finally they were not implemented, in particular, due to the change of political authorities in Ukraine in 2019.

6. DIIA.CITY PROJECT

The new government that positions itself as the one supporting digital economy development suggested creation of a special legal and tax regime for the IT industry "Diia.City", following the Belarus "Park of High Technologies". The respective framework law was adopted by the Verkhovna Rada on July 15, 2021. "Diia.City" does not presuppose any opportunities for companies-residents to replace the work model of registering relations with employees with the private entrepreneur's model. Instead, it presupposes introduction of the so called *gig-contracts* for which the 1971 Labour Code will not be valid and lower labour taxation rates for developers: 5% of personal income tax, 1.5% of military tax, 22% of unified social tax.

The ideologists and supporters of "Diia.City" stress that such approach makes the relations between companies and developers legal, preserving key fiscal advantages but enhancing social guarantees. Regulation of corporate relations within "Diia.City" may be considered within the framework of another publication, but it has got some advantages for the IT business. Besides that, the government offers a number of other guarantees, in particular, in the field of copyright protection, venture investment, inspections conducted by state authorities, etc.

At the same time, its opponents stress that this regime is expected to be a temporary one: it is set for 15 years, Hence, after the expiry of this period (if it is not prolonged) general norms of employment law will be applicable to the relations between companies and developers, including taxation. Besides that, introduction of "Diia.City" not within the framework of the general PE model but as a specific legal regime may lead to its canceling if any political changes occur. Finally, the future of companies that do not enter "Diia.City" (since entry is voluntary) remains unclear in terms of whether they will not be forced to enter it due to the risk of their relations being re-qualified from PE into labour ones.

The authors of "Diia.City" lay rather great hopes on this regime. The government considers that by 2025 this regime will additionally create 450,000 jobs in the IT industry and will enable to ensure the IT industry growth in Ukraine by 16.5 bln. USD (Diia City, n.d.). Also, deputy prime minister and minister of digital transformation of Ukraine Mykhaylo Fedorov considers that "Diia.City" provides additional protection for the labour rights of developers, since gig-contracts provide them with "freelance advantages, and, hence, additional social guarantees: paid vacation for a minimum of 17 work days, sick-leaves, maternity leave for at least 70 days, observance of specialist's rights in case of dismissal, impossibility of imposition of financial fines or reduction of the amount of remuneration for a gig-specialist" (Government Portal, 2020).

However, anyway, there are some doubts as to how successful in terms of labour formalization in the IT field "Diia.City" is going to be. First of all, this project is state-driven, and not initiated by the IT industry, and that will not urge business to trust in it and to be ready to change their PE model for the "gig-contract" model. Also, transition to "gig-contracts" is possible only for developers, but not for other specialists of IT companies: HR managers, administrative and financial managers, sales managers, and so on. That may lead to even greater shadowing of the sector of labour in this field. Finally, the project will not be a success if the key market players are not involved in it: developers by themselves are not an integral community capable of individually or jointly dictate its rules to employers.

CONCLUSIONS

Summing up, it should be stressed that the PE model applicable in Ukraine now is far from being ideal and creates a great many risks for IT developers, in particular, as far as protection of their individual labour rights and freedoms is concerned. However, special legal and tax regimes like "Diia.City" can hardly be a sustainable solution meeting the challenges in the field of labour relations in the IT industry.

The reason for the search of new, "hybrid" forms of labour relations organization by the Ukrainian IT business lies in the tax load and imperfect employment legislation, and, most important, absence of a transparent dialogue between the state and business. It is on the settlement of those challenges that the process of de-shadowing of labour relations between developers and companies in the IT industry primarily depends. And the search of respective solutions should be taking place only within the framework of the trilateral dialogue: state – IT business – IT developers.

At the same time, the experience of Ukraine can be assessed positively, in particular, due to the fact that the government is not trying to quickly and drastically liquidate or prohibit hybrid work models applied in the economy. This approach, when the government is guided by the "do no harm" principle testifies to the understanding of the advantages provided by the application of hybrid work models in the economy in transition. In particular, now the monthly income of developers in Ukraine exceeds the average salary from 1.5 to 15 times, and they form a middle class.

However, IT business in Ukraine (or any other business in other states) should realize that the actions of the state are grounded on the logical principles of interaction with business. This lies in the use of acceptable forms of doing business by businesses, including in the labour field, fiscal discipline in tax payment, respect for human rights, including the right to labour. Observance of those principles constitutes a precondition for sustainable doing of business, therefore, both parties are interested in it.

We consider that solving of the problem of application of the PE model in the IT industry in Ukraine lies not in the creation of exceptions, as in the case with "Diia.City", but in taking steps that would be beneficial for the whole society. These may lie in the modernization of labour relations in accordance with the requirements of the digital economy, tax load reform, for instance, due to gradual increase in the tax rate to achieve the indicators beneficial both for the government, and for business, and a clear and transparent dialogue between business and the

state. The latter may be promoted by digital technologies, and the Government of Ukraine is taking active steps in this direction. Such algorithm is rather universal, and it is applicable in other economies with similar phenomena.

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